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# FEDERAL LEGISLATION ON STATE TAXATION OF INTERSTATE COMMERCE: Key Areas of Controversy

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## The Background of P. L. 86-272

In 1959, Congress, for the first time in our history, enacted legislation designed to restrict the powers of the states to tax businesses engaged in interstate commerce. For 160 years, the Supreme Court sought to chart out the restrictions on state taxing powers imposed by the Commerce Clause, and the Due Process Clause, without benefit of the exercise by Congress of its powers granted under the Constitution. Hundreds of Supreme Court decisions, many handed down by a sharply divided court, delineated the limits of state taxing power in virtually every area of business taxation—property taxes, corporate franchise, capital stock and income taxes, and in more recent times, in the sales and use tax fields.<sup>1</sup> The traditional approach of the Court has been based on the conception that under the Commerce Clause, until Congress acts, interstate businesses must remain free to trade, unfettered by direct state taxes. This philosophy created a haven for national enterprises immune from franchise, capital stock, gross receipts and at times other taxes imposed by the states and local governments. As has been true generally in our constitutional law, a dynamic and growing economy, coupled with changing political and social attitudes, reflected themselves in shifts, changes and reversals in Supreme Court decisions charting out the permissible scope of state taxation of interstate commerce in the silence of Congress.

Beginning in the thirties—it is not irrelevant to note that this was the period of the great Roosevelt reform era—the majority view in the Court began to shift to a new reading of the impact of the Commerce Clause on state taxation. Under this view, the Commerce Clause is designed not to free interstate businesses of state and local taxation, does not carve out an area of immunity for the nation wide enterprise, but instead it merely insures equality for interstate business with intrastate business, it prevents discrimination against the out of state venture, and it debars multiple tax burdens on interstate businesses not borne by local businesses.

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1. The history is traced in Hellerstein, *State and Local Taxation*, Ch. 6 (2d ed. 1961); and Hartman, *State Taxation of Corporate Income from a Multistate Business*, 13 Vand. L. R. 21 (1959).

Two 1959 decisions—significantly, one arising in a Southern state, Georgia, and the other in a Midwestern state, Minnesota, the regions of the country that have been most zealous in seeking to obtain more revenues from the sprawling national companies located in the heavy manufacturing states—authorized the states to tax the income of an out of state corporation doing an exclusively interstate business in the state, where the measure of the tax was fairly apportioned, and there was adequate Due Process connection with the taxing state.<sup>2</sup> The states hailed the decisions as marking their tax liberation; at long last they could exact tax from the out-of-state vendors exploiting their markets, which had gone untaxed by them theretofore. Businessmen, on the other hand, raised a great outcry against the holdings; the decisions would Balkanize America, they would create tax barriers to interstate trade within the nation, and they would put an end to the long cherished tax immunity that national businesses had enjoyed in many states. Besides, argued the accountants and lawyers for manufacturers, wholesalers associations and mail order houses, the envisaged broadening of state taxation of multistate businesses would impose costly and cumbersome accounting and compliance burdens on business, especially the smaller business selling in more than one state, and greatly complicate enforcement of the levies by the states and local governments.<sup>3</sup>

### The Willis Subcommittee Report

Within six months after the 1959 decisions were handed down, Congress, acting with unusual alacrity, enacted Public Law 86-272, admittedly as a stop gap measure; and directed a Congressional Committee to make an overall study of how Congress should exercise its long dormant powers to regulate interstate commerce in the state tax field. Public Law 86-272, in essence, prohibited the states or their local subdivisions from imposing any tax measured by net income on any non resident or foreign corporation engaged in interstate commerce, if the activities in the taxing jurisdiction are limited to soliciting orders for sales of tangible personal property, where the orders are approved outside the state and the shipments filled by delivery across state lines.

Five years later, after the most extensive study of state taxation of in-

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2. *Williams v. Stockham Valves & Fittings, Inc. and Northwestern States Portland Cement Co. v. Minnesota*, 358 U. S. 450 (1959).

