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Constitutional Considerations of Federal Control Over the Sovereign Taxing Authority of the States

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CONSTITUTIONAL CONSIDERATIONS OF FEDERAL CONTROL OVER THE SOVEREIGN TAXING AUTHORITY OF THE STATES

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In 1959, the Supreme Court decided the companion cases of Northwestern States Portland Cement Co. v. Minnesota and Williams v. Stockham Valves and Fittings, Inc.1 The Court held in those cases that a state may constitutionally impose a fairly apportioned net income tax on an out-of-state corporation engaged only in interstate business within the taxing state. In response to those cases, Congress enacted Public Law 86-272,2 which established minimum jurisdictional requirements that must be met before a state can impose and assess a net income tax on income derived from interstate commerce. The statute contained an additional title directing congressional committees to recommend to the Congress "proposed legislation providing uniform standards to be observed by the states in imposing income taxes on income" derived from interstate commerce.3

Although Congress has not yet established uniform standards for states imposing taxes on income derived from interstate commerce,4 there have

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1. 358 U.S. 450 (1959). For a discussion of these cases, see text accompanying notes 29-35 infra.
4. To date Congress has supplemented Pub. L. No. 86-272 four times. The first supplement, the Airport Development Acceleration Act of 1973, Pub. L. No. 93-44, § 1113, 87 Stat. 907 (codified at 49 U.S.C. § 1513 (1976)) prohibits states from imposing "a tax, fee, head charge, or other charge, directly or indirectly" with respect to air commerce. Section 1513(b), however, permits a state to impose property taxes, net income taxes, franchise taxes, and sales or use taxes with respect to air commerce. The second supplement, the Securities Act Amendments of 1975, Pub. L. No. 94-29, § 21, 89 Stat. 97 (codified at 15 U.S.C. § 78bb(d) (1976)), restricts state taxation with regard to the change in beneficial or record ownership of securities based only on the physical location of the facilities of registered
been numerous attempts to do so. Most recently, Senator Mathias introduced S. 2173, a rather comprehensive bill that provided jurisdictional guidelines for states imposing gross receipts taxes as well as sales or use taxes. Moreover, S. 2173 mandated the use of an apportionment formula for the allocation of interstate corporate income for state income tax purposes.

As with earlier versions of bills that would have restricted state taxation of all taxpayers engaged in interstate commerce, the approach of S. 2173 varied from the government’s approach taken during a recent Senate debate over the proposed Tax Convention with the United Kingdom. The proposed treaty stirred substantial controversy, particularly with regard to article 9(4), which would have restricted a state’s use of any formula for clearing agencies or registered transfer agents. The third, the Railroad Revitalization and Regulatory Reform Act of 1975, Pub. L. No. 94-210, § 306, 90 Stat. 531 (codified at 49 U.S.C.A. § 26c (West Supp. 1978)), prohibits states from taxing railroad property more heavily than other industrial and commercial property. The last, the Tax Reform Act of 1976, Pub. L. No. 94-455, § 2121(a), 90 Stat. 521 (codified at 15 U.S.C. § 391 (1976)), restricts states from imposing a tax on the generation or transmission of electricity which thereby discriminates against out-of-state producers or consumers. For a full discussion of these statutes, see notes 76–84 and accompanying text infra.


8. Tax Convention with the United Kingdom of Great Britain and Northern Ireland, reprinted in EXEC. REP. No. 95-18, 95th Cong., 2d Sess. (1978) hereinafter cited as Tax Convention. Article 10 of the proposed treaty included a provision for a refund by the United Kingdom of its Advance Corporation Tax (ACT) to United States’ shareholders of British corporations.

On April 25, 1978, the Senate Foreign Relations Committee favorably reported the proposed Tax Convention and recommended that the Senate ratify it by giving its “advice and consent.” Id. at 1. Such “advice and consent” is required by Article II of the Constitution, which mandates: “[the President] shall have Power, by and with the Advice and Consent of the Senate, to make Treaties . . . .” U.S. Const. art. II, § 2, cl. 2.

9. Art. 9(4) of the proposed Tax Convention stated:

Except as specifically provided in this Article, in determining the tax liability of an enterprise doing business in a Contracting State, or in a political subdivision or local authority of a Contracting State, such Contracting State, political subdivision,
determining taxable income of British branch operations and businesses directly or indirectly controlled by British enterprises. Under the combined reporting method, the only method feasible for taxing international businesses, income is allocated for state income tax purposes by an apportionment formula that takes into account the sales, payroll, and property values of a business within the state. These features are then compared with the total worldwide sales, payroll, and property values of all corporations related by common ownership and operation to the entity doing business within the state wherever located. This arbitrary method obviates the tremendous administrative difficulties that a state would encounter if attempting to account separately for business income within a state in which the activities of a unitary business were also carried on outside the state's borders.

State tax administrators, testifying before the Senate Foreign Relations Committee, expressed concern over possible adverse effects that article 9(4) restrictions would have on the states. In addition to arguing that states presently using the combined reporting method would suffer a reve-

or local authority shall not take into account the income, deductions, receipts, or outgoings of a related enterprise of the other Contracting State or of an enterprise of any third State related to an enterprise of the other Contracting State.

Tax Convention, supra note 8, at 60-61.

10. A three factor combined reporting allocation formula that takes into account sales, payroll, and property values is constructed as follows:

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\frac{\text{Intrastate Sales}}{\text{Worldwide Sales}} + \frac{\text{Intrastate Payroll}}{\text{Worldwide Payroll}} + \frac{\text{In-State Property}}{\text{Worldwide Property}}
\]

The resulting fraction is divided by three (as a result of the three factors) and is then multiplied by worldwide business income. The result is income attributable to the state. In 1964, twenty-six states used a three factor formula; two states used a two factor formula; and three states used a one factor apportionment formula. See H.R. Rep. No. 88-1480, 88th Cong., 2d Sess. 170 (1964). Since states use different allocation formulas, it is possible for the same income to be taxed twice because identical income can be attributed to different states using different formulas. A more detailed description of the combined reporting method, also known as the unitary method, can be found in Tax Treaties with the U.K., the Republic of Korea, and the Republic of the Philippines: Hearings Before the Senate Comm. on Foreign Relations, 95th Cong., 1st Sess. 151-59 (1977) (statement of Theodore W. deLooze) [hereinafter cited as 1977 Hearings].

11. A unitary business is a group of two or more corporations in which: (1) generally more than 50% of the voting stock of each member corporation is directly or indirectly owned by a common owner or owners, and (2) each member corporation is engaged in activities that are integrated with or dependent upon the activities of the entire group of corporations. See, e.g., Butler Bros. v. McColgan, 17 Cal. 2d 664, 678, 111 P.2d 334, 341 (1941). See also Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924).
nue loss should article 9(4) be enacted,\textsuperscript{12} the administrators expressed fear that such a restriction would serve as precedent for further federal encroachment on state taxing powers.\textsuperscript{13} It was also argued that the treaty process was not the proper method for imposing such a restriction on the states; rather, it was suggested that if such a restriction was ever to be appropriate, it should be adopted through the legislative process after open debate in both Houses of the Congress.\textsuperscript{14}

To the delight of those administrators who testified, the Senate ratified the Tax Convention with the United Kingdom but reserved article 9(4).\textsuperscript{15} On the other hand, the threat of similar restrictions in future tax treaties,\textsuperscript{16} as well as the potential for future laws to establish a restrictive uniform method for all states in their apportionment of the income of multistate and multinational businesses, continues to haunt the same state tax administrators.

