The Difficulty of *Getting Serious About State Corporate Tax Reform*

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I. Introduction

In his Note, *Beyond BATSA: Getting Serious About Corporate Tax Reform*,[1] Quinn Ryan examines several common defects of state corporate income taxes that, in isolation or in combination, create distortions, inequities, and complexity, and argues for federal legislation that would substantially reduce the problems he describes. I will expand a bit on Ryan's analysis, review some history, and argue that neither multilateral state action nor federal legislation—especially legislation that would not make matters worse—is likely to occur.

* The author acknowledges the helpful comments Walter Hellerstein made on an earlier draft of this comment.

1. Quinn T. Ryan, *Beyond BATSA: Getting Serious About State Corporate Tax Reform*, 67 WASH. & LEE L. REV. 275 (2010).

II. The Four Components of a Uniform System

An ideal system of state corporate income taxes would exhibit uniformity in four important respects: the definition of the potential taxpayer (or of the corporate group whose economic activities are considered in determining tax liability); standards for jurisdiction to tax, hereinafter "nexus"; the definition of income that is potentially subject to tax; and the method used to divide taxable income among the states.[2] Uniformity of rates would not be required, should not be imposed, and, as in Ryan's Note, is not considered further.[3]

The "system" of state corporate income taxes actually found in the United States fails on all four counts,[4] although there is a fair amount of uniformity across states in the definition of income[5]—an issue that will, for that reason, not be considered further here. State assertion of nexus is restricted by federal statutory law (Public Law 86-272) under certain circumstances, but not others, and whether a federal constitutional restriction on the assertion of nexus in the sales and use tax area is applicable for income tax purposes is a matter of continuing controversy in state courts.[6] Although a model law, the Uniform

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2. These are not the only characteristics of a good subnational income tax. *See generally* Charles E. McLure, Jr., *The Nuttiness of State and Local Taxes—And the Nuttiness of Responses Thereto*, 25 STATE TAX NOTES 841 (2002) [hereinafter McLure, *Nuttiness of State and Local Taxes*] (urging uniformity in state and local taxes); Charles E. McLure, Jr., *The Long Shadow of History: Sovereignty, Tax Assignment, Legislation, and Judicial Decisions on Corporate Income Taxes in the US and the EU*, *in* COMPARATIVE FISCAL FEDERALISM 119 (Reuven S. Avi-Yonah et al. eds., 2007) [hereinafter McLure, *Long Shadow*] (discussing the practice of tax assignment). For an analysis of the proper structure of a subnational income tax that focuses on economic distortions, see William F. Fox. et al., *How Should a Subnational Corporate Income Tax on Multistate Businesses Be Structured?*, 58 NAT'L TAX J. 139 (2005).

3. Indeed, state sovereignty over tax rates is the key to a viable federal system. By comparison, all other design features of subnational taxes are secondary. *See generally* Charles E. McLure, Jr., *Tax Assignment and Subnational Fiscal Autonomy*, 54 BULL. INT'L FISCAL DOCUMENTATION 626 (2000) (discussing the "tax assignment problem": what taxes should subnational governments levy and how should subnational governments collect). For a profoundly different view, see American Legislative Exchange Council (ALEC) Resolution to Oppose NCCUSL Effort to Rewrite the Uniform Division of Income for Tax Purposes Act, http://www.nccusl.org/Update/Docs/UDITPA/UDITPA_ALECresolution.pdf (last visited Jan. 24, 2010) (on file with the Washington and Lee Law Review), which states, "a uniform tax on corporate income contravenes ALEC's mission to support state sovereignty."

4. For more extended discussions, see McLure, *Nuttiness of State and Local Taxes*, *supra* note 2; McLure, *Long Shadow*, *supra* note 2.

5. *See* JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION ¶ 7.02 (3d ed. 1998 & Supp. 2009) ("The outstanding characteristic of state corporate net income taxes is their broad conformity to the federal corporate income tax."). Despite what Hellerstein and Hellerstein call "broad conformity," state and federal tax bases exhibit important differences, to which Hellerstein and Hellerstein devote 130 pages. *Id.* ¶¶ 7.02–.17.

