STATE TAXATION OF MULTISTATE BUSINESSES

Problems of discriminatory state taxation of multistate business have long plagued the courts, and have recently been a subject of special congressional study. The courts have frequently confronted "vertical" discriminations — differential treatment by a single state of its local and multistate taxpayers. The House study gives limited attention to this vertical problem, but seems more concerned with achieving "horizontal" uniformity — uniform treatment of multistate taxpayers by each of the states. This indiscriminate quest for horizontal uniformity is heedless of the severe inroads upon state taxing powers which it entails. In part, the House Report's lack of discrimination results from inadequate recognition that some horizontal uniformities are useful only to prevent vertical discriminations. The failure of recognition, in turn, causes the House Report to ignore the full dimensions of the problem of vertical discrimination. This Note will suggest that the problems discussed in the House Report should be solved with means more moderate than horizontal uniformity.

The Report's undue emphasis upon horizontal considerations is best indicated by its apportionment proposal. The legislation proposed by the House Report would establish a uniform method for dividing the multistate taxpayer's tax base among states with jurisdiction to tax. At present, states not only use

1. Special Subcommittee of the Committee on the Judiciary, State Taxation of Interstate Commerce, H.R. Rep. No. 1480, 88th Cong., 2d Sess. (1964) [hereinafter cited as House Report]. The House subcommittee was authorized to examine "all matters pertaining to the taxation of interstate commerce by the States . . . ." Public Law 86-272, 73 Stat. 555 (1959), as amended, Public Law 87-17, 75 Stat. 41 (1961), (the background of which is related in House Report, vol. 1, 7-9). But, for practical reasons, it delimited the scope of its study, focusing upon state income and retail sales and use taxation, and upon incorporated multistate taxpayers. Id. at 14-18. More precisely, its emphasis was upon state income taxation. E.g., id. at 591-99. The remainder of this Note will adopt a similar perspective in order to facilitate comparison with the House Report. But many of the problems to be discussed, and the solutions to be proposed, apply to state taxation of multistate taxpayers generally — regardless of the kind of tax imposed, the form in which the multistate taxpayer operates, or the sort of economic activity in which such a taxpayer is engaged.

2. The "vertical"-"horizontal" distinction has not been applied previously in this context, but is believed to be a useful tool of analysis.

3. Perhaps this predisposition of the House subcommittee — which focuses primarily upon state income taxation of multistate taxpayers, supra note 1 — is accounted for in part by the existence of a counterpart horizontal statute at the federal level. And it also may be due to a tendency to view the states' taxation of multistate taxpayers in terms of a horizontal "system" of state taxation — a perspective which de-emphasizes that "the system" is merely an abstraction from the taxing systems of particular states. E.g., House Report, vol. 1, at 598.


The wholly local taxpayer is taxed by his state upon 100% of its total tax base. The function of the states' apportionment formulas is to determine what portion of the multi-
different methods of allocation — separate accounting, specific allocation and formula apportionment — but also the formulation of each method varies with the state. Since a state can choose the method most favorable to itself, this diversity might subject a multistate taxpayer to cumulative taxation on more than 100 per cent of its tax base. The proposed uniform standard would allow a state to tax only the portion of the tax base which is “fairly attributable” to it, thus limiting cumulative taxation to 100 per cent of the taxpayer’s base.

This uniformity is desirable only as a means of preventing vertical discriminations. Concern with the cumulative effects of divergent apportionments is better understood in terms of a discrimination against the multistate taxpayer by a particular taxing state. When the state apportions to itself an unduly high state taxpayer’s total tax base should be taxed by particular states, to “relate the taxpayer’s presence within the State to his presence everywhere.” House Report, vol. 1, at 168. The apportionment formula determines what part of the taxpayer’s total net income is taxable by a particular state by reference to the proportions of selected aspects of the taxpayer’s total business which are connected with that state. Three general aspects, or “factors,” are available for use by the states: property, payroll and sales. Id. at 168-70. “[E]ach factor is expressed as a fraction, with the numerator representing dollar value within the State and the denominator dollar value everywhere.” Id. at 168. Where a single-factor formula is employed by the taxing state, the portion of the taxpayer’s total net income attributable to that state is determined by multiplying total net income by the ratio or fraction yielded by comparing the value, for example, of the taxpayer’s in-state property with that of its total property. Similarly, where a multiple-factor formula is used, the apportionment ratio to be applied against total net income consists of the sum of the fractions yielded by analysis of each factor averaged by dividing that sum by the number of factors employed.


6. See Developments in the Law, 965-66, 1013; Harriss, Interstate Apportionment of Business Income, 49 Am. Econ. Rev. 398, 399-400 (1959); House Report, vol. 1, 389, 414-16. As the House Report points out, this diversity also might produce cumulative taxation on less than 100% of the multistate enterprise’s tax base.

It should be noted that the courts have not acted to eliminate diversity among the states’ methods of dividing income; rather, they sustain a variety of approaches so long as each is somehow deemed fair. This limited judicial role, however, is appropriate. See House Report, vol. 1, 160, and citations therein.

7. Cf. House Report, vol. 1 at 246. Put more broadly, such a standard would fix cumulative taxation, both actual and potential, at no more (and no less) than 100% of the multistate enterprise’s tax base. A uniform formula would attribute portions of the multistate taxpayer’s total net income to all states with which the taxpayer had the connections deemed relevant by Congress. Some of those states might not impose a tax; at present thirty-seven states plus the District of Columbia levy a corporate income tax. House Report, vol. 1, 255-56, nn. 1-3. That they do or do not should be irrelevant to the operation of the uniform formula. See note 10 infra; cf. House Report, vol. 1, 389, 390, 414-15. The function of an apportionment formula is to determine to what extent a state may tax the multistate taxpayer if it wishes to do so.

8. In this Note, the term “vertical discrimination” will be used not in its generic sense, but to refer only to discriminations against multistate taxpayers. “Reverse vertical discrimination” will refer to discriminations against wholly local taxpayers.
share of the multistate enterprise’s tax base, the state effectively taxes the portion of that base “fairly attributable to” it at a higher rate than it imposes upon his wholly domestic counterpart.\(^9\) Indeed, cumulative taxation on more than 100 per cent of the tax base injures the multistate taxpayer only through this kind of single-state vertical discrimination.\(^10\)

Although the House Report fails to recognize the vertical implications of its apportionment proposal, it proposes other horizontal uniformities in part to prevent vertical discrimination. The Report criticizes a variety of discriminatory deduction provisions commonly employed by the states — “[t]he allowance of an extra depreciation deduction on in-State property, the allowance of charitable contributions only if made to local donees, and the allowance of an intercorporate dividend deduction only if the paying corporation is taxed in the State.”\(^1\) The Report would eliminate these discriminations by imposing uniform and nondiscriminatory deduction provisions on all the states.\(^12\) This

9. Both the House Report and the commentators recognize, of course, that there is something discriminatory about the multistate taxpayer, unlike the single-state taxpayer, being taxed upon more or less than 100% of its tax base. But they do not recognize that this cumulative sort of discrimination becomes concrete only through a correlative vertical discrimination by a single taxing state. See House Report, vol. 1, at 389, 414-16, and cf., id. at 157; see Developments in the Law at 965-66, 1013.

10. Cf., Symposium on State Taxation of Interstate Commerce, 27 Tenn. L. Rev. 239, 242 (1960). It should now be clear why the uniform apportionment formula must attribute portions of the multistate taxpayer’s total tax base to all states with which the taxpayer has the relevant connections, whether or not those states impose the tax in question. See note 7 supra. Modifying a uniform apportionment formula by attributing portions of the tax base not to all states with which the multistate taxpayer has the relevant connections but only to those states which impose the tax in question would permit the very vertical discriminations which the horizontally uniform formula was designed to prevent. In each of the states which imposes the tax, the multistate taxpayer will be taxed upon a tax base in excess of that “fairly attributable to” that state, and thus at a higher rate than is imposed upon his local competitors in that state. Alternatively, the vertical discrimination can be conceptualized as occurring in the state which could tax, but chooses not to do so. That state in effect taxes its multistate and local taxpayers at the rate of 0%. If the excess taxes paid to the taxing states because of the unfair attribution are viewed as being borne in the state which might have taxed but did not, then the multistate taxpayer is taxed at a rate above 0% there. However conceptualized, an apportionment formula modified in the manner described would effect a rate discrimination against the multistate taxpayer in one of the states to which some of his total tax base was fairly attributable.