Implicit in the arguments against article 9(4), as well as against future treaty provisions and bills restricting state taxation of income derived from interstate commerce, is the thought that such restrictions simply take away too much of the sovereignty possessed by the states. These arguments are based upon constitutional considerations\textsuperscript{17} and concern the interplay

\begin{footnotesize}
\begin{enumerate}
\item See 1977 \textit{Hearings}, supra note 10, at 63-70 (testimony of Daniel G. Smith, President, National Association of Tax Administrators).
\item \textit{Id.} at 64-66.
\item \textit{Id.} at 44 (statement of Paul J. Oosterhuis, Legislation Counsel, Joint Comm. on Taxation). This point of view was also expressed in a letter dated July 18, 1977 from Chairman Al Ullman of the House Ways and Means Committee to former Chairman John Sparkman of the Senate Foreign Relations Committee, \textit{reprinted in id.} at 3-4.
\item 124 CONG. REC. S9840-42 (daily ed. June 27, 1978). Following Senate ratification, the revised treaty must be renegotiated with Great Britain. That country is currently in the process of evaluating the treaty without the article 9(4) restrictions. [1978] DAILY TAX REP. (BNA) G-2 (Nov. 6, 1978).
\item For example, in June, 1978, the Treasury Department announced that a public meeting would be held concerning negotiations to develop a new income tax treaty between the United States and Italy. 43 Fed. Reg. 26816 (1978). That announcement suggests that a similar restriction could be negotiated in that tax treaty.
\item It should be noted that the constitutional prohibitions apply with equal force to both laws and treaties. Article VI (the supremacy clause) of the United States Constitution mandates: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land . . . ." U.S. CONST. art. VI, cl. 2. One might be tempted to argue, based upon the language of the supremacy clause, and the Supreme Court's significant decision in Missouri v. Holland, 252 U.S. 416 (1920), that laws and treaties are somehow different and are therefore to be judged by different standards. The Supreme Court in \textit{Holland} stated:
Acts of Congress are the supreme law of the land only when made in pursuance of the Constitution, while treaties are declared to be so when made under the authority of the United States. It is open to question whether the authority of the United States means more than the formal acts prescribed to make the convention. We do
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among the tenth amendment, the due process clause of the fourteenth amendment, the commerce clause, and the necessary and proper clause. These considerations go to the heart of the relationship between the federal government and the states in our constitutionally based federal form of government. This article will discuss the constitutional limitations on the states' power of taxation and examine the federal government's restrictions on this power. It will also suggest several approaches for future congressional attempts to restrict the states' taxing authority.

I. THE POWER TO TAX AS RETAINED BY THE STATES

In the landmark decision of M'Culloch v. Maryland, the Supreme Court recognized the states' sovereign power of taxation. Chief Justice Marshall stated:

not mean to imply that there are no qualifications to the treaty-making power; but they must be ascertained in a different way.

Id. at 433.

The Supreme Court's position with regard to the standard against which treaties are to be judged shifted some thirty-seven years later, as illustrated by the well-reasoned opinion of Reid v. Covert, 354 U.S. 1 (1957). The Court there concluded that treaties and laws are alike in that both must comply with the Constitution. Justice Black, writing for the majority, stated that the difference in language found in the supremacy clause with regard to treaties and laws is a result of the attempt by the framers of the Constitution to make clear that treaties made by the United States while operating under the Articles of Confederation would remain in effect. Id. at 16-17. Justice Black concluded:

It would be manifestly contrary to the objectives of those who created the Constitution, as well as those who were responsible for the Bill of Rights—let alone alien to our entire constitutional history and tradition—to construe Article VI as permitting the United States to exercise power under an international agreement without observing constitutional prohibitions.

Id. at 17 (footnote omitted).

Even though Justice Black's discussion of the supremacy clause is merely dictum, since the case concerned an executive agreement, the historical context in which he analyzed the supremacy clause provides a reasonable basis for such a construction of the clause.

18. U.S. Const. amend. X states: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."


20. "The Congress shall have the power . . . [t]o regulate Commerce with foreign Nations, and among the several States . . . ." U.S. Const. art. I, § 8, cl. 3.

21. U.S. Const. art 1, § 8, cl. 18 states: "The Congress shall have the power . . . [t]o make all Laws which shall be necessary and proper for carrying into Execution the foregoing powers . . . ."

22. 17 U.S. (4 Wheat.) 316 (1819) In M'Culloch, the Supreme Court held that the creation of the Bank of the United States was a valid exercise of congressional power and that a Maryland bank tax, as applied to a branch of the Bank of the United States, was unconstitutional.
[T]hat the power of taxation is one of vital importance; that it is retained by the states; that it is not abridged by the grant of similar power to the government of the Union; that it is to be concurrently exercised by two governments: [these] are truths which have never been denied.  

Thus it is clear that the constitutional delegation to the federal government of the "power to lay and collect Taxes" is not an exclusive delegation of power. In fact, the founding fathers, when framing our federal system of government, envisioned practically "uncontrolled" state taxing powers. Alexander Hamilton, writing under the name Publius, stated in *The Federalist* that "the individual States would, under the proposed constitution, retain an independent and uncontrollable authority to raise revenues to any extent of which they may stand in need by every kind of taxation except duties on imports and exports."  

The recognition of the sovereign state power to tax, however, does not mean that the state taxing power may be exercised indiscriminately. The Constitution expressly prohibits states from imposing taxes on imports or exports as well as from imposing any tonnage duties. Moreover, the courts on numerous occasions have construed the commerce clause as a limitation on state taxation when such taxation would interfere substantially with the national economy. In fact, the Supreme Court has decided so many controversies concerning the limitation of the commerce clause in regard to state taxing schemes that Justice Clark, speaking for the

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23. Id. at 425.
26. No State Shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its Inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Control of the Congress.
27. U.S. Const. art I, § 10, cl. 3 states: "No State shall, without the Consent of Congress, lay any Duty of Tonnage . . . ." The Supreme Court stated in Clyde Mallory Lines v. Alabama, 296 U.S. 261, 265-66 (1935), that this "prohibition against tonnage duties has been deemed to embrace all taxes and duties . . . which operate to impose a charge for the privilege of entering, trading in or lying in a port . . . ."
Court in *Northwestern States Portland Cement Co. v. Minnesota*, commented, "[t]his Court alone has handed down some three hundred full-dress opinions spread through slightly more than that number of reports."

In *Northwestern States*, the Court analyzed several prior decisions and summarized them as:

stand[ing] for the doctrine that the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the states for tax purposes by formulas utilizing in-state aspects of interstate affairs. In fact, in *Bass, Ratcliff and Gretton* the operations in the taxing state were conducted at a loss, and still the court allowed part of the over-all net profit . . . to be attributed to the State.

The holding in *Northwestern States* and the later decision of the Supreme Court in *Complete Auto Transit, Inc. v. Brady* clearly illustrate that the

30. *Id.* at 457-58. The tax involved in *Northwestern States* was a Minnesota income tax imposed on an Iowa corporation which owned no real estate in Minnesota, maintained no bank accounts there, and warehoused no merchandise in the state. The corporation did, however, regularly solicit orders for the sale of its products in Minnesota. The net income derived from this activity provided a sufficient connection with Minnesota for state tax purposes. The tax involved in *Williams v. Stockham Valves and Fittings, Inc.*, the companion case to *Northwestern States*, was a Georgia income tax imposed on a Delaware corporation that did not maintain any warehouse or storage facilities in Georgia but did maintain a sales and service office in the state. As in *Northwestern States*, the net income derived from the activity in Georgia provided a sufficient connection with Georgia for state tax purposes.

*Bass* considered the constitutionality of New York’s franchise tax determined by use of an allocation formula against a British corporation selling ale in New York. The Court found that New York possessed the power to attribute a proper proportion of the “unitary business,” see note 11 supra, income to New York for tax purposes.

