SLICING THE PIE: A CALL FOR CONGRESS TO ENACT SINGLE-FACTOR PAYROLL APPORTIONMENT OF INTERSTATE BUSINESS REVENUE

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INTRODUCTION

Almost all states levy some form of corporate income tax.[1] In administering a corporate income tax system, states must make a series of policy decisions, including the tax rate and tax base. A more interesting problem arises, however, when considering corporations that do business in multiple states: how to determine the portion of income attributable to business within each state. This policy of apportionment is a crucial element of a corporate income tax system.

Although the federal government has considered involving itself in determining how this income is apportioned to the various states, it never has. States have very little federal restrictions on their capacity to determine for themselves how much interstate corporate income should be subject to their corporate income taxes. This leaves the states the crucial task of "slicing a taxable pie[.]"[2] While there have been efforts to bring uniformity to the states' apportionment schemes, states have recently splintered in their approaches. This is driven in large part by the states' incentive to maximize their revenues while shifting tax burdens onto out-of-state corporations.

The result is a system that is increasingly complex and difficult for corporations to navigate. It is a system that often subjects interstate corporations to overlapping taxation. Moreover, it is a system that increasingly pushes its tax burdens onto corporations that have very little ability to achieve political recourse. It is time for Congress to step in once

1. 50 State Statutory Surveys: Taxation: Corporate Income Tax, *Nature and Basis of Tax*, 0140 SURVEYS 9 (WestLaw, Oct. 2015). Only Nevada, South Dakota, Texas, Washington, and Wyoming have no corporate income tax.

2. Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 186 (1995).

and for all to fix this broken system and institute a simple, uniform formula of apportionment that guarantees states cannot reach out and tax those who are largely unrepresented in the state assemblies.

Congress should implement single-factor payroll apportionment through legislation that mandates apportionment according to the percentage of the business's payroll expenses paid to residents of that state. This formula presents the most straightforward approach to apportioning income with the lowest costs of compliance and administration. Applying it at the congressional level assures uniformity and negates the states' incentive to craft their own laws to maximize the reach of their tax schemes. Further, it focuses the state's taxing power on the corporations that employ individuals within its border—the very businesses that are most likely to be represented in the political process that determines the tax rate.

I. THE HISTORY OF APPORTIONMENT

The early history of our nation under the Articles of Confederation taught the founding fathers a valuable lesson about the importance of federal oversight of interstate commerce. Absent a national government with the power to restrict state action, states began to impose taxes that harmed interstate commerce. In reaction, the framers of the United States Constitution expressly banned state taxes on imports and exports. The Supreme Court has also applied the Due Process Clause and the Commerce Clause of the Constitution to restrict the states' ability to tax businesses not based in their state.

Nevertheless, these restrictions have not put an end to the states' ability to reach out and tax businesses outside of their state. The courts have permitted states taxing jurisdiction over businesses so long as the business has even a minimal presence in the state. States also retain considerable flexibility to determine what percentage of those out-of-state businesses' revenues is attributable to activity in the state and, therefore, subject to the state's taxes.

The importance of this flexibility increased with the proliferation of state corporate income taxes in the early twentieth century. With limited federal oversight, states have developed fragmented approaches to apportioning business revenue, a system that increases the complexity and costs of engaging in interstate commerce. Worse still, states have found ways to use their apportionment formulas to shift their tax burdens from businesses within their states to businesses outside of their states.

A. The Constitution and Congress place very limited restrictions on the states' ability to decide for themselves how to apportion interstate business revenue.

In 1824, the Supreme Court of the United States stated, "the prevailing motive [for adopting the Constitution] was to regulate commerce; to rescue it from the embarrassing and destructive consequences, resulting from the legislation of so many different States, and to place it under the protection of a uniform law."[3] Concern over the tendency toward "economic Balkanization" motivated the founding fathers to bar the individual states from acting in a manner detrimental to the country as a whole:[4]

> [T]he desire of the commercial States to collect, in any form, an indirect revenue from their uncommercial neighbors must appear not less impolitic than it is unfair; since it would stimulate the injured party by resentment as well as interest to resort to less convenient channels for their foreign trade. But the mild voice of reason, pleading the cause of an enlarged and permanent interest, is but too often drowned, before public bodies as well as individuals, by the clamors of an impatient avidity for immediate and immoderate gain.[5]

This concern over "laws that would excite . . . jealousies and retaliatory measures" served as the central rationale for the Interstate Commerce Clause.[6] It also explains the founders' decision to make taxes on imports and exports the only form of tax the states were barred from

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3. Gibbons v. Ogden, 22 U.S. 1, 11 (1824) (noting also that the restrictions under the Articles of Confederation had left the states able to regulate commerce for themselves and that this had led to "a perpetual jarring and hostility of commercial regulation"); *see also* Hughes v. Oklahoma, 441 U.S. 322, 325-26 (1979) ("[The Commerce Clause] reflected a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.").

4. *See* Wardair Can., Inc. v. Fla. Dep't. of Revenue, 477 U.S. 1, 7-8 (1986) ("[S]tate regulation that is contrary to the constitutional principle of ensuring that the conduct of individual States does not work to the detriment of the Nation as a whole, and thus ultimately to all of the States, may be invalid under the unexercised Commerce Clause.").

5. THE FEDERALIST NO. 42, at 264 (James Madison) (Clinton Rossiter ed., 1961).

6. C & A Carbone, Inc. v. Town of Clarkstown, N.Y., 511 U.S. 383, 390 (1994) ("The central rationale for the rule against discrimination is to prohibit state or municipal laws whose object is local economic protectionism, laws that would excite those jealousies and retaliatory measures the Constitution was designed to prevent.") (citing THE FEDERALIST NO. 22, at 143-45 (Alexander Hamilton) (Clinton Rossiter, ed., 1961)).

administering under the Constitution.[7] In fact, concern over the policies of some of the states to impose higher taxes on the citizens of other states under the Articles of Confederation motivated some of the crucial changes included in the Constitution.[8] During the debates at the Constitutional Conventions, James Madison stated the following in response to concern that some states might use taxation to protect their own businesses: "The encouragement of Manufacture in that mode requires duties not only on imports directly from foreign Countries, but from the other States in the Union, which would revive all the mischiefs experienced from the want of a Genl. Government over commerce."[9]

Nevertheless, the Supreme Court has never interpreted the Constitution as prohibiting the states from taxing interstate commerce entirely. It has held that states may tax a corporation's net income from interstate commerce to the extent that the business was done within the state.[10] This includes "such portion of the income derived from interstate commerce as may be justly attributable to business done within the state by a fair method of apportionment[.]"[11] The Court has primarily applied two clauses to limit a state's ability to apply corporate income taxes: the Due Process Clause and the Commerce Clause.[12]

The Due Process Clause[13] generally limits a state's jurisdiction to tax people or companies, requiring "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax."[14] Further, a state is limited to taxing only that portion of the taxpayer's income or property fairly apportioned to the taxpayer's activities

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7. *See* U.S. CONST. art. I, § 10, cl. 2 ("No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports[.]"); *see also* PAULINE MAIER, RATIFICATION: THE PEOPLE DEBATE THE CONSTITUTION, 1787-1788, at 364 (2010) ("The only taxes exclusive to the federal government were on imports; for all others, the states and the central government . . . would have 'concurrent jurisdiction.'").

8. *See Tench Coxe to Virginia Commissioners*, THE FOUNDERS' CONSTITUTION (1987), http://press-pubs.uchicago.edu/founders/documents/a1_10_2s2.html (referencing the fact that several of the states, prior to adoption of the Constitution, imposed higher taxes on goods shipped into the state on ships belonging to citizens of other states and lauding the state of Pennsylvania for treating the citizens of all states equally for purposes of taxation); *see also* James Madison, *Preface to the Debates in the Convention of 1787*, THE FOUNDERS' CONSTITUTION (1987), http://press-pubs.uchicago.edu/founders/documents/a1_10_2s3.html (noting that Rhode Island was the only state not to send delegates to the convention of the states because of its concern that the convention would deprive it of the ability to tax its neighbors through their consumption of imported supplies).