6. Ryan, *supra* note 1, at 291–92, 301–07.

Division of Income for Tax Purposes Act[7] (UDITPA), has been in existence for over fifty years, it deals with only one of the four areas where uniformity would be desirable, not all income tax states have adopted it or patterned their laws after it, and, despite UDITPA's endorsement of an apportionment formula that accords equal weight to the taxpayer's payroll, property, and sales, there is substantial variation in the weights that the states actually apply, with an increasing number giving sales double or greater weight—or even sole weight, presumably for economic development reasons.[8]

In his note, Ryan has emphasized the lack of a clear nexus standard and the need for a uniform definition of income and a uniform method of dividing income, describing the inequities, economic inefficiencies, and complexity that result from the current defective system.[9] He argues that the federal government should enact legislation that would allow a state to assert nexus over any corporation that has an economic presence in the state, rather than the legislation pushed by the business community,[10] which would further limit state assertion of nexus for income tax purposes by extending the physical-presence test found in the sales and use tax area to income taxation.

I find nothing to dispute in Ryan's analysis;[11] after all, I also have railed against the inequities, distortions, and complexity created by the current system,[12] have advocated a nexus standard based on economic presence for both income taxes and sales and use taxes,[13] have criticized the legislative

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7. UNIF. DIV. OF INCOME FOR TAX PURPOSES ACT (1957).

8. *See* MICHAEL MAZEROV, CTR. ON BUDGET & POLICY PRIORITIES, THE "SINGLE SALES FACTOR" FORMULA FOR STATE CORPORATE TAXES: A BOON TO ECONOMIC DEVELOPMENT OR A COSTLY GIVEAWAY? 15–19 (2005), http://www.cbpp.org/3-27-01sfp.pdf (last visited Jan. 26, 2010) (discussing UDITPA's approach and the double-weighted sales formula) (on file with the Washington and Lee Law Review); *id.* at 21–59 (discussing the sales-only formula).

9. Ryan, *supra* note 1, at 315–20.

10. *Id.* at 320–26.

11. I would, however, place less emphasis on "throwback" because the same political forces that favor placing greater weight on sales also militate against the enactment of throwback. *See* Fox et al., *supra* note 2, at 154–55 (providing a substantive criticism of throwback).

12. McLure, *Nuttiness of State and Local Taxes*, *supra* note 2.

13. Thus, I wrote in Charles E. McLure, Jr., *Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws*, 52 TAX L. REV. 269 (1997), the following:

> *Taxable activity should imply nexus*, unless it is de minimis. . . . [A] person that has a physical presence in the state or that conducts activities in a state that are factors in the formula the state uses to apportion income among the states (commonly payroll, property, and sales) should be subject to the income tax jurisdiction of that state, unless such activities in the state are de minimis.

Id. at 395–96. *See also generally* Charles E. McLure, Jr., *Implementing State Corporate* proposal to substitute instead a test based on a physical presence (a forerunner to the Business Activity Tax Simplification Act[14] (BATSA) that Ryan finds defective),[15] have decried the shift toward sales-only apportionment,[16] have argued that many of the problems that Ryan describes could be avoided if only a state would adopt combination,[17] and have proposed a comprehensive and sensible UDITPA.[18]

III. Unilateral, Multilateral, and Federal Action

In thinking of what can and should be done, I find it useful to distinguish among reforms that a single state could introduce unilaterally, those that require

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Income Taxes in the Digital Age, 53 NAT'L TAX J. 1287 (2000); Dan Bucks & Frank Katz, *Explanation of the Multistate Tax Commission's Proposed Factor Presence Nexus Standard*, 25 STATE TAX NOTES 1037 (2002).