12. Id. at 587-90. It is unclear whether the proposal would impose horizontal uniformity with respect to all aspects of the tax base or merely to the particular deductions discussed in the House Report. The alternatives are said to “vary from complete conformity to very limited substantive restriction.” Id. at 590. The particular discriminatory deduction provisions cited in the Report are apparently cited only as examples of “provisions under which the deductibility of an item turns upon the occurrence of an event within the taxing State.” Id. at 588. Since, in theory, any deduction provision can be so drafted, that class might include all deduction provisions. And in practice, horizontal uniformities employed to prevent vertical discriminations would be futile if the states were
proposal would severely interfere with state taxing powers by preventing them from employing their existing power to define tax bases in order to accomplish revenue or regulatory objectives. Such interference is unnecessary in view of the judicial doctrine that vertical discriminations against multistate taxpayers violate the interstate commerce clause. Reliance on this doctrine would remedy discrimination without curtailing the states' authority to define tax bases in any non-discriminatory manner.

The House Report suggests that horizontal uniformity of tax bases would not only eliminate vertical discriminations, but would also simplify multistate-taxpayer compliance with states' tax statutes. While such taxpayers would surely find it simpler to work with a uniformly defined tax base, the benefits of simplicity seem too slight to justify this interference with state taxing powers. As the House Report itself recognizes, "it does not seem probable that the costs induced by differences in the definition of taxable income present a significant burden to many companies today." Moreover, a measure short of uniform definitions of fixed content would greatly simplify compliance without restriction upon state taxing powers. Congress could require all states to adopt the "moving Federal base — that is, a definition of taxable income which begins with the Federal figure" — and to explicitly enumerate those respects in which the state base departs from the federal one. While a requirement of uniform but "moving" tax bases would entail state revision of tax statutes, the states' taxing powers would remain intact. The states would be free to make departures from the uniformly defined tax base so long as those departures were enumerated. This "uniformity of form" would not simplify compliance as much as would fixed or "substantive" uniformity, since differences among state definitions of tax base would persist. But it would eliminate the primary source of difficulty and expense in complying with various definitions left free to manipulate any deduction provision, or indeed the tax rate itself. Therefore, if vertical discriminations were sought to be prevented by the use of horizontal uniformities given nondiscriminatory content, all aspects of the tax base, and the tax rate, might be made horizontally uniform. Accord, id. at 583.


14. See text accompanying notes 63-78 infra; but note that Congress must strengthen enforcement of this doctrine. A congressional requirement of vertical uniformity might be applied to all aspects of the tax base and to tax rates as well. Perhaps the House Report was referring to this alternative solution to the problem of vertical discriminations when it stated:

Although the prevention of discrimination against multistate taxpayers might be achieved without a requirement that the States conform to the Federal definition of taxable income, it would be at least an incidental benefit of conformity. [Emphasis added.]

HOUSE REPORT, vol. 1, at 588.

15. Id. at 583-87, 589-90.
16. Id. at 585.
17. Id. at 589-90.
18. Id. at 590. Only "substantive" horizontal uniformity is, in fact, horizontal uniformity.
determining the respects in which the states' tax bases differ.\textsuperscript{10} The House Report has considered the use of horizontally uniform but "moving" tax bases only in the area of state income taxation, apparently because the federal income tax statute provides the needed horizontally uniform definition.\textsuperscript{20} But the moving-base approach could be used to simplify the system of multistate taxation even when no similar federal tax exists. Congress need only establish uniform tax bases to serve as prototypes.

Beyond questions of desirability, the proposals for horizontal uniformity raise serious constitutional doubts. Since Congress has never imposed such far-reaching restrictions on state taxing powers, the constitutional question is open: to what extent may Congress infringe upon state tax powers under the authority to regulate interstate commerce?\textsuperscript{21}

In his definitive examination of federal systems, Wheare stresses that one must "distinguish the taxing power from other legislative powers. Its nature is different. It is the power to raise means, [not] to regulate specific fields." He concludes that federal powers "must not be used so as to deny to the states the . . . power to provide the means by which they are to carry out the functions which are left to them in the constitution."\textsuperscript{22} This principle was neglected by neither the framers nor the elaborators of the Constitution. In the Federalist papers, even Hamilton argued that state taxing powers could be subjected to no congressional restriction whatever.\textsuperscript{23} In \textit{Gibbons v. Ogden} Marshall recognized that "the power of taxation is indispensable to [the states'] existence."\textsuperscript{24} Although Marshall was referring primarily to the states' need for revenue, effective governance by the states requires use of the taxing power for nonrevenue purposes also. The states' power to tax has always been seen in the same light as the federal power — a power to be used for any govern-

\begin{itemize}
  \item [19.] Id. at 583-84, 589-90.
  \item [20.] Cf. id. at 278-79. Compare note 3 \textit{supra}.
  \item [21.] The question treated here involves congressional authority to restrict state taxing powers against the will of the states. Were the states willing to give up certain of their taxing powers in return for federal grants-in-aid, this would seem unobjectionable, at least if they were assured independent access to obligatory federal grants unconditioned as to use. \textit{Cf.}, \textit{HANAN}, \textit{F I N A N C E AND TAXATION, ESSAYS ON THE AUSTRALIAN CONSTITUTION}, 247 (2d ed. 1961) for an analysis of the somewhat analogous Australian experience.
  \item [22.] \textit{WHEARE, FEDERAL GOVERNMENT} 107-08 (4th ed. 1963). And see id. at 93.
  \item [23.] \textit{The Federalist} No. 32, at 249 (Hamilton ed. 1880) (Hamilton). A premise of his absolutist argument was that, in the absence of congressional action, the states possess taxing powers under the constitution except to the extent expressly restricted in that document. \textit{Id.} at 251-52. This intermediate position is well settled today. \textit{E.g.}, Hellerstein \& Hennefeld, \textit{State Taxation in a National Economy}, 54 \textit{Harv. L. Rev.} 949, 951-54 (1941), noting especially nn. 7-11 and accompanying text. But these authors take the further position that, when Congress regulates state taxation of interstate commerce, "the constitutional picture changes completely; then any tax inconsistent with the congressional action is invalid by reason of the grant of supremacy to Congress." \textit{Id.} at 953. This position assumes, however, that there are no constitutional limits upon congressional power to regulate state taxation.
  \item [24.] \textit{Gibbons v. Ogden}, 22 U.S. (9 Wheat.) 1, 199 (1824).
\end{itemize}
mental purpose.\textsuperscript{25} Taxing powers enable the state to regulate private conduct, to fix the relative sizes of the state and private sectors, and to finance state-selected programs.

However, it is a commonplace that congressional power to regulate interstate commerce is virtually unlimited. Within the context in which this assertion is usually made, it is quite accurate. Since the decision in \textit{Gibbons v. Ogden}, Congress' commerce power has been defined as one to regulate those "branch[es] of trade" which themselves constitute or affect "commercial intercourse" among the states.\textsuperscript{26} And Congress may today regulate many sectors of the national economy previously deemed to be wholly "intrastate" and without substantial effect upon interstate commerce. In sustaining broad assertions of the commerce power, however, the courts have stressed the interstate nature of the activity regulated, and have not emphasized the state power displaced or restricted.\textsuperscript{27} This emphasis is necessary when Congress attempts a broad interference with the state taxing power, a power essential to the capacity to govern. New constitutional doctrine must be fashioned to protect state taxing powers from undue interference, without preventing Congress from accomplishing any legitimate objectives.

Since Congress has no explicit power to regulate state taxation, any regulation must be justified by both the commerce clause and the "necessary and proper" clause.\textsuperscript{28} The oft-venerated exposition of the "necessary and proper" clause was handed down by Chief Justice Marshall in \textit{McCulloch v. Maryland}.

\begin{quote}
Let the end be legitimate, let it be within the scope of the constitution, and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consist with the letter and spirit of the constitution, are constitutional.\textsuperscript{29}
\end{quote}

A brief inquest will suggest that these words should not have so long outlived their author.

