A PRIMER ON INTERSTATE TAXATION

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PICTURE a map of the United States. Each state is marked out in red or yellow or green or orange, in between the blue that is saved for the oceans and the dull white of Mexico and Canada. Now imagine a series of walls ten miles high running along the boundaries of each block of color and shutting every state off from the states around it. It will be helpful to remember that problems of interstate taxation are treated by the law very much as though those imaginary walls were real.

Now the average man knows well enough what a tax is. It is a sum of money that must be paid to a government because the payer owns something or does something or gets something. If the tax is "on" anything it is on the man or the company that must pay the tax. Sometimes the tax is a flat tax, like a two dollar school tax that must be paid by everyone who lives in the school district. More often the amount of the tax is measured according to the value of whatever the taxpayer owns or does or gets that makes him have to pay the tax. So much seems sufficiently simple.

But the lawyer, unfortunately, does not see it this way. To him it is far more complicated. In the law, the tax is "on" the person who pays it only when there is nothing else "on" which the tax can be said to lie. If a man is taxed because he has an oil well, the tax is said to be "on" the oil well. If he is taxed because he makes money from the oil well, the tax is "on" the income he makes, or maybe "on" the privilege of making it. If he is taxed because he sells oil from his well, the tax is "on" the sales. If he or his son is taxed because he leaves the well to his son at his death, the tax is "on" the handing over of the well. Again, a man who drives his own car must usually pay three taxes a year—one because he owns the car, one to get license plates so the car may be used on the roads, and one for a driver's license so that he can drive it without being arrested. He has little doubt that the three taxes are on him; he has to pay them. But to the law, the first tax is "on" the car, the second "on" the privilege of running the car on the public roads, and the third "on" the personal privilege of driving it.

Now this business of finding out what a tax is "on" may seem a harmless little game of words. But in law it is a serious business. The law calls the thing the tax is "on" the "subject" of the tax. And it is when the "subject" of a tax can not readily be pinned down to one state that there arises a problem of interstate taxation. For a problem in interstate taxation is nothing more than the dispute which comes up when

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more than one state wants to tax the same person or company for owning or doing or getting the same thing.

It is then that the law seems to put those high walls around the borders of the states. For the law goes at an interstate tax problem in this way: First it decides just what the disputed tax is "on," or the "subject" of the tax. Then it decides whether this "subject" has a "situs" in the state that is trying to collect the tax. If so, the tax and its "subject" are said to be within the state's "jurisdiction." And when the law says that a state has "jurisdiction" to collect a certain tax because the "subject" of the tax has a "situs" in the state, it is really putting within the imaginary walls of that state the thing that the taxpayer owns or does or gets and for which he is being taxed.

Now it is quite a feat to put, for the time being, within the boundaries of one state something that a man owns or does or gets in several states. And it is even more of a feat if that something is so abstract—such as the privilege of passing on at death the right to receive dividends from a corporation—that it is pretty hard to give it a geographical location at all. But this does not bother the law. The law takes it as a matter of course that problems of interstate taxation are to be decided by giving the "subject" of the tax, no matter how abstract nor how ubiquitous, a "situs" inside or outside the walls that surround a state's "jurisdiction."

There are two kinds of interstate tax problems—those that have been answered and those that have not been answered. Sometimes the answers are changed, but until they are, the old answers still hold good. The answers are given by the Supreme Court which, so far as problems in interstate taxation are concerned, embodies the law. A list of the Supreme Court's latest answers, which must always be coupled with the names of cases in which these answers were given, makes up what lawyers call the Law. Here it is.

In the first place, interstate tax problems almost always come up in connection with three kinds of taxes—what the law usually calls property taxes, inheritance taxes, and income taxes. Property taxes are those that a person or company must pay for having or owning something, and are measured according to the value of the thing the person or company is taxed for having. Inheritance taxes are those that must be paid when a person dies and leaves something he owned to somebody else, and are measured by the value of whatever the person leaves when he dies. Income taxes are those that a person or company has to pay for making money, and are measured according to how much money the person or company makes. Sometimes the law calls a property tax or an income tax by some other name, such as a "franchise" tax "measured by" property or income, but so far as problems of interstate taxa-

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tion are concerned, the name makes no difference. The three kinds of taxes might just as well be called Have taxes, Die-and-Leave taxes, and Earn taxes.

The Law of the Have Taxes

There are two kinds of Have taxes, depending on what it is that the person or company has and is being taxed for having. If it is something substantial and definite, like a house or a flock of sheep or a gallon of whiskey, the law calls it a tangible. If it is a right to have or get money or something in the future, even though it may be written down on a piece of paper, like an I. O. U. or a mortgage or a share of stock or a bank account, the law calls it an intangible. A tangible, then, is really an Object and an intangible a Right.

Now the easiest sort of interstate tax problem comes up when a man lives in one state and owns an object in another state. Which state can tax him for owning it? The law says first of all that the tax is "on" the object. The object, then, is the "subject" of the tax. The "subject" has a "situs" in the state where the object actually is. That state has "jurisdiction." It can tax the man because he owns the object.[1] The state where he lives can not tax him.[2] The law says that the excuse for this is that the state where the object is protects and takes care of the object. Of course, the state where the man lives protects and takes care of him. But it is perfectly clear that, once it is decided that the tax is "on" the object, only the state where the object is can tax the man for owning it. Remember that there is a wall around that state's borders.