14. Business Activity Tax Simplification Act of 2009 (BATSA), H.R. 1083, 111th Cong.

15. Walter Hellerstein & Charles E. McLure, Jr., *Congressional Intervention in State Taxation: A Normative Analysis of Three Proposals*, 31 STATE TAX NOTES 721 (2004).

16. *See* McLure, *Nuttiness of State and Local Taxes*, *supra* note 2, at 849 ("State corporation income taxes exhibit nuttiness . . . in a recent trend to use only sales to apportion income among states . . . ."). *See also generally* Michael Mazerov, *Federal "Business Activity Tax" Bill: Half of a Two-Pronged Strategy to Gut State Corporate Income Taxes*, 35 STATE TAX NOTES 399 (2005).

17. If a state taxes each member of a corporate group as a separate entity, without regard to its economic relations with its corporate affiliates, it opens its treasury to the sorts of abuse that Ryan describes, including manipulation of transfer pricing and the use of out-of-state holding companies and affiliated financial services providers that lack nexus in the state to siphon off taxable income. If, on the other hand, the state considers the activities of the unitary group to which the taxpayer belongs in determining the amount of income it taxes, ignoring transactions between members of the unitary group, such abuses cannot occur. *See* McLure, *Nuttiness of State and Local Taxes*, *supra* note 2, at 853 (suggesting the adoption of unitary combination, thereby avoiding "the need to assert *Geoffrey* nexus or to tax domestic dividends"); *see also* William F. Fox & LeAnn Luna, *State Corporate Tax Revenue Trends; Causes and Possible Solutions*, 55 NAT'L TAX J. 491 (2002) (discussing state corporate tax revenue trends, the underlying causes of the decline in corporate tax revenues, and the alternative means of slowing or ending the decline in corporate tax revenues); Fox et al., *supra* note 2, at 146–48 (noting the benefits and faults of combined reporting); MICHAEL MAZEROV, CTR. ON BUDGET & POLICY PRIORITIES, A MAJORITY OF STATES HAVE NOW ADOPTED A KEY CORPORATE TAX REFORM—"COMBINED REPORTING" 6 (2009), http://www.cbpp.org/4-5-07sfp.pdf (last visited Jan. 29, 2010) ("The primary goal of combined reporting is to create a level playing field for all businesses[,] . . . ensur[ing] that large multistate corporations cannot end up paying income tax at a lower effective tax rate than small businesses . . . .") (on file with the Washington and Lee Law Review). It also may be necessary to expand the definition of entities subject to the "corporate" income tax or to combination to include certain types of pass-through entities.

18. Charles E. McLure, *A Comprehensive and Sensible UDITPA*, 37 STATE TAX NOTES 929 (2005).

multilateral action by the states, and those that require federal action because the states do not act in concert or cannot overcome existing federal restraints on their powers.[19] By its very nature, unilateral action cannot eliminate differences in state policies and the complexity and economic inefficiencies they create;[20] only multilateral or federal action can do that. But unilateral state action can minimize some of the abuses and the accompanying inequities and revenue losses attributable to opportunities for tax planning that are created by unsound state policy choices. On the other hand, unilateral state action can also create or accentuate opportunities for inequities and abuse, and it may contribute to lack of uniformity, as in the common, albeit unilateral, shifts to placing greater weight on sales.

A. Unilateral Action

Combination. Requiring combined reporting among unitary corporations is an example of the first type of policy. By enacting such a requirement, a single state acting unilaterally could protect itself from the abuses inherent in separate company reporting. There would be no need for other states to enact similar requirements. Although uniformity across states in the way a unitary group is defined would be beneficial, it would not be required.[21] It is particularly important that the Supreme Court has placed its imprimatur on combination.[22] There is no doubt that a state has the power to require

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19. I follow this approach, for example, in McLure, *Nuttiness of State and Local Taxes*, *supra* note 2.

20. This is somewhat of an overstatement. Competitive shifts in the weight placed on sales in the apportionment formula could eventually produce a uniform formula in which weight is accorded only to sales. This would reduce complexity, but not distortions, abuse, and inequity.