The issue before the Supreme Court in *Norfolk & W. Ry.* was the constitutionality of a North Carolina statute that mandated the use of a formula allocating income and operating costs by comparing the mileage of railway tracks within the state against the entire mileage of a railroad company throughout the country. In upholding the state’s apportionment formula, the Court noted: “A division of revenues and costs in accordance with state lines can never be made for a unitary business with more than approximate correctness.” 297 U.S. at 684.

32. 358 U.S. at 460. Although the Court’s language in *Northwestern States* regarding the *Bass* case, see note 31 supra, initially suggests that a tax may be imposed when the operations within a state are conducted at a loss, the Court in *Bass* convincingly reasoned that the company’s profits were the result of a series of transactions. Accordingly, since “the process of manufacturing result[s] in no profits until it ends in sales—the State was justified in attributing to New York a just proportion of the profits earned . . . ” 266 U.S. at 282.
33. 430 U.S. 274 (1977). The Supreme Court held in *Complete Auto Transit* that a Mississippi tax on the “privilege of doing business” was not per se unconstitutional under the commerce clause merely because the tax was applied to an activity performed partially in
commerce clause limitation on the sovereign state taxing powers does not create an exemption from state taxation for businesses engaged in interstate commerce. Rather, these decisions indicate that businesses engaged in interstate commerce must pay their fair share of state taxes, and that only when state taxing schemes substantially burden interstate commerce will the commerce clause restrict such taxing methods.

Even though a state tax may withstand a constitutional challenge based on the commerce clause, such a tax may nevertheless violate the due process clause of the fourteenth amendment. To establish that a state taxing statute is discriminatory under the due process clause and therefore unconstitutional, however, the taxpayer must show that the statute favors local business over interstate business by, for example, impermissibly confiscating property of the interstate business. To illustrate, the Supreme Court in *A. Magnano Co. v. Hamilton* held that an excise tax of fifteen cents per pound imposed on all butter substitutes sold within a state did not violate the due process clause of the fourteenth amendment. The Court acknowledged the magnitude of the state taxing power by comparing it to that concurrently exercised by the federal government. The Court stated that

interstate commerce. The Court expressly overruled its earlier decision in Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951), in which the Court had prohibited a state from imposing a tax on the "privilege" of engaging in interstate commerce without violating the commerce clause. See also *Central R.R. Co. v. Pennsylvania*, 370 U.S. 607 (1962) (commerce clause not a bar against the imposition of Pennsylvania's property tax on the full value of the company's railroad freight cars, even though a determinable portion of the freight cars were outside Pennsylvania for a portion of the tax year); *Capital Greyhound Lines v. Brice*, 339 U.S. 542 (1950) (Maryland tax of 2% of the fair market value of vehicles operated on Maryland highways upheld regardless of whether vehicle owner was engaged exclusively in interstate commerce).

34. As noted in *Complete Auto Transit*, "the Court consistently has indicated that 'interstate commerce may be made to pay its way ...'" 430 U.S. at 281.


36. E.g., *America Oil Co. v. Neill*, 380 U.S. 451 (1965) (state imposition of an excise tax upon a dealer entirely disassociated from any in-state activities violates due process); *Frick v. Pennsylvania*, 268 U.S. 473 (1925) (imposition of inheritance taxes on the transfer of tangible property located outside a state is a deprivation of property without due process of law).

It should also be noted that the Court in *Austin v. New Hampshire*, 420 U.S. 656 (1975), struck down a New Hampshire commuters' income tax as violative of the privileges and immunities clause. U.S. CONST. art. IV, § 2, cl. 1. The Court construed the clause as prohibiting the making of nonresidence or noncitizenship as the basis for imposing a tax burden.

Taxpayers have also attempted to invalidate state taxes on the basis of the equal protection clause of the fourteenth amendment, U.S. CONST. amend XIV, § 1. These attempts have generally failed. See *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356 (1973); *Nashville, C. & St. L. Ry. v. Browning*, 310 U.S. 362 (1940).
the due process clause of the fourteenth amendment will prohibit state taxation only if it is "so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as, for example, the confiscation of property . . . ."\textsuperscript{38}

Thus, although state sovereign power of taxation is recognized as a vital state exercise, it cannot be allowed to violate other constitutional mandates. Within these limits, however, state taxation has been generally recognized as a constitutional exercise of power.

II. CONGRESSIONAL LIMITATIONS ON THE STATES' SOVEREIGN POWER TO TAX

A. Congressional Regulation of Interstate Commerce

Even though a state's method of taxing interstate business does not violate the commerce or due process clauses, that same taxing scheme may nonetheless be restricted by Congress. Restrictions of this nature are not based on any unconstitutional state action but rather on Congress' determination that such restrictions are necessary to ensure the free flow of interstate commerce.\textsuperscript{39} Thus, pursuant to its power to regulate commerce, Congress has enacted several laws that restrict state taxation of interstate businesses.\textsuperscript{40}

Congressional power under the commerce clause is sweeping. The

\textsuperscript{38} Id. at 44.

\textsuperscript{39} For example, the Supreme Court in South Carolina Highway Dep't v. Barnwell Bros., 303 U.S. 177 (1937), in discussing state and federal regulation of highways, stated: "Congress, in the exercise of its plenary power to regulate interstate commerce, may determine whether the burdens imposed on it by state regulation, otherwise permissible, are too great, and may, by legislation designed to secure uniformity . . . curtail to some extent the state's regulatory power." Id. at 189-190 (emphasis added). The rationale set forth in \textit{South Carolina Highway Dep't} was adopted by the Louisiana Supreme Court in International Shoe Co. v. Cocreham, 246 La. 244, 164 So. 2d 314, \textit{cert. denied}, 379 U.S. 902 (1964), to uphold the constitutionality of Public Law 86-272, which established minimum jurisdictional standards before a state can impose a net income tax on income derived from interstate commerce. \textit{See} 15 U.S.C. §§ 381 to 384 (1976); notes 70-75 and accompanying text, \textit{infra}.

The mere fact that Congress has not acted in a certain area does not mean that it is thereafter foreclosed from doing so. \textit{See generally} Biklé, \textit{The Silence of Congress}, 41 HARV. L. REV. 200 (1927). This proposition was made clear in \textit{Heart of Atlanta Motel, Inc. v. United States}, 379 U.S. 241 (1964), in which the Supreme Court upheld the constitutionality of the Civil Rights Act of 1964 by virtue of the commerce clause. Prior to the Civil Rights Act, Congress had not attempted to prohibit discrimination in a comprehensive way. Nonetheless, congressional failure to exercise its commerce clause power in the civil rights context did not preclude it from doing so. Thus, in \textit{Heart of Atlanta}, that exercise was constitutional.

\textsuperscript{40} \textit{See} text accompanying notes 70-84 \textit{infra}.
Supreme Court has recognized that this clause "is complete in itself, may be exercised [by Congress] to its utmost extent, and acknowledges no limitations, other than are prescribed in the constitution."\(^{41}\) In addition, the necessary and proper clause allows Congress to legislate concerning matters that are technically not included in its commerce clause power, but which are necessary to effectuate the underlying federal policy of the clause.\(^{42}\) The limits of the necessary and proper clause power were enunciated at an early date in *M'Culloch v. Maryland*: "Let the end be legitimate, let it be within the scope of the constitution, and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consist with the letter and spirit of the constitution, are constitutional."\(^{43}\)

The question of whether the federal government is constitutionally restricted in limiting the states' taxing power requires an analysis of the extent of express congressional power under the commerce clause, as well as the scope of implied powers endowed by the necessary and proper clause, to effectuate a legitimate commerce-related end. It is undisputed that the congressional power to regulate commerce is as vast as the national economy\(^ {44}\) and that it subsumes both the enumerated commerce clause power as well as the necessary and proper clause power.\(^ {45}\) Vastness, however, cannot be properly defined as that which is without limits. The very fact that other powers are granted to Congress in article I, section 8 of the Constitution indicates that the power to regulate commerce is limited to some degree.\(^ {46}\) Otherwise, no other grant of power would have been deemed necessary. Moreover, the Supreme Court has recognized that Congress' commerce power has limits. In a recent decision, the Court noted that it "has never doubted that there are limits upon the power of

\(^{41}\) 22 U.S. (9 Wheat.) 1, 196 (1824).