But there are some sorts of objects which do not know that the law has put walls between the states and which move, in spite of those legal walls, from one state to another. Sometimes, they are always on the move, like freight cars. Sometimes, like goods being delivered from place to place, they move only once. In either case they create interstate tax problems, for the law must decide which states may tax their owners for owning them.

If, like freight cars, the objects are always moving, the law uses what it calls a "unit rule" to decide what states may tax the owners. The "unit rule" lets a state through which the objects keep moving in and out pretend that part of the objects are always in that state. So if a lot of freight cars owned by one owner keep moving through a state, the state may figure out how many cars are usually in the state

1. Carstairs v. Cochran, 193 U. S. 10 (1904); Old Dominion Steamship Co. v. Virginia, 198 U. S. 299 (1905).

2. Delaware, Lackawanna & Western Ry. Co. v. Pennsylvania, 198 U. S. 341 (1905); Union Refrigerator Transit Co. v. Kentucky, 199 U. S. 194 (1905).

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while moving through it, and may pretend that that many cars are always sitting inside the state and not moving. Of course this gives that number of cars a permanent "situs" in the state, and the state can tax their owner for owning them.[3] In this way the law keeps its state walls intact by pretending that part of a lot of moving objects are always sitting in each of the states through which all of them are always moving.

But suppose the objects have a home base and very seldom move into other states; or suppose when they move they do not go through other states—like a fleet of ships. Then those other states can no longer use the "unit rule," because they can no longer say that part of the objects are always moving through. And then and only then the law says that the state of the home base may tax the owner for owning all the objects.[4] This is not just because the objects have a home base. For if other states could pretend that part of the objects were always in them, the state of the home base would have to pretend too, and it could only tax the owner for owning some of the objects, not all of them.[5] It is because the law must put all of the objects between walls so that their owner can be taxed for owning all of them, and if the law can not divide them up between a lot of states, the state of the home base seems the best place to put them.

Suppose, however, the objects do not move through states and have no home base either, like a fleet of ships almost always on the seas. Then at last the law lets the state where the owner lives, or if the owner is a company, where the company was set up, tax that owner for owning the objects.[6] This is a little awkward for the law, for, remember, the tax is "on" the objects and not "on" the owner, and the objects are very definite things. But the law has no other place to put them. So it reluctantly puts them inside the walls of the state where the owner lives, even though the objects be sea-going ships and the state be in the middle of the prairies a thousand miles from the coast.

Next come objects which do not make a habit of moving but which happen to make a trip from state to state, like goods on their way to be finished or delivered or sold. The state to which they are sent can of course, after they get there, tax their owner for owning them, for by that time they have a "situs" in that state and the tax is "on" them.[7]

3. Pullman's Palace Car Co. v. Pennsylvania, 141 U. S. 18 (1891); American Refrigerator Transit Co. v. Hall, 174 U. S. 70 (1899).

4. New York Central Ry. v. Miller, 202 U. S. 584 (1906); see Hays v. Pacific Mail Steamship Co., 17 How. 596 (U. S. 1854); Morgan v. Parham, 16 Wall. 471 (U. S. 1872).

5. Johnson Oil Refining Co. v. Oklahoma, 290 U. S. 158 (1933).

6. Southern Pacific Co. v. Kentucky, 222 U. S. 63 (1911).

7. Brown v. Houston, 114 U. S. 622 (1885). Cf. Woodruff v. Parham, 8 Wall. 123 (U. S. 1868).

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How about the state from which they start their journey? The law says that that state may tax their owner until the goods are started on their trip to another state. Sometimes it is a bit hard to tell whether the goods have really started their trip or are just moving around inside the state getting ready to start. But the law is clear. Before they start, the state may tax their owner.[8] After they start, they are already outside the state's wall although they have not yet crossed its border.[9]

Goods sent from state to state often go through other states on their way and sometimes those states try to tax the owner. But the law says that goods that are actually moving through a state are not within its walls, just as they are not within the walls of the state from which they are sent after they have started moving to another state. Suppose, however, the goods stop for a while in a half-way state. If the reason they stop is to help them keep on moving, as to be shifted from a train to a truck or from a pipeline to a tank car, then the law says that they are really still moving and so are still not inside the state's walls, and so the state can not tax their owner.[10] But if the reason the goods stop is not to help them to keep moving but some other reason, as to be weighed or marked or sold, then the weighing or marking or selling brings the goods within the state's walls and the state may tax their owner.[11] Still this is true only when the goods actually stop in the state to have something done to them. If they keep moving through the state while they are being weighed or marked or sold, then the fact that they are moving keeps the fact that they are being weighed or marked or sold from bringing them inside the state's walls.[12]

If it happens then that the states through which goods are moving can not tax their owner for owning them, can the state where he lives do it instead, as it can with ships on the seas? This is one of the unanswered problems of interstate taxation. At least one state has done it;[13] but although the Supreme Court has never actually said no to this kind of tax because it has never had a case dealing with just this kind of tax, it has hinted no,[14] and usually that is enough. So much for the Have taxes on people and companies because they own Objects.

The problems get more complicated when states want to tax people

8. Coe v. Errol, 116 U. S. 517 (1886); Diamond Match Co. v. Ontonagon, 188 U. S. 82 (1903).

9. Champlain Realty Co. v. Town of Brattleboro, 260 U. S. 366 (1922); Hughes Brothers Timber Co. v. Minnesota, 272 U. S. 469 (1926).

10. Carson Petroleum Co. v. Vial, 279 U. S. 95 (1929).

11. General Oil Co. v. Crain, 209 U. S. 211 (1908); Bacon v. Illinois, 227 U. S. 504 (1913); Minnesota v. Blasius, 290 U. S. 1 (1933).