9. *Records of the Federal Convention*, THE FOUNDERS' CONSTITUTION (1987), http://press-pubs.uchicago.edu/founders/documents/a1_10_2s4.html.

10. W. Live Stock v. Bureau of Revenue, 303 U.S. 250, 255 (1938).

11. *Id.*

12. Lisandra Ortiz, *Joyce v. Finnigan*: *Adoption of the "Best" Approach in Hopes of Some Uniformity*, 67 TAX LAW. 979, 981-82 (2014).

13. U.S. CONST. amend. XIV, § 1 ("[N]or shall any State deprive any person of life, liberty, or property, without due process of law[.]").

14. Miller Bros. v. Maryland, 347 U.S. 340, 344-45 (1954).

in that state.[15] With that said, very little is required of the taxpayer to satisfy the Due Process requirement of "minimum contacts."[16] In fact, physical presence within the state is not required at all.[17] Instead, for the state to gain taxing jurisdiction under the Due Process Clause, the touchstone is the business's purposeful availment of the state's market.[18]

The Due Process Clause restrictions on the state taxing power are supplemented by the Court's jurisprudence under the Commerce Clause. [19] In addition to the affirmative grant of power to regulate interstate commerce, the Supreme Court has long held that the Commerce Clause also places a negative restriction against state action in the same arena.[20] Today, this doctrine of the "dormant Commerce Clause" is well-established.[21]

Originally, the Supreme Court held that any tax burden placed by the states on interstate commerce was unconstitutional under the Commerce Clause.[22] Today, the Court applies a four-pronged test to establish the constitutionality of a state tax imposed on an out-of-state corporation engaged in interstate commerce: (1) the tax must be applied to an activity with a substantial nexus with the taxing State; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the State.[23]

The Supreme Court has established that the substantial nexus required for state tax purposes under the Commerce Clause is a more significant test than the minimum contact required under the Due Process

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15. *See, e.g.*, Mobil Oil Corp. v. Comm'r of Taxes of Vt., 445 U.S. 425, 436-37 (1980) ("For a State to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a 'minimal connection' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise.").

16. Quill Corp. v. North Dakota, 504 U.S. 298, 307 (1992) ("[I]f a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's *in personam* jurisdiction even if it has no physical presence in the State.").

17. *Id.*

18. *Id.*

19. U.S. CONST. art. I, § 8, cl. 3 ("The Congress shall have Power . . . [t]o regulate Commerce . . . among the several States[.]").

20. *See* Gibbons v. Ogden, 22 U.S. 1, 209 (1824) (Marshall, C.J.) ("[A]s the word 'to regulate' implies in its nature, full power over the thing to be regulated, it excludes, necessarily, the action of all others that would perform the same operation on the same thing. . . . There is great force in this argument, and the Court is not satisfied that it has been refuted.").

21. *See* Dep't. of Revenue of Ky. v. Davis, 553 U.S. 328, 337 (2008).

22. Leloup v. Port of Mobile, 127 U.S. 640, 648 (1888) ("[N]o state has the right to lay a tax on interstate commerce in any form, whether by way of duties laid on the transportation of the subjects of that commerce, or on the receipts derived from that transportation, or on the occupation or business of carrying it on, and the reason is that such taxation is a burden on that commerce, and amounts to a regulation of it, which belongs solely to congress.").

23. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977); *see also* Nw. States Portland Cement Co. v. Minnesota, 358 U.S. 450, 452 (1959).

Clause.[24] Traditionally, the Court stuck to a bright-line rule, requiring the seller to have some physical presence within the state.[25] That physical presence requirement, however, can be satisfied with minimal presence such as a sales force, plant, or office.[26] Nevertheless, the Court has resisted efforts to lower this barrier.[27] In reaching this decision, however, the Court has specifically noted that the extent of the states' reach in the taxation of interstate businesses is an issue that Congress is "better qualified to resolve" and that Congress "has the ultimate power to resolve."[28]

The central purpose of the second prong of the test, fair apportionment, is "to ensure that each State taxes only its fair share of an interstate transaction."[29] Courts, in evaluating this point, look to the internal and external consistency of the tax.[30] This often overlaps with the third prong which bars taxes that discriminate against interstate commerce. Such discrimination might occur "either by directly providing a commercial advantage to local business . . . or by subjecting interstate commerce to the burden of 'multiple taxation[.]'"[31] To determine whether a particular state tax subjects taxpayers to multiple taxation, the Supreme Court applies the internal consistency test, hypothetically assuming that every state has the same tax structure and then asking whether this hypothetical scenario would result in multiple taxation.[32] With that said, if another state in fact has a different method of apportionment, the same income can be apportioned to be taxed by either both states or no state at all without running afoul of the Constitution.[33] As the following discussion demonstrates, however, these

24. Quill Corp. v. North Dakota, 504 U.S. 298, 313 (1992).

25. *Id.* at 315; *see also* Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 758 (1967) (holding that Illinois could not impose a use tax on purchases when the seller's only connection with the state was by mail or common carrier).

26. *Quill Corp.*, 504 U.S. at 315.

27. *See, e.g.*, Nat'l Geographic Soc'y v. Cal. Bd. of Equalization, 430 U.S. 551, 556 (1977) (holding that California could impose a use tax on National Geographic's mail-order activities in the state because the company maintained two offices in the state which solicited advertising for the magazine).

28. *Quill Corp.*, 504 U.S. at 318.

29. Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 184 (1995) (quoting Golderg v. Sweet, 488 U.S. 252, 260-61 (1989)).

30. *Id.* at 175-76 ("Internal consistency looks to whether a tax's identical application by every State would place interstate commerce at a disadvantage as compared with intrastate commerce. There is no failure of such consistency in this case, for if every State were to impose a tax identical to Oklahoma's—i.e., a tax on ticket sales within the State for travel originating there—no sale would be subject to more than one State's tax. External consistency, on the other hand, looks to the economic justification for the State's claim upon the value taxed, to discover whether the tax reaches beyond the portion of value that is fairly attributable to economic activity within the taxing State.").

31. Nw. States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959).

32. Comptroller of Treasury of Md. v. Wynne, 135 S. Ct. 1787, 1801-02 (2015).

33. *See* Moorman Mfg. Co. v. Bair, 437 U.S. 267, 279 (1978) ("The potential for attribution of the same income to more than one State is plain.").

restrictions have done little to constrain the states' creativity with respect to the apportionment of business revenue.

B. State efforts to unify behind a single approach to apportion interstate business revenue have failed absent federal intervention.

Wisconsin enacted the nation's first modern state income tax in 1911.[34] As use of corporate income taxes spread, the states' formulas for apportioning the income of multistate corporations were "all over the map."[35] The National Tax Association,[36] as early as 1922, began to seek a uniform rule of apportionment for the states to adopt.[37] By the late 1930s, the National Tax Association began to support the Massachusetts formula, which placed equal weight on payroll, property, and sales.[38] The formula was a product of "political expediency and ease of adoption" rather than economic principal or theory.[39] It was a political compromise between the manufacturing states, which preferred property and payroll factors, and the market states, which preferred the sales factor.[40]

In 1933, the National Tax Association adopted a model law that included a single business tax on corporate income and the Massachusetts formula.[41] This proposal, however, was not adopted by the states.[42] In 1957, the Uniform Law Commission took up the task of crafting a uniform method of apportionment.[43] Although most states were initially reluctant to collaborate on the project, the Uniform Law Commission ultimately adopted the Uniform Distribution of Income for Tax Purposes Act

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34. Charles E. McLure, Jr., *Understanding Uniformity and Diversity in State Corporate Income Taxes*, 61 NAT'L TAX J. 141, 142 (2008).

35. *Id.* at 146; s*ee also* H.R. REP. No. 88-1480, Vol. 2, 118 (1964) ("[V]ariation appears to be its most significant historical characteristic. Not only have there always been wide diversities among the various formulas employed by the States, but the composition of those formulas seems to be constantly changing.").

36. The National Tax Association is a nonpartisan, nonpolitical educational association of tax professionals "dedicated to advancing the theory and practice of public finance" founded in 1907. *About NTA*, NATIONAL TAX ASSOCIATION (Jan. 3, 2016), http://www.ntanet.org/about-nta.html.