\(^{42}\) For the text of the necessary and proper clause, see note 21 *supra*. During, as well as after, the ratification of the Constitution, there was disagreement as to the extent of the power granted the federal government by virtue of the necessary and proper clause. *See generally* I C. WARREN, THE SUPREME COURT IN UNITED STATES HISTORY 499, 500-03 (1922). The concept evolved, however, that the necessary and proper clause "is not the delegation of a new and independent power, but simply provision for making effective" the enumerated powers found in article I, section 8 of the Constitution. Kansas v. Colorado, 206 U.S. 46, 88 (1907). *See generally* Dodd, IMPLIED POWERS AND IMPLIED LIMITATIONS IN CONSTITUTIONAL LAW, 29 YALE L.J. 137 (1919).

\(^{43}\) 17 U.S. (4 Wheat.) 316, 421 (1819).

\(^{44}\) *See, e.g.*, Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241 (1964) (discussed in note 39 *supra*); Wickard v. Filburn, 317 U.S. 111 (1942) (congressional power to regulate commerce justifies the federal regulation of commodities prices and practices affecting such prices).

\(^{45}\) *See* note 42 *supra*.

\(^{46}\) *See* U.S. CONST. art. 1, § 8, cls. 1-17.
Congress to override state sovereignty, even when exercising its otherwise plenary" power to regulate commerce.47

The pertinent constitutional limitation on Congress’ power to regulate commerce by restricting state taxing power is, of course, the very sovereignty of state taxing authority, implicitly recognized by the tenth amendment.48 The Supreme Court’s assessment in Fry v. United States of the tenth amendment’s recognition of state sovereign powers is revealing:

While the Tenth Amendment has been characterized as a ‘truism,’ stating merely that ‘all is retained which has not been surrendered,’ . . . it is not without significance. The Amendment expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the States’ integrity or their ability to function effectively in a federal system.49

This dicta in Fry expressing that Congress may not exercise power that would impair the ability of the states to function in our federal system of government was made the basis for the later Supreme Court decision in National League of Cities v. Usery.50 In National League of Cities, the


If the Congress, using the virtually inexhaustible resources of the . . . [commerce clause power] and the power permitted by the Necessary and Proper Clause, can subordinate to its uses all state functions which impinge on “commerce” . . . then federalism as it was thought to exist has changed radically and fundamentally . . . We have not a federal, but a national system of government.

Salmon, supra at 296.

48. See note 18 supra.

49. 421 U.S. 542, 547 n.7 (1975) (quoting United States v. Darby, 312 U.S. 100, 124 (1941)). Although the Supreme Court in Fry concluded that the Economic Stabilization Act, Pub. L. No. 91-379, 84 Stat. 799 (1970) (expired April 30, 1974), was constitutional as applied to state and local government employees, it noted that “we are convinced that the wage restriction regulations constituted no. . . drastic invasion of state sovereignty.” 421 U.S. at 547 n.7.

Justice Rehnquist, dissenting in Fry, argued that Congress had encroached too heavily on an area of traditional state functions. Id. at 549-59. He distinguished arguments attacking federal acts not within congressional authority under the commerce clause from those attacks grounded on constitutional rights. Thus, Ohio, in arguing the Act as applied to state employees was violative of the tenth amendment, claimed it was “not simply asserting an absence of congressional legislative authority, but rather [was] asserting an affirmative constitutional right, inherent in its capacity as a State, to be free from such congressionally asserted authority.” Id. at 553. Whether such a claim would prevail was “quite a different question,” but an overriding deference to congressional authority would be “simply a denial of the inherent affirmative constitutional limitation on congressional power which [Justice Rehnquist] believe[s] the States possess.” Id. See also United States v. Jackson, 390 U.S. 570 (1968) (congressional exercise of its commerce clause power invalid when the resultant legislative enactment conflicts with the constitutional right to trial by jury).

Court determined that Congress' power to regulate commerce was not so exclusive and unlimited as to permit Congress to impose the minimum wage and maximum hour provisions of the Fair Labor Standards Act\textsuperscript{51} upon most employees of state and local governments. The Court stated:

Congress may not exercise [its commerce clause power] . . . so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made. We agree that such assertions of power, if unchecked, would indeed . . . allow 'the National Government [to] devour the essentials of state sovereignty' . . . and would therefore transgress the bounds of the authority granted Congress . . . .\textsuperscript{52}

Both \textit{National League of Cities} and \textit{Fry} indicate that there are aspects of state sovereignty that cannot be regulated constitutionally by Congress and that the tenth amendment is an "express declaration" that "our federal system of government imposed definite limits upon the authority of Congress to regulate the activities of the States as States by means of the commerce power."\textsuperscript{53} The Court concluded in \textit{National League of Cities} that "insofar as the challenged amendments operate to directly displace the States' freedom to structure integral operations in areas of traditional governmental functions, they are not within the authority granted Congress . . . by the commerce clause."\textsuperscript{54} Whether state taxing power is a "traditional governmental function" has not yet been expressly decided, however. Nonetheless, since the economic viability of state governments depends upon the power to tax, and because the taxing power is a legitimate function of the state as a sovereign, state taxation should clearly qualify as a "traditional governmental function."

This conclusion is amply supported by Alexander Hamilton in \textit{The Federalist}:

\begin{quote}
[\textit{I} though a law, therefore, for laying a tax for the use of the United States would be supreme in its nature, and could not legally be opposed or controlled; yet, a law abrogating or preventing the collection of a tax laid by the authority of a state (unless upon imports and exports) would not be the supreme law of the land, but an usurpation of power, not granted by the constitution.\textsuperscript{55}
\end{quote}

\begin{itemize}
\item \textsuperscript{51} 29 U.S.C. §§ 201 to 219 (1976).
\item \textsuperscript{52} 426 U.S. at 855 (quoting Maryland v. Wirtz, 392 U.S. 183, 205 (1968) (Douglas, J., dissenting)).
\item \textsuperscript{53} \textit{Id.} at 842.
\item \textsuperscript{54} \textit{Id.} at 852.
\item \textsuperscript{55} \textit{THE FEDERALIST} No. 33 (A. Hamilton) at 208 (J. Cooke ed. 1961). Furthermore, the Supreme Court recognized at an early date that "the power of taxation is indispensable to [the states'] existence . . . ." \textit{Gibbons v. Ogden}, 22 U.S. (9 Wheat.) 1, 197 (1824).
\end{itemize}
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The continued vitality of the compact made between the states and the federal government in 1789 is underscored in National League of Cities. It remains open to question, however, whether the states' freedom to select various methods of taxation will come within the umbrella of traditional governmental functions integrally related to state operation and protected by National League of Cities.