12. Kelley v. Rhoads, 188 U. S. 1 (1903).

13. Carlos Ruggles Lumber Co. v. Commonwealth, 261 Mass. 445, 158 N. E. 897 (1927).

14. See Bacon v. Illinois, 227 U. S. 504, 511 (1913).

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because they own, not definite objects, but Rights, often written on pieces of paper, like stocks and bonds and personal notes and insurance policies. The law still says the tax is "on" the right, not on the owner. But it is not so easy to find a definite "situs" in one state or another for a thing so abstract as a right. It might seem that the simplest solution, when the right is written down on a piece of paper as most rights are, would be to attach the right to the piece of paper, treat the piece of paper like an object, and give it a "situs" where it actually is. But this is just the one solution that the law refuses to follow.[15] The law says that the right is something more than the piece of paper and that it must have a "situs" of its own which is in no way connected with where the piece of paper happens to be.

A right, says the law, is attached to the person or company that owns the right. Its "situs" is in the state where the person lives or where the company was set up or "incorporated." That state can always tax the owner of the right for owning it, no matter where any piece of paper connected with the right may be.[16] This is not just because the person who must pay the tax lives in that state, for the tax, remember, is not "on" him. It is because the right which he owns and which is the "subject" of the tax, being attached to him, has its own "situs" in the state where he happens to live. And even if the right is a bond of a nation-wide corporation and the paper bond itself is kept in a foreign country, the right is safely within the walls of the owner's state so that that state may tax him for owning it.

Yet the law realizes that a right is not a definite and substantial thing like an object. So the law once in a while, in spite of the state walls, lets a right be in more than one state at one and the same time. If rights are regularly used by their owner in business in another state, as by being accounted for and managed in a branch office in the other state, or like bonds or insurance policies left in the other state as security, or an account in a bank in the other state, then the law gives these rights a special or "business situs" in the other state. And the other state, along with the owner's home state, can then tax the owner for owning the rights.[17] The reason for this is not that pieces of paper connected with the rights may be kept in the other state; for, remember, a right is always separate from its piece of paper. And so the other state

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15. Buck v. Beach, 206 U. S. 392 (1907). Cf. Selliger v. Kentucky, 213 U. S. 200 (1909).

16. Kirtland v. Hotchkiss, 100 U. S. 491 (1879); Hawley v. Malden, 232 U. S. 1 (1914); Fidelity & Columbia Trust Co. v. City of Louisville, 245 U. S. 54 (1917).

17. Bristol v. Washington County, 177 U. S. 133 (1900); State Board of Assessors v. Comptoir National D'Escompte, 191 U. S. 388 (1903). Cf. New Orleans v. Stempel, 175 U. S. 309 (1899).

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may tax an owner for rights used regularly in business there, even though the papers may be kept somewhere else[18] or the rights not written down on paper at all.[19]

Then there are certain kinds of rights that always have a special "situs" other than their regular "situs" in the state where their owner lives. Shares of stock in a corporation have a special "situs" in the state where the corporation was set up.[20] This only means of course that that state, as well as the state where the owner lives, can tax the owner for owning the stock. The law says that this is because the state where the corporation was set up is responsible for there being any stock at all. Yet this reasoning never holds good for objects; only rights can be inside the walls of more than one state at one time. Mortgages on land or buildings may have a special "situs" in the state where the land or buildings actually are.[21] The law thinks this kind of right so firmly attached to the land or buildings that it never really leaves them. Of course, like all other rights, a mortgage is also attached to its owner, so if he lives in one state and owns a mortgage on land or buildings in another state, both states can tax him for owning it.

A queer kind of right is the extra amount that the rails of a railroad or the wires of a telephone company or such are worth, because they are part of one big system and not just disconnected objects. This sort of right is said to be attached to the rails or wires just as a mortgage is attached to its land. And the states through which the rails or wires run can each tax their owner for part of the extra amount that all the rails or wires together are worth.[22] Just as with freight cars, the states use the "unit rule" to divide up that extra amount and pretend that part of it is in each state, although actually it is attached to all the rails and wires in all the states taken together.

The Have taxes get most complicated when the thing that an owner is taxed for having is held in trust by one person or company for another person or company. The law says first of all that the thing is really owned by the person or company that holds the thing in trust, or the trustee, because even though the trustee has the thing only for the benefit of somebody else, who is called the cestui, still it is the trustee who really has the thing that is held in trust. If the thing held in trust is

18. Metropolitan Life Insurance Co. v. City of New Orleans, 205 U. S. 395 (1907).

19. Liverpool & London & Globe Insurance Co. v. Orleans Assessors, 221 U. S. 346 (1911).

20. Corry v. Baltimore, 196 U. S. 466 (1905).

21. Savings & Loan Society v. Multnomah County, 169 U. S. 421 (1898).

22. Cleveland, Cincinnati, Chicago & St. Louis Ry. Co. v. Backus, 154 U. S. 439 (1894); Western Union Telegraph Co. v. Taggart, 163 U. S. 1 (1896); Adams Express Co. v. Ohio State Auditor, 165 U. S. 194 (1897).