37. McLure, *supra* note 34, at 146.

38. *Id.*

39. Richard Pomp, *Report of the Hearing Officer: Multistate Tax Compact Article IV [UDITPA] Proposed Amendments*, MULTISTATE TAX COMM'N 1, 11 (Oct. 25, 2013), http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Pomp%20final%20final3.pdf.

40. *Id.*

41. *The Project to Revise UDITPA*, MULTISTATE TAX COMM'N 1, 4-5 (2009), http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Minutes/The%20Project%20to%20Revise%20UDITPA.pdf.

42. *Id.* at 5.

43. *Id.*

("UDITPA").[44] Like the National Tax Association's proposal before it, UDITPA applies the Massachusetts formula to apportion business revenue.

Once again, there was little support among the states.[45] At this point, Congress got involved, passing the Interstate Income Act of 1959 (known as Public Law 86-272).[46] Title I of Public Law 86-272 bars states from asserting income tax jurisdiction over a business whose only contact with a state is solicitation of orders for sales of tangible personal property.[47] Public Law 86-272's application is limited, however, to taxes based on net income (as opposed to gross receipts taxes) and only protects businesses, not incorporated or otherwise domiciled in the taxing state, that sell tangible personal property.[48]

Title II of Public Law 86-272 charged the U.S. House Judiciary Committee and the Senate Finance Committee to "make full and complete studies" of the issue "for the purpose of recommending to the Congress proposed legislation providing uniform standards to be observed by the States in imposing income taxes on income [derived from interstate commerce]."[49] This task was charged to the "Special Subcommittee on State Taxation of Interstate Commerce," which was known as the Willis Committee for its chairman, Rep. Edwin Willis of Louisiana.[50] The Willis Commission ultimately recommended federal legislation to establish a uniform state apportionment that would be equally weighted but only use two factors: property and payroll.[51] The proposal was more extensive than this, however, also recommending a uniform definition of taxable income that would substantially conform with the federal definition.[52] Even further, it gave the U.S. Treasury Department authority to issue uniform rules and regulations and create a uniform tax return.[53] The House of Representatives

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44. *Id.*

45. *Id.* Only three states had adopted UDITPA by 1964: Alaska, Arkansas, and Kansas.

46. Interstate Income Act of 1959, Public Law 86-272, 73 Stat. 555 (codified at 15 U.S.C. §§ 381-384).

47. 15 U.S.C. § 381; *see also* Giles Sutton et al., *The Increasingly Complex Apportionment Rules for Service-Based Businesses (Part II): Unique Issues*, J. MULTISTATE TAX'N AND INCENTIVES 6, 11 (Jan. 2008).

48. 15 U.S.C. §§ 381-383; *see also* Sutton et al., *supra* note 47. The following activities are not protected by the Act: repair and maintenance services, collection activities, installation services, technical support services, repossession activities, picking up or replacing equipment, recruiting or training personnel, consigning tangible personal property, and leasing equipment or facilities within a state.

49. Interstate Income Act of 1959, Public Law 86-272, 73 Stat. 555.

50. *See* H.R. REP. NO. 88-1480, at 1-2 (1964); *see also* McLure, *supra* note 34, at 149.

51. McLure, *supra* note 34, at 154.

52. *Id.*

53. *Id.* at 155.

went so far as to adopt an amended version of the Willis Committee proposal in 1968, but the Senate failed to act on the issue.[54]

The States, fearful of losing sovereignty, took a renewed interest in UDITPA.[55] Several adopted it through the Multistate Tax Compact, which incorporated UDITPA nearly word for word.[56] The Compact became effective in 1967, creating the Multistate Tax Commission as its administrative agency.[57] As many as forty-eight states and the District of Columbia ultimately joined the Committee, either by adopting the Multistate Tax Compact by statute or by joining the Committee as either sovereignty or associate members.[58]

The U.S. Senate took up the subject of apportionment of interstate corporate taxes in 1973. The Senate considered two bills: one modeled after earlier legislation in the House that would impose a uniform maximum apportionment[59] and one authorizing the newly-generated Multistate Tax Compact.[60] At the time, business interests preferred the former, as indicated by the support of the United States Chamber of Commerce, while state administrators preferred the latter.[61] Ultimately, the Multistate Tax Compact won out as a compromise between the two forces.[62]

This period represents the pinnacle of uniformity in business revenue apportionment among the states, with Iowa the only state to substantially forgo the then-standard Massachusetts formula.[63] Whatever uniformity UDITPA created, however, quickly deteriorated:

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54. *First Annual Report*, MULTISTATE TAX COMM'N 1 (Jan 28, 1969), http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Resources/Archives/Annual_Reports/FY67-68.pdf.

55. *The Project to Revise UDITPA*, *supra* note 41, at 6. The First Annual Report of the Multistate Tax Commission stated, "The origin and history of the Multistate Tax Compact are intimately related and bound up with the history of the states' struggle to save their fiscal and political independence from encroachments of certain federal legislation introduced in congress during the past three years." *First Annual Report*, *supra* note 54, at 1 (citing H.R. 11798 introduced in 1965, H.R. 16491 introduced in 1966, and H.R. 2158 introduced in 1967).

56. *The Project to Revise UDITPA*, *supra* note 41, at 6.

57. *Id.*

58. Today, fifteen states (Alabama, Alaska, Arkansas, Colorado, Hawaii, Idaho, Kansas, Missouri, Montana, New Mexico, North Dakota, Oregon, Texas, Utah, and Washington) and the District of Columbia remain full members of the compact. Only Nevada and Virginia have no formal membership with the Commission. *Member States*, MULTISTATE TAX COMM'N, http://www.mtc.gov/The-Commission/Member-States (last visited Jan. 4, 2016).

59. Interstate Taxation Act of 1973, S. 1245, 93d Cong. (1973).

60. S. 2092, 93d Cong. (1973).

61. *See State Taxation of Interstate Commerce: Hearings Before the Subcomm. On State Tax'n of Interstate Commerce of the Com. On Finance*, 93d Cong. 85 (1973) (statement of Leonard E. Kust – Member, Taxation Committee, Chamber of Commerce of the United States).

62. *See id.*

63. McLure, *supra* note 34, at 156 (adopting, instead, a sales-only apportionment formula).

> [S]tates are increasingly moving away from two of its provisions in particular – equal weighting of the three factors, and sales factor sourcing for services and sales of intangible property. In addition, a handful of specific provisions have proven to be unclear. The lack of clarity has made those provisions targets for change or clarification by state regulation, legislation, litigation, and sometimes all three.[64]

States were initially reluctant to break from UDITPA's apportionment formula for fear of running afoul of constitutional constraints. The Supreme Court's 1978 opinion in *Moorman Manufacturing Co. v. Bair* calmed those fears by establishing that states were free to formulate independent policies for apportioning corporate income until Congress intervened.[65] After the *Moorman* decision, other states have followed Iowa's lead by increasing the weight on the sales factor "to gain a competitive advantage[.]"[66] The sales factor, as discussed above, had originally been introduced as a nod to market states that sought to increase the percentage of revenue they could tax among businesses based in the manufacturing states but which made extensive sales within the taxing state. Today, it has become a tool by which many states extend the reach of their taxing authority to out-of-state businesses.

Some states have been very transparent about their motivation for moving towards an increased reliance on the sales factor. The bill analysis presented on the California State Assembly floor when it considered

64. *The Project to Revise UDITPA*, *supra* note 41, at 7; *see also* Charles E. McLure, Jr., *The Difficulty of Getting Serious About State Corporate Tax Reform*, 67 WASH. & LEE L. REV. 327, 329 (2010) ("[D]espite UDITPA's endorsement of an apportionment formula that accords equal weight to the taxpayer's payroll, property, and sales, there is substantial variation in the weights that the states actually apply, with an increasing number giving sales double or greater weight–or even sole weight, presumably for economic development reasons.") (citing Michael Mazerov, *The "Single Sales Factor" Formula for State Corporate Taxes: A Boon to Economic Development or a Costly Giveaway?*, CTR. ON BUDGET & POLICY PRIORITIES 1, at 15-19 and 21-59 (Sept. 2005), http://www.cbpp.org/3-27-01sfp.pdf).