3. See *Hearings Before Select Committee on Small Business of United States Senate*, 86th Cong. 1st Sess. (1959); *State Taxation of Interstate Commerce*, Sen. Rep. No. 453, 86th Cong. 1st Sess. (1959); *Hearings on S. J. Res. 113, S. 2213 Before the Committee on Finance of United States Senate*, 86th Cong. 1st Sess. (1959); and *State Taxation of Income Derived from Interstate Commerce*, Sen. Rep. No. 658, 86th Cong. 1st Sess. (1959).

terstate commerce in our history, conducted by a full-time staff of lawyers, economists and statisticians, the House Judiciary Subcommittee, headed by Congressman Edwin Willis of Louisiana, completed its report.<sup>4</sup> This report is a gold mine of legal and economic data in the field, and just as I understand no evening newspaper in New York could manage without the New York Times, so no serious student or teacher of state and local taxation can operate now without benefit of this report. And the report and the Committee's recommendations went far beyond the controversy in state taxation which gave it birth, for they deal not only with franchise, capital stock and income taxes, but also gross receipts and sales and use taxes.

The Willis Subcommittee proposed sweeping and far-reaching Federal legislation designed to carry out their recommendations. A storm of protest arose from virtually all quarters—the state taxing authorities, businesses and academicians. The result was that the Willis Subcommittee, after hearings, withdrew its original bill and during the summer of 1966 substituted a considerably more modest set of proposals.<sup>5</sup> Although the bills never reached a vote in the House or Senate—presumably because of the pressure of other high priority legislation—Mr. Willis has announced that he will reintroduce the revised bill early in the next session of Congress and press for its enactment.<sup>6</sup>

In considering the major areas of the controversy ahead, at the outset we face the question as to whether there should be any further Congressional intervention in the field. Many states are vigorous in their opposition to Congressional intervention in the state taxation field and not only oppose further Federal legislation, but demand the repeal of Public Law 86-272. This is a highly unlikely result, so that the realistic questions revolve about the kind of legislation Congress ought to enact. We turn to the key controversies as to Federal legislation.

### Net Income and Capital Stock Taxes

Beginning with state and local taxation of income or capital stock of corporations, whether in the guise of franchise taxes or direct net income taxes, there are two key focal points of controversy—the jurisdiction of the states to tax the out-of-state corporation, and the allocation and apportionment of the income or capital stock measures of the tax among the states.

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4. Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, *State Taxation of Interstate Commerce*, H. R. Rep. 1480, 88th Cong. 2d Sess. (1964).

5. H. R. 16491, 89th Cong. 2d Sess.

6. At this writing the bill has been reintroduced into the 1967 session of Congress.

### A. Jurisdiction to tax

Public Law 86-272, the Federal statute now in force, grants immunity from state taxes measured by net income to the out-of-state vendor selling tangible personal property, if the vendor limits its activities in the state to solicitation and shipment into the market. The maintenance of a sales office in the state is apparently beyond the permissible minimum standards. Likewise, a stock of goods for delivery to customers cannot be maintained in the state—even in a public warehouse—by the out-of-state vendor, without incurring liability to state or local taxes on income.

The big push of representatives of trade associations, Chambers of Commerce, and others reflecting the business point of view, has been to tighten the jurisdictional curbs on state taxation of business income by the adoption of a "permanent establishment" rule as a jurisdictional requirement for franchise, net income or capital stock taxes. This is the type of test of taxation of non-resident businesses widely used in international taxation, which is embodied in tax treaties between the United States and many other countries. But the contours of which is "permanent establishment" are by no means clear or readily agreed upon. Not every regularly maintained office or place of business would necessarily constitute a permanent establishment. Thus, the Financial Executives Institute urged the Willis Subcommittee to exclude from "permanent establishment", sales offices and purchasing offices. The National Association of Manufacturers sought to minimize warehousing, purchasing offices and research installations by excluding such business activities from the definition of a taxable "permanent establishment". The Willis Subcommittee adopted a permanent establishment test of its own as a condition to state taxation, which it calls a "business location".<sup>7</sup> In the original Willis bill, "business location" meant owning or leasing real property in a state, or maintaining an employee's base of operations there. Consequently, under this business location test, the out-of-state vendor could exploit the local market, free of state and local taxes measured by income, only if it had neither employees nor places of business in the state. However, this test permitted the maintenance of local stocks of goods in the states.

