A Solution to the Problem of State Taxation of Interstate Commerce

John Dane Jr.
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THE TAXATION of corporations doing business in more than one state necessarily involves sharply conflicting interests. No formula can possibly be devised which, on the one hand, will meet the legitimate demands of the states for revenue and, on the other hand, will meet the legitimate demands of interstate corporations for the minimum of compliance problems. However, the economic welfare of the country demands that some adjustment between these competing interests be made and, in arriving at such an adjustment, concessions will have to be made on both sides.

This, in essence, is the problem which the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary has been attempting to resolve. One does not have to read widely in the reports of the Subcommittee's hearings to realize the complexity of the problem, a complexity brought on by the complexity of the American economic scene. Snap judgments on the merits of the solution embodied in the bill which the Subcommittee filed in 1966 (H.R. 16,491),¹ based on one's own particular predilections and ex-

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1. 89th Cong., 2d Sess. (1966). The most important features of H.R. 16491 are described in H.R. Rep. No. 2013, 89th Cong., 2d Sess. 4-8 (1966), in which the House Committee on the Judiciary reported the bill favorably and without amendments:

A. Business location standard
This title establishes a uniform standard for determining the circumstances under which a company may be held subject to each of the four taxes covered by the bill. A State or political subdivision could not impose a corporate net income tax, capital stock tax, or gross receipts tax with respect to a sale of tangible personal property on any person unless that person had a business location in the State, and could not require a person to collect a sales or use tax with respect to a sale of tangible personal property unless that person had a business location in the State or regularly made household deliveries in the State (sec. 101). . . .

The concept of maintaining a business location in a State is defined in section 511 of title V and generally means owning or leasing real property within the State or having one or more employees located in the State. The one addition to the uniform business location jurisdictional standard, applicable only to the sales or use tax, is the regular making of household deliveries in the State. The term is defined in section 514 of title V to mean the delivering of goods by the seller, other than by mail or common carrier, to the dwelling places of his purchasers. . . .

B. Retention of Public Law 86-272
Public Law 86-272, prohibiting States from imposing net income taxes on persons soliciting orders for acceptance and filling out-of-State, is retained. The protection of Public Law 86-272 is in effect extended to capital stock, sales and use, and gross receipts taxes by section 513(d) of title V which provides that employees

(507)
experience, are all too easy to arrive at. Each person tends to view the problem solely from his own perspective. A tax administrator or governor of a state is primarily concerned with whether the bill will increase or decrease his state’s revenues. A corporation executive,

engaging in the type of activities in a State protected under Public Law 86-272 are not to be considered as located in that State and constituting a business location in the State.

Those corporations excluded from coverage of the income and capital stock tax provisions of the bill continue to be protected by Public Law 86-272 from income taxation although the business location jurisdictional standard is not applicable to them with respect to net income and capital stock taxes.

**TITLE II — MAXIMUM PERCENTAGE OF INCOME OR CAPITAL ATTRIBUTABLE TO TAXING JURISDICTION**

**A. Optional two-factor formula**

No mandatory uniform method for dividing income or capital among the States is prescribed, but those interstate companies covered by the bill are protected by a supplement to the jurisdictional standard in the form of a maximum limit on the percentage of income or capital which can be taxed. Such a company with a business location in more than one State need pay no more tax to any State or political subdivision than that calculated under a two-factor property, payroll apportionment formula. In determining the maximum amount of income or capital attributable to any State the two-factor apportionment fraction is applied to the corporation’s entire taxable income or capital before State attribution rules are applied. The definition of taxable income or capital is determined under State law (sec. 201) . . .

**B. Excluded corporations**

A number of types of corporations are excluded from coverage of the income and capital stock tax provisions and are described in section 506 of title V. They include, among others, transportation, utility, insurance, and financial companies, and corporations whose average annual income for Federal tax purposes is in excess of $1 million . . .

**TITLE III — SALES AND USE TAXES**

**A. General**

Title III has several provisions designed to reduce multiple sales taxation and to facilitate the collection responsibilities of the interstate seller . . .

**B. Reduction of multiple sales and use taxation**

Overlapping multistate sales taxation is mitigated by section 301. An interstate sale must have its destination in a State in order for that State or any political subdivision thereof to impose a sales tax or require a seller to collect a sales or use tax with respect to the sale. Destination is defined in section 310 of title V to conform to the definition proposed by the National Conference of Commissioners on Uniform State Laws in their Uniform Division of Income for Tax Purposes Act.

A State other than the State of destination, however, may require a seller to collect a sales or use tax for the State of destination even though the seller does not have a business location or regularly make household deliveries in the State of destination . . . Section 301(a) preserves any existing power of a State having jurisdiction under section 101 to exercise it on behalf of another State, but does not remove any present barrier in State constitutions or statutes.

A use tax may not be imposed on a person without a business location in the State or on an individual without a dwelling place in the State . . .

Where under these rules the same person is still subject in more than one State to sales or use tax on the same property a credit is required to be given by a taxing jurisdiction for prior taxes paid (or a refund in case a sales tax is paid to the seller after a use tax is paid in another State) . . .

**C. Reduction of sales and use tax collection burdens on interstate sellers**

In order to achieve uniformity in the treatment of freight charges with respect to interstate sales, section 303 establishes the rule that freight charges on interstate sales which are separately stated are excluded from the sales price in the measure of a sales or use tax.

The burden on the seller of ascertaining, often at his peril, whether or not his interstate sales into other States are taxable sales is alleviated by section 304,
however, wants to know whether his firm's tax bill will be increased or decreased and whether his costs of compliance will be raised or lowered. Many people have expressed surprise at the Subcommittee's conclusions, of which H.R. 16,491 is the embodiment. Two questions, in particular, have been most often asked. Why has the Subcommittee remained wedded, in the case of corporations with a net income of one million dollars or less, to a two-factor allocation formula, based solely on payrolls and property, and eliminated the sales factor which appears in the vast majority of existing state allocation statutes? Why has the Subcommittee freed out-of-state sellers who have no business location within the state of the purchaser's residence and make no household deliveries therein from the obligation to collect such state's use tax, thus effectively overruling *Scripto v. Carson* and *General Trading Co. v. State Tax Comm'n*.

**I. Analysis of Proposed Alternatives to H.R. 16,491**

In order to arrive at an evaluation of the merits of H.R. 16,491, it is necessary to familiarize oneself with all of the testimony which was presented before the Subcommittee at the hearings on its original bill, H.R. 11,798. Relatively few witnesses actually gave the Subcommittee any hard facts — and this is true for both sides of the fence. It was a rare witness who saw anything but his own point of view or tried to see the arguments on the other side. However, certain motifs, like themes in a musical composition, were repeated and repeated throughout the hearings.

The first of these recurrent motifs was the unsupported statement that the federal government has no jurisdiction to interfere in the field of state taxation. This assumption disregards the fact that in recent years many Supreme Court Justices have subscribed to the view that the judicial system is inadequate to deal with the problems of multistate taxation and have either directly or implicitly called on Congress...