21. The Supreme Court implicitly has accepted, as a constitutional matter, a certain degree of nonuniformity in this area, by stating that "the unitary business concept . . . is not, so to speak, unitary: there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach." Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 167 (1983). The states thus have some latitude to use inconsistent definitions of a unitary business. There are, however, constitutional restraints on these definitions, at least when they become overly expansive. *See, e.g.*, ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 327 (1982) (invalidating state tax based on interpretation of UDITPA's definition of "business income" that exceeded constitutional limits); F.W. Woolworth Co. v. Taxation & Revenue Dep't, 458 U.S. 354, 372–73 (1982) (same).

22. The judicial history of mandatory combination and the unitary business principle are inextricably intertwined. The unitary concept was applied initially in taxation of express companies to justify the taxation of an apportioned part of the economic activities of an entire single entity. Later it was used to justify the combination of the activities of related corporations engaged in a unitary business. Combination can be required only if a unitary

combination when there is a unitary relationship between members of a corporate group. There is also no doubt that Congress has the power under the Commerce Clause to ban combination—or to require it—if it chose to do so.[23]

Nexus. States have considerably less latitude to act unilaterally—or even multilaterally—when it comes to assertion of nexus, and the extent of that latitude is uncertain. The lack of latitude is most vividly illustrated by the physical presence test of nexus in the sales and use tax area first announced in *National Bellas Hess, Inc. v. Department of Revenue*[24] and reaffirmed in *Quill Corp. v. North Dakota.*[25] Congress could eliminate that test, and the Supreme Court might even do so, by overruling *Quill*, if the states were to eliminate enough of the differences in their sales and use taxes that the Court thought that imposing a duty to collect use tax would no longer place an undue burden on interstate commerce.[26] But until then, *Quill* remains good law, limiting state assertion of nexus for use tax purposes.

By comparison, as Ryan notes, the situation is considerably less clear in the case of nexus for income taxes purposes.[27] The only broad-based federal

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business exists; mere common ownership is not enough. The Supreme Court emphasized the importance of the unitary principle in the context of the apportionment of the income of a group of affiliated corporations (albeit not in the context of combined reporting) in 1980, stating that "the linchpin of apportionability . . . is the unitary business principle." Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425, 439 (1980). The Court subsequently applied the same principle in the context of combined reporting in *Container Corp. See* Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 166 (1983) ("At the very least, . . . a State [may] not tax a purported 'unitary business' unless at least some part of it is conducted in the State."); Walter Hellerstein, *The Case for Formulary Apportionment*, 12 INT'L TRANSFER PRICING J. 103, 107 (2005) ("[T]he case for formulary apportionment of the income of a group of commonly controlled corporations often goes hand in hand with the case for reporting the income of those entities on a consolidated or combined basis."); HELLERSTEIN & HELLERSTEIN, *supra* note 5, ¶ 8.07[1] (providing an overview of the constitutional underpinnings of the unitary business principle).

23. Regarding the plenary powers Congress has to regulate interstate commerce, see Walter Hellerstein, *The US Supreme Court's State Tax Jurisprudence: A Template for Comparison*, *in* COMPARATIVE FISCAL FEDERALISM, *supra* note 2, at 67, 69.

24. Nat'l Bellas Hess, Inc. v. Dep't of Revenue, 386 U.S. 753, 758–60 (1967) (holding that Illinois had no power to impose liability on out-of-state mail order firm to collect use taxes imposed by state law).

25. Quill Corp. v. North Dakota, 504 U.S. 298, 313 (1992) (recognizing that "a corporation may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause").

26. On efforts to create this degree of uniformity, see HELLERSTEIN & HELLERSTEIN, *supra* note 5, ch. 19A. On the politics of the matter, see John A. Swain & Walter Hellerstein, *The Political Economy of the Streamlined Sales and Use Tax Agreement*, 58 NAT'L TAX J. 605 (2005).