In general, this approach by the Willis Subcommittee reflected, except for the ability to stock goods without tax, what seemed on the surface to be a fairly reasonable middle ground between the pressure of the states to eliminate jurisdictional restrictions on their powers to tax income derived from the local market and the pressure of business for greater restrictions on the states. However, the proposal of the Willis Subcommittee to permit the out-of-state vendor to maintain a stock of goods in a

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7. See Subcommittee Report, note 4 *supra*, at pp. 489-508.

state and thereby fill its customers' orders promptly from local stocks, such as a public warehouse, a broker's or independent salesmen's storehouse, without subjecting the vendor to tax, came as a distinct surprise in many quarters. Traditionally, the regular maintenance of property in a state has been an accepted basis for taxation of the out-of-state vendor, and from an economic marketing point of view, an inventory is perhaps the hallmark of the merchant who has localized himself in the local market in full competition with the local merchant. The states have bitterly protested this jurisdictional exclusion. I think we can fairly expect this proposal to be a key controversial issue in the months ahead; and it's a little hard to see why this provision should not be deleted.

The revised version of the Willis bill make an important change that brings its "business location" test considerably closer to the permanent establishment test of jurisdiction to tax sought by business spokesmen than did its original proposal. The amended bill still begins by providing that renting or owning real estate, or having an employee in the state will satisfy the jurisdictional test, but then it proceeds to cut the heart out of the employee location rule by exempting the employees about whom the controversy has raged—salesmen. Thus, a foreign corporation could maintain a whole staff of permanent salesmen in a state and still not be taxable, so long as the salesmen do not work out of premises owned or rented by the out-of-state vendor. No explanation is offered in the Committee Report as to why this significant shift favoring tax immunity of the out-of-state business was made. It is certain to be the target of attack by the states.

There is another aspect of selling activities in the taxing jurisdiction that ought to be noted. Under both the original Willis bill, as well as the modified version, the proposed jurisdictional requirements exempt from tax foreign corporations that market their products through sales representatives, or other independent agents who are not employees. Such independent contractors may maintain their own offices or business establishments in the states, from which they solicit orders for their principals, without subjecting their principals to tax; and these non-employee representatives may also maintain in their warehouses stocks of their principal's goods to meet the needs of local customers in the local market. The difference between an employer-employee relationship and an agent-principal relationship will often depend on legal formalities that have little economic significance. Under this jurisdictional rule, even if the vendor should be made taxable if he maintains salesmen-employees in the state, we might see a large scale shifting of employee-salesmen to so-called "agency" relationships, with the agents maintaining their principals' former establishments in their own names. Of course, they will in one way or another be reimbursed for such costs by the principal. It

doesn't take much legal ingenuity to effect such a shift, and it may mean only different forms of legal documents, without any significant change in economic relationships. And this provision is destined not only to increase manipulation by contract, but it will also doubtless invite numerous controversies and litigation, in which the states will attack the transactions as "sham", or as not achieving the independent contractor relationship.

The volume of sales at stake in these controversies is of considerable magnitude. The Subcommittee's report found that "more than half the companies studied made more than 25 per cent of their sales into states whereby they had no offices or real property of their own," and that "well over a quarter of the companies studied made more than 55 per cent of their sales into such states". This is by no means "limited to the smaller companies" for the same results obtain for companies with gross sales of over \$5 million a year.<sup>8</sup> This aspect of the modified Willis bill, extending exemption to vendors who market their goods through local sales representatives, whether they have the status of employees or independent contractor agents, does not commend itself, in my thinking, as an acceptable accommodation of the competing interests of the states, interstate businesses and the local intrastate competitors.