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an object, then, as with other objects, the state where the object is can tax the trustee for owning it. And if the thing held in trust is a right, then, as with other rights, it is attached to its owner, the trustee, and the state where he lives can tax him for owning it. But if the thing held in trust is a right, then it has been claimed that the state where the cestui lives should also be allowed to tax, on the theory that rights held in trust are really attached to the cestui because, though they are held by the trustee, they are held for the benefit of the cestui. Of course the Supreme Court answered no, rights can not be attached to two kinds of owners at the same time and the real owner is the trustee.[23] But the Supreme Court realized that, when a thing is held in trust, the cestui for whom it is held in trust has a special kind of right in what he is going to get in the future from the thing that is now held in trust for him. And the Supreme Court hinted that maybe, then, the state where the cestui lives could tax him for owning this special kind of right, even though it can not tax him for owning the regular rights, like stocks and bonds, that are held in trust and owned by the trustee.[24] This is still an unanswered problem.

Then suppose a man puts rights in trust for his own benefit and arranges the trust so that he really manages the trustee who manages the rights. Can the state where the man lives then tax him for owning the rights, not because he is the cestui, but because in managing the trustee he also makes himself the owner of the rights in place of the trustee? Or can the state where a trust is set up and managed get in a tax, on the ground that the rights held in trust have a "business situs" there? These are other examples of the unanswered problems that can come up under the Have taxes, because the law is made by giving "subjects" a "situs" inside the walls of state "jurisdiction." And except for still other unanswered problems that may some day be raised, here ends the interstate Law of the Have taxes.

The Law of the Die-and-Leave Taxes

The next big group of taxes causing interstate problems are the Die-and-Leave taxes, which the law calls inheritance taxes, or sometimes estate taxes, death taxes, or transfer taxes. These are nothing more than the taxes that must be paid when someone dies and leaves something he owned to somebody else. Sometimes they must be paid by the person to whom the thing is left, and sometimes they must be paid out of money or other things left by the person who died. But so far as

23. Brooke v. Norfolk, 277 U. S. 27 (1928); Safe Deposit & Trust Co. of Baltimore v. Virginia, 280 U. S. 83 (1929).

24. See Safe Deposit & Trust Co. of Baltimore v. Virginia, 280 U. S. 83, 95 (1929).

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interstate problems are concerned it does not matter to the law who has to pay the tax. For the tax, remember, is not on the person who pays it. The tax is "on" the handing over of the thing from one person to another. So the law is only interested in giving this business of handing over, which is the "subject" of the tax, a "situs" inside the walls of some state so that state can do the taxing.

Now the law of the Die-and-Leave taxes used to be very much the same as the law of the Have taxes. So, when the things left by a person who died were rights, and sometimes even when they were objects, more than one state could ask for taxes. But the Supreme Court decided a few years ago that, though a right was so abstract that it might be inside the walls of more than one state at the same time, a handing-over was much more definite and could not be two places at once. So when the "subject" of a tax is not a right itself, as with the Have taxes, but the handing over of a right or an object, as with the Die-and-Leave taxes, only one state can tax. And this is true even though, for example, a man who lived in one state happens to die in another state, and leaves to a person in a third state some stock of a corporation that was set up in a fourth state and does business in forty-eight states. This, then, is one of the places where the law has changed the answer to an interstate problem.

The law of the Die-and-Leave taxes is very simple today. If a man dies and leaves an object to somebody else, the law says the handing over of the object takes place inside the walls of the state where the object actually is when the man dies, and only that state can collect a tax.[25] If a man dies and leaves a right, instead of an object, to somebody else, that right was so attached to the man who owned it that it stays in the state where he used to live, is handed over inside the walls of that state, and only that state can tax.[26] And that is just about all there is to the interstate Law of the Die-and-Leave taxes, as it stands today.

Of course, there are many other problems but they are all unanswered. If a man dies and leaves a right to somebody else, and the right has been used regularly in business in another state so that it has a "business situs" there, can that state tax instead of the state where the man lived before he died? The Supreme Court itself says that this is a problem that it has not answered.[27] The same kind of problem comes up if the right that a man dies and leaves is a mortgage on land or buildings,

25. Frick v. Pennsylvania, 268 U. S. 473 (1925).

26. Farmers Loan & Trust Co. v. Minnesota, 280 U. S. 204 (1930); Baldwin v. Missouri, 281 U. S. 586 (1930); First Nat. Bank of Boston v. Maine, 284 U. S. 312 (1932). Cf. Blodgett v. Silberman, 277 U. S. 1 (1928).

27. See First National Bank of Boston v. Maine, 284 U. S. 312, 331 (1932).

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which was of course attached to the land or buildings as well as to the owner, and so may have been in two states at the same time;[28] or if the thing that is handed over is a right that was held in trust.[29] In these cases and in many more, the Supreme Court will have to decide whether the handing over of the right takes place in one state or the other, because it has already decided that a handing-over can only be in one state at a time.

Some people think that the Supreme Court will change the answers back again and let more than one state tax when a man dies and leaves a right to somebody else. They have several reasons for thinking this. The legal reason is that a handing over of a right is just as indefinite as a right itself, and so there is no reason why it should not be in more than one state at the same time. The real reason is that people who die and leave rights are usually rich men, and there is no reason why only one state should be allowed to tax a rich man for dying and leaving something. Also, some of the states have strongly objected to not being allowed to tax the way they used to before the Supreme Court stopped them. Finally, some of the members of the Supreme Court itself did not want to change the answers when the rest of the Court changed them. But all this has nothing to do with the Law. The Law is that only one state can tax when a man dies and leaves something to somebody else.