27. *See* Ryan, *supra* note 1, at 301–07.

legislation in this area, Public Law 86-272,[28] applies exclusively to those who make only sales of tangible property, leaving those who derive income from selling services or from owning or licensing intangible property subject to the much less precise and restrictive nexus restraints derived from the Commerce and Due Process Clauses.[29] There continues to be litigation in state courts over whether the bright-line physical presence test for assertion of nexus in the sales and use tax area also applies to nexus for income taxation, although the overwhelming body of case law has answered that question in the negative.[30] Unfortunately, the Supreme Court has left the issue in judicial limbo, by refusing to grant certiorari in key cases, most notably in *Geoffrey, Inc. v. South Carolina Department of Revenue and Taxation* and its progeny.[31] Enough time has passed since the *Geoffrey* and similar decisions that it seems reasonable to believe that the Court will not soon (if ever) address the perplexing question of whether an economic presence creates nexus for income tax purposes. But the possibility that the Court will decide that it does not—and the implied need to make massive refunds—means that in this area states that employ a test of nexus based on economic presence live under a Damocles sword.

Division of Income. In its decision in *Moorman Manufacturing Co. v. Bair*,[32] the Court made it clear that, absent congressional limitation, states have

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28. Pub. L. No. 86-272, 73 Stat. 555 (1959) (codified at 15 U.S.C. §§ 381–391 (2006)).

29. *Id.* § 101(a)(1), 73 Stat. at 555.

30. *See* HELLERSTEIN & HELLERSTEIN, *supra* note 5, ¶ 6.11[3] (discussing post-*Geoffrey* developments).

31. *See* Geoffrey, Inc. v. Comm'r of Revenue, 899 N.E.2d 87, 92–93 (Mass. 2009) (concluding that the imposition of the taxing state's corporate excise tax did not violate the Commerce Clause because, even though the corporation had no physical presence in the taxing state, the corporation's licensing agreements with companies in the taxing state constituted a substantial nexus with the taxing state), *cert. denied*, 129 S. Ct. 2853 (2009); Capital One Bank v. Comm'r of Revenue, 899 N.E.2d 76, 81–82 (Mass. 2009) (concluding that the imposition of financial institution excises on an out-of-state financial institution did not violate the Commerce Clause because, even though the institution had no physical presence in the taxing state, substantial nexus existed between the taxing state and the institution's activities with the state), *cert. denied*, 129 S. Ct. 2827 (2009); Tax Comm'r v. MBNA Am. Bank, N.A., 640 S.E.2d 226, 235–36 (W. Va. 2006) (finding that a foreign credit card company, with its principal place of business and commercial domicile in Delaware, had a substantial economic presence in West Virginia, thereby establishing a "substantial nexus"), *cert. denied*, 551 U.S. 1141 (2007); Lanco, Inc. v. Dir., Div. of Taxation, 908 A.2d 176, 176 (N.J. 2006) (sustaining the imposition of corporate income tax liability on a foreign corporation having no physical presence in the state "but deriv[ing] income through a licensing agreement company conducting retail operations" in the state), *cert. denied*, 551 U.S. 1131 (2007); Geoffrey, Inc. v. S.C. Tax Comm'n, 437 S.E.2d 13, 19 (S.C. 1993) (sustaining a state tax on plaintiff's royalty income and finding the state tax not violate of the Due Process Clause or the Commerce Clause of the United States Constitution), *cert. denied*, 510 U.S. 992 (1993).

32. Moorman Mfg. Co. v. Bair, 437 U.S. 267, 271–72, 276 (1978) (holding that Iowa's

considerable latitude in choosing the apportionment formula to be used to divide the business income of a multistate corporation.[33] Because of desires to avoid burdening the origin-based productive factors of labor and capital, there has been a "race to the bottom" in shifting from the once-prevalent equally weighted three-factor formula of UDITPA to formulas that place greater or sole weight on sales,[34] which in the case of sales of tangible property are determined on a destination basis. In the first instance, this shift shattered the uniformity that prevailed before *Moorman* and made more lucrative the tax planning made possible by Public Law 86-272. One can conceive of a day when uniformity is restored—when all the states have adopted sales-only apportionment, although this would restore uniformity only if, contrary to current practice, the states also agreed to a uniform attribution rule for assigning receipts from services and intangibles. Moreover, in the absence of a nexus test based on economic presence, even a uniform sales-only apportionment rule would not restore equity, as it would further enhance the profitability of tax planning.