In another respect the modified Willis bill broadens state taxing jurisdiction—the jurisdictional (as well as the apportionment and allocation) provisions of the bill are not applicable to businesses with annual net incomes of over \$1,000,000. This quantitative exclusion refers to the taxpayer's income from all sources, not merely from the taxing state; it is determined by reference to Federal net income, and is the average of the last 5 years' results of the taxpayer and affiliated corporations—a 50% ownership and 50% voting power relationship are the tests used for affiliation. The Committee does not spell out the reason for this exclusion, of larger enterprises from the bill, but the background is that one of the major reasons given for the Congressional legislation was the need to protect smaller businesses, which do not have accounting and other staffs to advise them on the laws and administrative practices of the states, to keep the requisite data to file returns and generally enable them to comply with the tax laws. Moreover, the Committee had emphasized the small amounts of state tax involved in the multi-state operations of smaller businesses.

How have the states reacted to this exclusion of larger businesses? The proposal is the reverse of what some state tax men have urged. Thus, it has been suggested that the states be left with wide powers to tax and,

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8. *Id.*, p. 493. For an overall critical evaluation of the Willis Subcommittee's Report, see Hellerstein, *Allocation and Nexus in State Taxation of Interstate Business*, 20 Tax Law Rev. 259 (1965).

indeed, that Congress should affirmatively empower the states to impose income, franchise or capital stock taxes on any foreign corporation or out of state vendor which exploits the market, whether by local salesmen or by mail order or by radio and television. However, to give relief to smaller enterprises from burdensome accounting and compliance costs and to eliminate state enforcements costs where the tax revenues are minimal, Congress could prohibit the states from imposing such taxes on out of state vendors that do not sell more than e.g. \$100,000 worth of goods a year in the taxing state, unless the business maintains a substantial location in the state, or a stock of goods there. They argue that such a test would be much simpler and much fairer than the Willis Subcommittee's basic approach. But if Congress is to adopt the Willis proposal, the states now argue that \$1,000,000 of net income is much too high a cut off point; they would cut the figure sharply.

It is to be observed that the revised Willis bill would not eliminate all Federal protection given to the larger businesses that would be included from its terms. The proposal is that Public Law 86-272 be retained, so as to keep the specific restrictions or state taxation of net income now in force for all corporations.

All the jurisdictional limitations of the Willis bill under consideration would apply equally to capital stock taxes, and as we shall see shortly, would be carried over to sales and use tax collections.

### B. Apportionment and Allocation

While it was the liberalization of state jurisdiction to tax net income by the 1959 Supreme Court decisions that triggered the Congressional action and resulted in Public Law 86-272, a considerable part of the Subcommittee study and its report are devoted to apportionment and allocation. Many businesses, and especially the great national and international corporations, are subject to income or franchise or capital stock taxation in all or most of the states in the Union, by any of the jurisdictional standards being considered. A major complaint against the existing state tax structures by such businesses has had to do with the methods used to determine the portion of the income or capital stock that is to be taxed by the various states. For more than half a century the states have struggled to develop and refine methods of cutting up a corporation's total net income or its capital employed in all states and foreign countries, so as to determine the portion of the base to be taxed by the particular state.<sup>9</sup> Formulas have been devised to determine what portion of the total net operating or business income is attributable to a

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9. This history is detailed in the Subcommittee Report, note 4 *supra*, pp. 129-133.

state; and frequently non-operating income, such as dividends, interest and rentals have been the subject of rules as to how they should be allocated. A favorite technique is to allocate all interest dividends to the state of commercial domicile.