The Law of the Earn Taxes

Now the hardest problems come up when more than one state tries to tax the same person or company for making the same money. These taxes "on" income, or Earn taxes, are newer than the Have taxes and the Die-and-Leave taxes, so many of the problems are still unanswered. The taxes can be divided into two kinds — those on people, and those on companies.

First, the state where a man lives may tax him for making money, even though he makes it by doing work or business in another state or out of things that he owns in another state.[30] This is because the state where he lives protects and takes care of him while he is spending the money, no matter where he makes it. Of course this state also takes care of him while he is owning objects in another state but can not tax him for owning them. This is one of the differences between a Have tax and an Earn tax. The Have tax is "on" the object and the Earn

28. See Baldwin v. Missouri, 281 U. S. 586, 594 (1930).

29. Cf. Bullen v. Wisconsin, 240 U. S. 625 (1916); Bates v. Decree of Judge of Probate, 131 Me. 176, 160 Atl. 22 (1932).

30. Maguire v. Trefry, 253 U. S. 12 (1920); Lawrence v. State Tax Commission of Mississippi, 286 U. S. 276 (1932).

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tax is "on" the making or getting of money, even if it is made out of an object that is owned in another state.

But the law has also said that a state where a man makes money, by doing work or business there, or out of things that he owns there, can tax him for making the money even though he does not live there.[31] This is because that state protects and takes care of the work or the business or the things out of which the money is made. Now if the money is made by doing work, or out of objects that are owned, like coal-mines or cows or taxicabs, it is easy enough to tell where the money is made. But it is not so easy if the money is made, as so much money is, out of rights that are owned, like stocks or bonds or mortgages. For a right, remember, is one of the few things that can be inside the walls of more than one state at the same time. If so, which state can tax the man who owns it for making money out of it, or can they all tax him along with the state where he lives? This is an unanswered problem.

As a matter of fact, the Supreme Court has never really said that as many as two states can tax the same man for making the same money, because it has never really been asked. When it said that the state where a man lived could tax him, the state where the money was made was not trying to tax him. And when it said the state where the money was made could tax a man, the state where he lived was not trying to tax him. So all the Court has actually said is that either the state where a man lives or the state where his money is made may tax him for making it. It has never said that both states might tax him at the same time, or, if not, which state may do the taxing. It will probably have to decide this pretty soon.

A few state courts have tried to guess what the Supreme Court will decide. They have gone so far as to say that when a man in their state makes money out of objects he owns in another state, as by renting out land in the other state, then only the other state should tax him for making that money, and the state where he lives should not.[32] This, they say, is because the money he makes is so attached to the object he makes it out of that it is made in the state where the object is. But if he makes money by selling an object, like a plot of land, in another state, then, since he no longer owns the object, the money he makes is no longer attached to it, and the state where the man lives can tax him

31. Shaffer v. Carter, 252 U. S. 37 (1920); Travis v. Yale & Towne Mfg. Co., 252 U. S. 60 (1920).

32. Opinion of the Justices, 84 N. H. 559, 149 Atl. 321 (1930); Pierson v. Lynch, 237 App. Div. 763, 263 N. Y. Supp. 259 (3d Dep't, 1933), aff'd 263 N. Y. 533, 189 N. E. 684 (1933). Cf. Hutchins v. Commissioner of Corporations and Taxation, 272 Mass. 422, 172 N. E. 605 (1930).

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for making that money.[33] Of course, what one or two state courts say can not keep other states from trying to tax a man twice for making the same money, no matter how he makes it. And until they try, and the Supreme Court decides about it, that part of the Law is still an unanswered problem.

Earn taxes on companies, instead of people, are a little different. The state where a company is set up corresponds to the state where a person lives. Possibly, as with people, the law would let that state tax the company for all the money the company makes. But it is a lot easier for a big company to give up its charter and get set up in another state than it is for a person to move his home into another state. So the states have not tried to tax companies for making money just because the companies are set up in them. The states are afraid that the companies would move to other states which did not try to tax them for all the money they made.

Many states, however, do tax companies for the money they make in those states. The law says that this is all right.[34] Now if a company does all its business in one state, it is easy enough to tell that it makes all its money in that state. And that state can tax it for making the money there. But if a big company makes its money by buying or selling or making or owning things in a lot of states, it is not very easy to tell how much of the money is made in each of the states. Still the law says that each state can only tax the company for making as much of the money as is made in that state.

Here the law lets a state use something very much like the "unit rule," which is called an "allocation fraction."[35] An "allocation fraction" is a fraction made up of sums that the state can count up more easily than it can count up how much money is made in the state. The top of the fraction may be the value of all the objects the company owns in the state, or the total amount of wages the company pays in the state, or the total value of the goods the company sells in the state; and the bottom of the fraction will then be, correspondingly, the value of all the objects the company owns everywhere, or the total amount of all the wages the company pays, or the total value of all the goods the company sells. The state then multiplies this fraction times all the money the company makes, and says that that much of the money was made in that state. Different states use many different sums in their fractions,

33. Pierson v. Lynch, *supra* note 32.

34. United States Glue Co. v. Town of Oak Creek, 247 U. S. 321 (1918); Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113 (1920); Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission, 266 U. S. 271 (1924).

35. Underwood Typewriter Co. v. Chamberlain; Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission, both *supra* note 34.

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but the purpose of all of them is to pretend that part of the money a company makes in a lot of states is made in one state. In this way, the making of that part of the money is brought inside the walls of that state so that it can tax the company for making that part of the money.