Summary. States have considerable latitude both to employ combination and to choose their own apportionment formulas. They have, however, until recently been somewhat loathe to require combination, which would allow them to minimize the risk of abuse inherent in separate corporate accounting.[35] By comparison, they have been eager to modify apportionment formulas, but in ways that aggravate abuse, as well as lose revenue. Finally, their power to assert nexus over out-of-state taxpayers is uncertain, but limited by federal law.

B. Multilateral Action

Because states have the power to act unilaterally to require combination and to choose apportionment formulas, they clearly have the power to act in

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single-factor sales formula, used to apportion income of interstate business for income tax purposes, violated neither the Due Process Clause nor the Commerce Clause of the United States Constitution).

33. *Id.* at 274. The Court stated the following:

> [T]he States have wide latitude in the selection of apportionment formulas and that a formula-produced assessment will only be disturbed when the taxpayer has proved by clear and cogent evidence that the income attributed to the State is in fact out of all appropriate proportion to the business transacted in that State or has led to a grossly distorted result.

Id. (citations and quotations omitted).

34. Mazerov, *supra*, note 8, at 59.

35. It must be noted, however, that in the past few years several states (some for purposes of gross receipts taxes) have required combined reporting. *See* Mazerov, *supra* note 17, at 2 (providing a state-by-state map of the current status of combined reporting).

concert[36] to adopt a uniform definition of what constitutes a unitary business or a single formula for apportioning income, as long as they stay within the guidelines of the Supreme Court's delineation of the unitary business principle and fair apportionment, which should not be difficult.[37] But there has been little movement in this direction, and, indeed, as noted, there is much less uniformity of apportionment formulas than before *Moorman*. State latitude to adopt uniform nexus standards for income tax purposes, although seemingly not constrained by the physical-presence test of *Quill*, is substantially less because they are constrained by Public Law 86-272 with regard to income from sales of tangible personal property. The constitutional restraints on nexus outside the scope of Public Law 86-272 remain uncertain. The failure (or legal inability) of the states to take action to reduce uniformity results in the distortions, the opportunities for tax planning, and the complexities that Ryan describes.

C. Federal Action

Congress could, in theory, require the states to apply a uniform definition of a unitary business, a uniform apportionment formula, and a nexus standard based on economic presence, thereby eliminating the distortions, opportunities for tax planning, inequities, and complexities that concern Ryan. It seems, however, for reasons to be described in the final section, that this is not likely to happen.

IV. The Willis Committee Report

Before I turn to the prospects for achieving uniformity, through either multilateral state action or federal legislation, it will be convenient to review some history that began a half-century ago but still casts a long shadow. It was, perhaps, our last best hope for uniformity.

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36. The Supreme Court ruled in *United States Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452 (1978), that states were free to enter into compacts that do not enlarge the powers granted to the states under the Constitution at the expense of federal powers. U.S. Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452, 471 (1978) ("[T]he application of the Compact Clause is limited to agreements that are directed to the formation of any combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States." (quotations omitted)).

37. *See* HELLERSTEIN & HELLERSTEIN, *supra* note 5, ch. 8 (describing the unitary business principle and the fair apportionment criterion and indicating that the relevant constitutional standards are quite forgiving).