Because the Supreme Court has had no help from Congress in setting up guide lines for resolving the claims of the various states, a wide variety of methods of apportionment and allocation have developed and have been approved as constitutional. The result has been a bewildering maze of varying and conflicting rules and approaches, and it has produced undertaxation of some companies and overtaxation of others. For example, Georgia uses a formula that apportions sales to the state of the destination of the goods, whereas Alabama apportions them to the location of the sales office to which the salesman who took the order is attached. Because of these conflicting rules, if a company does all its business in Alabama and Georgia, maintains plants and warehouses in both states but its sales offices only in Georgia, neither state will include the receipts from sales made to Alabama customers in making the apportionment. As a consequence, the corporation would pay taxes to the two states on less than its entire income; part of it would escape tax. But if the sales offices were maintained in Alabama instead of Georgia, receipts from sales made to Georgia customers would be taken into account by both states, and the corporation would be taxed on more than 100% of its income.

I have given you a very simple example. Consider the fact that 24 states apportion sales receipts, in whole or in part, to the state of destination of the goods, 7 reverse the procedure and apportion sales receipts (in whole or in part) to the state of origin (that is the state *from* which the goods are shipped), 12 states choose the locus of the sales office to apportion sales receipts, while 8 others apportion to the place where the sales negotiation takes place<sup>10</sup>. No one who has struggled with the intricate problems of seeking to comply with the allocation and apportionment requirements of the states will, I think, dissent from the conclusion of the Willis Report that the present system for the division of income is characterized by diversity and complexity, requires extraordinarily complex accounting, and results in overtaxation of some companies and undertaxation of others.

To clean up this mess, the Willis Committee recommended that Congress require the states and local governments to adopt a uniform method of apportioning and allocating income and capital stock, if they are to be empowered to tax manufacturers, producers, wholesalers, retailers engaged in interstate commerce, and, indeed, most businesses other than

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10. See the Subcommittee Report, note 4 *supra*, at p. 182.

public utilities, banks, insurance companies and transportation companies. The bill would also require the states to define net income in their tax measures so as to conform generally to the definitions in the Federal Internal Revenue Code (with some exceptions). And the bill sets out the uniform formula and the allocation methods that state and local governments must use.

### (1) Voluntary Action by the States

There has been no great controversy over the proposal to use Federal net income as a uniform tax base, for many states already have gone far to conform their definitions to the Federal conception. However, a storm of protest arose from the states against the apportionment and allocation proposals. At the outset, the states contend that Federal legislation is not needed to achieve uniformity in apportionment and allocation. They point out that the states are now moving rapidly to achieve uniformity in this area by their own legislative action. There are now some 13 or 14 states that impose taxes measured by net income that have adopted essentially uniform apportionment and allocation methods by enacting the Uniform Division of Income For Tax Purposes Act, 7 or 8 of these adoptions have taken place within one past year or so.<sup>11</sup> Other states are seriously considering such action for the next legislative session. As you know, your own State Legislature has appointed a Commission, which includes in its membership the distinguished Commissioner Morrisette, to report a measure to the next session of the Virginia Legislature. In addition, a strong movement has recently developed among the states to adopt a multistate compact to deal with apportionment and allocation. The States, therefore, hold that left alone, they will do the job of achieving uniformity of apportionment and allocation without the necessity of Federal intervention.

Some people, however, are rather skeptical about relying on the States for voluntary action in this area. Even under the threat of Federal intervention, there are still only a minority of income tax States that have adopted the uniform apportionment and allocation of income legislation. Moreover, the Uniform Act is severely limited in scope—a number of types of businesses are excluded, and the formula used is ill-adapted to such businesses as transportation, communication, radio and television, magazine publication and a good many others that require apportionment methods tailored to their specific operations. Besides, the

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11. The Uniform Act is printed in *Hearings Before the Select Committee on Small Business of the United States*, note 3 *supra*. For an analysis of the model act, see Lynn, *The Uniform Division of Income for Tax Purposes Act Re-Examined*, 46 Va. L. Rev. 1257 (1960); Pierce, *The Uniform Division of Income for State Tax Purposes*, 37 Taxes 747 (1959).

States have in some cases adopted the uniform formula with their own special variations, and, of course, always remain free to amend their laws so as to make further departures from the uniform act. Overall, self regulation has not worked out very satisfactorily in our economy generally and it seems less than adequate in this area.