65. Moorman Mfg. Co. v. Bair, 437 U.S. 267, 280 (1978) ("While the freedom of the States to formulate independent policy in this area may have to yield to an overriding national interest in uniformity, the content of any uniform rules to which they must subscribe should be determined only after due consideration is given to the interests of all affected States. It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income. It is to that body, and not this Court, that the Constitution has committed such policy decisions.").

66. McLure, *supra* note 34, at 156. California, originally a full member of the Compact, having adopted its entire text in 1974, adopted a different apportionment formula in 1993, double-weighting the sales factor. *See* Gillette Co. v. Franchise Tax Bd., No. S206587, 2015 WL 9589602, at *3 (Cal. Dec. 31, 2015) (affirming that the 1993 legislation superseded the apportionment formula found within the Compact itself even though remaining portions of the Compact remained in effect).

legislation to double-weight the sales factor stated that the bill was "intended to improve California's business climate by shifting the corporate tax balance against those 'who simply sell into our huge consumer market without putting manufacturing jobs here.'"[67] The California Senate Revenue and Taxation Committee was even more explicit, saying, "The bill would have the effect of reducing the tax for most California-based businesses, and increasing the tax on most businesses based in other states and on some businesses based in foreign countries."[68]

This is not to say that state legislators are simply predatory and eager to get their hands on the wealth of other states. Rather, the climate of competition has forced their hands if they wish to ensure their states' own businesses and citizens are given the best opportunity to succeed. In California, one member of the Senate Revenue and Taxation Committee referred to the decision to double-weight the sales factor as a "bad idea whose time has come[,]" noting that "now that many other states have taken the plunge, and made self-serving adjustments to their formulas, . . . California-based businesses are being harmed by our lack of action in conforming with the emerging 'standard' of an expanded sales factor."[69]

By 1993, at least seventeen states had increased the weight of the sales factor to account for at least half of the formula.[70] By 2007, thirty-three states had increased the weight of the sales factor.[71] Today, thirty-six states plus the District of Columbia place at least that much weight on the sales factor.[72] Nineteen states plus the District of Columbia have gone so far as to use a single sales factor apportionment formula, eliminating the property and payroll factors entirely.[73] Recognizing the movement toward increased reliance on the sales factor, in 2013 the Multistate Tax Commission's Uniformity Committee recommended amendment of the Multistate Tax Compact to double-weight the sales factor.[74] The Executive Committee, however, voted to allow states to determine the weighting of the various factors for themselves, merely recommending the double-weighting of the sales factor as their preferred solution.[75]

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67. Cal. B. Analysis, S.B. 1176 Assem. (March 5, 1993); *see also* Giles Sutton et al., *The Increasingly Complex Apportionment Rules for Service-Based Businesses: Basic Issues*, J. MULTISTATE TAX'N AND INCENTIVES 24, 26 (Oct. 2007) ("Competitive economic pressures to attract high-wage jobs . . . have caused states, from a policy perspective, to reduce the apportionment weighting of physical-presence factors such as payroll and property and increase the weighting of the market-based sales factor.").

68. Cal. B. Analysis, S.B. 1176 Sen. (Apr. 21, 1993).

69. *Id.*

70. *Id.*

71. Sutton et al., *supra* note 67, at 27.

72. *See* Appendix A.

73. *See* Appendix A.

74. *Report of the Hearing Officer*, *supra* note 39, at 8.

75. *Id.* at 9.

In addition to expanding the reach of their taxing power, the states have increasingly diverged from a uniform approach to apportionment. The resulting system is not ideal:

> This, then, is an assessment of the State income tax system and its effect on interstate commerce in the United States today. It is the picture of a system which works badly for both business and the States. It is the picture of a system in which the States are reaching farther and farther to impose smaller and smaller liabilities on more and more companies. It is the picture of a system which calls upon tax administrators to enforce the unenforceable, and the taxpayer to comply with the uncompliable.[76]

Looking forward, there is no indication that the states have either the will or the ability to solve the problem of business revenue apportionment on their own.

II. CONGRESS SHOULD INTERVENE

The history of business revenue apportionment demonstrates the inability of the states to come to a reasonable solution absent federal action. Indeed, it was the possibility of federal action that encouraged a brief period of harmony among the states through the adoption of UDITPA. As federal attention faded, however, the states have fallen once again into disarray, producing an unworkable business climate.

The time has come for Congress to intervene. First, fractured apportionment policies are the product of a self-destructive interstate competition the founding fathers aimed to prevent. Second, this competitive environment has compelled the states to adopt policies that violate the principle of no taxation without representation. Third, the lack of uniformity that results from state autonomy in this arena is harmful to our nation's business environment. For these reasons, this is precisely the kind of dispute between the states that Congress was meant to resolve.

While the states might balk at the idea of federal intrusion on state autonomy for purposes of state taxation, federal intervention on the issue of apportionment will still leave to the states the ability to determine for themselves the proper tax rate to apply and the tax base to which it will be applied within the limits of revenue apportioned to the state. The states have now been given ample opportunity to come to a solution on the question of revenue apportionment and they have failed. For these reasons, congressional action on this issue is both desirable and justified.

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76. H.R. REP. No. 88-1480, V. 1, at 598 (1964).

A. Fractured apportionment policies are the product of a self-destructive interstate competition the founding fathers aimed to prevent.

The founding fathers were acutely aware of the dangers that result when a majority of voters "are united and actuated by some common . . . interest[] adverse to the rights of other citizens, or to the permanent and aggregate interests of the community." [77]A faction that reaches such majority status is dangerous because it is not cured by the republican principle that "enables the majority to defeat its sinister views by regular vote."[78] Instead, the only natural mechanism for curtailing the effects of a majority faction is found through enlarging the republic, thus making it more difficult for such a majority to work in concert to achieve destructive ends.[79]

Majority factions are particularly troublesome when it comes to tax policy:

> The apportionment of taxes on the various descriptions of property is an act which seems to require the most exact impartiality; yet there is, perhaps, no legislative act in which greater opportunity and temptation are given to a pre-dominant party to trample on the rules of justice. Every shilling with which they overburden the inferior number is a shilling saved to their own pockets.[80]

Where states are permitted to indirectly tax the wealth generated by businesses based in other states, an externality problem exists. The voters of the state are united in their interest to maximize revenues to fund services offered by the state from which they receive substantially all the benefit. Where they can do so by increasing revenue from out-of-state sources, the out-of-state sources have no means of defeating such proposals in state elections and the voters of the state face a much smaller proportion of the cost.

As discussed above, the founders experienced this problem first-hand in their years under the Articles of Confederation. Today, those same "embarrassing and destructive consequences" once found to be the result of the freedom of states to regulate interstate commerce for themselves are occurring again because Congress has failed to satisfactorily address the problem of business revenue apportionment. Congress should intervene

77. THE FEDERALIST NO. 10, at 72 (James Madison) (Clinton Rossiter ed., 1961).
78. *Id.* at 75.
79. *Id.*
80. *Id.* 74-75.

now to stem the tide and rescue the states from this self-destructive mode of competition.

B. This competitive environment has compelled the states to adopt policies that violate the principle of no taxation without representation.

As discussed above, the competition between the states has compelled states to extend the reach of their corporate taxes to reach businesses based outside of their state. This produces dangerous policy results not just for our federal system, but also for the rights of those taxed. Every year, students across this country are taught the mantra of many of the early participants in the American Revolution: "No Taxation Without Representation." The increasingly widespread reliance on the sales factor violates this principle.