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which provides that certificates or other written evidence from the buyer indicating the basis of nontaxability conclusively relieve the seller from collecting or paying the tax. In addition, on interstate sales to business buyers who are registered with the State for sales tax collection purposes, the seller is relieved of collection responsibilities if he receives evidence from the buyer that he is registered with the State.  

H.R. 16491 was reintroduced into the 90th Congress as H.R. 2158, and as amended by the Special Subcommittee on State Taxation of Interstate Commerce, was reported out favorably by the House Committee on the Judiciary on March 7, 1967.

2. 362 U.S. 207 (1960). The Supreme Court held that an out-of-state business could be required to collect and pay over a use tax on sales made within the taxing state even though it maintained no facilities in the state and its sales were made entirely through independent contractors.

3. 322 U.S. 335 (1944). The Court held that an out-of-state business could be required to collect and pay over a use tax on sales made within the taxing state even though it maintained no facilities in the state and its sales were made entirely by traveling salesmen.
to act. Moreover, there is no need to take time to demolish this straw man. The very fact that the able and experienced Fred L. Cox, Director of Interstate Tax Affairs, of the Georgia Department of Revenue, who has always been a strong supporter of the states' right to independence in matters of taxation, has played a considerable part in working out the compromises involved in H.R. 16,491, is convincing evidence that the states now recognize the legitimate role of the federal government in this area. As a matter of fact, it is not unlikely that if H.R. 16,491 is not passed in the near future, the pressures for reduction in the compliance burden on interstate corporations will increase to such an extent that much more restrictive legislation will eventually be passed.

The second motif was that, given time, the states would get together and solve the problem by enacting a uniform law for the allocation of income. In this connection, it should be pointed out that in many cases, the witness would go on to say that the Uniform Division of Income for Tax Purposes Act (hereinafter referred to as the

5. Under the Uniform Act, which was drafted by the National Conference of Commissioners on Uniform State Laws and which is referred to in the testimony before the Subcommittee as the "NCCUSL", business income is allocated under a three-factor formula based on property, payroll and sales (§ 9). "Business income" is defined as income arising from transactions and activity in the regular course of the taxpayer's business (§ 1(a)). Special rules are provided for the allocation of rents and royalties from real and tangible personal property, capital gains, interest, dividends and patent or copyright royalties to the extent that they do not constitute business income (§ 4).

The property factor under the Uniform Act is a fraction, the numerator of which is the average value of the taxpayer's real and tangible property owned or rented and used in the taxing state and the denominator is the average value of all such property wherever located. Property owned by the taxpayer is valued at original cost and property rented by the taxpayer is valued at eight times the annual rental, less any sub-rentals. The property factor contained in H.R. 16491 differs from that contained under the Uniform Act by eliminating from both numerator and denominator: (1) property which is included in inventory, (2) property which has been permanently retired from use, and (3) tangible property rented out by the taxpayer for more than one year. In valuing leased property, H.R. 16491 allows no deduction for sub-rentals. H.R. 16491 excludes from the denominator of the property factor, the value of any property in a state where the taxpayer has no business location.

The payroll factor under the Uniform Act is a fraction, the numerator of which is the total amount paid within the taxing state for compensation and the denominator is the total compensation paid everywhere (§ 13). The rules for determining where compensation is paid follow those used for unemployment compensation purposes (§ 14). H.R. 16491 differs from the Uniform Act in excluding from both numerator and denominator of the payroll factor wages paid to retired employees and wages paid to employees not located in any state.

The sales factor under the Uniform Act is a fraction, the numerator of which is the total sales of the taxpayer in the taxing state and the denominator is the total sales of the taxpayer everywhere (§ 15). Sales of tangible personal property are in a state if (a) the property is delivered or shipped to a purchaser, other than the United States government, within such state regardless of f.o.b. point or other conditions of sale or (b) the property is shipped from a place of business within such state and (1) the purchaser is the U.S. government or (2) the taxpayer is not taxable in the state of the purchaser (§ 16). Sales of other than tangible property are in the taxing state if (a) the income-producing activity is performed in such state or (b) the income-producing activity is performed both in and outside such state but the greater
"Uniform Act") has recently been proposed in his state legislature but unfortunately had failed of enactment. It is also significant that the uniform law, as enacted by the states, is "uniform" in name only. The statement of the Subcommittee's counsel, Mr. Sutherland, sums up the present situation:

I should like to note for the record the differences present in the laws of a list of 12 States, including the District of Columbia. In Virginia and South Carolina they have not adopted the uniform act, but have included in their statutes some provisions of the uniform act. The differences remaining include, among others, the definition of a sale for purposes of the sales factor, that is, where a sale is located.

In Alaska and Indiana, as material prefatory to the use of the uniform formula, they have expressed a preference for separate accounting, so that the taxpayer who followed the statute would only arrive at the use of the uniform formula where that company did not give an accounting for the income related directly to the particular State.

In New Mexico the use of the uniform formula is optional with the taxpayer, so that the carefully advised taxpayer would first use some other method, before reaching the uniform formula, to see which would be more beneficial to him.

In Arkansas and Idaho, there is a provision that a corporation which has subsidiaries of certain defined classes should — unlike in the NCCUSL proposal — include within its business income to be apportioned income derived from those subsidiaries.

In Michigan, there is no definition at all of the income to be apportioned.

In the District of Columbia again, their regulation at present has a different definition of where sales are to be located in certain cases, than is provided by the Commissioners' proposal.

This leaves a hard core of only three States in which the NCCUSL proposal as drafted by the Commissioners is used.6

Judge Morgan, of the District of Columbia Tax Court, in a letter to one of the Subcommittee members, made some pertinent comments on the subject of the Uniform Act:

Eleven States have adopted what I, perhaps, technically erroneously described in my testimony as the "Uniform Division

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of Net Income for Tax Purposes Act." I use the term "erroneously" advisedly, because 10 of the States which I had in mind have so substantially varied or changed the provisions in the uniform act that uniformity has been diluted, if not destroyed. I should add that at the time of my testimony I was advised that those States had adopted the uniform act. It was not until later that I learned of the variations.

Only one State, namely, North Dakota, has really adopted the uniform act. For your convenience and for clarity I am enclosing in this letter a printed copy of the uniform act and statements of the variations or changes made by the above mentioned 10 States. With the exceptions of New Mexico each of the States deleted sections 19 and 20 of the uniform act, which read as follows:

"Section 19. This Act shall be so construed as to effect its general purpose to make uniform the law of those States which enact it."

"Section 20. This Act may be cited as the Uniform Division of Income for Tax Purposes Act."

It is, therefore, clear that nine States (including the District of Columbia) did not intend to adopt the uniform act. It should, however, be observed that, while the variations or changes made by the 10 States are substantial and to the extent as to destroy uniformity the idea or concept of the three-factor formula is maintained.7

The specific variations adopted by the states follow his letter.8

Since the time of Mr. Sutherland's testimony and Judge Morgan's letter, Massachusetts has enacted its own version of the Uniform Act, under which interest income is included in income to be allocated by the three-factor formula.9 Thus a corporation which has its commercial domicile in a state which has enacted the uniform act in its original form is taxed on all its interest income in that state and is also taxed on a portion of such income in Massachusetts.