Marshall's formulation concludes his discussion of this question: to what "extent"\textsuperscript{30} may Congress go beyond its enumerated powers by virtue of the necessary and proper clause? The discussion begins by assuming its conclusion:

The counsel for the State of Maryland have urged various arguments, to prove that this clause, though in terms a grant of power, is not so in effect; but is really restrictive of the general right, which might otherwise be implied, of selecting means for executing the enumerated powers.\textsuperscript{31}

\textsuperscript{25} See, \textit{e.g.}, \textit{Magnano Co. v. Hamilton}, 292 U.S. 40, 43, 47 (1934); \textit{United States v. Sanchez}, 340 U.S. 42, 44-45 (1950), relying explicitly upon \textit{Magnano}.

\textsuperscript{26} \textit{Gibbons v. Ogden}, 22 U.S. (9 Wheat.) 1, 189-90, 193 (1824).


\textsuperscript{28} \textit{U.S. Const. art. I, § 8}.

\textsuperscript{29} \textit{McCulloch v. Maryland}, 17 U.S. (4 Wheat.) 316, 421 (1819).

\textsuperscript{30} \textit{Id.} at 405, 410.

\textsuperscript{31} \textit{Id.} at 412.
Thus, although the issue was the extent of congressional power under the necessary and proper clause, Marshall avoided this question of degree and focused instead on whether the clause constituted a "grant" of power, an issue on which there was no disagreement. Then, after recognizing that Congress, simply by implication from its enumerated powers, would have power to select appropriate means of implementation, he imposed upon the state the burden of showing that the clause was not merely redundant. On this point, Marshall seems to have relied on his intimate knowledge gained while framing the constitution.

That this idea [broad authority to implement enumerated powers] was entertained by the framers of the American constitution, is not only to be inferred from the nature of the instrument, but from its language. But while representing a majority of the Court, Marshall was apparently among the dissenting framers.

Although Marshall's circumratiocination cannot justify a generally broad construction of the necessary and proper clause, a broad construction can be justified in the particular context it appeared. Marshall's exegesis of the clause is found in the section of his opinion relating to congressional power to establish a national bank, an implied power which would restrict no power of the states. But the ultimate issue in McCulloch was whether the national bank was immune from state taxation. Marshall avoided the question of whether it was "necessary and proper" for a national bank to be immunized from state taxation by posing the question in terms of constitutional immunity of a sovereign. He elaborated no standard for the scope of implied congressional powers which conflict with state powers. Marshall's broad construction of the necessary and proper clause is confined on the facts of McCulloch to those situations in which congressional power is unlimited by principles of federalism. Every analogy upon which he relies also suggests this limitation upon his holding, as, for example, his compelling argument from the fact that Congress

32. In addition to the quotation accompanying note 31 supra, see id. at 406, 420.
33. Id. at 407.
34. Ibid. And see id. at 408, 420, for other statements of Marshall as framer.
35. Id. at 401-25.
36. Id. at 425.
37. Id. at 425-37. The congressional statute creating the national bank did not purport to bestow upon it immunity from state taxation. Technically, then, Marshall was free to pose the question as a constitutional one, not involving congressional powers under the necessary and proper clause. In doing so, however, he chose to ignore the ultimate derivation of the bank's immunity from the congressional statute creating the bank.
38. Even if Marshall was not required to elaborate the necessary and proper clause in this context, supra note 37 and accompanying text, it is odd that he did not do so in dictum. For he, above all, was mindful that he was "expounding" a constitutional provision for future generations and circumstances. Id. at 407, 415.
39. Id. at 416-18.
has the power to punish for the breach of those laws which it has the power to adopt.

[A] limited construction of the word "necessary" must be abandoned in order to punish. . . . If the word "necessary" means "needful," "requisite," "essential," "conducive to," in order to let in the power of punishment for the infraction of law; why is it not equally comprehensive when required to authorize the use of means which facilitate the execution of the powers of government without the infliction of punishment?40

One reason which might be suggested is that "equally comprehensive means" may sometimes impair the powers of the states, most crucially the power to tax. Marshall did not neglect the critical importance of state taxing powers.41 He recognized that the power to tax is also the power to survive. Indeed, he implied that this power is virtually unlimited, except by the principle of sovereign immunity.

It is admitted that the power of taxing the people and their property is essential to the very existence of government, and may be legitimately exercised on the objects to which it is applicable, to the utmost extent to which the government may choose to carry it. . . . [Moreover] the power of taxation is not confined to the people and property of a State. It may be exercised upon [multistate taxpayers] . . . The sovereignty of a State extends to every thing which exists by its own authority, or is introduced by its permission; but does it extend to those means which are employed by Congress to carry into execution powers conferred on that body by the people of the United States? We think it demonstrable that it does not. Those powers are not given by the people of a single State. They are given by the people of the United States, to a government whose laws, made in pursuance of the constitution, are declared to be supreme. Consequently, the people of a single State cannot confer a sovereignty which will extend over them.42

While Marshall's broad formulation of the necessary and proper clause should not be taken to permit undue congressional encroachments upon state taxing powers, neither should his broad formulation of the states' power to tax non-federal entities be taken to preclude Congress from ever regulating state taxation of multistate enterprises. A flexible test, responsive to conflicting claims of state and federal power, is demanded. The "necessary and proper" clause provides such a test, if the words are construed strictly where the essential state power of taxation is involved. "Necessary" is an ambiguous word, as Marshall himself recognized.43 What follows, however, is not that we must attribute to it some fixed content, upon the questionable hypothesis that the framers both foresaw the variety of situations to which the clause might be applied and intended that the same meaning be given in all of them.44 Rather, in the fashion of judges, we must particularize our construction of the clause,

40. Id. at 418.
41. See text accompanying note 24 supra.
42. Id. at 428-29.
43. Id. at 415.
44. Id. at 414-15, 419.
giving it a meaning appropriate to the context. And in doing so, "we must never forget, that it is a [federal] constitution we are expounding." 45

When state taxing powers and congressional interest in commerce conflict, Congress should be constitutionally obligated to accomplish its objectives in the way which least conflicts with state authority. 46 It should not be permitted to employ all "appropriate" means, but only those means "necessary" to its purposes. This test requires that Congress have a legitimate interest in regulating the entire group affected by its legislation. Thus Congress could legislate for all multistate taxpayers as a class only if its objectives permitted no finer distinctions. Furthermore, the particular regulation imposed would have to be narrowly tailored to the congressional purpose.

The House Report proposals affect the entire class of multistate taxpayers, but this broad coverage would be constitutionally permissible. Whether the proposals are necessary to prevent malapportionment of the multistate taxpayers' tax bases, to simplify their compliance problems, or to protect them from vertical discrimination, inclusion of the entire class is essential. However, some of the particular regulations which the Report would apply to this class pose more difficult constitutional problems.

The proposed uniform apportionment proposal is minimally restrictive of state tax powers, and entirely consistent with the constitution. Since apportionment formulas are used only with respect to multistate taxpayers, the proposal would not affect state tax policies of general application. Moreover, the most common effect of diverse state apportionment formulas is that of vertical discrimination. No measure short of a horizontal uniform apportionment could prevent the "cumulative" vertical discriminations which result from the diversity. 47

The House Report suggestion of horizontally uniform tax bases is not so easily justified. 48 The Report directs this proposal to two objectives: reduction

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45. Id. at 407.

46. It might be argued that this strict, necessary and proper test, designed to protect state taxing powers, might unduly prevent Congress from overriding state regulatory policies. Thus a state, recognizing the breadth of congressional authority to override exercises of the police power, might add a tax to its regulatory scheme in the hope of sheltering it from congressional action. This attempt, however, would be futile. If the Congress could prevent implementation of the disapproved state policy only by striking down the regulatory scheme and its enforcing tax, the strict necessary and proper test would sustain the congressional action. On the other hand, if means short of striking down the tax in its entirety were available — e.g., the removal of one of several conditions upon which tax liability was dependent — the test would demand the use of the lesser means. But the test proposed would never prevent Congress from accomplishing its objective.