B. A Balancing Approach

In his concurring opinion in National League of Cities, Justice Blackmun characterized the majority's analysis as a balancing approach. Such an approach to the relationship between the commerce clause and state taxation has apparently been recognized by the Supreme Court for years. For example, in McGoldrick v. Berwind-White Coal Mining Co., the Court stated that prior cases testing the validity of state and local taxes had balanced the competing constitutional demands at stake. The Court identified the concern that "commerce between the states shall not be unduly impeded by state action, and that the power to lay taxes for the support of state government shall not be unduly curtailed." Thirty-seven years later, the need for an accommodation was reiterated in Boston Stock Exchange v. State Tax Commission. The Supreme Court recognized the necessity for "the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers ...." Consequently, the constitutional analysis of any federal limitation on the states' taxing power must balance the congressional power to regulate commerce and the states' sovereign power to tax as recognized by the tenth amendment.

The Supreme Court has indicated that it would allow certain congressional intercession in the area of state taxation of interstate trade. In Northwest Airlines, Inc. v. Minnesota, the Court upheld Minnesota's personal property tax as applied to Northwest Airlines' entire fleet of air-

56. 426 U.S. at 856 (Blackmun, J., concurring).
57. 309 U.S. 33 (1940).
58. Id. at 48. In McGoldrick, the Supreme Court determined that the application of a New York sales tax to the delivery of coal shipped from Pennsylvania pursuant to contracts of sale previously made in New York did not violate the commerce clause.
59. 429 U.S. 318 (1977). At issue in Boston Stock Exchange was a New York transfer tax on securities transactions that taxed out-of-state transactions more heavily than in-state transactions. Finding the tax unconstitutional, the Court emphasized that the fundamental purpose of the commerce clause is to protect and preserve free trade among the states. Id. at 335. Since a tax that favors in-state transactions is in direct conflict with the purpose of the commerce clause, such a tax is constitutionally impermissible. Id. at 336.
60. Id. at 329.
planes. Although not all the airplanes were in the state during the taxable year, the Court found that taxing the company violated neither the commerce clause nor the due process clause. Although the tax was upheld, Justice Frankfurter nevertheless indicated that Congress could have “exert[ed] its controlling authority over commerce by appropriate regulation and exclude[d] a domiciliary State from authority which it otherwise would have . . . .”62

Most recently, in *Moorman Manufacturing Co. v. Bair*,63 the Supreme Court upheld Iowa’s single-factor sales formula for apportioning interstate business income.64 The Court observed, however, that although states were generally free to mandate methods for the allocation of income derived from interstate commerce, that freedom

may have to yield to an overriding national interest in uniformity . . . . 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.65

It is important to note that although the Court recognized Congress’ power to mandate uniformity, it premised this conclusion with the statement that “the content of any uniform rules to which they must subscribe should be determined only after due consideration is given to the interest of all affected States.”66 This dictate suggests that in future cases involving federal

62. *Id.* at 298.
64. Iowa’s single factor formula compares gross sales in Iowa with total gross sales of an interstate business. *Id.* at 269 n.1. The resulting fraction is then multiplied by adjusted total net income to determine the amount of taxable income attributable to Iowa. *Id.* at 270 n.3. The Iowa taxable income amount is then multiplied by the Iowa tax rate and the result is the tax obligation. *Id.* Since the majority of other states use the three factor formula, see footnote 10 supra, which takes into account not only sales, but also payroll and property, there is a greater likelihood of double taxation of the same income of those companies that do business in Iowa and states that use a three factor formula. See generally Studenski, *The Need for Federal Curbs on State Taxes on Interstate Commerce: An Economist’s Viewpoint*, 46 Va. L. Rev. 1121, 1133 (1960). Justice Stevens, speaking for the majority, however, dealt with the double taxation argument by terming it “speculative,” 437 U.S. at 276. He concluded that the record did not establish that there had been, in fact, duplicative taxation. *Id.* To eliminate the risk of duplication, the Court would have to “prescribe a uniform definition of each category in the three-factor formula,” a task better left to Congress since such a uniform code “would require a policy decision based on political and economic considerations that vary from state to state.” *Id.* at 278-79.

Justice Powell, dissenting, differed from the majority on the detrimental effect of the state law. He concluded that the law violated the commerce clause because “[i]n the context of virtually universal use of the basic three-factor formula, Iowa’s use of the single-factor sales formula necessarily discriminated against out-of-state manufacturers. *Id.* at 297 (Powell, J., dissenting).

65. *Id.* at 280.
66. *Id.*
regulation of state taxation, courts must first recognize the sovereignty of the states' taxing power, and then strive to balance that power against Congress' power to regulate commerce.\textsuperscript{67}

C. An Analysis of Existing Federal Laws Limiting State Taxation of Interstate Business

Following the \emph{Northwestern States} decision,\textsuperscript{68} in which the Supreme Court gave its imprimatur to state and local taxation of an interstate business based on sales activity within the jurisdiction, many multistate businesses pressured Congress for legislation delimiting the sweep of the decision.\textsuperscript{69} As a result, Congress has passed several acts to restrict state taxation of interstate business. Public Law 86-272, the first of the acts following \emph{Northwestern States}, established minimum jurisdictional prerequisites for a state-imposed income tax on multistate businesses, mandating a significant nexus between a state and business activity before the exercise of a state's sovereign power to tax.\textsuperscript{70} Essentially, the statute requires business activity beyond the mere solicitation of orders or the maintenance of an office by nonemployees.\textsuperscript{71} Mere solicitation of orders would be sufficient business activity for the imposition of an income tax only when a corporation is incorporated in the state or an individual is either a resident

\textsuperscript{67} Even Justice Powell, with whom Justice Blackmun joined in dissenting, recognized that the Court's duty was to "'make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers.'" \textit{Id.} at 283 (quoting \textit{Boston Stock Exch. v. State Tax Comm'n}, 429 U.S. 318, 329 (1977)).

\textsuperscript{68} 358 U.S. 450 (1959). \textit{See} notes 29-35 and accompanying text \textit{supra}.

\textsuperscript{69} \textit{MULTISTATE TAX COMPACT}, preamble at C-3.


\textsuperscript{71} The first section of Public Law 86-272 states:

\begin{quote}
No State, or political subdivision thereof, shall have power to impose, for any taxable year . . . a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).
\end{quote}

of the state or is domiciled there.\textsuperscript{72} As recognized by the Supreme Court in \textit{Heublein, Inc. v. South Carolina Tax Commission},\textsuperscript{73} however, Congress did not mandate in Public Law 86-272 a particular method for determining any state income tax; instead the Act only sets jurisdictional parameters. This statute survived a direct constitutional challenge in \textit{International Shoe Co. v. Cocreham}.\textsuperscript{74} Upholding the statute's constitutionality, the Louisiana Supreme Court emphasized that Congress may exercise its power under the commerce clause to prohibit the imposition of a state tax when such a tax "unduly burdens the free flow of . . . commerce."\textsuperscript{75}

In section seven of the Airport Development Acceleration Act of 1973,\textsuperscript{76} Congress expressly prohibited states from imposing taxes or other "charges" with respect to air commerce. Congress was careful, however, not to be too restrictive and allowed states to impose property taxes, net income taxes, franchise taxes, and sales or use taxes with respect to air commerce.\textsuperscript{77} Like Public Law 86-272, this statute also survived a constitutional challenge. The Pennsylvania Supreme Court, in \textit{Allegheny Airlines},
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*Inc. v. City of Philadelphia,*\(^78\) upheld the Airport Development Acceleration Act, adopting an approach similar to that taken in *Cocreham* that exhibited little deference to state sovereignty. In a short opinion marked by little discussion, the court concluded that the federal law was enacted pursuant to Congress’ constitutional authority to regulate interstate commerce.\(^79\)

In the Securities Act Amendments of 1975,\(^80\) Congress adopted an approach somewhat analogous to that taken in Public Law 86-272 and restricted state taxation stemming from the change in beneficial or record ownership of securities based only on the physical location of the facilities of registered clearing agencies or registered transfer agents. Congress, however, did not restrict states from the imposition of taxes with regard to the change of securities ownership based upon any other factor that might subject the change in ownership to state taxation.\(^81\) Although there are no cases determining the constitutionality of this section of the Securities Act Amendments, this statute, like Public Law 86-272, is based on the congressional exercise of the power to regulate commerce and would appear to be well within the authority of that power.