Sometimes a company claims that it did not make as much money in a state as the state figured out by using the "allocation fraction." Then the law says that if the company can prove that it did not make that much money, it does not have to pay a tax for making that much money.[36] Of course this is all the company wants. And of course the company can usually arrange its account books to "prove" this. In this way, a company can say that it makes most of its money in a state that does not tax it at all for making money, or in a state that, by using an "allocation fraction," taxes it for making much less money than the company says it makes in that state when it is trying to get out of taxes in another state.[37] But this has nothing to do with the law. The law is only interested in dividing up the money a company makes in a lot of states, so that it will fit inside the walls of separate states.

Finally, there is one time when the law will not let a company be taxed at all for making money in a state where the company does business and makes money. That is when all the business a company does in a state is very closely connected with another state, as when all the goods sold in a state are shipped in directly from another state.[38] The law is not very clear about how close the connection must be. But if even a very few of the goods sold in a state were made or bought or stored in that state before they were sold, then the rule does not work at all. Then the state can tax the company for all the money it makes in the state, including the money made by selling goods shipped in directly from another state. So, only when every cent of money a company makes in a state comes from business that is very closely connected with other states, does the law say that no part of the money was made entirely within the walls of any one state. Of course this is actually just as true of all the money that is made by every company that does business in a lot of states. But if the law were to admit this, it could never very well put walls around the making of money by these companies; and then none of the states could ever tax them for making it.

At any rate, this finishes the Law of interstate tax problems. Of course there are many other kinds of taxes than Have taxes and Die-and-Leave taxes and Earn taxes. Probably the commonest is the tax "on" sales that a person or a company may have to pay for selling some-

36. Hans Rees' Sons v. North Carolina, 283 U. S. 123 (1931).

37. See Comment (1931) 40 YALE L. J. 1273.

38. Alpha Portland Cement Co. v. Massachusetts, 268 U. S. 203 (1925).

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thing, and that is added to the price of the thing sold so that the buyer really pays the tax. But with all these other taxes, once the law has said what the tax is "on," it is usually pretty easy to give this "subject" a "situs" inside some state's walls. Then only that state will so much as claim the right to tax. And when only one state claims the right to tax, there is no interstate tax problem.

The Legal Articles

Now a great many very learned articles and even a few books have been written about the problems of interstate taxation.[39] Most of them try to explain the answers that the law has given to the answered problems, and when the answers seem queer the articles try to make them seem reasonable. A lot of the articles try to figure out the answers to the unanswered problems, but the writers, not being the Supreme Court, can only guess. And many of the articles wonder whether some of the present answers may not soon be changed.

For instance, they wonder whether the law will change the answers on the Have taxes, as it did on the Die-and-Leave taxes, so that only one state will be allowed to tax a man or a company for owning a right. Sometimes they wonder instead whether the law will change back the answers on the Die-and-Leave taxes, so that more than one state will again be allowed to tax a man for dying and leaving a right that he owned to somebody else. Or they wonder what the law will do with the Earn taxes, and whether it will really let several states or only one state tax the same man for making the same money.

All these articles talk about the problems in legal words. For instance, they argue that a right, when it is the "subject" of a tax, should have a "situs" in only one state. Or they argue that two states can easily have "jurisdiction" at the same time, to put a tax "on" the handing down of something at a man's death. Or, getting more complicated, they suggest that Earn taxes can have two different kinds of "subjects." Thus they would call a tax on a man for making money a tax "on" the money he makes or "on" his privilege of making it. But if he makes the money

39. It has seemed to me unnecessary to clutter this article with references to secondary legal materials. Those who want such materials regardless may take for a first dose the seventeen articles and two books—representing only the more learned contributions of the last five years—cited in the second footnote of Maurice H. Merrill's article, *Jurisdiction to Tax—Another Word* (1935) 44 YALE L. J. 582, which incidentally strikes me as a more able piece of legal analysis than any of those he cites. I have also referred to a Comment, *supra* note 37, because it applies to the details of one of the interstate tax problems, certain of the notions which are more fully developed in the present article. The article is, after all (and, I hope, self-evidently), no more than an attempt to clarify the problems by stating them in words of one economic syllable, and perhaps thus to simplify their solution merely by avoiding the fuzziness of legal jargon.

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out of an object that he owns, then they would say that the tax, like a Have tax, is also "on" the object. In this way, since the tax could have two "subjects," each "subject" could have a "situs" in a different state and both states could have "jurisdiction." And all this is just to show how two states could tax the same man for making the same money.

Now it is true that some of these articles give other reasons for their arguments and guesses and suggestions. They may say that the "subject" of a tax should have its "situs" in the state that is most responsible for taking care of that "subject" or helping to create it or allowing it to happen at all. In this way "jurisdiction" would depend on "benefit." And "benefit," although it is not always very easy to find and measure, is at least easier to find and measure than "jurisdiction." Or the articles may go so far as to say that the reason a "subject" should have only one "situs" is that it is not fair to tax the same person or company twice for owning or doing or getting the same thing. Or, on the other side, they may argue that it is perfectly fair to tax a rich person or company twice for owning or doing or getting the same thing, especially when more than one state contributes some "benefit" to the "subject" of the tax.

But none of the articles, even when they give more sensible reasons for what they say, seem able to get away from the confusing legal talk of "subjects" and "situs" and "benefit" and "jurisdiction." They stay under cover of these words and ideas instead of breaking through or around them. In short, they take the legal walls between the states for granted, without stopping to realize that they are there or wonder why.