For purposes of business revenue apportionment, it is important to understand how businesses—and the people that make them up—are represented in state legislatures. Businesses, in the words of Judge Posner, are a "legal fiction."[81] For purposes of representation, they are best understood as groups of people. Robert Dahl once stated that "[t]he actual political effectiveness of a group is a function of its potential for control and its potential for unity."[82] This supposition has led to a debate among academics as to whether businesses actually unify substantially enough to exert influence on the political system that is dangerous to democracy. As one political scientist put it, though, this debate misses the point: "Policies match the collective desires of business only when citizens, through their policy preferences and voting choices, embrace ideas and candidates supportive of what business wants. To bolster its odds of winning in politics, business needs to seek backing from the broader public."[83]

A business's interests are represented in a legislature only to the extent that those interests overlap with those of the citizens who are represented by that legislature. Applying this concept to the question of apportionment of business revenue, each factor that is included in the Massachusetts formula shifts the burden of taxation onto businesses with different degrees of representation in the state legislature. The payroll factor shifts the burden onto businesses that employ more people in the state. The property factor shifts the burden onto businesses that own more property in the state. Because property tends to require people to care for it and often serves as the place of employment, the property factor also likely shifts the

81. Cenco, Inc. v. Seidman & Seidman, 686 F.2d 449, 455 (7th Cir. 1982) (Posner, J.) (pointing out that the beneficiaries of a judgment in favor of a corporation are the people behind the business such as stockholders).

82. Robert A. Dahl, *A Critique of the Ruling Elite Model*, 52 THE AM. POL. SCIENCE REV. 463, 465 (1958) (emphasis removed).

83. MARK A. SMITH, AMERICAN BUSINESS AND POLITICAL POWER: PUBLIC OPINION, ELECTIONS, AND DEMOCRACY, 8 (2002).

burden onto businesses that employ more people in the state, though with less precision than the payroll factor. The sales factor, on the other hand, shifts the burden onto businesses with customers in the state.

If a business's interests are more likely to overlap with those of its employees, representation should be stronger for businesses covered by the payroll and property factors. If a business's interests are more likely to overlap with those of its customers, the representation should be stronger for businesses covered by the sales factor. For several reasons, it is clear that the former, rather than the latter, is true. Employees are more likely to hold interests similar to those of the businesses that employ them.[84] Employees are also more likely to hold interests similar to those of their coworkers.[85] This makes sense because of the strong impact of social groupings on the political leanings of an individual.[86] We also know that the personal financial interests of the voter are important to his vote.[87] These personal financial interests are most likely to align with the interests of the business that employs the voter, considering the extent to which his well-being depends on the health of the business that supplies his paychecks.

While customers are likewise interested in reducing the prices of the businesses that supply the goods and services they purchase, there is no parallel social grouping and a much more diffused connection between the interests of the customer and the interests of the seller. A given employee has far fewer employers than a given customer has businesses from which he purchases. Therefore, it is much less likely to be true that a business is represented through the votes of its customers than it would be that it is represented through the votes of its employees.

One potential caveat to this line of reasoning might be found in the potential for businesses to exert influence on the legislative process through lobbying, bypassing the electoral process entirely. To whatever extent a business might be able to influence legislation in this way, the ability to engage in lobbying is very limited for out-of-state businesses. Indeed, political scientists have determined that "groups often must have some sort of presence and support within the legislator's district" in order to engage in the effective use of lobbying tactics.[88] This, along with the cost of engaging

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84. *See generally* Oddbjørn Knutsen, *The Impact of Sector Employment on Party Choice: A Comparative Study of Eight West European Countries*, 44 EUR. J. OF POL. RES. 593 (2005) (finding that sector employment has an impact on party choice in Denmark, Britain, France, Italy, Belgium, Germany, and the Netherlands).

85. *See* MICHAEL S. LEWIS-BECK, ET AL., THE AMERICAN VOTER REVISITED 70 (2014) (finding that a vast majority of American voters indicated in a poll that their work associates belong to the party of the candidate for whom the voter had cast his ballot).

86. *See id.* at 305.

87. *See, e.g.*, Rebecca Riffkin, *Jobs, Government, and Economy Remain Top U.S. Problems*, GALLUP (May 19, 2014), http://www.gallup.com/poll/169289/jobs-government-economy-remain-top-problems.aspx (finding that twenty percent of respondents in a Gallup poll identified jobs or unemployment as the most important problem facing the country).

88. Jennifer Wolak et al., *Much of Politics Is Still Local: Multi-State Lobbying in State Interest Communities*, 27 LEGISLAT. STUD. Q., 527, 529 (2002) (citing ELISABETH R.

in lobbying, explains the findings of political scientists who determined that most organizations, even among those that do engage in lobbying, do not have a lobbying presence in more than one state.[89]

For these reasons, businesses are not effectively represented in the legislatures of states where their employees do not reside. Therefore, the increasing reliance on the sales factor, relative to the payroll or property factors, indicates a decreased connection between the business's representation and its tax liability in a state. This fact would have alarmed our nation's founders.

One of the strongest critiques presented by those opposed to the ratification of the Constitution focused on the power that it gave the federal government to levy direct taxes on citizens.[90] Some argued that this would violate the people's "right to be taxed by representatives who underst[and] their circumstances."[91] Indeed, one early critic of the Constitution on these grounds stated the following: "The most certain criterion of happiness that any people can have, is to be taxed . . . by those representatives who intermix with them, and know their circumstances."[92]

The fundamental importance of representation should remain today an important consideration in any discussion of tax policy. The fact that federal inaction in this area has permitted the states to expand the use of the sales factor, increasingly reaching out to tax those not represented in their state legislatures, serves as yet another reason for Congress to intervene.

C. The lack of uniformity that results from state autonomy in this arena is harmful to our nation's business environment.

The Constitution barred the states from collecting duties on imports or exports, in part because of the benefits of uniform national commercial legislation.[93] Chief among the benefits of uniformity of tax laws among the states is that it holds down the costs of compliance for businesses and

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GERBER, THE POPULIST PARADOX, (1999); KEN KOLLMAN, OUTSIDE LOBBYING: PUBLIC OPINION AND INTEREST GROUP STRATEGIES (1998); LAWRENCE S. ROTHENBERG, LINKING CITIZENS TO GOVERNMENT (1992); JOHN R. WRIGHT, INTEREST GROUPS AND CONGRESS, (1996)); *See* Daniel E. Bergan, *Does Grassroots Lobbying Work? A Field Experiment Measuring the Effects of an e-Mail Lobbying Campaign on Legislative Behavior*, AM. POLITICS RES., Vol. 37, No. 2 (2009).

89. Wolak et al., *supra* note 88, at 537 (finding that more than half of all organizations registered to lobby were only registered to lobby in a single state and that the mean number of states in which an organization was registered to lobby was only 1.635).

90. MAIER, *supra* note 7, at 367.

91. *Id.*; *see also id.* at 413 (describing the argument of one critic of the proposed Constitution in North Carolina who stated that state legislatures were more aware than Congress of the people's ability to pay).

92. *Id.* at 414 (quoting Judge Samuel Spencer from the North Carolina ratifying convention).

93. *Id.* at 189.

administration for the states.[94] The report of the Willis Committee found that the costs related to division of income among the states "w[ere] exhibited by more [businesses surveyed] than any other cost group" except for filing costs, which are necessarily incurred by all businesses filing taxes.[95] Interestingly, recordkeeping for preparation of sales factors was the most common work associated with this cost.[96] Compliance costs, understandably, were highest among the largest companies.[97] According to their study conducted in 1962,[98] manufacturers with gross receipts over $1 million faced costs of up to $5,913 just in complying with the various states' apportionment laws.[99] Adjusted for inflation, this would equate to costs of $47,696.18 in 2017.[100]

That is not to say that only large businesses face the costs of this lack of uniformity. Indeed, smaller businesses are often less able to absorb even the smaller relative costs that come with compliance in this arena. The following is an excerpt from a letter included in the appendix to the Hearings of the Subcommittee on State Taxation of Interstate Commerce when the Senate took up the issue of business revenue apportionment in 1978:

> The increase in the burden of keeping records and filing forms is becoming tremendous. It falls most heavily on the small business, which cannot afford a staff of accountants and lawyers to cope with a multiplicity of differing state laws. . . . Small as we are, we have to study thoroughly the specific requirements and differences that exist between the various state tax systems. . . . Thus, the small firm is penalized by the present multiplicity of different systems and the large firm realizes an "economy of scale" that has nothing to do with efficiency or quality of production or service to the consumer.[101]

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94. McLure, *supra* note 34, at 141; *see generally* Sanjay Gupta and Lillian F. Mills, *Does Disconformity in State Corporate Income Tax Systems Affect Compliance Cost Burdens?*, 56 NAT'L TAX J. 355 (2003).