47. HOUSE REPORT, vol. 1, 588. For similar reasons, the Report's proposal to eliminate the diversity now existing among the states' rules regarding timing of income and deduction items should be approved. Id. at 412-13, 588. See generally notes 4-10 supra and accompanying text.

48. The Report itself is somewhat hesitant about the imposition of horizontal uniformities of fixed content in this area — noting that "[w]hile the desirability of uniform
of compliance cost and elimination of vertical discrimination. The Report identifies the major source of compliance cost for the multistate taxpayer as the cost of ascertaining the differences among state taxing bases. To the extent that the Report's proposal is designed to reduce this cost, it is unnecessary. Adoption of the moving federal base approach would greatly reduce this cost. 49 But the House Report may have proposed substantive base uniformity in order to eliminate that cost entirely by removing the differences of definition. 60 In that case, a different question would be presented — whether the congressional objective was sufficiently weighty to permit major infringement of state taxing powers. While the “necessary and proper” test is not directly relevant to the weighing of congressional objectives (rather than means), the same state interest is at stake and should be given commensurate respect. On the other hand, the costs arising solely from the fact of differences among state definitions — that is, those which arise after the relevant differences are known — are admitted by the House Report to be insubstantial. 61 The second objective, elimination of vertical discrimination, can be achieved by more narrowly tailored congressional action. 62

While the federal interest in horizontal base uniformity is slight, the proposal would likely involve a far greater interference with state taxing powers than the Report reveals. For reasons of administrative feasibility, states may be required to adjust the tax base applicable to local taxpayers to match the multistate base. Indeed, this adjustment may be required by the equal protection clause. 63 In either case, the federal legislation would in effect fix tax bases applied by the states to their local taxpayers. 64 The House proposal is not

See notes 16-19 supra and accompanying text.

50. It is not entirely clear whether this was among the purposes for which substantive horizontal uniformity in the area of tax base was sought. See House Report, vol. 1, 583-87, 589-90.

51. See id. at 583-84, and particularly text accompanying note 15 therein.

52. See note 14 supra and accompanying text.


54. It is arguable, moreover, that Congress might be required by the equal protection requirement implicit in the fifth amendment, see Bolling v. Sharpe, 347 U.S. 497 (1954), to assure that wholly local taxpayers will not suffer reverse vertical discriminations when multistate taxpayers’ bases are fixed. The consequence of either de facto or explicit extension of tax base uniformity to local taxpayers would be a congressional fixing of the tax base applied by the states to their local taxpayers. Apart from such extensions, Congress, in order to employ horizontal uniformity as a means of preventing vertical discrimination, would at least have to fix, as the minimum base employed by the states for their local taxpayers, that which it established for multistate taxpayers. Because substantive horizontal base uniformity with respect to multistate taxpayers is unnecessary for the accomplishment of any of the purposes mentioned by the House Report, its partial or complete extension to local taxpayers would also be unnecessary.
"necessary and proper" within the meaning of that phrase suggested above.55

Some commentators have made even more drastic proposals to eliminate horizontal disuniformities. They argue that horizontal uniformity would enable

55. The analysis also raises serious questions as to the validity of proposed horizontally uniform jurisdictional standards, House Report, vol. 1, 481-516 (summarized at 513-16), as well as those already in existence. Public Law 86-272, 73 Stat. 555 (1959), as amended, 15 U.S.C. §§ 381-84 (Supp. III, 1961). Both operate only to restrict admittedly constitutional assertions of state taxing jurisdiction. See generally House Report, vol. 1, 11, 12. The difficult questions involved have not been confronted by the Supreme Court. The decisions sustaining the validity of Public Law 86-272 are inadequate. See Int'l Shoe Co. v. Cocreham, 246 La. 244, 164 So. 2d 314 (1964), cert. denied, XLVII Shepard's L.A. Citations, No. 2 292 (1965). State ex rel. Ciba Pharmaceutical Products, Inc. v. State Tax Commission, 382 S.W.2d 645 (1964). The proposed jurisdictional standard is said to be necessary, in part, to provide clarity in the states' jurisdictional standards, thus improving both the levels of voluntary compliance and the possibilities of state enforcement. House Report, vol. 1, at 514, 489. Even if we assume that there is some congressional interest, under the commerce clause, in accomplishing these objectives, congressionally imposed jurisdictional standards of fixed content are a means unnecessarily restrictive of state taxing powers. Congress might enact a "moving" prototype jurisdictional standard, from which the states would be free — within the bounds of due process — to depart so long as those departures were explicitly enumerated. Cf. notes 17-19, 48-51 supra and accompanying text. Such a standard might include both qualitative and quantitative tests, and the states might be compelled to employ both. See generally House Report, vol. 1, 489-513. When a multistate taxpayer contemplates operations within a state, he can as easily consult that state's definition based upon the moving federal standard as he can a fixed federal standard. Surely state enforcement officials can do the same.

The proposed standard is also said to be necessary to achieve consistency with the proposed uniform apportionment formula, in order to assure that both pursue the same "policy as to where income should be subject to income taxation." House Report, vol. 1, 513. However, Congress has no authority to fix general policy regarding jurisdiction to tax. Moreover, the uniform apportionment formula is desirable not to implement some "policy" as to where income should be taxable, but rather to prevent vertical discriminations. See note 9 supra and citations therein, notes 4-10 supra and accompanying text. In establishing a uniform apportionment formula, Congress will inevitably affect where income is taxable. But this is only an incidental effect of a proposal necessary to prevent vertical discriminations. See House Report, vol. 1, 560.

The proposed jurisdictional standard is finally said to be necessary because any apportionment formula "will result in the attribution by some companies to some States of very small proportions of their income." Id. at 513-14. The suggestion is that this "compliance burden" is "undue." Ibid. As distinguished from other compliance costs with which the House Report is concerned, see notes 15-19 supra and accompanying text, the "compliance" costs of particular relevance to this proposal are only those incident to the filing of returns and those reflecting payment of taxes. Id. at 488. The first of these costs is inevitable, so long as there is state taxation; the second is not a "compliance" cost at all, but is the product of compliance. The House Report's objectives are less ambitious. Its concern is not with these costs as they affect all multistate taxpayers, but only as they affect small multistate taxpayers. Id. at 514, 515, 505-06; cf. id. at 7. As to them, Congress may have legitimate reasons for restricting state taxation. See note 62 infra. But if Congress's legitimate concern is with this particular class of multistate taxpayers, it is necessary, and therefore constitutional, to restrict state taxation of only this class. See paragraph accompanying note 46 supra. Public Law 86-272, enacted for the legitimate purpose
multistate taxpayers to allocate their resources among the states by reference to market factors alone, without regard to varying tax burdens. Eliminating these varying tax burdens would free the multistate taxpayer from "artificial" considerations, and thus allow him to use his resources most efficiently.60 While not followed to this conclusion by its advocates, this logic would seem to require not merely that all states apply identical rates to identically defined tax bases, but that the states impose exactly the same kinds of taxes. Under the constitutional test developed above, Congress might impose this broadest of horizontal uniformities only if it accepted the theory that any tax difference among the states is inefficient. But this theory misconceives the nature of state taxes.

State governments, like private businesses, vary in the extent to which they provide an ample "return," in the form of government services, upon tax cost "investment."67 Some commentators have rejected the concept of a tax "return" because it is difficult to generalize about the benefits received by "the average taxpayer."58 But from the perspective of each individual taxpayer, the return varies depending on the state government involved. The individual taxpayer can consider the states' varying returns as well as their differing tax burdens when selecting states in which to operate.69 Thus horizontal disuniformity is not "artificial" to the extent that the state governments provide different services.60

of protecting small multistate enterprises, House Report, vol. 1, at 7, should be deemed unconstitutional because its imprecise drafting has resulted in the insulation from state taxation of enterprises of substantial size. Id. at 438-39. Compare Bittker, Federal Income Taxation of Corporations and Shareholders 403 (student ed. 1963). Congress might avoid this consequence in any new legislation by adding to its proposed restriction upon state tax jurisdiction one qualification — that the restriction operate only with respect to businesses below a specified size. But cf., House Report, vol. 1 at 510-11. See generally id. at 481-516 (summarized at 513-16).