Even those states which have adopted some or all the provisions of the Uniform Act have administrative practices which are directly at variance with the provisions appearing on the statute book. In a most remarkable colloquy between Mr. Zeifman, the Subcommittee's counsel, and the tax collector of a western state, the witness was forced to admit that, while the Uniform Act adopted by his state based the property factor of the allocation formula upon "original cost," the

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7. 1966 Hearings 494.
8. 1966 Hearings 496-98.
practice of his department was to use federal depreciated cost. It seems that an out-of-state company must not only familiarize itself with the provisions of the "uniform" law of each state in which it operates, it must also become acquainted with the instances where administrative practice differs materially from such provisions.

Let no one think that this is an isolated example culled from the testimony before the Subcommittee. An interesting exchange occurred during the hearings between Mr. Murray Drabkin, former Chief Counsel for the Subcommittee, and the Executive Officer of the Franchise Tax Board of a western state, who had been critical of the 40,000 dollars salary limitation contained in the payroll factor of the allocation formula provided in H.R. 11,798.

MR. DRABKIN. . . .

You criticize the use of a $40,000 limitation on includible income in the payroll factor. I wonder what California actually does, Mr. Huff, in the administration of its income tax laws in the case of a California based, let's say, movie company, which has a star to whom it pays $750,000 a year. How does it treat that $750,000 for purposes of the apportionment formula?

MR. HUFF. When you just come up with a casual example of the movie industry, which I know is more than casual, because that is the one instance where there is an exception. I make no apology for it. This is the type of thing that has grown up in the practices, and, as you are aware, my tenure here is relatively short, and this is one of the items on our list to take a look at as far as practices are concerned. This doesn't make it right.

MR. DRABKIN. I understand, but where does this rule appear?

MR. HUFF. It isn't a rule; it is an administrative practice.

MR. DRABKIN. So this is a rule which a California-based company might know about, but a company based elsewhere really wouldn't know about until it had a lot to do with California?

MR. HUFF. This is entirely possible, and it is similar to the same kind of house rules you might find in the Internal Revenue Services, and differences within the district, too.

MR. DRABKIN. What is the cutoff point you use on talent salaries?

MR. HUFF. I cannot give a specific answer.

10. 1966 Hearings 589.
Mr. Drabkin. About $40,000?

Mr. Huff. I can't give you an answer. I am not saying that is right just because we do it. It is not on a dollar cut-off, but is on a classification basis.

Mr. Drabkin. How does that work?

Mr. Huff. It is as far as — certain classifications of stars.

Mr. Drabkin. And you eliminate their income entirely from the payroll tax?

Mr. Huff. Yes sir.

Mr. Drabkin. On the ground they are worthless to the company?

Mr. Huff. I do not defend that.

Mr. Drabkin. This is what you insinuate?

Mr. Huff. No, I am saying it is just as bad for us to do it as for you to do it, and freeze it into law.\textsuperscript{11}

Another theme that is constantly reiterated throughout the testimony is that "interstate business must pay its way." Nobody has ever disputed this. But that doesn't mean that it must pay somebody else's way, and in the case of collection of the use tax by the out-of-state seller, this is what is being sought by the opponents of H.R. 16,491 and its predecessor, H.R. 11,798. Except in the case of a true vendor type tax with no mandatory pass-on, the purchaser, not the vendor, is the person on whom the ultimate burden of the tax in intended to fall. The vendor is merely an involuntary tax collector. If he has enough nexus with the taxing state, he ought to be forced to be a tax collector "malgré lui," but when he has little or no nexus, it is completely unfair to charge that "interstate business is not paying its way" if the vendor is not required to collect the use tax — all that is happening is that it is not paying somebody else's way. In addition, where jurisdictional standards relating to state income taxes are stiffened, as they are for businesses with under one million dollars net income under section 101(1) of H.R. 16,491, there is no question of the interstate firms so protected "not paying their way." They are just concentrating their payments in fewer states, the ones in which they have a "business location." If all of these states have a corporation income tax, no income will escape taxation. If some of these states do not have a corporation income tax, it is reasonably certain that some

\textsuperscript{11} 1966 Hearings 126.
other form of tax will force a corporation with a business location in such states to contribute to their revenue needs.

Finally, there remains to be considered the complaint of many state tax administrators that adoption of the two-factor allocation formula contained in section 201 of H.R. 16,491 and restrictions on the obligation of out-of-state sellers to collect the use tax contained in section 101(2) of H.R. 16,491 would seriously affect state tax revenues. These complaints took two mutually contradictory forms. One group objected because the revenues of their states would be increased, the increase coming from locally-based businesses. The other group objected because the revenues of their states would be decreased as a result of smaller tax collection from out-of-state businesses. These two conflicting objections demonstrate clearly the goal of the objectors — which is to raise as much money as possible from out-of-state business and as little as possible from in-state business. Such a goal is 180 degrees off target. The interests of sound tax administration are best served by restricting tax enforcement efforts to those firms which are most closely connected with the taxing state. The interests of the business community are fully compatible with those of tax administration since they call for concentrating tax liability in those states where major, rather than peripheral, activities are carried on.

II. ARGUMENTS IN SUPPORT OF THE TWO-FACTOR FORMULA

In order to persuade Congress to enact new limitations on the power of the states to tax interstate commerce, it is necessary to do more than merely demonstrate that the arguments against any further limitations are unsound. It is necessary also to establish that the projected limitations are well conceived and in the national interest. The first of these limitations which must be considered is the use of the two-factor allocation formula provided in section 201 of H.R. 16,491 in the case of corporations with an average annual income of less than one million dollars. A careful reading of the Subcommittee's original report makes clear the reason for the elimination of the sales factor.\textsuperscript{12} After hearing all the testimony, the Subcommittee concluded that merely making sales in a state, with no business location therein, should be insufficient to establish tax jurisdiction. The conclusion necessarily followed that the inclusion of sales in the allocation formula would be undesirable since it would result in allocating income to states which had no jurisdiction to tax.

The argument that the state where the sale takes place contributes to the production of income indubitably has theoretical economic validity. But this theoretical validity must give way to the practicalities of the situation. As pointed out above, we are involved in an area of legitimate conflicting interests. In adopting a two-factor formula, the Subcommittee has chosen to give greater weight to the promotion of the flow of interstate commerce, and in so doing has been forced to sacrifice the niceties of economic theory. The theoretical arguments are not, however, wholly on the side of those seeking to retain the sales factor. As was pointed out by Mr. J. V. Pelt, III, Vice President and Treasurer of Vulcan Materials Company, Birmingham, Alabama:

I think it [the sales factor] is inequitable, because I think the services that a State renders, and for which they should be collecting income taxes, are devoted to the presence of people and property in the State.