### (2) The Willis Bill Formula: H. R. 11798

If we are to have a Federally imposed uniform formula, the great issue is whether Congress should adopt the formula proposed by the Willis bill. A major feature of the Committee's recommendation is its espousal of a two factor apportionment formula for business income—consisting of property and payroll thereby eliminating altogether the receipts or sales factor. The Committee found that the most serious difficulties and complexities in apportionment, the most troublesome compliance and accounting burdens arose out of the receipts factor, particularly the need to identify the origin or destination of every shipment of goods. It also concluded that it would make very little difference revenue-wise, even to most of the non-manufacturing states, if the receipts factor were eliminated altogether. Consequently, in the interest of simplicity and ease of compliance and audit, the Willis bill proposed the two-factor formula.

The two factor formula plan has met with vigorous resistance among the states. The three-factor formula, consisting of property, payroll and receipts, was recommended in 1939 by a Committee of the National Tax Association as a sound basis for apportioning business income and capital stock among the states. In the quarter of a century that has elapsed since the N.T.A. Committee gave its imprimatur to these three factors—<sup>12</sup> they have won virtually unanimous acceptance as proper standards for measuring the claims of the several States to share in the income tax base. 37 out of 38 States that use net income as a measure of their corporate tax employ these three factors.

And the most recent development and refinement in corporate net income base apportionment has been the acceptance and adoption of the destination test for apportioning receipts from sales—at the time the Subcommittee wrote its report, 24 out of 38 States had adopted this test in whole or in part, and since then at least 3 other States, Idaho, New Mexico and California, have enacted that test. In addition to protesting the Willis Committee's abandonment what has become a national consensus in favor of the three factor formula, with the destination test of sales as the most acceptable yardstick for dividing the income tax base of the multi-state vendor, the states argue that the elimination of the receipts factor would short-change the agricultural and less industrialized

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12. 1939 Proc. National Tax Association 190, 205.

states and favor the heavy manufacturing states. The latter already obtain a large weighting in apportioning income to their states through the property and payroll factors. If the state where markets are exploited by out-of-state manufacturers and vendors are to be able to make interstate businesses pay anything like their fair share of the market sales' taxes, the formula to be used must include a receipts factor with the factor of destination rule of apportionment. And the states entered into a battle of statistics with the Willis Committee seeking to demonstrate that the revenue losses to the states would be substantial and significant, and would shift tax loads within the taxpaying group.

Finally, the states contend that the Committee's major reason for discarding the receipts factor—simplification of compliance and administration—will be accomplished by any uniform formula, and that it is not necessary to eliminate the receipts factor with its destination test to achieve that result.

One of the fascinating aspects of public reaction to the apportionment provisions of the Willis bill was that business interests generally did not rally to the Committee's support on this score. I suspect this was as great a surprise to the Committee as it was to the states. Spokesmen for business have pretty generally concentrated their fire instead on the jurisdictional provisions of the bill, not apportionment. And a good many have been concerned with special problems that affect their own individual tax positions, such as the definition of what is a unitary business, the treatment of dividends from subsidiaries, and the handling of income from sources outside the United States.

Whatever the explanation, business did not rally to the support of the two-factor formula and the states fought it. As a result; the revised Willis bill makes what looks, on the surface at least, like a sharp retreat from the original Willis bill's apportionment proposals.<sup>13</sup> Instead of exercising the Congressional power to require uniformity in apportionment and allocation, the revised bill grants to taxpayers an option either to determine the income or capital stock to be apportioned to the states, by the application of state's apportionment and allocation methods, or by using the two-factor formula originally proposed. The states may keep their existing patchwork of varying and conflicting formulas, but a business covered by the Act, may compute its tax under both the state's regular apportionment method and under the Willis two-factor formula; it will then pay its tax under the cheaper technique. Since the provisions do not apply to purely intrastate businesses, or those with a five year average Federal net incomes only over \$1,000,000, the regular state formula alone will apply to them.