95. H.R. REP. NO. 88-1480, V. 1, at 346-47 (1964).

96. *Id.* at 347.

97. *Id.* (noting that this is largely due to such factors as complexity of accounts, spread of liability, and overall size).

98. H.R. REP. NO. 88-1480, V. 2, at A127 (1964) (cover letter dated June 27, 1962). The study asked participants to reveal costs associated with their fiscal year covered by their most recent federal income tax return.

99. H.R. REP. NO. 88-1480, V. 1, at 347 (1964).

100. *CPI Inflation Calculator*, BUREAU OF LABOR STATISTICS, http://data.bls.gov/cgi-bin/cpicalc.pl?cost1=5913&year1=1962&year2=2017 (last visited on Mar. 20, 2017).

101. *State Taxation of Interstate Commerce*, *supra* note 61, at 417 (statement of Sidney B. Hutton, Jr., on behalf of the American Association of Nurserymen).

With this cost of compliance in mind, it is easy to see why the United States Chamber of Commerce supported imposition of a uniform standard of apportionment, at least as a cap on the amount of revenue any state could apportion to itself, when the Senate considered taking action in the 1970s.[102] Uniformity would also drastically cut back on the litigation that has littered the arena of business revenue apportionment in recent years.[103] Congress, therefore, should take action to simplify the increasingly complex apportionment calculus that interstate businesses must undertake and that the states must enforce.

D. State autonomy will be limited only as to apportionment of taxes and is justified because of the states' failure to come to a reasonable solution on their own.

States understandably feared the loss of autonomy that would come with congressional imposition of a standard formula of apportionment when Congress took up the proposals of the Willis Committee.[104] This fear was based at least in part on the Committee's proposal that Congress impose not just a formula but also federal administrative oversight over these taxes.[105] Nevertheless, some have argued that, in light of the multitude of problems that have accompanied the modern system, the states would have been better off if they had simply taken the suggestion of the Willis Committee.[106]

This Note suggests nothing more than for Congress to impose a uniform apportionment formula on the states, leaving the states entirely free to administer their corporate income taxes. To that extent, the proposal is less intrusive on state autonomy than the Willis Committee's. Like prior proposals, this one would also leave states free to determine for themselves the appropriate tax rate to apply and otherwise determine for themselves the appropriate tax base.

The goal of this proposal is not to achieve uniform tax policy in all areas, but rather to limit the scope of variation so as not to allow states to engage in battle through apportionment formulas. Uniformity is not beneficial if it extends to tax rates because this would eliminate the beneficial effects of tax competition.[107] The imposition of a single formula for apportionment of business revenue forces states to engage openly in this

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102. *Id.* at 85 (statement of Leonard E. Kust – Member, Taxation Committee, Chamber of Commerce of the United States).

103. McLure, *supra* note 34, at 148; *see also* John A. Swain, *Reforming the State Corporate Income Tax: A Market State Approach to the Sourcing of Service Receipts*, 83 TUL. L. REV. 285, 293 (2008).

104. McLure, *supra* note 34, at 155.

105. *Id.*

106. *Id.* ("Although the states won that battle, they may have lost the larger war, as they are left with the complexity, tax planning, and revenue losses of the present system.").

107. *Id.* at 141.

beneficial competition with their tax rates rather than through the back door of revenue apportionment.

Imposition of a standard apportionment formula is an entirely reasonable reaction to the history of state action on this issue. States have failed to reach a sensible solution to the problem of dividing the revenue of interstate businesses. Instead, the states have engaged in a self-destructive competition, unnecessarily burdening business. The states failed to reach any uniformity prior to Congress stepping in and considering action in the 1960s and 1970s. The uniformity that came after this was short-lived and has completely failed in recent years. Congress has given the states ample time to come up with a solution on this issue. Now, it is time for Congress to act.

III. SINGLE-FACTOR PAYROLL APPORTIONMENT

Of course if Congress should act, it then becomes important to discuss how exactly revenue should be apportioned. To answer that important question requires consideration of both the policy and practical implications of various alternatives. States have relied on three primary factors to determine how to apportion a business's revenue: sales, property, and payroll. The Massachusetts formula, adopted from the early years of the movement toward uniformity, simply took these factors and weighted them equally. However, neither policy nor practice justifies this approach.

Of these three factors, the payroll factor is the superior method of apportionment and should be chosen to the exclusion of the other two. The sales factor violates important policy considerations of representation and has produced tremendous litigation in its application. While the property factor does not produce the policy concerns inherent in the sales factor, its application has been similarly complex. The payroll factor alone avoids both policy and practical problems in apportioning revenue.

While each factor was chosen to balance the interests of different states that play different roles in our national economy, the states that might fear loss of revenue from exclusive reliance on the payroll factor should find comfort in two points. First, there is evidence that the actual impact this policy will have on state revenue will be minimal. Second, whatever short-term impact this will have on state tax revenue for states that tend to be on the market end, rather than the production end, of business transactions will be made up for in their retaining the ability, in the long-term, to use tax policy to attract business to employ more of their residents.

A. The Massachusetts formula is a forced political solution that cannot be justified in policy or practice.

The Massachusetts formula, which simply averages the three factors that have been used at various times to apportion business revenue,

was never based in policy but was instead a product of politics. It was never popular among economists.[108] Nobel prize winning economist William Vickrey described the formula as a "simple but arbitrary and capricious formula [with] all the earmarks of having been concocted by a committee of lawyers who had forgotten anything they ever were taught about statistics or economics."[109] Perhaps more importantly, the value of the formula is limited to the value of each of its constituent elements. As the following discussion will illustrate, two of the three constituent elements of the formula have serious problems of their own.

B. The sales factor violates important policy considerations of representation and has produced tremendous litigation in its application.

In practice, the sales factor "has been subject to considerable controversy and litigation."[110] In fact, the sales factor has "undoubtedly generated the most litigation of any of the apportionment factors."[111] First of all, determining the location of sales made by service providers, as opposed to those who sell tangible personal property, has become an increasingly complex question.[112] Some states use a method of income-producing activity sourcing,[113] while others use market-based sourcing.[114] To further complicate matters, some states also apply special rules to source "personal services," but they generally do not define that term.[115] For similar reasons as those that motivate states to increase the weight of the sales factor generally, the modern trend among the states is to apply the market-based sourcing approach.[116] One problem with this approach is that it is often difficult for a service provider to determine exactly where its customers benefit from its service.[117]

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108. *See Report of the Hearing Officer*, *supra* note 39, at 11-12.

109. *Id.* (citing William Vickrey, *The Corporate Income Tax in the U.S. Tax System*, 73 TAX NOTES 597, 602 (1996)).

110. McLure, *supra* note 34, at 148; *see also* Swain, *supra* note 103, at 293.

111. Swain, *supra* note 103, at 293.

112. *See* Sutton et al., *supra* note 67, at 26 (noting the increased frequency of and difficulty in sourcing transactions involving transmission of a digital file electronically or a service that is heavily technology and intangible dependent).

113. States using the income-producing activity rule typically source the service receipts to the state where the majority of the cost of performing the service is incurred. *See id.* at 28.

114. States using the market-based sourcing rule typically source the service receipts to the state where the customer is considered to have received the service. *See id.*

115. Sutton et al., *supra* note 47, at 8.

116. *See generally* Giles Sutton et al., *The Increasingly Complex Apportionment Rules for Service-Based Businesses (Part III): The Trend Toward Market-Based Sourcing*, J. MULTISTATE TAX'N AND INCENTIVES 6 (May 2008).

117. *Id.* at 10.

Another problem with applying the sales factor is the *Joyce-Finnigan*[118] issue: deciding whose sales should be included in the sales factor numerator of a group of corporations subject to combined reporting when only some of the members of the group have nexus in the taxing state.[119] States have split as to which approach they have adopted.[120] All of these problems, and the different solutions the states apply, only exacerbate the problem of lack of uniformity among the states.