In other words, if you have physical presence of people and you have your plants in that State or your warehouses, then the State should be participating in the allocation formula. If you only ship into the State, the State renders practically no service, and for that reason it does not seem to me that the three-part formula, even though it has had a great deal of common use in the past, is equitably a very good formula.  

Even if the establishment of congruence between jurisdiction to tax and allocation of income is not a sufficient reason for the elimination of the sales factor, the sales factor has serious practical disadvantages especially in the case of smaller business establishments. This was well pointed out in the statement presented to the Subcommittee by John T. Kirk, Chairman of the Board of the National Association of Wholesalers:

Normal distribution market areas are no respecters of State boundaries and distribution businesses do not normally keep their sales records on a State-by-State basis. This is particularly true in the case of the thousands of smaller business organizations engaged in multistate marketing.

It is for this reason, particularly, that we endorse the two-factor formula for division of income or capital for tax purposes. Sale [sic] are usually recorded by customer and by territory. Sales territories are neither respecters of political subdivision boundaries nor even of State lines. Tens of thousands of wholesale salesmen travel in more than one State. Modern wholesale selling techniques call for "marketing specialists" who concentrate on one

13. 1966 Hearings 394.
commodity or line of commodities and who may travel a whole market area, covering 10 or even 20 sales territories and two to five or more States.

Some witnesses will contend that using sales by destination as a third factor in determining division of income for tax purposes makes good economic sense but we submit it does not make good marketing sense or good cost sense.\footnote{14} The elimination of the sales factor means that the revenue to be gained by a state claiming tax jurisdiction in marginal and doubtful cases will be greatly reduced. This circumstance will go a long way to minimizing disputes between taxpayers and tax administrators and consequent litigation.

Another point should be made. In almost all debates such as that involving the allocation formula, the disputants tend to advance arguments for their positions which may or may not be the considerations which really motivate them. It is more than likely that Mr. Kirk of the National Association of Wholesalers got to the meat of the matter when he said: "We are firmly convinced that the opposition of State tax administrators to use of the two-factor formula is based on a desire to protect their home State businessmen. We conclude that if all States had to use the two-factor formula — no State would suffer appreciable loss of revenue."\footnote{15} Anyone who has had experience with the controversies surrounding the enactment of tax legislation can testify to the soundness of Mr. Kirk's observations. For example, during the prolonged struggle to enact a sales tax in Massachusetts, the one argument for the sales tax which met with universal acceptance was that the tax would, in part, fall on non-residents such as tourists and students. Taxation without representation is no less a danger today than it was in the period prior to the American revolution.

III. Arguments in Support of the Restrictions on Liability to Collect the Use Tax

The necessity for bringing order out of the present chaos is best illustrated by a simple statement of the nature of the chaos, which is contained in the testimony of Mr. Harold T. Halfpenny of Chicago, Illinois:

In testimony before the special subcommittee, I pointed out in 1962 that 35 States and the District of Columbia required the collection of compensating use taxes by out-of-State sellers, and

\footnote{14} 1966 Hearings 58.
\footnote{15} Ibid.
that the circumstances under which this duty is imposed vary widely; five separate standards are used.

Five States required collection for "maintaining a place of business" in the State; 5 used "agent operating" in the State as the test, and 12 added "agent operating temporarily"; 3 more used "solicitation" by "agent" as a standard.

The fifth and most drastic of the State nexus requirements is that which requires collection of the use tax by out-of-State sellers who distribute catalogs or other advertising matter within the State, and have no other connection with it. Eleven States used this standard in 1962, and the 2 States that have adopted use tax acts since then have included the "mail order" nexus; these are New York and Idaho.

The same diversity among the States exists today as in 1962, and has been further complicated by two directly conflicting court decisions. In 1962, the constitutionality of the requirement that out-of-State sellers who do only a mail-order business collect the use tax had not been tested. Since the 26th of January, the Supreme Courts of the States of Alabama and Illinois have been in direct conflict on this point.16

The two cases referred to in Mr. Halfpenny's testimony are State v. Lane Bryant, Inc.17 and Department of Revenue v. National Bellas Hess, Inc.18 In the National Bellas Hess case, the defendant corporation was a national mail order corporation incorporated in Delaware and qualified to do business only in Delaware and Missouri. From its only plant, located in Missouri, it mailed catalogs nationwide. Orders from customers were received and accepted in Missouri. The goods were mailed or shipped by common carrier from its plant in that state to which payments by customers were mailed. It did not maintain in Illinois any place of business of any kind nor did it have therein any agent, salesman, canvasser, solicitor or other type of representative to sell or take orders, to deliver merchandise, to accept payments or to service the merchandise it sold. It did not have any tangible property, real or personal, or any telephone listing in Illinois. It did not advertise its merchandise for sale in newspapers, or billboards, or by radio or television in that state. The factual pattern in the Lane Bryant case was substantially identical.

In the Lane Bryant case, the Supreme Court of Alabama held that the corporation might not be held liable for the collection of the

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17. 277 Ala. 385, 171 So. 2d 91 (1965).
Alabama use tax. For such a liability to exist, there would have to be a distribution of catalogs in a manner sufficient to provide a business nexus with Alabama, by an agent, salesman or independent contractor in Alabama. In the absence of such nexus, the imposition of liability for use tax collection would violate the due process clause and the commerce clause of the federal constitution. The Supreme Court of Illinois reached the opposite result in the *National Bellas Hess* case, reasoning that the exploitation of the consumer market by continuous mail order solicitation provided a sufficient nexus to support liability for collection of the use tax and that no violation of either the commerce clause or the due process clause was involved. It is interesting to note that certiorari has been granted by the Supreme Court.\(^\text{19}\)

The quotation from Mr. Halfpenny's testimony makes crystal clear the difficulty which faces an out-of-state seller in determining whether or not the statute of the particular state into which he is making a sale does or does not require him to collect the use tax. Exactly the same method of operation may subject him to collection liability in state A, absolve him from liability in state B, and leave him completely uncertain in state C.

Let us suppose, however, that an out-of-state vendor gets over the first hurdle and is advised by his tax counsel that his method of doing business in state A clearly renders him liable to collect its use tax. He is then faced with the next question — to what sales does the obligation apply? Mr. William J. Stevens, President of the National Association of Photo-Lithographers, had some interesting observations on this point:

A California postcard manufacturer explains that if he sells cards to a distributor for resale, he does not collect State sales tax, but if the cards go to a hotel, which distributes them free as advertising, the card manufacturer is required to collect a sales tax for this portion of his business.

An Indiana printer has this problem. A New York firm orders a large supply of posters with the instructions to hold the posters in Indiana until the printer is given the names of local dealers across the country that are to be added to a certain number of the posters. The Indiana printer thus holds the posters until he is ordered to mail them. When he bills the New York purchaser he has no knowledge of what posters are going where; thus, he makes no allowance for sales taxes. He then finds himself engaged in a correspondence war with various State sales tax bureaus.\(^\text{20}\)

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Mr. Kirk, of the National Association of Wholesalers, testified along the same line:

Our industry problem is mostly created by the use tax provisions of the various State and political subdivision laws. As vendors we are supposed to be able to decide whether the specific item purchased is for resale or for use. This we cannot do.