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13. H. R. 16491, 89th Cong. 2d Sess.

We have thus come the full circle; a four and a half year study designed to achieve as one of its major objectives uniformity in state income and capital stock tax apportionment, simplification and easing of costs and burdens of compliance and collection, winds up by proposing that the states may retain the existing crazyquilt structure, and then adds a new layer of complication and costs by providing an alternative optional method of apportionment and allocation that the states must make available to certain designated segments of interstate businesses!

Perhaps the real explanation for this apparently ironic denouement is that its draftsmen see the proposal merely as a device to force the states by indirection to abandon their present apportionment formulas in favor of the two-factor formula, because of the impossible problems of living under this hybrid proposed structure. If such is the devious purpose of the optional formula proposed by the Willis bill, then I suggest that the proposal ought to be rejected summarily on its merits.

For myself, I do not believe that we can effectively achieve the kind of uniformity in apportionment and allocation that we sorely need without Congressional intervention. And we shall need uniform methods not only in manufacturing and selling, but also in transportation, radio and TV and airlines and other industries which need techniques specifically adapted to the characteristics of their businesses. My own preference is for Congress to establish an administrative agency, empowered to prescribe apportionment and allocation methods for all businesses engaged in interstate operations, an agency that could modify its formulas in the light of experience and issue regulations and interpretations and generally administer the act.<sup>14</sup> If Congress itself is to promulgate formulas, it ought to begin by adopting the widely used three-factor formula, with a destination test of sales and require its use by states taxing multistate manufacturers or merchants. In this way, these enterprises will contribute to the revenues of the states whose market they exploit, and they will be put on a more nearly even basis than now obtains tax-wise vis-a-vis local merchants. Then, after we have lived with this formula for a few years, Congress can, in the light of our experience, consider action as applied to other businesses, or make such changes in the formulas as the experience dictates.

### Sales and Use Taxes

The *Scripto* case, decided the year after Public Law 86-272 was enacted, dealt with the duty of the out-of-state vendor to collect use taxes.<sup>15</sup> Sixteen years earlier, the Court had held that the out-of-state vendor

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14. For an elaboration of this proposal, see Hellerstein, *loc. cit. supra* note 8.

15. *Scripto, Inc. v. Carson*, 362 U. S. 207 (1960).

selling through salesmen and shipping goods into a state, could constitutionally be made the market state's use tax collector from the consumer, even though the seller was doing an exclusively interstate business in the state.<sup>16</sup> In *Scripto* the Court upheld the state's power to compel the seller to collect the tax when he sold through independent agents instead of employees.

A great hullabaloo was voiced in business circles against this ruling. I confess I've never quite understood why this rather easy step from the employee-salesmen to the independent sales representative caused such a stir, except perhaps because of the fact that an atmosphere had been engendered by Public Law 86-272, in which business men now expected that Congress was ready to listen sympathetically to their complaints concerning state tax matters. There was also considerable demand for Congressional action to curb the attempts being made by some states to require use tax collection of mail order sales, an issue that is now pending in the United States Supreme Court in a case in which the State of Illinois imposed that obligation.<sup>17</sup>

Sales and use taxes are of enormous importance to the states and a local government. They have swept the country, and account for over 25% of state tax revenues; at rates of 2%-6%, they can be a significant factor in competitive selling. For all practical purposes affecting most articles, other than automobile purchases which can be policed through car registrations, the taxing authorities must rely largely on the vendor if sales and use taxes are to be effectively enforced. And if a local buyer can cut his price by 2% or 4% or 6% by buying from an out-of-state seller, local merchants will be at a serious competitive disadvantage. The use tax was developed, in part at least, to protect the local merchant.

The sales and use tax proposals of the Willis Committee as set forth in the bill it originally fathered, were, I think, a greater surprise and shock to the states, businesses and students of the field than any other features of the bill.