In the Railroad Revitalization and Regulatory Reform Act of 1975,\(^82\) Congress prohibited states from taxing railroad property more heavily

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79. 453 Pa. at 186, 309 A.2d at 159. The court concluded that once Congress exercised its authority over interstate commerce, “that field is not available for state or local action.”

No State or political subdivision thereof shall impose any tax on any change in beneficial or record ownership of securities effected through the facilities of a registered clearing agency or registered transfer agent or any nominee thereof or custodian therefor or upon the delivery or transfer of securities to or through or receipt from such agency or agent or any nominee thereof or custodian therefor, unless such change is beneficial or record ownership or such transfer or delivery or receipt would otherwise be taxable by such State or political subdivision if the facilities of such registered clearing agency, registered transfer agent, or any nominee thereof or custodian therefor were not physically located in the taxing State or political subdivision. No State or political subdivision thereof shall impose any tax on securities which are deposited in or retained by a registered clearing agency, registered transfer agent, or any nominee thereof or custodian therefor, unless such securities would otherwise be taxable by such State or political subdivision if the facilities of such registered clearing agency, registered transfer agent, or any nominee thereof or custodian therefor were not physically located in the taxing State or political subdivision.
81. Id.

any action described in this subsection is declared to constitute an unreasonable and unjust discrimination against, and an undue burden on, interstate commerce. It is unlawful for a State, a political subdivision of a State, or a governmental entity
than other industrial and commercial property. Likewise, in the Tax Reform Act of 1976, Congress expressly restricted states from imposing or assessing a tax on the generation or transmission of electricity if the tax discriminated against out of state manufacturers, producers, wholesalers, retailers, or consumers of that electricity. For purposes of the Tax Reform Act, a tax will be found to be discriminatory "if it results, either directly or indirectly, in a greater tax burden on electricity which is generated or transmitted in interstate commerce than on electricity which is generated or transmitted in intrastate commerce." While no cases have yet determined the constitutionality of either the Railroad Revitalization and Regulatory Reform Act of 1975 or the Tax Reform Act of 1976, these statutes, as limitations of state taxing power, are based both upon Congress' exercise of its constitutional power to regulate commerce as well as the existing constitutional prohibition against discriminatory state taxes found in the due process clause of the fourteenth amendment. Accordingly, these two acts would appear to be clearly within Congress' authority.

Despite these legislative actions, a divergence of views exists over the extent to which the states' power to tax interstate businesses may be restricted in the name of congressional power to regulate commerce. Professor Hellerstein of New York University Law School strongly argues that Congress has the power under the commerce clause to compel the states to use uniform methods to apportion multistate and multinational income. 

or person acting on behalf of such State or subdivision to commit any of the following prohibited acts:

(a) The assessment (but only to the extent of any portion based on excessive values as hereinafter described), for purposes of a property tax levied by any taxing district, of transportation property at a value which bears a higher ratio to the true market value of such transportation property than the ratio which the assessed value of all other commercial and industrial property in the same assessment jurisdiction bears to the true market value of all such other commercial and industrial property.

(b) The levy or collection of any tax on an assessment which is unlawful under subdivision (a).

(c) The levy or collection of any ad valorem property tax on transportation property at a tax rate higher than the tax rate generally applicable to commercial and industrial property in the same assessment jurisdiction.

(d) The imposition of any other tax which results in discriminatory treatment of a common carrier by railroad subject to this chapter.

83. Pub. L. No. 94-455, § 2121, 90 Stat. 1914 (codified at 15 U.S.C. § 391 (1976)) states in relevant part: "No State, or political subdivision thereof, may impose or assess a tax on or with respect to the generation or transmission of electricity which discriminates against out-of-State manufacturers, producers, wholesalers, retailers, or consumers of that electricity."

84. Id.

85. Hellerstein, The Power of Congress to Restrict State Taxation of Interstate Commerce, 12 J. Tax. 302 (1960). Professor Hellerstein begins with the proposition that the underlying controversy concerns the taxation by states of income derived from interstate
In contradistinction, Robert Roland, Collector of Revenue for the State of Louisiana, strongly argues that the commerce clause is not a sufficient constitutional grant of power on which to base Public Law 86-272, much less any legislation which would force some sort of uniform method upon the states for the apportionment of income derived from interstate business.\footnote{Roland, \textit{Public Law 86-272: Regulation or Raid}, 46 VA. L. REV. 1172 (1960).}

The problem with the views of Professor Hellerstein and Mr. Roland is that they neglect the fact that two constitutional powers are competing for prominence. If one focuses on the commerce clause, then the undeniable conclusion is that the federal government may almost unconditionally limit state power to tax interstate businesses. If instead one focuses on the sovereign power of the states to tax, then the undeniable conclusion is that the federal government may not unduly limit such power. The better view, however, is that the question of the extent to which Congress may limit the states' taxing power should be analyzed by balancing competing and legitimate constitutional powers.

III. \textsc{Constitutional Alternatives for the Federal Government}

Because the national economy does not easily adjust to the artificial political lines of state borders, Congress may deem it appropriate to provide some guidance for states and interstate businesses in the area of state taxation of interstate commerce. At least one authority has suggested that a real need exists for such guidance.\footnote{Studenski, \textit{supra} note 64.} The proper question therefore focuses

\begin{thebibliography}{9}
  \bibitem{Roland} Roland, \textit{Public Law 86-272: Regulation or Raid}, 46 VA. L. REV. 1172 (1960). Mr. Roland expresses his belief that state taxation of income "does not affect interstate commerce as to make congressional limitations thereof an appropriate means to the attainment of a legitimate end." \textit{Id.} at 1187.
  \bibitem{Studenski} Studenski, \textit{supra} note 64. Professor Studenski points out that double taxation of the same income may result when states use allocation formulas which focus on different factors. For example, state $X$ may allocate income on the basis of sales and state $Y$ may allocate income emphasizing the situs of manufacturing operations. The company that manufactures widgets in state $Y$ and sells those widgets in state $X$ may very well be taxed twice on the same income. \textit{Id.} at 1133. Double taxation, of course, leads to more disputes with state tax administrators. \textit{Id.} at 1133-34. Moreover, Professor Studenski argues that it is
\end{thebibliography}
on the manner in which Congress may constitutionally provide such guidance while giving sufficient deference to the sovereignty of the states.\textsuperscript{88}

Several options exist. The two previous laws passed by Congress that restrict state taxing authority and which have been adjudged to be constitutional\textsuperscript{89} offer lessons for future attempts at finding the "delicate adjustment between the national interest . . . and the legitimate interest of the individual States."\textsuperscript{90} The approach taken by the Airport Development Acceleration Act\textsuperscript{91} broadly restricts states from imposing taxes or "other charges" with respect to air commerce, but exempts from this broad restriction certain types of taxes such as property, income, franchise, and sales or use taxes. The exempted taxes are, of course, the major revenue sources for states and, accordingly, the Act effectively balances national interests and those of the states' revenue needs with respect to air commerce.