57. See Sufrin, Tax Incentives and Industrial Location, 10 Syracuse L. Rev. 21, 23-26 (1958). Cf. Hellerstein & Hennefeld, supra note 23, at 968. As the Sufrin article suggests, the return upon tax cost investment may include not only public services and facilities, but also such things as labor stability, which appears to vary directly with the level of governmental services.

58. See Developments in the Law at 957.

59. See Sufrin, supra note 57.

60. The states to some extent impose higher levels of taxation not only because of benefits attributable directly or indirectly to governmental activities, but also because of the presence within their boundaries of assets of sufficient value to induce taxpayers to pay the state for their use. See Developments in the Law at 968-69, but note that the assertion there that this practice is a frequent one is inadequately documented and somewhat inconsistent with note 82 therein. Perhaps Congress should prevent the states from imposing tax charges for benefits within their territory not attributable to the activities of their governments as such charges impede access to these resources. Total horizontal uniformity would be one way to prevent this practice, but it would seem to be a most
While the states may vary in providing governmental services, both multi-state and local taxpayers enjoy equally the benefits conferred by any single state. Therefore a vertical discrimination against multistate businesses in the tax burden imposed does not reflect economic return. Unlike horizontal disuniformity, vertical disuniformity denies multistate taxpayers equal access to local markets, causing misallocation in the national economy. Eliminating vertical discrimination would free the economy from artificial restraints.\footnote{Congress should attend more seriously to these vertical problems, and should require vertical uniformity.} A variety of things within a state's boundaries may be of particular value at some times and not others, to some multistate taxpayers and not others. If the taxes which reflect this practice are not of general application, but are imposed upon the particular groups tapping the asset in question, as is suggested in Brown, \textit{The Open Economy — Justice Frankfurter and the Position of the Judiciary}, 67 YALE L.J. 219, 232 (1957), the appropriate course for Congress would be to fix horizontally uniform tax levels only for those taxes which are imposed upon the utilization of particular assets, or perhaps only those assets of special interest to Congress. See note 62 infra. It would seem to be most difficult to ascertain whether taxes of general application, e.g., an income tax, reflected this practice to any extent, cf. Brown, supra this note, at 232. Were Congress to undertake this inquiry — a prerequisite to any decision to impose horizontal uniformity for generalized taxes in order to prevent this practice — it would have to consider to what extent assets apparently unrelated to governmental activity are so related in fact. For example, "productive skills," \textit{Developments in the Law} at 969, might be attributable to governmental service in the field of education. See Sufrin, supra note 57, at 24-25.

61. While the emphasis of this Note is upon vertical discriminations against multistate taxpayers, economic resources may be misallocated just as clearly by such discriminations in their favor. Multistate enterprises might be encouraged, by the prospect of tax advantages over in-state competitors, to make entry into the markets of — or to locate industrial facilities within — states which would not have been selected upon the basis solely of market considerations. These reverse vertical discriminations as well would be of legitimate concern to Congress under the Commerce Clause. That clause, while concerned with interstate companies' access to state economies, is probably concerned more fundamentally with the efficient allocation of the resources of interstate enterprises.

62. Particularized horizontal uniformity of tax level may be justifiable on economic grounds; it might be employed to encourage the activity of classes of multistate taxpayers, such as railroads or small businesses. It is also possible that the circumstances might call for fixing the horizontally uniform level of taxation at the lowest possible level — i.e., immunity. Congress has constitutional power to require horizontal uniformity of tax levels with respect to particular classes of multistate taxpayers in whom it has a legitimate regulatory interest. See paragraph accompanying note 46 supra. Cf. Grayson County State Bank v. Calvert, 357 S.W.2d 160 (Civ. App. Tex. 1962), and 15 Stat. 34 (1868), 12 U.S.C. § 548(1)(b) (1958), which was involved therein.

The situation in which the multistate taxpayer has no local competition within the taxing state illustrates the extent to which Congress for economic reasons may require the states to employ horizontally uniform tax levels. It is true that heavy tax burdens — which some may deem "excessive" — may be imposed upon the average multistate taxpayer in this situation. See \textit{Developments in the Law} at 971; but see the judicial rule \textit{id.} at 978-79. But the decision as to when tax burdens become "excessive" to multistate taxpayers as a class cannot be resolved in the abstract by Congress. It can be made only by the individual multistate taxpayer, which may choose — from the perspective of its
Had Congress considered this direct solution, it would have found that the courts have attempted to enforce vertical uniformity unaided by statute. Armed only with the interstate commerce clause, they have proclaimed that vertical discriminations against multistate taxpayers are unconstitutional. But the general rule has been undercut in several ways. In some cases, the courts simply ignore the question of discrimination. In other cases only “unreasonable” discriminations are proscribed, and the “rule of reason” is accompanied by hypothesis, that general interest is absent in the situation posed. Congress may impose horizontally uniform tax levels only for particular classes of multistate taxpayers or for taxes which unduly restrict the use of particular assets. See note 60 supra; Cooley v. Board of Wardens, 53 U.S. (12 How.) 298 (1851).


64. See, e.g., West Point Wholesale Grocery Co. v. City of Opelika, Ala., 354 U.S. 390, 392 (1957); I. M. Darnell & Son Co. v. City of Memphis, 208 U. S. 113, 119-20 (1908); Guy v. Baltimore, 100 U.S. 434, 439-40 (1879); Welton v. Missouri, 91 U.S. 275 (1875). Cf. Robbins v. Shelby County Taxing District, 120 U.S. 489, 497-99 (1887), in which the fact of discrimination was not considered decisive because of the Court’s adherence to the view that “interstate commerce cannot be taxed at all. . . .” As is conceded by the Court, id. at 499, the practical and logical consequence of this position was to vertically discriminate against local taxpayers by conferring a sheltered status upon their multistate competitors. This view, in part because of such consequence, was rejected in Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 452, 461-62 (1958), if not earlier, House Report, vol. 1, 7.

65. In these cases, the critical question from the viewpoint of a policy against vertical discriminations— as to which of the local businesses is in competition with the multistate competitor—seems not to have been considered at all. See, e.g., Caskey Baking Co. v. Virginia, 313 U.S. 117 (1941) (in which the court never inquired as to whether the multistate taxpayer competed primarily with local peddlers subject to taxation or with exempted local manufacturers); Colgate v. Harvey, 296 U.S. 404 (1935); General American Tank Car Corp. v. Day, 270 U.S. 367 (1926). The decisions cited are “multiple-statute” cases, involving a state argument that the apparently discriminatory tax provision is nondiscriminatory when viewed in conjunction with other statutes. In such cases, particularly when different kinds of taxes are imposed upon local and multistate taxpayers, the appropriate way to compare the taxes involved would seem to be, first, to isolate the multistate taxpayer’s local competitor(s), and then to compare the burdens which would be imposed by the applicable taxes upon each if they and their operations were of identical size.