In perhaps the most sweeping restrictions on the taxing powers of the States proposed by the entire legislation, the bill would have required the states to adopt the major features of a national, uniform sales and use tax prescribed by Congress, if the state was to have the power to require collection by an out-of-state business not having a "business location" in the State, or not regularly making household deliveries within the State. An elaborate system of dual Federal and state administration was envisioned. The justification for this extensive Federal intervention into the state tax field was that the burdens of sales and use tax collections on the multistate, in determining what was taxable and

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16. *General Trading Co. v. State Tax Commission*, 322 U. S. 335 (1944).

17. *National Bellas Hess, Inc.*, Docket No. 241.

what was not, who was exempt from tax and who was not, and so forth, that only a uniform act, Federally administered could deal with the issues. The bill did allow the states to grant exemptions not provided for in the so-called model tax and to adopt certain other variations, but these were to be administered through a cumbersome refund or immunity registration number system.

These proposals were met in all sectors with bewilderment and dismay—state tax administrators and business interests alike. Let me quickly dispose of these legislative aberrations by informing you that the whole elaborate scheme was quietly interred by the revised Willis bill. Instead, the revised Willis bill would restrict the state's power to require the out-of-state vendor to collect sales and use taxes generally to taxpayers that have a business location in the state. Since the same definition for "business location" is proposed for the sales and use tax provisions, as is used in the income and capital stock sections, they would substantially cut down on collections now being made by vendors who send travelling salesmen into a state, or who sell through independent contractors, or who maintain staffs of their own salesmen in a state without sales offices. And, of course, the revised bill would halt the attempts of the states to force collections of tax on mail order sales. I should note that the bill does permit the states to require collection of the use tax where the vendor makes regular household deliveries of goods in the state.

This issue of the duty of the out-of-state merchant to collect sales and use taxes is the focal point of the sales and use tax controversy that lies ahead over the revised Willis bill. To be sure, there are other important provisions in the bill; there is provision prohibiting the imposition of sales or use taxes in the case of interstate sales by any state other than the state where delivery of the goods takes place. There is a use tax credit requirement, so that where more than one state imposes tax, only one tax will be finally imposed. There is an exemption from tax for household goods, and automobiles brought into a state by a person moving into the state, where he acquired the goods while residing in another state. And there is a provision permitting the seller to rely on resale certificates of registered buyers as establishing non-taxability on a transaction. These proposals are not likely to cause much controversy. Such provisions are already in force in the laws of many states, and in general state tax administrators are not unsympathetic to them.

The real fight will come over the provisions in the bill designed to curtail the obligation of the out-of-stater to collect sales or use taxes. The tax administrators regard these proposals as a serious threat to their revenues, and as putting their local people at an unfair and significant competitive disadvantage. Moreover, there appears to be a growing vol-

ume in the mail order business, which some economists regard as a threat to customary local retailing, that is hurt by the use tax differential.

The major argument made by businesses is that it is too costly and too time consuming to master the tax laws of the states—and the hundreds of local, city, county and other tax laws—and that the burden of collecting taxes is far too onerous. Perhaps uniformity of sales and use tax collection rules within a single state might be required to eliminate local differences, something that the revised Willis bill requires. And, conceivably, the legislation might draw a line between those taxpayers that have officers or salesmen or independent sales representatives in a state, who can presumably familiarize themselves with the local law, requiring them to collect tax, and those who sell by traveling salesmen or mail order or by phone, who would not be required to collect the tax. Overall, however, I have the feeling that we are not ready for Federal legislation dealing with State sales and use tax collections by out of state vendors. We have been studying apportionment and allocation problems in the income and capital stock areas for decades. The main body of factual data collected by the Willis Committee staff related to those taxes. We are pretty much in the dark as to the dimensions of the sales and use tax problems, the costs and the competitive effects of avoiding collections and other factors; these were not the subject of extensive inquiry by the Committee. So serious a step as curbing the state's powers to require businesses to collect taxes from local consumers, which may give one segment or another in our economy a highly important advantage, ought not, I suggest be taken until we have a pretty firm factual basis for what we are doing. This legislation can await another day.