Another option would be to follow the approach taken in Public Law 86-272,\textsuperscript{92} the other statute determined to be constitutional, which defined the minimum jurisdictional standards required to be met before a state can impose an income tax. Jurisdictional standards of the sort embodied in Public Law 86-272 mandate only that a sufficient minimum amount of activity be carried on in the state seeking to impose an income tax before the tax can be imposed. These "minimum amount of activities" standards facilitate interstate commerce by setting forth bright line tests with which interstate traders can comply while at the same time not causing a significant drain on any state treasury. Moreover, bright line tests also facilitate the work of the various state tax administrators.

Portions of Senator Mathias' bill, S. 2173,\textsuperscript{93} set forth further jurisdictio-
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Tional parameters. For example, section 101 of S. 2173 prohibited a state from requiring any person to collect a sales or use tax in regard to the sale of tangible personal property unless the person has a business location in the taxing state or the person regularly makes household deliveries in that state. Further, section 117(d), entitled, "Continuation of Minimal Jurisdictional Standard," extended the restrictions on state income taxes found in Public Law 86-272 to state sales and use taxes. Another example of the use of this approach is found in section 201 of S. 2173, which prohibited states from imposing a gross receipts tax in regard to the interstate sale of tangible personal property, unless the sale was solicited through a business office of the seller in the taxing state. These portions of Senator Mathias' bill extending the minimum jurisdictional standards presently found in Public Law 86-272 would presumably have withstood constitutional attack. These provisions did not require states to adopt a particular method of taxation, but rather required that minimum connections exist.

the 95th Congress adjourned. Mathias intends to reintroduce the bill, however, during the next congressional session. [1978] DAILY TAX REP. (BNA) J-1 (Nov. 15, 1978).

94. Section 101 stated:

No State or political subdivision thereof shall have power to require a person to collect a sales or use tax with respect to a sale of tangible personal property unless the person has a business location in the State or regularly makes household deliveries in the State.

S. 2173 at § 101, reprinted in 123 CONG. REC. at S16233.

95. See notes 70-72 and accompanying text supra.

96. The provisions of § 117(d), a part of S. 2173's Title I, Sales and Use Taxes, stated:

An employee shall not be considered to be located in a State if his only business activities within such State on behalf of his employer are any or all of the following:

(1) The solicitation of orders for sales of tangible personal property, which are sent outside the State for approval or rejection and (if approved) are filled by shipment or delivery from a point outside the State.

(2) The solicitation of orders for sales of or for the benefit of a prospective customer of his employer, if orders by such customer to such employer to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(3) The installing or repairing of tangible personal property which is the subject of an interstate sale by the employer, if such installation or repair is incidental to the sale.

This subsection shall not apply with respect to business activities carried on by one or more employees within a State if the employer (without regard to those employees) has a business location in such State.

S. 2173 at § 117(d), reprinted in 123 CONG. REC. at S16234.

97. Section 201 stated:

No State or political subdivision thereof shall have power to impose a gross receipts tax with respect to the interstate sales of tangible personal property unless the sale is solicited directly through a business office of the seller in the State or political subdivision.

S. 2173 at § 201, reprinted in 123 CONG. REC. at S16234.
between the state seeking to impose a particular tax and the persons or activities being taxed. As with Public Law 86-272, such "minimum amount of activities" standards presumably would facilitate interstate commerce and not cause a significant reduction of state revenues while at the same time simplifying the work of the various state tax administrators.

This is not to say, however, that framing a statute in terms of a minimum jurisdictional standard will always meet constitutional demands. For example, Congress could pass a bill prohibiting states from taxing income derived from interstate commerce by establishing a minimum jurisdictional standard restricting state taxation to income derived solely from intrastate business. Such a restriction would cause large reductions in state revenues and entirely exempt interstate traders from paying their fair share of state taxes. Such a substantial reduction of the states' sovereign power to tax with the resultant revenue loss would presumably "devour the essentials of state sovereignty" and outweigh the exercise of the congressional power to regulate commerce. As a result, such a statute, if ever passed, would violate the Constitution.

Another equally unpalatable option would be to follow the approach taken in article 9(4) of the proposed Tax Convention with the United Kingdom. Such a restriction could be imposed on the states either on a treaty by treaty basis or by statute. As previously discussed, article 9(4) would have forbidden state use of any formula for determining income for British branch operations and businesses which are directly or indirectly controlled by British enterprises. Any restriction on the states that would prohibit the use of such methods for allocating taxable business income would be a significant curtailment of state taxing authority. Without the use of such formulas, a state would be required to account separately for income generated within a state when business activities were also carried on outside state borders. One of the main concerns to state governments in the area of state taxation of interstate trade is the concern that states retain their ability to administer state taxing schemes effectively. The current ability of state tax administrators simply to use an arbitrary formula rather than a subjective standard certainly eases the difficulty

99. See notes 8-16 and accompanying text supra.
100. See notes 9 and 10 and accompanying text supra.
101. See note 88 supra.
102. Without arbitrary formulas, state tax administrators would be forced to use subjective standards such as I.R.C. § 482, which requires the Internal Revenue Service to "distribute, apportion, or allocate gross income, deductions, credits, or allowances" between businesses that are jointly owned or controlled whenever "such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income
inherent in the allocation of income. The type of restriction that would prohibit the use of such apportionment formulas would result in a significant reduction of the states' sovereign taxing power. Accordingly, the harm inherent in this type of restriction would presumably outweigh the benefits of such an exercise of congressional power to regulate commerce and, as with the previous example, should be found to be violative of the Constitution.

Congress could, however, in the interest of establishing a uniform method for the division of income among states, mandate that all states allocate income on the basis of a particular formula method. An appealing formula method, which apportions income by taking into account intrastate payroll, sales, and property and comparing that to out-of-state payroll, sales, and property, is set forth in Article IV of the Uniform Division of Income for Tax Purposes Act. In the event that Congress did mandate a particular formula method, the possibility of duplicative income taxation by the states would be significantly eliminated at least in regard to multistate business and would therefore benefit interstate commerce. In

of any of" such businesses. For a discussion concerning the difficulties in administering I.R.C. § 482, see Comment, Multinational Corporations and Income Allocation Under Section 482 of the Internal Revenue Code, 89 HARV. L. REV. 1202 (1976).

103. See UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT, art. 4 [hereinafter cited as UNIFORM ACT]. The Uniform Act was adopted by the Commissioners on Uniform State Laws in 1959. It was designed as a model act for states to follow in order to aid taxpayer compliance and eliminate the possibility of double taxation of multistate businesses. The Act is set forth in 7A UNIFORM LAWS ANN. 91 (West 1978). Perhaps its most important provision is one providing for an apportionment formula that takes into account payroll, sales and property. See UNIFORM ACT at art. IV. It also established a Multistate Tax Commission with the mandate to recommend proposals for the increase in uniformity between different state tax laws. See id. at art. VI. As of this date, 28 states have adopted the model act. Interview with Jonathan A. Rowe, Deputy Executive Director of the Multistate Tax Commission, in Washington, D.C. (Dec. 1, 1978). For an example of the enacted law, see ILL. REV. STAT. ch. 120, § 871 (1971).

The Multistate Tax Compact, a model legislation package, has been entered into by a number of states to provide state rather than federal remedies for the problems arising from the taxation of multistate business. MULTISTATE TAX COMPACT, preamble at C-3 to C-4. Nineteen states are currently members of the Compact. Interview with Jonathan N. Rowe, Deputy Executive Director of the Multistate Tax Commission, in Washington, D.C. (Nov. 27, 1978). For a full listing of these states, see United States Steel Corp. v. Multistate Tax Comm’n, 434 U.S. 452, 454 n.1 (1978). The stated purposes of the Compact include the facilitation of proper determination of state and local tax liability; the promotion of uniformity and compatibility in state taxing systems; and the avoidance of duplicative taxation. MULTISTATE TAX COMPACT, art I.