66. The courts have not articulated a standard of reasonableness by which to evaluate vertical discriminations. See Hellerstein & Hennefeld, supra note 23, at 965. But in light of the general rule against vertical discriminations which they have formulated, the following decisions can be explained only upon the basis of some unarticulated “rule of reason.” The content of this rule is not known and cannot be derived from considerations of sound interstate commerce policy; the rule apparently rests upon grounds unrelated
by harsh burdens of proof so that all but the most blatant discriminations escape judicial disapproval.\textsuperscript{67}

to these policy considerations. See, e.g., Baltic Mining Co. v. Massachusetts, 231 U.S. 68, 72-73, 88 (1913), overruled on other grounds, Alpha Portland Cement Co. v. Massachusetts, 268 U.S. 203, 218 (1925); Ashbury Hospital v. Cass County, 236 U.S. 207, 211-12 (1914); Cheney Bros. Co. v. Massachusetts, 246 U.S. 147, 157 (1918); New York v. Roberts, 171 U.S. 658 (1898), (Harlan, J., dissenting, 666 at 638); Hendrick v. Maryland, 235 U.S. 610, 261 (1915); People ex rel. Thurber, Whyland Co. v. Barker, 141 N.Y. 118, 121, 35 N.E. 1073, 1074 (1894); In re Goodwin v. State Tax Commission, 286 App. Div. 694, 146 N.Y.S.2d 172, aff'd 150 N.Y.S.2d 203, appeal dismissed 352 U.S. 805 (1956); Prudential Ins. Co. of America v. Barnett, 200 Miss. 233, 27 So. 2d 60 (1946) (in which a federal statute designed for the purpose of preserving the states' powers to tax and regulate the business of insurance was construed to bestow upon the taxing state power to discriminate vertically against foreign insurance companies); Reserve Life Ins. Co. v. Bowers, 119 Ohio App. 251, 255-58, 27 Ohio Op. 2d 170, 172-74, 196 N.E.2d 114, 117-18 (1963), rev'd mem., 33 U.S.L. Week 4268 (U.S. Mar. 15, 1965). And see Developments in the Law 964 n. 51. Idaho Compensation Co. v. Hubbard, 70 Idaho 59, 211 P.2d 413 (1949), may also be read as sustaining a vertical discrimination against a foreign insurance company, if it is assumed that it was far more likely that local companies would have more than 50% of their assets invested in taxing-state-based property, and hence would qualify for lower tax rates. In addition, however, this decision should be read as sustaining a "derivative vertical discrimination" — see notes 88-89 infra and accompanying text — against foreign issuers of bonds; foreign \textit{and} domestic taxpayers were encouraged, by the prospect of lower rates, to invest in the bonds of the taxing state rather than those of outside issuers. Other cases involving such derivative vertical discriminations include Cudahy v. Wisconsin Dep't of Taxation, 261 Wis. 126, 52 N.W.2d 467 (1952); Collector of Revenue v. Hunt, 246 La. 605, 165 So. 2d 843 (1964); Sparks v. West Point Mfg. Co., 274 Ala. 102, 145 So. 2d 816 (1962); and cf. Board of Education v. Illinois, 203 U.S. 553 (1906).

Among the "rule of reason" cases which sustain vertical discriminations are many in which homage is paid to the traditionally broad power of the states to make classifications among taxpayers. See Developments in the Law at 958, and citations therein. See, e.g., Interstate Busses Corp. v. Blodgett, 276 U.S. 245 (1928); Colgate v. Harvey, 296 U.S. 404, 416-22 (1935); General American Tank Car Corp. v. Day, 270 U.S. 367 (1926); the Idaho Compensation Co. case, supra this note; Michigan Consol. Gas Co. v. Townships of Austin, Millbrook & Hinton, 373 Mich. 123 at 136, 128 N.W.2d 491 at 502 (1964); Miller v. Lamar Life Ins. Co., 158 Miss. 753, 771-74, 131 So. 282, 285-86 (1930) (in which a vertical discrimination against the foreign insurance company was justified on the ground that the taxing state might reasonably have desired to encourage the development of local insurers in order to assure the residents reduced costs). That objective could be accomplished more effectively by permitting foreign and local insurers to compete on equal terms. And see New York Life Ins. Co. v. State, 192 Wis. 404, 405-06, 211 N.W. 288, 288-89, \textit{writ of error dismissed}, 276 U.S. 602 (1928). Involved here was a "retaliatory" statute, which imposed upon foreign insurance companies all taxes applicable to local ones and, in addition, whatever costs in excess of that amount were imposed by the foreign insurer's state of incorporation upon insurers incorporated in the taxing state. While the ostensible function of such statutes is to assure horizontal uniformity as between the involved states' multistate taxpayers, its necessary effect — within the retaliating state — is to discriminate vertically in favor of local taxpayers, as it operates only to increase the tax burdens of foreign vis-à-vis local taxpayers. Cf. Bel Oil Corp. v. Roland, 242 La. 98, 137 So. 2d 308, appeal dismissed sub nom. Bel Oil Corp. v. Cochrane, 371 U.S. 21 (1962).

The court's expansive conception of the realm of reason is indicated by the "supportable sloppiness" doctrine. Courts have upheld some substantial discriminations on the ground that a degree of "untidiness" is unavoidable within complex state tax structures.\(^6\) Judicial willingness to tolerate untidy statutes seems to evidence a reluctance to force statutory revision on the states, a reluctance unbalanced by concern for the multistate litigator to whom the statute is more than merely untidy. The interests of interstate commerce are disregarded even more readily when the state alleges a police power purpose to justify the discrimination.\(^6\) Finally, if a multistate business competes with an identical local business, the state may classify the multistate business in a higher taxing category than the local competitor. In these cases the courts usually accept the classification without question.\(^7\)

The multistate taxpayer must argue against this generous view of "reasonableness" under extremely heavy burdens of proof. The courts impose both the traditional burden on one challenging the validity of state action,\(^7\) even if the state offers no justification,\(^7\) and almost impossible burdens on a range of other issues. The courts may require the taxpayer to exclude the possibility that some rational excuse might justify the discrimination.\(^7\) When the state alleges that a discriminatory tax provision is fair when viewed in conjunction with other tax statutes, most courts demand that the taxpayers prove that the total effect of the complex of statutes is discriminatory.\(^7\) Finally, in cases in

\(^{v} Franchise Tax Board, 33 Cal. Rptr. 544, 548, appeal dismissed 377 U.S. 215 (1964). Occasionally, however, despite these procedural obstacles, the contesting taxpayer succeeds. See cases cited supra note 64; in each of these cases, the discrimination appeared on the face of the taxing statute. But see Alaska v. Arctic Maid, 366 U.S. 199 (1961), sustaining a vertical discrimination against multistate "freezers."


\(^{69}\) See cases cited supra note 66. Just as the courts have failed to articulate their "rule of reason," they have failed to explain on what basis they choose to favor state regulatory interests over that of freeing multistate taxpayers from vertical discrimination, though each of these interests is constitutionally grounded.

\(^{70}\) The courts have been willing to sustain classifications discriminating against multistate taxpayers even in cases where the local competitors were in businesses identical to those of the multistate taxpayers. See note 66 supra and accompanying text. Where the competitors' businesses are not identical, the courts have found this dissimilarity between their products (or services) a convenient basis on which to support differential classifications between them. See, e.g., A. Magnano Co. v. Hamilton, 292 U.S. 40, 43 (1934). Here, the mere fact that the competing products were not identical was held to sustain the discrimination, without inquiry into whether any legitimate regulatory purpose existed to validate differential treatment of dissimilar but competitive products.


\(^{72}\) Id. at 283-84.

\(^{73}\) Ibid.

\(^{74}\) See, e.g., Colgate v. Harvey, 296 U.S. 404, 419-20 (1935); Interstate Busses Corp. v. Blodgett, 276 U.S. 245, 251 (1928); General American Tank Car Corp. v. Day, 270
volving unequal application of otherwise valid taxing statutes, a court may require the multistate taxpayer to prove that the discrimination was intentional.  

It is unclear what accounts for feeble judicial enforcement of the rule against vertical discrimination, since the courts have never explained their action. It is clear, though, that the reasons are extrinsic to that rule. Perhaps the courts' retreat can be explained by their reluctance to make national economic policy without congressional direction, particularly in deciding which vertical discriminations should be proscribed. But whatever the reasons for the courts' restraint, the consistency of their retreat suggests that Congress must define the extent to which the courts should strike down vertical discriminations.

In deciding what direction legislative action should take, it is useful to focus first on the paradigm example of vertical discrimination, where the multistate business is in direct competition with local businesses, but the state applies differential tax rates or differential definitions of effective tax bases. Here, where U.S. 367, 374 (1926). Cf., O'Connell v. State Board of Equalization. 95 Mont. 91, 119, 25 P.2d 114, 121 (1933). The situation in the General American Tank Car Case illustrates particularly well the hardship of placing this burden of proof on the contesting taxpayer, who lacks access to relevant information about the taxes in question.


76. Cf. House Report, vol. 1, 11. The courts' undercutting of their general rule against vertical discriminations may thus indicate a retreat from a judicial economic policy never politically established, a retreat which leaves the courts no actual standard for reasoned decision.