The Root of the Problems

What are those legal walls and how did they get there? The law says that they were built by the Constitution. They were built by the Constitution even though most of the states they surround today were nothing but uncharted wilderness when the Constitution was written. Now the Constitution was written almost one hundred and sixty years ago. In those days, almost all that any man owned was his house and his land and his livestock and his personal belongings, including maybe his slaves. Most goods were made in the shops where they were sold. The doing of business from state to state was a special trade in itself instead of, as now, an everyday affair involving almost all the business done in the entire country. So it is not surprising, nor was it stupid, that the Constitution made each state, jealous as they all were of their powers, practically supreme within its own boundaries. All the things that a state might want to tax a man for owning or doing were pretty

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well confined within one state by the nature of affairs, and problems of interstate taxation rarely if ever arose.

Looking back at the interstate tax problems that arise today, it is not hard to find their cause. It is the fact that the things men own and the business men do are of an entirely different nature than they were a hundred and sixty years ago. Responsible for the change is the development of railroads and telephones and coast-to-coast highways, of machinery and national chain-stores and intricate corporation finance, of a thousand and one devices that have helped the nation grow to the point where the average man must look at a map to find out what a state border is.

Men and business can forget state borders but the law can not forget. So the law must stretch the Constitution to fit a way of living and carrying on trade of which the writers of the Constitution never dreamed. The law must preserve in itself the state walls which men have ignored. And when problems arise because of the fact that men have ignored the walls, the law must somehow find the answers, if it find them at all, in a Constitution that was written when the walls meant something to men. At any rate, this is the way the law has treated problems of interstate taxation.

Is it possible, then, to get rid of the legal walls without scrapping or side-stepping the Constitution? Out of the strange patchwork that the law has pieced together in deciding which state may tax and which state may not tax, can a more up-to-date scheme of taxation be woven that will do away with both the answered and unanswered problems? At the least, it is worth a try.

Now the real root of all the interstate tax problems is extremely simple. The states need money to pay for the countless services they perform. They can get that money only through taxes. People and companies do not like to pay taxes even though the states perform services for them. Because they do not like to pay taxes, people and companies think it is especially unfair that they should pay taxes to two or more states for owning or doing or getting the same thing. And it is because they have partly persuaded the law to agree with them, that the law has used its walls to decide which states may tax. Is it possible, then, to be fair both to the states that need the taxes and to the people and companies that pay them, and still not raise problems for the law to decide with its walls?

A Plan to End the Problems

Remember again that the problems come up under the Have taxes, the Die-and-Leave taxes, and the Earn taxes. Now the Have taxes

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that people and companies must pay for owning objects do not cause real interstate problems unless the objects are moving. But almost all objects spend most of their time sitting in one state or another, even though they are occasionally shipped from state to state and though a very few of them, like freight cars, are always moving. So the states would not lose much in taxes if, to end those interstate problems, they were to tax people and companies for owning only such objects as are pretty permanently inside a state and not just moving through it. Or the states might even limit the taxes to objects that can not move, like land and mines and buildings — what the law calls "realty." In either way, these Have taxes would be reduced to objects with a real and stationary location. Nor is it unreasonable for a state where such an object is to tax its owner, because that is the state which takes care of the object and where the owner must use it if he use it at all. Yet, even if the states continue to tax people for owning moving objects, the use of state walls to decide the few problems arising is neither so important nor so confusing as when the law gives a "situs" to a right or a handing-over or a making-of-money.

Now the hardest Have tax problems come up when the law tries to give a "situs" to a right so that its owner may be taxed for owning it. But why should a man be taxed for owning a right? He can not wear it nor eat it nor live in it nor set up shop in it. All that he can do with it is make money out of it or hand it over to someone else to make money. And if he were to be taxed only when he makes money out of it, or dies and leaves it to somebody else to make money, that would seem to be enough. Certainly it would end the silly business of trying to put an abstract right into a geographical state, so far as the Have taxes are concerned. And if the states will not, of their own free will, stop taxing people and companies for owning rights, there is at least one way to persuade them to stop, and to do away with the rest of the interstate problems as well.

The rest of the interstate problems, and the most important ones, come up under the Die-and-Leave taxes and the Earn taxes. They are important because the states have recently been turning more and more to these taxes, so that a great deal of money is involved and a great many problems are unanswered. These problems, and even the answered ones, will soon cause countless disputes, as taxpayers quarrel with states, and states quarrel with each other, and the law goes calmly on putting legal walls around the making of money and the handing over of things at death. The problems will cause disputes, that is, unless they are never allowed to arise.

Now the federal government, as well as the states, collects a tax for

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the handing over of things at death, and taxes people and companies for making money. Why, then, should not the federal government collect some extra money under its taxes and put this extra money aside to be divided up and turned over to the states? The extra federal taxes could then be made to take the place of the state taxes that cause almost all the interstate problems. And the money would still come back to the states to spend.

The plan could be worked out very easily. First, Congress would pass a bill providing, in legal language — that a stated percentage of the revenue accruing from federal estate and income taxes be segregated for distribution to the states. Still in legal language — the bill would stipulate that payment of a share of the fund be made only to those states which abolished their own estate or inheritance taxes, their income taxes, and their property taxes on intangibles. In other words, the federal government would hand over part of the extra money only to states that were willing to give up, in return for it, their own Die-and-Leave and Earn taxes and their Have taxes on people and companies for owning rights. Very much the same kind of persuasion has been used, in a reverse way, by the federal government before, when it arranged to cut off as much as four-fifths of the federal Die-and-Leave tax for Die-and-Leave taxes paid to a state. Of course, this last arrangement would have to be done away with under the new plan. But then the Die-and-Leave tax rates would not have to be raised to get extra money, because the four-fifths that has been going to the states would come, as it did originally, to the federal government. And so only the federal Earn taxes would have to be increased to get extra money to turn over to the states under the plan. Finally, the bill in Congress would lay down rules for dividing the extra tax money among the forty-eight states. And the money could best be divided according to a standard made up of two factors — first, population; and second, the "basic wealth" of each state, or the total value of all the permanent objects, such as land and houses and factories, in the state.