In addition to these practical problems, the sales factor is the mechanism by which states extend the reach of their taxes to businesses outside of their state to tax businesses with little to no representation in their legislatures as discussed above in Section II-B. One need only look to the express words of state legislators increasing the weight of the sales factor to see what it is being used to do: "reduc[e] the tax for most [in-state] businesses, and increas[e] the tax on most businesses based in other states[.]"[121]

Economists have criticized use of the sales factor in particular. In fact, William Vickrey stated that the factor should be eliminated from the formula altogether due to its volatility and tendency toward being determined by trivial circumstances of the sale.[122] During the 1960s, when Congress was considering imposing a formula for apportioning income among the states, the most controversy surrounded use of a sales factor.[123] In the words of the Special Subcommittee on State Taxation, the sales factor is "the single element which is the most troublesome part of formula apportionment today."[124] Despite these concerns, the framers of UDITPA adopted the sales factor as part of the Massachusetts formula to allow the states that provide a market for the taxpayer's products to increase the reach of their taxing authority.[125] Congress should correct this mistake by establishing an apportionment formula that does not include this problematic sales factor.

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118. This name refers to two decisions of the California State Board of Equalization that reached opposite conclusions on the same issue. *See In re* Joyce, Inc., No. 66-SBE-070, 1966 WL 1411 (Cal. St. Bd. Eq. Nov. 23, 1966) (holding that only sales of taxable members count), *overruled by In re* Finnigan Corp., No. 88-SBE-022-A, 1990 WL 15164 (Cal. St. Bd. Eq. Jan. 24, 1990) (holding that all sales by members of the group count so long as any member of the group has nexus in the taxing state).

119. Ortiz, *supra* note 12, at 979.

120. *Id.* at 997 (noting that fifteen states follow the *Joyce* rule while ten states follow the *Finnigan* approach); *see also* Sutton et. al, *supra* 47, at 9-11.

121. Cal. B. Analysis, S.B. 1176 (Apr. 21, 1993).

122. William Vickrey, *The Corporate Income Tax in the U.S. Tax System*, 73 TAX NOTES 597, 602 (1996).

123. *See State Taxation of Interstate Commerce*, *supra* note 61, at 94 (1973) (statement of Leonard E. Kust, Member, Taxation Committee, U.S. Chamber of Commerce).

124. H.R. REP. NO. 89-952, pt. 6, at 1145 (1965).

125. Swain, *supra* note 103, at 288 ("The property and payroll factors are intended to give weight to the states in which production occurs ('origin' states), while the sales factor is intended to give weight to the states that provide the market for the taxpayer's products ('market' states or 'destination' states).").

C. While the property factor does not produce the policy concerns inherent in the sales factor, its application has been similarly complex.

Although not as problematic as the sales factor, the property factor is very difficult to measure, presents a series of difficult choices in determining the proper method of valuation, and often ignores intangible assets.[126] Under UDITPA, the property factor is based on the original cost to the user of assets, with no adjustment for either depreciation or inflation.[127] Further, intangible assets, which can be the "crown jewels" of a modern corporation, are not included in the calculation.[128] Solving these problems, however, would require further accounting procedures which might be more accurate, but more costly to comply with, especially for small businesses. Considering the property factor is meant to cover the same basic concept as the payroll factor, where the business operates, Congress can avoid these issues by simply removing the duplication of the property factor.

D. The payroll factor alone avoids both policy and practical problems in apportioning revenue.

The payroll factor is "relatively straightforward and satisfactory," especially when viewed in light of the other factors presently used to divide income.[129] Whatever controversy has existed in applying the payroll factor has typically involved determining the extent to which payment of independent contractors or subcontracted employees should be included in its calculation.[130] More importantly, the payroll factor furthers the policy objective of linking taxation to representation.

The payroll factor is intrinsically linked to representation because it treats the corporation as it is: a group of people. To the extent that employees of the business are compensated for their service to the corporation, they share the interests of the corporation. These people are the ones who benefit from government services. These people are the ones who are represented in the state legislatures. Using the payroll factor, a state can tax a business's revenue in proportion with the percentage of its payroll that goes to residents of that state.

The one concern with the use of the payroll factor in practice is the impact of outsourcing.[131] The problem that outsourcing creates in application of the payroll factor is that a business headquartered in one state could reduce its tax liability to that state by moving its production facilities

126. McLure, *supra* note 34, at 148.
127. *Id.*
128. *Id.*
129. *Id.*
130. *See* Sutton et al., *supra* note 47, at 13-16.
131. McLure, *supra* note 34, at 148.

outside of the state and hiring from that location. In applying a uniform formula, though, Congress removes this problem where businesses remain in the United States because this merely shifts the tax burden to the other state. Theoretically, moving facilities outside of the country could still be beneficial to the corporation if the foreign country maintains a different method of apportionment or a lower tax rate.

Nevertheless, the strong policy need for a connection between representation and taxation should still compel use of the payroll factor, even in the case of a business that moves its operations and personnel costs outside of the country. Doing so has drastically reduced the corporation's capacity for representation within the state. To the extent that the benefits of the wealth generated within the state remains with management in the state, the state would retain the ability to tax that portion of the business's revenue. Therefore, the payroll factor is the optimal method of apportioning business revenue among the states.

E. Whatever loss of revenue some states might incur because of this policy change will likely be minimal and outweighed by the long-term consequences of the current trend.

There is considerable speculation and disagreement involved in estimating the potential impact of various apportionment formulas on state tax revenue. The Willis Committee concluded, after extensive analysis, that the use of a two-factor, property-payroll formula would not appreciably affect any state's tax revenue and that "the great majority of States" would see no more than a one percent change in total tax revenues.[132] With that said, the proposal that the Willis Committee advanced in Congress never passed, in part due to complaints from Congressmen that it would cost their states millions of dollars in tax revenue.[133]

Whether real or not, the belief that the sales factor favors some states over others and, therefore, that its elimination would advantage some states and harm others, has played a crucial role in its continued use in virtually every apportionment formula proposed or implemented in recent years. This belief rests largely, however, on a shortsighted view of the use of the sales factor's impact on state economies. This view treats the orientation of the state's economy as a market participant or a producer as a static condition rather than dynamically related to the tax policy of the state.

The states' reliance on the sales factor rests in part on their determination that they could not attract businesses to relocate or otherwise

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132. H.R. REP. NO. 89-952, Vol. 4, pt. 6, at 1150-51 (1965).

133. *See* 114 CONG. REC. 14, 412 (1968) (statement of Rep. Richard Ichord) (claiming that the proposed formula could cost Missouri from $25 million to $50 million). *But see* 114 CONG. REC. 14, 407-08 (1968) (statement of Rep. Edwin Willis) (citing tax administrators from various states admitting that their initial fears of drastic impact on tax revenues were incorrect).

invest in physical locations within their borders.[134] Even if state lawmakers are not basing their votes on this concession, it is the practical effect of their decision. Eliminating or reducing the property and payroll factors reduces the tax impact of locating property and hiring within a state's borders.[135] For corporations, it means they are less able to flee high-tax jurisdictions.[136] For market states, it means they are unable to attract multistate corporations to locate within their borders through their tax policy. The short-term goal of increasing revenue from corporations producing in other states is a long-term loss for the market states that increase their reliance on a sales factor. While it might increase their tax base, it negatively impacts their ability to attract job-producing businesses to their state that can have a more long-lasting positive effect on the state's economy.

To illustrate this point, see the following example. Company A is based in State Y and employs only residents of State Y. Company A makes fifty percent of its sales to customers in State Y and the other fifty percent of its sales to customers in neighboring State Z. Company A's total revenue is $100,000. Assume that States Y and Z both apply a single-factor sales apportionment formula. State Y applies a tax rate of ten percent while State Z applies a tax rate of five percent. So long as Company A's sales remain the same, its tax liability to States Y and Z will remain unchanged regardless of where it is located. Even if State Z were to decrease its tax rate, that might encourage Company A to make more sales into the state, but it would not encourage Company A to move its operations to State Z and employ more of its residents.