As an industry, we merchant wholesaler-distributors sell almost exactly 50 percent of our total volume to retailers for resale. The other 50 percent is sold to industrial, commercial, service and contractor buyers who may resell or use the products in the performance of their trade or business. Some of their purchases are resold and some are used. Only the in-State (or political subdivision) buyer, who should possess either a registration, direct payment, commercial farmer or immunity number, really knows what is to be done with the goods. In all cases where any of the above mentioned numbers are furnished to an out-of-State vendor, the mere existence of the number in his files should be sufficient evidence of compliance and the tax collector should be required to look to the in-State holder of the number for the tax due, if any.21

The basic trouble with forcing an out-of-state vendor to collect a use tax is that he is neither the person on whom the burden of the tax is intended to fall, nor does he, in many instances, know the facts necessary to determine whether or not the tax applies. The sale may be for resale, or it may be of an exempt item, or to an exempt purchaser. The in-state purchaser knows the facts in these important areas; the out-of-state seller usually does not.

Mr. Alfred Finckel, testifying on behalf of the Hollow Metal Door and Buck Association, Inc., stated that he had offered to furnish the various states into which he sold goods with lists of sales made to customers in those states so that the states could collect the use taxes directly from their own residents, but the states refused to do so.22 Mr. Finckel certainly was approaching the problem from a logical point of view, even if not a strictly legal one. Each business has its own peculiar problems. For example, in the contracting industry, as Mr. Finckel also pointed out, customers retain a percentage of the amount due on each invoice until final completion and approval. However, use taxes must be collected on the full price of each shipment, regardless of any retained percentage. It is extremely difficult for the seller as a practical matter to collect the use tax on each billing. However, many states require the seller to advance out of his own funds

22. 1966 Hearings 631.
the taxes billed during any filing period, even though he does not and cannot collect the tax until later.\textsuperscript{23}

The mail order business, in particular, finds itself faced with almost insuperable obstacles in trying to carry out its obligations as a use tax collector. As Mr. Halfpenny pointed out:

First, smaller mail-order houses do not keep records of sales by States, and to require them to do so would impose a hardship on them. Most of these businesses make a considerable saving by not keeping detailed records of invoices, but simply ship the order back with the goods. The added expense of the record keeping of any other system would be tremendous.\textsuperscript{24}

Another view of this problem was presented by Mr. Harry Brown, on behalf of the American Book Publishers Council, Inc. and the American Text-Book Publishers Institute:

A law which would require companies like ours to collect State sales taxes throughout the United States would subject our industry to severe hardships. In the first place, the seller would be required to analyze its sales by States. To illustrate the scope of this undertaking in our case we might state that we issue presently approximately 5 million invoices per year to over 1 million different customers throughout the 50 States. Each such invoice would require a tax determination and computation and the millions of bills would have to be grouped and added according to States.

This is particularly burdensome in view of the comparatively small amount of the average invoice, that is, approximately $5. Some of the book clubs have even smaller averages. The comparable volume figures for smaller book clubs than ours are obviously less but the clerical problem for them would be even more serious since they operate with a small clerical staff and without the help of advanced business machines.\textsuperscript{25}

The argument has often been made that the restrictions which H.R. 16,491 places on the liability of out-of-state sellers to collect a use tax will give such out-of-state sellers a competitive advantage. Interestingly enough, there was a paucity of direct testimony by retailers who claimed they would be prejudiced by this type of interstate competition. Indeed, one should not overlook the highly undesirable competitive aspects of the present situation. The Subcommittee's studies indicate that it is the exception rather than the rule for an out-of-state seller who is subject to a state's use tax collection require-

\textsuperscript{23} 1966 \textit{Hearings} 630.
\textsuperscript{24} 1966 \textit{Hearings} 224.
\textsuperscript{25} 1966 \textit{Hearings} 605.
ments to comply with these provisions. The manpower of state tax departments being necessarily limited, non-compliance and non-enforce-
ment are, and will doubtless continue to be, widespread. Thus the seller who complies and discharges his duties properly is placed at a very serious disadvantage vis-a-vis non-complying competitors.

Therefore, while it must certainly be admitted that in some situations H.R. 16,491 will give an out-of-state seller a competitive advantage, it is quite clear from the testimony that this is the price we have to pay for a free flow of interstate commerce. If the out-of-state seller did not get this protection, he would in many instances just give up trying to make the sale. However, in many cases the out-of-state seller has no in-state competition. This point was well made by James R. Utley, Vice-President of a Detroit company which manufactures
different cards for automobile dealers and sends samples by direct mail to each new car dealer in the country. In his testimony, Mr. Utley stated:

A local printer would hesitate to produce for local consumption a line of cards comparable to ours since the start-up costs — artwork, plates, and color runs — of 4-color cards such as ours average about $150 for each card design we offer. The average automobile dealer spends less than $100 per year for his salesmen's business cards. Of course, we are able to amortize our start-up costs over hundreds of orders, nationwide.

These cards, in order to be reasonably priced, must be mass produced and offered to a large market, such as 6,700 Chevrolet dealers, 6,500 Ford dealers, 3,200 Chrysler-Plymouth dealers, et cetera.

It is safe to assume that the products we sell by mail order would not be available at a reasonable price from a local source. Therefore, our mail-order sales would have no appreciable competitive effect on local business.

The size of the average order is quite small. Our studies show that in 1965, the average size order was $17, and one-third of the orders were under $9 in value. Hence the pattern of business is a very large number of small orders, shipped to thousands of customers spread throughout the United States.

Accordingly, it is evident that we sell by mail order into every State, and many hundreds of cities, towns and counties. We are not able, and never will be able, to thoroughly understand the laws and regulations with regard to the payment or collection of sales and use taxes in all these jurisdictions. We could not afford a full-time attorney, and indeed, I doubt if we could hire anyone

competent to advise us on the detailed regulations of 39 States and hundreds of political subdivisions.\textsuperscript{27}

The myth of the possible competitive advantage of the out-of-state seller was effectively dealt with in the testimony of Mr. James M. Alter of Chicago.

We have local competitors in every State in which we sell. They have got some tremendous advantages over us. We have just one advantage of tax over them, now. It costs much more than 3 or 4 percent to ship the merchandise to those States, which the customer must pay, so that it seems to me alone equalizes the difference in cost with the tax.

The local wholesaler has the advantage of proximity, speed, friendship — and many other factors — that give him a competitive advantage. We are able to do business in these other States only because we carry a very large inventory of many esoteric items, and when a customer in a distant State needs something he can't order locally, he orders it from us. He certainly doesn't order from us something he can get locally.\textsuperscript{28}

Perhaps the most colorful description of the situation of mail order concerns appeared in the testimony of Stephen F. Harris, on behalf of the New England Mail Order Association:

The fact is we mail order dealers do not compete with retail stores. We do not compete with local stores. The kiss of death for a mail order product is to have it everywhere available in local stores. Practically every mail order business, aside from the giants like Sears, Roebuck & Co., is based on unusual products that have not yet gotten to stores.