In 1959, the Supreme Court handed down a decision that suggested that there might be little effective limit on state assertion of nexus in the corporate income tax area.[38] In response, Congress quickly enacted Public Law 86-272, which was intended to be only a temporary fix pending enactment of permanent legislation, and called for a thorough investigation of state taxes. The result, the Willis Report, was the most comprehensive analysis ever of the state corporate income tax. The Willis Committee made proposals for both substantive and administrative reforms that, if they had been enacted, would have essentially eliminated diversity in state corporate income taxes, except with regard to rates. These proposals were broadly consistent in many respects with what I have proposed here and elsewhere, the notable difference being the nexus standard.

Substantive Proposals. Both jurisdiction to tax and apportionment would be based on payroll and property (real property, in the case of nexus), and consolidation would be mandatory, based on common ownership.[39]

This system, despite any defects, would have been superior to what exists now. Most fundamentally, uniformity would prevail; the distortions and complexity that result from nonuniformity would not exist. Consolidation would eliminate opportunities for tax planning involving transfer pricing, Delaware holding companies, and financial services institutions headquartered in other states. The nexus standard of Public Law 86-272 would not exist, and issues related to throwback and the weight placed on sales in the apportionment formula—particularly the shift to sales-only apportionment—would not arise. It is true that states could not assert nexus based on economic presence (as indicated by sales or intangible assets), but this would not result in nowhere income. Also, sales would not appear in the apportionment formula, but the Willis Committee concluded that the effects of omitting sales from the apportionment formula were not quantitatively significant.[40]

Administrative Proposals. The Willis Committee recommended giving the Treasury Department authority to issue uniform rules and regulations governing state corporation income taxes, to create a uniform state tax return, to prescribe

38. Nw. States Portland Cement Co. v. Minnesota, 358 U.S. 450, 452 (1959) ("[N]et income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the same.").

39. *See* H.R. REP. NO. 89-952, at 1143–61 (1965) (recommending the definition of income to follow the federal definition, thereby eliminating the undesirable distinction between business and nonbusiness income).

40. *Id.* at 529–55.

use of a modified apportionment formula or separate accounting by particular taxpayers, and to resolve multistate conflicts.[41]

Most states objected to the loss of tax sovereignty inherent in the recommendations of the Willis Committee. Moreover, particular states feared loss of revenue if the proposals were enacted. Market states objected to elimination of the sales factor, and states of commercial domicile of corporations, which tax nonbusiness income, worried about the loss of revenue implicit in full apportionment. In addition, business objected to mandatory consolidation. State fear that the Willis Committee's proposals might be enacted helped to precipitate adoption of UDITPA by some states, the drafting of the Multistate Tax Compact, and the creation of the Multistate Tax Commission (MTC). Once the threat of federal legislation had subsided, the states went back, for the most part, to unilateral action—a course that received an enormous boost by the 1978 decision in *Moorman*.

V. The Politics of Uniformity

Recent history also suggests that uniformity—at least not uniformity that would increase equity, as well as reduce complexity and distortions—will not come about soon, whether through multilateral state action or federal action.

A. Multilateral Action

In August 2007, at the behest of the MTC,[42] the Uniform Law Commission convened a drafting committee to revise UDITPA.[43] This effort was abandoned quickly when organizations representing state legislators made

41. *Id.* at 1135–36, 1161–63.

42. *See* Letter from Joan Wagnon, Chair, Multistate Tax Comm'n, and Joe Huddleston, Executive Dir., Multistate Tax Comm'n, to Robert A. Stein, Esq., Chair, Comm. on Scope and Program, Nat'l Conference of Comm'rs on Unif. State Laws (Sept. 6, 2006) ("We believe model amendments or a complete rewrite are critical to preserving the original uniformity goals of UDITPA . . . .") (on file with the Washington and Lee Law Review); Memorandum from Joe Huddleston, Executive Dir., Multistate Tax Comm'n, to Charles A. Trost, Chair, Study Comm. on Revisions of UDITPA 1 (May 2, 2007) ("In the interest of preserving the broadest uniformity possible, we invite NCCUSL to work with us to review and draft model proposed amendments to UDITPA . . . .") (on file with the Washington and Lee Law Review).