78. In considering action in the area of vertical discrimination, Congress should bear in mind that its proposed actions to improve compliance and enforceability may bring to the surface many discriminations which today are merely potential ones, never occurring because of the frequency of multistate-taxpayer noncompliance. See House Report, vol. 1, 334.

79. "Direct" competition is here used to denote competition with respect to the same product (or service). It is to be distinguished from "primary" competition, see note 90 infra and accompanying text, a concept which will be employed to describe competition between a multistate taxpayer and his major local competitor whose product is dissimilar. Under the approach to be recommended, the multistate taxpayer's direct local competitors will be deemed to be his relevant competitors for purposes of determining whether vertical discrimination exists. The most sizeable of his competitors whose products are dissimilar will become relevant as primary competitors only where the multistate taxpayer faces no direct local competition. Where both direct and primary competitors are present, focusing solely upon the former class is an approach susceptible to abuse; where the multistate taxpayer is much larger than his direct local competitors, states might attempt to classify such direct but secondary competitors in higher taxing categories solely in order to discriminate in favor of the multistate enterprise's primary local competition. Although a showing of discriminatory intent would presumably invalidate such a tax, it is arguable that we should abandon the qualitative approach underlying the focus upon direct competition, and adopt instead a wholly quantitative one, considering in all cases the multistate taxpayer's relevant local competitors to be those with which the taxpayer
no problem of classification is present, Congress should reject traditional state justifications of discrimination and establish a rule that differential treatment is per se "unreasonable." 80

primarily competes — regardless of whether their competing products are identical or dissimilar. (Even if the dichotomy were abandoned in ascertaining relevant local competition, of course, it would remain relevant for determining whether the per se rule now to be proposed, or the rule of reason proposed at notes 90–94 infra and accompanying text, should apply.)

However, considerations of administrative feasibility call for retention of the distinction between direct and primary competition. Developments in the Law at 959–60 notes the possibility that the courts may be unable to resolve effectively the question of who one's competitors are — the question central to a policy of vertical uniformity. This judgment would ultimately justify the use of horizontal uniformity to prevent vertical discriminations, for this approach would have the advantage of permitting the courts to bypass the now central question. But Congress should postpone this evaluation of the courts until after they have had an opportunity to cope with the issue free from their self-imposed restraints. Assuming that the courts must cope with the issue, it would seem desirable, at least for a time, to simplify their task by considering the multistate taxpayer's relevant local competitors to be his direct competitors, thus avoiding the courts' having to grapple with quantitative data on the issue of primary competition. They would have to employ such data in only two situations: first, where no direct local competition exists; and second, where both direct and, allegedly, primary competition exists and the multistate taxpayer alleges that a local classification of his direct competitor was made for the purpose of discriminating in favor of his primary competitor.

In addition, a quantitative approach, unlike the qualitative approach, would focus not upon a static, but a fluid situation, changes in which are not easily recognized. For example, the multistate taxpayer's direct but secondary local competitor might enlarge its operation to the point at which it becomes the primary competitor as well. Were the courts to focus solely upon the question of primary competition, it would be necessary in every litigation to dispense with the principle of finality and substitute for it the rule that either the taxing state or the multistate taxpayer may subsequently re-open the question of which state tax is applicable, in light of quantitative changes in the nature of the multistate taxpayer's primary competition. Under the approach recommended, this possibility of re-opening the issue of who one's competitors are would exist where resort in the original case was to primary competition; but decisions relating to direct competitors would be final unless the multistate taxpayer's direct local competition subsequently left the market.

There is also a problem inherent in a purely quantitative approach beyond that of administrative infeasibility. If the multistate enterprise were taxed at the level of its primary local competitors, its secondary local competitors — with whom it directly competes — might suffer a reverse vertical discrimination. But if Congress wished to employ the quantitative approach whenever both direct and primary competition were present, it could avoid this incidental problem by requiring that the multistate taxpayer's secondary, direct competitor be taxed at the same level as the multistate taxpayer, which is by hypothesis its primary as well as direct competitor.

80. Where local and multistate taxpayers directly compete, no classifications of them in different tax categories should be tolerated, as no differences in their products exist which could serve as possible justifications for the differential treatment. But direct competitors may operate through different legal forms — e.g., the sole proprietorship and partnership, on the one hand, and the corporation, on the other — and as these are commonly treated differently for purposes of income taxation, vertical discriminations may result. Because the choice of form is the multistate taxpayer's and each form affords particular
The “supportable sloppiness” defense should be rejected; Congress should not be reluctant to require the states to rationalize their tax structures to the limited extent necessary to protect multistate competitors. The fact that a discrimination might result from inadvertence rather than a conscious policy is irrelevant to the primary congressional concern with artificial obstructions to the development of a national economy. Of course, if the damage complained of is _de minimis_, some degree of “untidiness” may be tolerated. And the _per se_ rule would not require that all of the relevant taxes be contained in a single statute. So long as the statutes, when viewed cumulatively, produce substantially equivalent tax burdens, they are unobjectionable. The multistate taxpayer, however, should not have to bear the burden (which most courts have imposed upon him) of showing that the effect of the total statutory scheme is discriminatory. Upon a showing that the _particular_ statute applicable to the multistate taxpayer is discriminatory on its face, the state, with its superior access to knowledge about its own statutes, should bear the burden of showing that such a discrimination is “cured” by other statutory provisions.

Other of the state’s general defenses also should be rejected. The taxing state may argue that the multistate taxpayer receives some benefit justifying a higher rate. But usually governmental services are conferred equally upon competing local and multistate taxpayers. Differential treatment should be sustained only when the multistate taxpayer receives benefits unavailable to his local competitors. All tax advantages, such discriminations are palatable. See _Spector Motor Service, Inc. v. Walsh_, 135 Conn. 37, 65-68, 61 A.2d 89, 102-03 (1948); _but see Youngstown Sheet & Tube Co. v. City of Youngstown_, 91 Ohio App. 431, 436-41, 108 N.E.2d 571, at 575-77 (1951). Of course, no differential treatment of direct competitors operating in the same form should be tolerated. See also note 84 _infra_ and accompanying text.

81. This defense of _de minimis_, however, should be carefully circumscribed. In evaluating the extent of the multistate taxpayer’s damage — _i.e._, the extent of the vertical discrimination — the question must not be simply whether the differential cost of the discrimination is substantial in relation to his overall financial position. It must be, in addition, whether the differential is significant from the perspective of the relative positions of the multistate taxpayer and his local competitors.

82. See note 74 _supra_ and accompanying text.

83. This imbalance will be reduced to the extent that discovery procedures are available to the taxpayer. But discovery against state governments may be limited by notions of “governmental privilege.” _Cf. Moore, Federal Practice_ 803-05 (rev. ed. 1963). Moreover, discovery would not necessarily serve to compel states to inquire into new factual questions not previously investigated. Finally, most multistate taxpayers are small. _House Report_, vol. 1, 71-75, 90-91. A discovery proceeding which yields for a small taxpayer only a mass of tax returns and statistics probably does not enable him in any realistic sense to ascertain, for example, whether his local competition, subjected to different kinds of taxes, bears equivalent tax burdens. _Cf. Developments in the Law_ at 960.

It should be noted that the allocation of the burdens of proof proposed here and at text accompanying notes 93-97 _infra_ should be applied regardless of whether the taxing state (suing to collect its tax) or the multistate taxpayer (suing for a refund) appears as plaintiff, since the interests involved and the policies applicable remain the same.

84. A progressive rate structure would not affect a vertical discrimination if the various brackets are applicable equally to local and multistate taxpayers. _Cf., Developments_
A state's discrimination is equally objectionable when caused by differential treatment of various deductions. For example, to permit a depreciation deduction only when the depreciable asset is located within the state confers a competitive advantage upon local taxpayers to the extent that the operations of multistate taxpayers are "centered outside the taxing State. . ." The state's argument that the "reasonable" purpose of such across-the-board differential tax treatment is to encourage the location of plant and equipment within the state is but a confession that its purpose is to distort the allocation of resources among the states. Denial of deductions for contributions to out-of-state charities, and denial of deductions for dividends received from out-of-state corporations involve two kinds of vertical discrimination: against the multistate taxpayer and against the out-of-state charity or corporation. These deduction provisions hurt multistate taxpayers because they are more likely to donate to foreign charities and invest in foreign corporations than are their local competitors. These deduction provisions discriminate against the out-of-

in the Law, 958, notes 90-94 infra and accompanying text. But evidence that the brackets are structured in such a way as to tax a large multistate enterprise disproportionately, especially if coupled with a showing that the rate structure was altered after the multistate business entered the state, would suggest a discriminatory intent — invalidating the tax in question. See note 75 supra and accompanying text.