The purchasing agent of Breck's of Boston, in a seminar recently, said, "An ideal mail order product might be a left-handed screwdriver that kills flies magnetically, plays music and is monogramed, and — if it were in our garden catalog — it would have to grow, too." He said, "We spend our lives looking for things that are unusual, novel, add to the pleasure of living and are not everywhere available in local stores.''

The thing that clobbers local stores is the local discount houses. Many of us mail order dealers are selling products which you can't get in local stores. This is the precondition for having a mail order business.

In my business, my average sale is $3.50. The sales tax would be 10 cents. My postage and delivery charge to the cus-

\textsuperscript{27} 1966 \textit{Hearings} 510-11.

\textsuperscript{28} 1966 \textit{Hearings} 1445.
customer would be 35 cents. He wouldn't save enough on the sales tax to make up for the delivery charge that we charge him.29

Anyone who has any reservations about the magnitude of the burden of use tax collection should read the entire statement of Mr. James M. Alter.30 To summarize it briefly, Mr. Alter's concern is a distributor of refrigeration and air conditioning supplies, tools, components and related equipment. It has approximately 25,000 customers and receives an average of 200,000 orders a year, the median order size being below twenty dollars. One-third of its sales are made over the counter or by telephone in eleven branches located in seven states. It has no branches, offices, salesmen or agents in the other forty-three states into which it sells. The remaining two-thirds of its sales are developed through the mails as a result of publishing three times a year a 320 page catalog which is sent to 60,000 firms. Sales tax returns are filed in the seven states where branches are located resulting in a compliance cost of 11,000 dollars, which is eighteen per cent of the tax monies remitted to the seven states involved. Mr. Alter projected that if his firm were required to file use tax returns in the other forty-three states, his compliance costs would approach 35,000 dollars and would represent thirty per cent of the tax collected. This compliance cost, looked at another way, would amount to one-half of one per cent of gross sales and fifty per cent of after-tax profits of the entire operation. These compliance costs may seem high. They would, of course, be much lower if all sales were taxable, but the fact is that only ten per cent of the products handled by Mr. Alter's company are not ordinarily resold. Accordingly, in each case resale numbers must be checked. In addition, many customers are exempt purchasers such as governmental units and charities. For these reasons each of the 200,000 orders received each year must be separately analyzed and in many cases correspondence must be entered into when a customer has failed to provide his resale number, or where he has claimed a resale exemption on items he intends to use himself.

Mr. Alter went on in his statement to compare the ease with which he did business in foreign countries with the difficulty he had in doing business in the United States:

If this situation is permitted to continue the small businessman especially will be denied free access to a national market that has traditionally been viewed as open to all of us. Indeed, as your report so aptly points out, the present system within the United States is already so complex and so unwieldy that it simply can-

30. 1966 Hearings 1438-42.
not be complied with by the typical small firm. This system is not only in striking contrast to our American tradition, but what is startling is that it is in striking contrast to the system which is rapidly developing throughout the world for commerce among the Nations.

Let me give you an example. If a Dutch company maintains no facilities in West Germany, the German Government will not require it to pay a tax, or obtain a seller permit, simply because it mails catalogs of its products to prospective German purchasers. Yet many States in the United States are now calling on all persons who mail advertising literature within their borders to register and collect taxes.

Let me give you another example, with respect to my own business. I can ship air conditioning parts to persons who order them from me and who are located in foreign countries, yet I know of no single foreign country which expects me to pay an income tax simply because my products end up within their borders. Yet I understand that all of the State tax administrators in the United States have agreed that, in their view, I should be required to pay some form of tax — either a gross receipts tax or an income tax or collect a sales or use tax — to each State where my products are shipped. Under these circumstances it would seem to me that the time has come for Congress to act, and that the time has long since passed for reliance on the States to act individually, in the national interest.

At this point, I would like to make several observations about the approach of the State officials who have testified. My observations are not based on an examination of every statement submitted, but I have had a chance to peruse a number of the statements. Basically, their emphasis has been directed at the problems of collection of taxes from and through nonresident businesses. They want their States to be able to levy net corporate income taxes on nonresident companies, and require out-of-State vendors to collect and remit sales and use taxes to their State. Not one State official laid any emphasis on assisting the businessmen of their own State to participate in a nationwide market.

No State tax administrator and no State attorney general and no Governor gave any recognition to the fact that the businessmen of their State are dealing in market areas which extend beyond their State lines. Only the mayor of New York and a member of the Arizona State Tax Commission expressed any concern over the harassment of constituent businessmen by other tax jurisdictions. Mayor Lindsay recognized that the businesses of New York City were being required to bear heavy compliance costs in coping with other State tax laws and urged some sort of alleviating remedy.\(^\text{31}\)

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An interesting sidelight on the operation of Mr. Alter's firm is that in 1964 it received the President's E Certificate for Export Excellence. Certainly this is the type of an enterprise which our system of taxation should be designed to encourage.

One aspect of the compliance problem which has been repeatedly overlooked by the State Tax Administrators who objected to the Subcommittee's recommendations in the use tax area was highlighted in Mr. Alter's Statement:

A great deal of petty correspondence is required in administering mail order use taxes. A customer, for example, who has not supplied us with his resale tax number, must automatically be charged a use tax. Unhappily, he does not always feel obligated to pay that tax, and a distressing amount of tactful persuasion is often necessary. We must sometimes explain to buyers of tools or instruments that their resale number is not applicable for equipment they are using themselves. We must advise customers who have sent cash in advance, that they haven't sent enough. We must argue with customers who have altered their invoices. We must adjust tax errors on monthly statements. Needless to say, all of this is enormously expensive, and yet if we do not do it — if we decide that collecting a 30-cent tax is not worth writing another letter — then we must pay that tax ourselves, which several States forbid, by law.

Even worse is the constant attrition of normal customer relations inherent in this situation. Hundreds of times each month we must weigh the risk of antagonizing good customers, against the cost of paying their small tax debts for them and breaking the law.

Many of the State Tax Administrators brought up the point that the findings of the Subcommittee did not show any undue compliance burden on interstate firms at the present level of enforcement. This is indisputably the truth. However, the findings in the Subcommittee's original report were based on the original testimony taken during the period December 4 through December 13, 1961. The testimony taken during the early part of 1966 in connection with H.R. 11,798 tells an entirely different story. On the basis of this later testimony, of which that of Mr. Alter is only one example, there is ample basis for a finding of an undue compliance burden, even at present levels of enforcement.