43. *See* Press Release, Unif. Law Comm'n, National Law Group Revising Important State Tax Law (Feb. 13, 2008), *available at* http://www.nccusl.org/Update/Docs/UDITPA/UDITPA_PressRelease_021308.pdf (announcing formation of the drafting committee to reexamine UDITPA).

it clear that it was not welcome and that any revision of the model statute would be widely rejected by the states.[44]

This outcome was hardly unexpected.[45] Corporations generally have a vested interest in nonuniformity, as it allows them to play one state against another in gaining generous tax treatment. Nor are the states necessarily interested in uniformity, which they reject so they will be able to cater to business, in order to attract investment—or simply to retain sovereignty for its own sake.[46]

B. Federal Action

The political dynamics are a bit different in the case of federal legislation that would increase uniformity. Business would like to see additional restraints on state assertion of nexus and would bitterly oppose federal legislation legalizing a test of nexus based on economic presence. It presumably would not want a return to the days of uniform apportionment formulas, unless the formula adopted was weighted heavily toward sales. It also would oppose a requirement for mandatory combination. (Uniformity of definitions of the unitary group would probably matter much less.)

State positions on nexus rules and perhaps combination generally would be diametrically opposed to those of business. But states also likely would resist federal limits on their ability to choose apportionment formulas. This opposition goes beyond a desire to engage in beggar-thy-neighbor policies by altering the apportionment formula. It reflects widespread resistance to federal encroachment on state fiscal sovereignty. This resistance helps explain the defeat of what, in retrospect, may have been the best hope for rationalizing state corporate income taxes, the 1965 proposals of the Willis Committee.

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44. *See* John Buhl, *ULC Committee Recommends Halting UDITPA Revision Study*, 53 STATE TAX NOTES 7, 7 (2009) (noting the Uniform Law Commission's recommendation to terminate a study of whether to revise UDITPA); Joe Huddleston & Shirley Sicilian, The Project to Revise UDITPA 9 (2009), http://www.mtc.gov/Uniformity.aspx?id=4562 (follow "The Project to Revise UDITPA" hyperlink) (last visited Feb. 8, 2010) (noting the strong opposition to the project from, among others, the Committee on State Taxation, ALEC, and the Tax Executives Institute) (on file with the Washington and Lee Law Review).

45. Indeed, I had predicted it in Charles E. McLure, Jr., *Understanding Uniformity and Diversity in State Corporate Income Taxes*, 61 NAT'L TAX J. 141 (2008).

46. *See supra* note 3 and accompanying text (noting ALEC's preference for state sovereignty).

C. Political Stalemate?

Business appears to be engaged in a two-part strategy to undermine the state corporate income tax, pushing for a physical presence test of nexus, and for sales-only apportionment in state capitals. States seem only too happy to increase the weight on sales, but not to accept a tighter constraint on nexus. Which side will prevail in Washington remains to be seen.

The only important multilateral state actions in this area, the drafting of UDITPA, the adoption of the Multistate Tax Compact, which incorporated UDITPA, and the creation of the MTC, were precipitated by the specter of federal legislation proposed by the Willis Committee and lay well within the states' constitutional competence.[47] This experience has little salience in the current debate over nexus rules. The threat that BATSA may become law is not likely to fire up the states to enact a uniform test based on economic presence. The issue is not merely that the states cannot agree to act in accord. Rather, in the absence of definitive guidance from the Supreme Court, there is considerable uncertainty as to what is allowable under the Constitution.

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47. *See* W. Bartley Hildreth et al., *Interstate Tax Uniformity and the Multistate Tax Commission*, 58 NAT'L TAX J. 575 *passim* (2005) (discussing the progress of state corporate income tax uniformity); Bartley Hildreth et al., *Cooperation or Competition: The Multistate Tax Commission and State Corporate Tax Uniformity*, 38 STATE TAX NOTES 827 *passim* (2005) (tracing the history of the MTC and discussing the progress of state corporate income tax uniformity).