Sales Factor Apportionment	Company A's Tax Liability		
	To State Y	To State Z	Total
If located in State Y	$5,000	$2,500	$7,500
If located in State Z	$5,000	$2,500	$7,500

Alternatively, assume that States Y and Z both apply a single-factor payroll apportionment formula. In this scenario, the tax rates imposed by the two states become very important to Company A in deciding whether to relocate.

Payroll Factor Apportionment	Company A's Tax Liability		
	To State Y	To State Z	Total
If located in State Y	$10,000	$0	$10,000
If located in State Z	$0	$5,000	$5,000

134. *See* Sutton et al., *supra* note 67, at 26.
135. Swain, *supra* note 103, at 289.
136. *Id.* at 290.

Moreover, for corporations, the increased reliance on the sales factor has two negative consequences. First, it means that states can no longer compete with one another for the corporation's physical presence through their corporate income taxes because the location of the corporation has little bearing whatsoever on the corporation's tax burden to the state. Second, the largest corporations within each state, and thus the ones with the greatest ability to influence tax policy, are less interested in the tax rates in their own state, which reduces the incentive for states to keep tax rates lower. Therefore, an apportionment scheme that focuses almost exclusively on the location of sales weakens the political mechanism for keeping corporate taxes low. As seen in the illustration above, the lowest tax liability for the business is where the business has the flexibility to locate in the state with the lowest tax rate under a payroll factor apportionment scheme.

On the other hand, an apportionment scheme that focuses exclusively on payroll strengthens that political mechanism by placing tax revenues in the jurisdiction in which interested parties within the corporation have the most ability to influence legislation. Although it might negatively impact the short-term tax revenues of market states, it improves these states' ability to seek long-term wins by attracting businesses to employ more of their citizens.

CONCLUSION

The legacy of our nation's early experience under British rule and the Articles of Confederation includes two lessons which now compel the conclusion of this Note: (1) taxing authority must be linked to the representation of the taxed entity and (2) the states must not be left to compete against one another in interstate commerce in a manner destructive to the national economy. Apportionment of interstate business revenue presents problems for states on both points. Although the Supreme Court and Congress have taken limited steps to curtail the destructive effects of state policy in this arena, the states have nevertheless produced a vast array of discordant rules that fail to meet these policy objectives and produce a multitude of problems in practice.

The solution presented in this Note is simple: Congress should settle the matter once and for all by establishing the formula for slicing the pie of interstate business revenue. This solution produces desperately-needed uniformity for businesses operating in multiple states, minimizing the costs of compliance and administration. Further, Congress should choose a single-factor payroll formula of apportionment because it indelibly links taxing authority with the principles of representation. It also presents fewer problems in practice than the alternative factors used to apportion business revenue.

The present state of apportionment policy in this country presents quite the contrast to this simple solution:

> It is the picture of a system which works badly for both business and the States. It is the picture of a system in which the States are reaching farther and farther to impose smaller and smaller liabilities on more and more companies. It is the picture of a system which calls upon tax administrators to enforce the unenforceable, and the taxpayer to comply with the uncompliable.[137]

The solution this Note presents, alternatively, would work for businesses and the states. It would limit the states to taxing only the income linked to businesses represented in their legislatures. It would also minimize the costs of compliance and administration.

The cruel irony of the current trend of the states to increasingly rely on the sales factor is that it cements the position of the market states by not allowing them to offer incentives for businesses to relocate to their states. This Note's proposal allows the market states, those who have pushed for the use of the sales factor from the beginning, to retain the ability to incentivize businesses to relocate within their borders through the competitive use of tax rates. This is good both for the states and the businesses for which they will compete.

The long history of apportionment among the states has demonstrated the inability of the states to come to a reasonable solution such as this on their own. While voluntary state action on matters such as this would be preferable, federal action to prevent self-destructive competition among the states in interstate commerce was authorized by the framers of the Constitution to prevent a repeat of the discordant relationship between the states that developed under the Articles of Confederation. They recognized that a prosperous national economy would require a neutral arbiter to step into situations such as this. To fulfill that purpose and rescue the states from themselves, now is the time for Congress to act.

APPENDIX

State	Sales Factor Weight[138]	Citation
Alabama	50%	Ala. Code § 40-27-1
Alaska	33%	Alaska Stat. Ann. § 43.19.010

137. H.R. REP. No. 88-1480, V. 1, 598 (1964).

138. It is important to note that many states have special formulas for certain industries. Further, some states allow taxpayers the option to elect different formulas in some situations. Nevertheless, the numbers above indicate the typical weight placed on the sales factor in the apportionment formulas for each state.

State	Weight of Sales Factor	Citation
Arizona	50%	Ariz. Rev. Stat. Ann. § 43-1139
Arkansas	50%	Ark. Admin. Code 006.05.308-26-51-709
California	100%	Cal. Rev. & Tax. Code § 25128.7
Colorado	33%	Colo. Rev. Stat. Ann. § 24-60-1301
Connecticut	100%	Conn. Gen. Stat. Ann. § 12-218
Delaware	50%	5 Del. Admin. Code § 1114
District of Columbia	100%	D.C. Code § 47-1810.02
Florida	50%	Fla. Stat. Ann. § 220.15
Georgia	100%	Ga. Code Ann. § 48-7-31
Hawaii	33%	Haw. Rev. Stat. § 235-29
Idaho	50%	Idaho Code Ann. § 63-3027
Illinois	100%	35 Ill. Comp. Stat. Ann. 5/304
Indiana	100%	Ind. Code Ann. § 6-3-2-2
Iowa	100%	Iowa Admin. Code r. 701-54.5
Kansas	33%	Kan. Stat. Ann. § 79-3279
Kentucky	50%	Ky. Rev. Stat. Ann. § 141.120
Louisiana	100%	La. Rev. Stat. Ann. § 287.95
Maine	100%	Me. Rev. Stat. Ann. tit. 36, § 5211
Maryland	50%	Md. Code Ann., Tax-Gen. § 10-402
Massachusetts	50%	Mass. Gen. Laws Ann. ch. 1-182, § 38
Michigan	100%	Mich. Comp. Laws Ann. § 206.115
Minnesota	100%	Minn. Stat. Ann. § 290.191
Mississippi	33%	Miss. Code Ann. § 27-7-24
Missouri	33%	Mo. Ann. Stat. § 32.200
Montana	33%	Mont. Code Ann. § 15-1-601
Nebraska	100%	Neb. Rev. Stat. Ann. § 77-2734.05
Nevada	No Corporate Income Tax	
New Hampshire	50%	N.H. Rev. Stat. Ann. § 77-A:3
New Jersey	100%	N.J. Admin. Code § 18:7-8.1
New Mexico	70%	N.M. Stat. Ann. § 7-4-10
New York	100%	N.Y. Tax Law § 210-A
North Carolina	100%	N.C. Gen. Stat. Ann. § 105-130.4 (effective Jan. 1, 2018)
North Dakota	33%	N.D. Cent. Code § 57-38.1-09
Ohio	60%	Ohio Rev. Code Ann. § 5733.05
Oklahoma	50%	Okla. Stat. Ann. tit. 68, § 2358
Oregon	100%	Or. Rev. Stat. Ann. § 314.650
Pennsylvania	100%	72 Pa. Stat. Ann. § 7401
Rhode Island	33%	R.I. Gen. Laws Ann. § 44-11-14
South Carolina	100%	S.C. Code Ann. § 12-6-2252
South Dakota	No Corporate Income Tax	
Tennessee	60%	Tenn. Code Ann. § 67-4-2012
Texas	No Corporate Income Tax	
Utah	33%	Utah Code Ann. § 59-7-311

State	Weight of Sales Factor	Citation
Vermont	50%	Vt. Stat. Ann. tit. 32, § 5833
Virginia	50%	Va. Code Ann. § 58.1-408
Washington	100%	Wash. Rev. Code Ann. § 82.04.460
West Virginia	50%	W. Va. Code Ann. § 11-24-7
Wisconsin	100%	Wis. Stat. Ann. § 71.04
Wyoming	No Corporate Income Tax	