The testimony taken in connection with H.R. 11,798 would seem to require a complete rethinking of the desirability of requiring an out-of-state seller to collect the use tax imposed by the state of the buyer's

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32. 1966 Hearings 1443.
33. 1966 Hearings 1439.
residence. While the Supreme Court has upheld the constitutionality of this requirement,\(^{34}\) this does not mean that this method of collecting the use tax is the most desirable one from the point of view of promoting the economic welfare of the country as a whole. While states up to now have been generally unsuccessful in requiring their own residents to pay a use tax on goods imported from another state, very little imagination has been shown in the development of new techniques in this area. One line of attack is suggested by the method of enforcing the income tax on dividends which involves the filing of information returns by dividend paying corporations. Following this analogy, vendors might be required to file annual information returns reporting sales of article shipped into a particular state. Such a procedure would involve some compliance expense by the vendors, but such expenses would be much less than the present system which requires each vendor, at his peril, to determine which of its sales are taxable and to collect the tax on these sales. The next step would be for the states to enforce more strictly present statutory provisions calling for the filing of use tax returns by consumers. States imposing personal income taxes could easily include a use tax return as a part of their income tax return forms. Modern data processing installations should then have no trouble in matching data shown on information returns with that reported on the use tax returns. While it must be admitted that this system is untried and might well require considerable readjustment of present practices, it would at least put the burden of enforcing the use tax where it belongs — on the tax administrators of the state of the purchasers' residence rather than on the out-of-state vendor.

In summary, an out-of-state vendor who has no business location in the state of the purchaser's residence and does not make household deliveries into that state should not be required to collect a use tax for the following reasons. First, it is essential that there be a uniform rule with respect to the amount of in-state activity which is necessary before use tax collection liability attaches. Second, such in-state activity should be substantial because an out-of-state seller with only marginal connections with the purchaser's state is put to a tremendous burden if he must inform himself with respect to all the intricacies of the laws of every state in which he sells. In many cases, this purchaser is himself a registered vendor and easily available to the tax enforcement authorities of his own state. He, not the seller, knows the use to which the property is to be put, which in many cases determines the tax status of the transactions. Third, unfair competition with local sellers, while it doubtless exists, does not justify a serious restriction

on the free flow of interstate commerce. Fourth, the economic burden of the use tax is intended to fall on the purchaser, and there is no equitable justification for transferring the burden of collecting the tax to the out-of-state seller. The situation was accurately summed up by Mr. Harold T. Halfpenny, testifying on behalf of the Automotive Services Industries Association:

The States have imposed the duty of tax collection on persons not within their jurisdiction simply as a matter of expediency — because that is the easiest way to cause collection to be made. If the States could collect from their own citizens, the same amount of revenue would be realized from the use tax. The States, then, are imposing a restraint upon interstate commerce in the name of expediency alone, with no other justification. 35

IV. Suggested Improvements in H.R. 16,491

There are a number of improvements which could be made in the two-factor allocating formula. It has been suggested that H.R. 16,491 represents a one-way tax reduction street so far as businesses with less than one million dollars of annual net income are concerned. This objection can easily be met by providing that a corporation must use the two-factor formula in all states where it is taxable or in none. This would prevent corporations from being able to pick and choose only those states where the two-factor formula works out to their advantage. Of course, the states themselves have not been averse to rigging allocation formulas to their own advantage as is evidenced by Hawaii, whose Special Deputy Attorney General, Allen I. Marutani, testified that his state uses the two-factor formula of property and payroll for manufacturing corporations but adds a destination based sales factor in the case of corporations whose principal activity is selling. 36

The aggregate tax revenue to be obtained from corporations with under one million dollars of net income is not great, so, even under the bill as drawn, no substantial loss in state taxes will accrue. Mr. Fred L. Cox of the Georgia Department of Revenue found that, in the case of returns processed in Georgia from April 1964 to April 1965, corporations with taxable income of over one million dollars filed .36 per cent of all returns and paid 46.48 per cent of all the tax collected. 37

At the recent National Tax Association meeting at Denver, Mr. Cox

35. 1966 Hearings 996.
37. 1966 Hearings 857.
reported on figures secured from the Internal Revenue Service for fiscal years ending June 1959 through June 1963 which showed that corporations with over one million dollars of taxable income represented approximately one-half of one per cent of the returns filed and seventy per cent of the total net income.

On the other hand, if small businesses claim that a three-factor formula involves too great a compliance burden, it should be forced to be consistent, particularly in view of the fact that no corporation would be forced to elect the two-factor approach if it involved additional tax liability. The use of a cut-off based on size has been alleged to raise constitutional objections. These objections have never been very clearly spelled out. If corporations with net incomes under 25,000 dollars are treated more leniently under the federal income tax law than corporations with net incomes in excess of this purely arbitrary dividing line, there would not seem to be any constitutional reason why a similar favorable treatment of smaller corporations should not be constitutionally permissible in the field of state taxation. Finally, on this point it is pertinent that the complaints with respect to the compliance problem inherent in a three-factor formula come without exception from the smaller corporations. If the evil to be remedied exists only in a limited area, it would seem unreasonable to object that the remedy should be confined to that area.

Representative Edward Hutchinson raises a valid point in his minority report that the jurisdictional standard in H.R. 16,491 permits an out-of-state vending machine operator to conduct his entire business in a state without subjecting himself to liability, either to pay an income tax or to collect a sales or use tax. This criticism could be easily met by extending the definition of a business location contained in section 511 of H.R. 16,491 to include the owning or renting of vending machines in the taxing state.

H.R. 16,491 does not really come to grips with the ever increasing problem of municipal income, sales and use taxes. As section 101 is now written, a municipality has tax jurisdiction if a corporation has a business location in another municipality in the particular state or, in the case of sales and use taxes, makes household deliveries in such other municipality. This rule should be changed to provide that before a municipality can have tax jurisdiction, the taxpayer must have a business location in that municipality or, in the case of sales and use taxes, makes household deliveries in that municipality.

38. 1966 Hearings 855.
The provisions of section 301(a)(2) would permit the states, through the device of interstate collection compacts, to circumvent the desirable restrictions on liability for use tax collection contained in section 101(2). The operation of section 301(a)(2) is described in the House Judiciary Committee Report:

A State other than the State of destination, however, may require a seller to collect a sales or use tax for the State of destination even though the seller does not have a business location or regularly make household deliveries in the State of destination. For example, New Jersey and New York could adopt parallel procedures whereby New Jersey would require sellers with business locations in New Jersey to collect tax on their sales for shipment to New York buyers, even though the sellers had no jurisdictional contact with New York, in return for New York imposing on its sellers a collection obligation on their sales to New Jersey buyers. Section 301(a) preserves any existing power of a State having jurisdiction under section 101 to exercise it on behalf of another State, but does not remove any present barrier in State constitutions or statutes.

There is no logic in this exception to the general jurisdictional rule. If requiring a New York seller, who has no business location in New Jersey and makes no household deliveries therein, to collect the New Jersey use tax on sales to New Jersey residents imposes an undue burden on interstate commerce, the existence of a reciprocal collection agreement between New York and New Jersey in no way reduces this burden.