Although all Compact members are free to retain their existing division of income provisions, they are required to make the UNIFORM ACT available to any taxpayer wishing to use it. "Consequently, any taxpayer could obtain the benefits of multijurisdictional uniformity whenever he might want it." Id. at preamble, C-4.

The Compact recently survived attacks on its constitutionality in United States Steel Corp. v. Multistate Tax Comm’n, 434 U.S. 452 (1978).
view of the substantial benefits interstate commerce would derive from a uniform formula and in view of the ease of administration of such a method for state tax administrators, the legitimacy of such a congressional exercise of its power to regulate commerce would presumably outweigh this type of limitation on the states' taxing power and accordingly should be determined to be constitutional.

Another option available to Congress is a variant of the option just discussed and was set forth in Title III of Senator Mathias' bill, S. 2173.104 Under this option, a state would not have been allowed to impose on a corporation taxable in more than one state a net income tax in excess of an amount determined by an apportionment formula taking into account property, payroll, and sales.105 Section 302 of that bill, however, exempted from taxable income all foreign source income as defined by the Internal Revenue Code,106 as well as all dividend income received from corporations in which the corporate taxpayer owns fifty percent or more of the voting stock.107 These exemptions would have decreased the state revenue of those states that presently include such income. Further, section 303(a) of Senator Mathias' bill permitted states either to require or a corporation to elect that the determination of taxable corporate income be computed with reference to the group of commonly owned corporations of which the

105. Section 301 provided:
A State or a political subdivision thereof may not impose for any taxable year on a corporation taxable in more than one State, other than an excluded corporation, a net income tax measured by an amount of net income in excess of the amount determined by (1) multiplying the corporation's base by an apportionment fraction which is the average of the corporation's equally-weighted property, payroll, and sales factors for the State for the taxable year and (2) adding to the amount determined under clause (1) the amount of income allocable to the State for the taxable year. For this purpose the base to which the apportionment fraction is applied shall be the corporation's apportionable income as defined in this title for that taxable year. No State shall, by reason of not including dividends or foreign source income in apportionable income, make any offsetting adjustment of an otherwise allowable deduction which is unrelated to such excluded dividends or foreign source income.


106. See I.R.C. §§ 861 to 864.
107. Section 302 stated:
Dividends received from corporations in which the taxpayer owns less than 50 percent of the voting stock, other than dividends which constitute foreign source income, are income allottable to the State of commercial domicile of such taxpayer. No dividends received from corporations in which the taxpayer owns 50 percent or more of the voting stock and no foreign source income of such taxpayer shall be apportionable or allocable to any State.

S. 2173, § 302, reprinted in 123 CONG. REC. at S16234.
corporate taxpayer is a member. Section 303(b) of S. 2173, however, would expressly have limited states from including in such a group of commonly owned corporations any financial institutions or any corporation whose income is substantially derived from foreign sources. At the same time, that subsection nevertheless did not preclude a corporate taxpayer from including such affiliates if it were advantageous to do so. Because the bill proposed this one-sided advantage for corporate taxpayers, it would have undoubtedly caused revenue losses for states. Corporate taxpayers, which include affiliated financial institutions whose income is substantially derived from foreign sources, would include this income only when it would reduce state tax obligations. Even though the approach found in Title III of S. 2173 is based initially on a uniform apportionment formula, the added conditions limiting state application accompanied by the resultant loss of state revenues are the sorts of curtailment of state taxing authority that would presumably outweigh the exercise of the congressional power to regulate commerce. Consequently, this sort of restriction should be found to constitute a "usurpation of power not granted by the Constitution."

Congress has yet another option, albeit draconian, which would give the states a choice between losing revenue sharing payments or accepting a

108. Section 303(a) provided:
   (a) Except as otherwise provided in subsection (b), any State may require, or a
   corporation may elect, that the taxable income of the corporation be determined by
   reference to the combined or consolidated net income and the combined or consol-
   idated apportionment factors of all affiliated corporations in the affiliated group of
   which the corporation is a member.
S. 2173, § 303(a), reprinted in 123 CONG. REC. at S16234.
109. Section 303(b) provides:
   (b) No State may require, for purposes of subsection (a), that a combination or
   consolidation of an affiliated group include—
   (1) any excluded corporation, or
   (2) any corporation, substantially all the income of which is derived from
   sources without the United States.
For purposes of this subsection, substantially all the income of a corporation
(whether a domestic or a foreign corporation) shall be deemed to be derived from
sources without the United States if 80 percent or more of its gross income is de-
rived from sources without the United States in the current taxable year and in
each of the two preceding taxable years (excluding any period during which such
corporation was not in existence).
S. 2173, § 303(b), reprinted in 123 CONG. REC. at S16234.
110. See note 105 and accompanying text supra.
111. See THE FEDERALIST No. 33 (A. Hamilton) at 208 (J. Cooke ed. 1961). See text
accompanying note 55 supra.
112. "Under a revenue sharing strategy a portion of federal tax receipts is disbursed by
means of a predetermined formula to state and local governments, with a few strings at-
tached." L. FRIED, A. RIVLIN, C. SCHULTZE, & N. TEETERS, SETTING NATIONAL PRIORI-
restriction on their sovereign taxing power. In this circumstance, the restriction on the states' sovereign tax authority could be most severe. This approach may, nonetheless, be constitutional. As noted by the United States District Court for the District of Columbia in County of Los Angeles v. Marshall: "legislation that allows the state a choice—to avoid enacting a scheme that may interfere with its sovereignty—does not directly interfere with a state's sovereignty and is not in the violation of the tenth amendment."¹¹³ If the Congress deemed this approach appropriate, there would be no need to balance the competing constitutional powers of the states' taxing authority and the congressional power to regulate commerce because the states would waive their constitutional argument if revenue sharing payments were accepted.

IV. CONCLUSION

Regardless of any alternative, the Supreme Court's command in Moorman that "the consent of any uniform rules . . . should be determined only after due consideration is given to the interest of all affected States,"¹¹⁴ must be heeded. Due to the substantial congressional interest provoked by state taxation of multistate businesses since the Supreme Court's 1959 pronouncement in Northwestern States, it is likely that Congress will eventually take some sort of action. The optimum congressional solution must strike that delicate balance between the sovereignty of the states to structure their tax laws to provide themselves with adequate revenues and the desirability of the minimum amount of interference on the national economy.

¹¹³. 442 F. Supp. 1186, 1190 (D.D.C. 1977) (emphasis in original). The court in Marshall rejected the state challenge to the implementation of the Unemployment Compensation Amendments of 1976, 26 U.S.C. §§ 3301 to 3311 (1976), which require state and local governments to finance unemployment benefits of such governments' former employees. Failure of the state and local governments to enact conforming legislation results in the denial of a federal tax credit to private employers and the loss to the state of certain federal reimbursements. Distinguishing the case from National League of Cities, see text accompanying notes 50-55 supra, the district court noted that "the imposition of an unemployment compensation scheme is at the option of the state." 442 F. Supp. at 1190. Although the plaintiffs attempted to label any "choice" made by the states as "illusory" and in reality "coerced," the court viewed the attached federal strings as merely congressional "motive." Id. at 1190-91. Indeed, "Congress has great latitude in fixing the terms upon which its money allotment . . . may be conditioned . . . . This Court finds that it is within the power of Congress to attempt to deal with the problems of unemployment by inducing the states to extend unemployment compensation to public employees." Id. at 1191.