If the bill were passed and the plan put in action, the results would be fair to everybody concerned. People and companies would never have to pay taxes to two states for owning or doing or getting the same thing. As a matter of fact, the extra tax they would pay to the federal government would in most cases be even smaller than the tax they might otherwise have to pay to one state, because the expense of collecting the state taxes would be saved. And the states in turn would be saved the trouble and expense of figuring out and collecting these taxes.

Furthermore, each state would get its fair share of the tax money. For, the states, remember, need that money only to perform services for, and take care of people and objects. Surely then, the money should be

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divided according to the number of people and the value of the objects each state must protect and serve. Moreover, just as people and companies would never have to pay taxes to two states, none of them could get out of paying these taxes at all by living or doing business in states that did not tax. And finally, there would be no more use for the state walls.

Of course, if this plan were proposed in Congress a lot of objections would be raised. Certain state politicians would howl about state rights and state pride, but they would not mean that. All they would mean would be that the plan, if carried out, would cause them or their friends to lose state jobs. Certainly a state's pride can not be hurt by a mere offer to hand over money to the state if it will give up other money in return.

Then the states where most of the rich men live would object strongly. They would object because they are used to getting a larger share of the Die-and-Leave and Earn taxes than the federal government would give them under the plan. Now these states have been getting a larger share under the state wall system of taxation only because the rich men happen to live in them. What these states do not care to remember is that the rich men or their fathers or grandfathers made and make their money and acquire their rights by doing business, not in one state, but all over the country or even the world. And in order to talk for more taxes, these states would keep their eyes closed to the fact that men have forgotten state boundaries in developing the nation's wealth and their own personal fortunes.

Under the plan, these states' shares of the tax money would be measured by the people and the real wealth within their borders. They could not justly ask for more. And in spite of all objections, it would be just about impossible for such a state to turn down the federal government's offer, once the plan was adopted and the offer made. For the federal government would collect the extra tax money regardless. And the taxpayers of the state, rather than pay two sets of taxes, would force the state to join the federal plan.

Finally, the law itself might object to the plan after it was under way. At least certain lawyers, who make money by handling interstate tax problems, would say beforehand that the law would object. But unless and until the Supreme Court were to call the plan illegal, even those lawyers could not know. Now the only legal objection that might lead the Court to turn down the plan is that the federal government may not, even by merely making offers to the states, take away from the states the powers that the Constitution promised them. The power to tax, the objection would run, is one of the most important of the state powers. Therefore the federal government may not ask the states to

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give up, even of their own free will, part of their taxing powers. But there is a legal answer to this. For, legally, the states would not be giving up part of their taxing powers; they would only be refraining from exercising those powers. And this only means that a state, should it wish, could at any time turn down the federal government's offer and start collecting its own taxes again. That no state would ever do this in no way affects the law.

Any possible legal objection to the plan would really come from a reluctance to turn over to the federal government full control of an activity that the states are used to handle for themselves. The argument is very close to the states' rights idea and is often expressed as a vague fear of "centralization." But such an objection would come with bad grace from the law. For it is through the Supreme Court that the law has, up to now, handled interstate tax problems and told the states what they might and might not do. And the Supreme Court is, after all, a part of the federal government itself. Surely it would be more sensible for the federal government to handle the taxes from the beginning with an orderly plan than to continue to handle them in a piecemeal way after the states have done their best.

Yet in spite of all this, the law might refuse to let the federal government use the plan. For the law is sometimes a willing slave to duty.[40] And if the states were allowed to get rid of their Earn taxes and their Die-and-Leave taxes and their Have taxes for the owning of rights, then there would be almost no more problems of interstate taxation for the law to answer, just as there were almost no problems when the Constitution was written. And then the law would no longer have to insist that there are walls between the blocks of color on a map of the United States.

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40. That a majority of the Supreme Court is willing and anxious to extend and further complicate the state wall plan of taxation seems apparent from the decision in *Senior v. Braden*, handed down on May 20, 1935, after this article had gone to press. In that case, the state of Ohio was forbidden to tax an Ohio resident for making money out of rights, represented by certificates in a trust, which owned land both inside and outside of Ohio. Although the opinion is confusing, it seems to change the Law of the Earn taxes so that a man may no longer be taxed by the state in which he lives for making money out of things in another state. At least the opinion implies that the leading case allowing such a tax (Maguire v. Trefry, *supra*, note 30) was later discredited by the one state decisions on the Die-and-Leave taxes (*supra*, note 26), although, as Mr. Justice Stone points out, in an able dissent joined by Justices Brandeis and Cardozo, an even more recent decision (Lawrence v. State Tax Commission, *supra*, note 30) upholds the right of a state to tax its residents for making money in other states. The fact that in the instant case, at least part of the money was definitely made in Ohio casts considerable doubt on the exact meaning of the majority opinion. Thus the law continues to confuse state tax systems with complicated theories about imaginary state walls.

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