H.R. 16,491 also calls for the application of the two-factor formula to the taxpayer's entire net income. While strong arguments have been made for this procedure, it would seem more desirable to follow the Uniform Law and make specific allocation of such items as rents and royalties from real and tangible personal property, capital gains, interest, dividends and patent or copyright royalties, to the extent that these items constitute non-business income. This would not result in any substantial allocation of income to states without taxing jurisdiction.

Finally, H.R. 16,491 develops the property factor by valuing owned property at original cost. The use of cost less depreciation taken in prior years would greatly simplify the compliance problems of taxpayers.

41. 1966 Hearings 783.
V. Evaluation of H.R. 16,491

In evaluating the present bill, the income tax aspect will be considered initially. The basic philosophy of the Subcommittee embraced two major principles. First, compliance and enforcement problems could best be reduced by restricting tax jurisdiction to those states where the taxpayer had a substantial presence in the form of a business location. Under this approach, each taxpayer would file fewer returns than under the present system and each state tax department would have fewer and more substantial returns to process. Second, a congruence should be established between jurisdiction to tax and allocation of income. Income should not, as is the case under the Uniform Act, be allocated to states which have no jurisdiction to tax it. Thus, taking the universe of states and the universe of taxpayers, every corporation would be taxable somewhere on all its income. There would, of course, be substantial readjustments. Particular taxpayers would be concentrating their payments in fewer states. For example, a corporation with the bulk of its manufacturing operations in Massachusetts would pay a larger tax to that state but its liabilities in other states would be reduced, either because of lack of jurisdiction to tax in some of such states or because a smaller portion of its income would be allocable to them by reason of the elimination of the sales factor.

The above was the scheme of H.R. 11,798, the predecessor of H.R. 16,491. It ran into virtually unanimous opposition on the part of many state officials. In order to meet this opposition and to arrive at the widest possible consensus, the Subcommittee set about to find a compromise. The basis for such a compromise was found in a most interesting set of statistics developed by one of the most thoughtful students of state taxation, Mr. Fred L. Cox of Georgia. Since the objections to the sales factor came almost universally from medium and small corporations, the logical move was to grant an option to use the two-factor formula to corporations with under one million dollars of net income. Such a change should meet the great bulk of taxpayer objections to the use of the three-factor formula. On the other hand, the revenue collecting officials should have little ground for complaint because they would retain the right to apply the three-factor formula in cases which involve the lion's share of the revenue. Of course, such a compromise spoiled the logical consistency of H.R. 11,798, which applied the two-factor allocation formula to all corporations regardless of their size other than corporations engaged in transportation, insurance, banking, furnishing utility services, and holding

companies. Small corporations under H.R. 16,491 will get a tax reduction and income will continue to be allocated to states which have no jurisdiction to tax. As pointed out previously, sharply conflicting interests are involved in this area. Each side was entitled to some consideration, and such consideration is given to them under the new bill.

In the other highly controversial area, the liability of the out-of-state seller to collect a use tax for the state of the purchaser, strong equities exist on the side of the seller; but it is not his tax we are concerned with. Rather, it is the tax of the buyer. The seller is merely being dragooned into the position of an involuntary tax collector. The justification for requiring the seller to collect the tax is pure expediency since the tax collecting authorities claim that they cannot effectively enforce their claims against the purchaser on whom the burden of the tax is intended to fall. Again the Subcommittee sought a compromise solution. In H.R. 11,798 this took the form of pressure on the states to enact a uniform sales tax act which would have eliminated the present compulsion on interstate sellers to familiarize themselves, at their peril, with confusing and divergent state sales tax patterns. And, as was the case with its income tax proposals, this proposal met almost unanimous objection from state officials.

In H.R. 16,491 the Subcommittee attempted to harmonize the conflicting viewpoints, but, as is the case with all compromises, the result falls short of theoretical perfection. In-state purchasers from out-of-state sellers who have no business location in the state and who do not make household deliveries in the state have a good chance of escaping sales tax liability unless they are registered vendors whose books are open to sales tax auditors. Here, again, there are conflicting interests to be weighed. There can be no escaping the fact that some legitimate use tax liability will be evaded under the bill. No figures are available as to the extent of the interstate purchases which are involved. In many instances they will be confined to small ticket items. Otherwise, the cost of postage may well exceed the use tax. Most people buying such an item as a radio set want a nearby seller whose guarantee can be more easily enforced. In other cases, the product is not available locally and this is the major reason for going out-of-state to purchase it. It cannot be denied that use tax liability will be avoided, but at least relatively few in-state sellers will be made to face unfair tax-free competition. Against these violations of a

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44. See testimony of Mr. Harold T. Halpenny in text accompanying note 16 supra.
state's legitimate taxing rights must be weighed the burden placed on interstate commerce by compelling the seller: (1) to allocate his sales by states — something he may not ordinarily do and which in the case of a small concern may result in costs disproportionate to the tax collected; (2) to inform himself with respect to the sales tax laws of the states into which he sells; (3) to determine in some cases whether the article is to be put to a taxable or non-taxable use; and (4) to prepare and file use tax returns.

If any credence is to be placed in the testimony before the Subcommittee to the effect that the present situation is intolerable and will get worse if the Supreme Court affirms the National Bellas Hess case, and if it is assumed, as experience indicates it must, that there is no substantial likelihood of securing uniformity in state sales taxes, the loss by the states of some use tax payments seems not too high a price to pay for the benefits to be gained by the national economy from the adoption of H.R. 16,491. The reversal of National Bellas Hess will not obviate the need for the restrictions on liability for collection of the use tax. Such a decision by the Court would protect only those out-of-state sellers who confine their activities in the state of the purchaser's residence to solicitation by mail. It would offer no protection to out-of-state sellers who use newspaper, magazine, radio or television advertising or to those who send salesmen into the purchaser's state but do not own or lease real property, have a salesman located there, or make household deliveries. Sellers in the latter category, no less than mail order sellers, deserve, in the Subcommittee's opinion, to be freed from the burdens referred to in the preceding paragraph.

VI. Conclusion

No evaluation of H.R. 16,491 should be attempted without a thorough appreciation of what preceded the drafting of this bill: the 471 pages of testimony taken at the hearings in 1961, the four years of intensive study by the Subcommittee's staff, the preparation of H.R. 11,798, and the subsequent hearings on that bill which proceeded from January 26 to April 6, 1966 and filled 1,858 pages of the record. Of all these steps, the most important was the hearings on H.R. 11,798.

The testimony taken in 1961 was, of necessity, highly generalized since the witnesses at that time were not directing their testimony to any specific legislative proposal. By 1966 the situation had entirely changed and each witness was focusing directly on the provisions of a single bill. The record developed at this time is a unique storehouse of information with respect to the problems of small and medium-sized businesses which seek to sell their products in more than one state.
Interstate business is faced with considerable problems in complying with a maze of conflicting state taxing statutes, regulations and administrative practices. The Subcommittee has offered a solution to these problems. While it would be presumptuous to contend that the conclusions embodied in H.R. 16,491 are incontrovertibly correct, any criticism of the Subcommittee's judgments should be based upon a thorough familiarity with the record.