85. Cf., text accompanying notes 11-12 supra. See generally House Report, vol. 1, 587-88, 251-80 (summarized at 278-80); and note the variations in treatment of the exemption for interest on obligations of the taxing and other states, id. at 258. Such discriminations are rooted in essentially parochial state interests. Id. at 276-78.

86. Id. at 588.

87. This would seem to be the only utility of the practice. Id. at 276.

88. Compare id. at 587-88, which does not distinguish between differential treatment of depreciation deductions and that of deductions for charitable contributions and intercorporate dividends with id. at 277-78, which appears to do so. They are distinguishable in that while both are likely to affect vertical discriminations at the taxpayer level, the latter also necessarily affect the kind of derivative vertical discriminations described above. See Idaho Compensation Co. v. Hubbard, 70 Idaho 59, 211 P.2d 413 (1949), discussed supra note 66, and Colgate v. Harvey, 296 U.S. 404, 416-22 (1935), sustaining such derivative discriminations.

One alleged purpose of denying the deduction for dividends received from out-of-state corporations not subject to the taxing state's income tax is to "mitigate a form of double taxation." House Report, vol. 1, 278. See Colgate v. Harvey, 296 U.S. 404, 416-22 (1935). It is argued where the paying corporation is not subject to the taxing state's income tax, there is no double taxation involved — by the taxing state which grants the deduction — and hence the deduction should not be available. But if the pre-dividend income of the paying corporation is subject to income taxation in the state in which it is generated (as will often be the case, since thirty-seven states plus the District of Columbia presently levy a corporate income tax, House Report, vol. 1, 255-56, notes 1-3), double taxation nevertheless occurs. If the taxing state is to prevent double taxation with respect to dividends paid by locally taxed payer corporations, then sound interstate commerce policy would seem to require a similar result with respect to such payer corporations subject to income taxation outside the taxing state. See id. at 276, 278. That state's revenue interest should be considered irrelevant in this context, as revenue objectives may be pursued only in a manner consistent with the policy against vertical discriminations.
While a \textit{per se} rule is appropriate when the taxing state discriminates between local and multistate competitors with identical services or products, a more difficult problem is presented when the competing services or products are not identical. Here a legitimate regulatory purpose might justify the state in categorizing the multistate business in a higher taxing category than his major local competitor. Congress must decide whether the interests of interstate multistate commerce should be subordinated to the state's interest in employing its taxing power for regulatory purposes. Congress should qualify the \textit{per se} rule in this limited category of cases in order not to undermine state regulatory schemes. But such deference should be severely restricted. The state's classification should be permitted only when the state bears the burden of proving that the higher-taxing statute has a regulatory (as well as a revenue) purpose, and that the regulatory scheme would be undermined if the multistate taxpayer were taxed at a lower level.

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89. The proposed congressional action against discriminatory definitions of the tax base raises more general questions concerning the desirability of state subsidies or tax breaks for the location of facilities or the undertaking of activities within the state. Even if a subsidy is made available to local and multistate businesses alike, its function is to encourage activities or investments within the state which presumably would not be present in the absence of an artificial inducement. Across-the-board subsidies or tax breaks made available without respect to the industry involved can serve no proper function; like tariffs, they operate to misallocate the resources of the national economy for the sake of parochial state interests. More particularized subsidies or tax breaks might, however, serve legitimate functions. They may be needed to assure that imperfections of the market mechanism do not deprive the state or its citizens of particular products or services. In most cases these failures call merely for measures to encourage specific industries to provide their goods or services within the state, without attempting to affect plant location. Only where the need is for the development of the state's infrastructure may incentives be conditioned upon location within the state. And in no case may subsidies or tax breaks be legitimately made available only to local, and not to multistate businesses. See Miller v. Lamar Life Ins. Co., 158 Miss. 753, 771-74, 131 So. 282, 283-86 (1930), criticized supra note 66.

90. Here the multistate taxpayer, if he faces local competition at all, faces "primary" rather than "direct" competition. These terms are defined at note 79 supra.

91. For purposes of this discussion, it is assumed that the state's regulatory purpose is a reasonable one from the perspective of a wholly domestic case.

92. It should be noted that the "lesser-taxed" category may not be subject to the particular tax — e.g., a sales tax — at all.

93. Revenue interests alone are of course insufficient to sustain vertical discriminations. Compare note 88 supra.

94. Compare the mindless approach of the Magnano case, supra note 70. What is being suggested can best be illustrated by considering a hypothetical case. Assume the existence of the XYZ Motorscooter Co., Incorporated and having its manufacturing facilities in State A, but making sales in both States A and B. State B imposes two sales taxes which might be applicable to XYZ — a lower one applicable to "two-wheel vehicles," which has applied previously in wholly domestic cases to sales of bicycles,
Once the multistate taxpayer has produced evidence sufficient to support a finding that his major local competitor is taxed in the lower category, the risk of non-persuasion should be upon the state on all issues. It must prove either that the taxpayer does not compete primarily with those in the lower category, or that the classification serves a valid regulatory purpose. Imposing the risk of non-persuasion upon the state is consistent with the policies underlying allocation of burdens of proof generally. First, this allocation encourages the production of evidence concerning regulatory purpose by placing the burden upon the party with superior access to information. Second, this allocation avoids imposing upon the taxpayer the requirement of disproving all conceivable regulatory purposes. Finally, the proposed allocation places the risk of non-persuasion upon the party whose loss will less seriously affect congressional objectives if the issue is decided incorrectly.

95. See Morgan, Maguire & Weinstein, Cases on Evidence 426-27 (4th ed. 1957). But see McCormick, Evidence 675 (1954). See note 83 supra and accompanying text. On the question of primary competition, this general policy has been partially abandoned by placing only a prima facie burden on the multistate taxpayer; assuming there may be situations in which the multistate taxpayer's interest lies in introducing only that quantum of evidence necessary to establish a legally sufficient showing on the question of primary competition, a thoroughly consistent application of this policy would impose the risk of non-persuasion upon him in order to encourage the production of all the evidence at his command. But this policy is not an absolute one, and its minor qualification is justified by another policy consideration. See note 97 infra and accompanying text.

96. Accord, Morgan, Maguire & Weinstein, op. cit. supra note 95 at 426 with respect to “negative” burdens of proof. On the issue of primary competition, the state bears no impossible or negative burden of proof. By showing that the taxpayer primarily competes with local taxpayers classified in the higher-taxed category or with any local businesses other than those in the lesser-taxed category, the state may exclude the hypothesis on which the taxpayer's prima facie case is grounded. In contrast, placing the burden of proof on the issue of regulatory purpose upon the taxpayer, would require him to refute the possibility that the state was moved by a regulatory purpose.

97. Regarding the issue of regulatory purpose, the judgment that an erroneous decision would more seriously affect multistate competitors than it would state regulatory programs is, of course, a qualitative policy judgment. Regarding the issue of primary competition, Congress has not yet expressed a concern with single-state vertical discriminations against local taxpayers. Absent such an interest, the risk of an erroneous decision upon this question should be imposed upon the state, representing its local com-
decision upon the state does not preclude it, after losing on the issue of regulatory purpose, from clarifying that purpose in future legislation. A losing taxpayer gets no such second chance.

petitioners, rather than upon the multistate taxpayer. But if Congress were to assert such an interest, see note 61 supra, there would be a more difficult, and somewhat arbitrary, decision to be made in allocating this risk. Perhaps the risk might be imposed upon the state, proceeding from the factual assumption that generally, in making tax classifications, the states more often seek to protect local from multistate taxpayers than vice versa.