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Duplicative Taxation Among the States: A Problem Not Worth Solving?

Julie Roin*

Abstract:

Recent legal and economic changes—not to mention the rise in telecommuting caused by COVID--have raised the salience of a long-simmering fact about the operation of state and local income tax systems: some multistate employers and employees pay a combined income tax liability that is higher than the tax they would have borne had they operated in just one jurisdiction. Seemingly beyond the reach of the courts to correct, there have been persistent calls for Congressional action to eliminate or reduce this "duplicative" taxation. This Article suggests that the alleged problem may be both less of a problem, and more resistant to a solution, than is commonly understood.

One of the predicates of a national marketplace is the abolition of many state laws that favor in-state over interstate commerce. In practice, this aim, though embedded in Constitutional text[1] and practice,[2] is remarkably hard to attain. In particular, it has proven difficult to reconcile state

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[1] Article 1 of Section 8 of Constitution explicitly provides Congress with the power "[t]o make all Laws which shall be necessary and proper…to regulate Commerce…among the several States."

[2] *See* Gonzales v. Raich, 545 U.S. 1 (2005) ("For the first century of our history, the primary use of the [Commerce] Clause was to preclude the kind of discriminatory state legislation that had once been permissible."); National Bella Hess, Inc. v. Dept. of Revenue of State of Ill., 386 U.S. 753, 760 (1967) (purpose of the Commerce Clause is to "ensure a national economy free from unjustifiable local entanglements…[to create] a "single indivisible nation"); Richard C. Shragger, *Cities, Economic Development, and the Free Trade Constitution*, 94 VA. L. REV. 1091, 1092-93 (2008) ("Much has been made of the commercial genius of the American Constitution and the judicial decisions that have knitted the disparate colonies into one common market. Courts and commentators understand the successful integration of the colonies into a fee trade block as one of the Founding generation's chief aim…."). Courts have construed the Constitutional language not only to grant affirmative legislative powers to Congress, but also to grant courts the power to strike down state and local legislation which "subvert the common national market

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sovereignty over fiscal affairs with tax neutrality between single state and multistate taxpayers.[3] In their efforts to maximize their own tax revenues and other economic interests, states often enact (or try to enact[4]) tax rules that lead to double taxation of multistate taxpayers, that is, rules which result in more than one state imposing tax on a tax base without offset or other regard for taxes levied by other states on that same base. In turn, this duplicative taxation appears to distort taxpayer behavior in ways that confound both the concept and operation of a national economic marketplace. Legal changes and increases in the fiscal pressure on states have exacerbated these distortions, as they have caused many states to raise tax rates and cleverly expand their (asserted tax) jurisdiction. The end result is an increase in the cost and likelihood of disparities in the tax treatment of wholly in-state and multistate taxpayers.

For an old and familiar example of duplicative taxation, one needs to look no further than the states' use of different formulas for apportioning the business income earned by taxpayers with multistate business activities. For a short period of time, almost all states employed a three-factor apportionment formula.[5] This formula apportioned one-third of taxpayers' income on the basis of

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to their own economic interests." *See* Adam B. Thimmesch, *The Unified Dormant Commerce Clause*, 92 TEMPLE L. REV. 331, 333 (2020); Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1098 – 1101 (1986). The Dormant Commerce Clause, as this judicial power is known, is discussed in greater detail *infra* Section IV.

[3] *See* Thimmesch, *supra* note 2, at 333 ("[T]here is an inherent and intractable tension between state sovereignty and the pursuit of a common national market—barring volitional, complete, and unanimous coordination between the states.").

[4] Not all of these attempts survive judicial scrutiny. *See, e.g.*, Comptroller of the Treas. v. Wynne, 575 US 542, 545 (2015) ("We have long held that States cannot subject corporate income to tax schemes similar to Maryland's, and we see no reason why income earned by individuals should be treated less favorably."); *id.* at 550-51 (listing prior cases holding state tax regimes invalid); Michael S. Knoll & Ruth Mason, *The Economic Foundation of the Dormant Commerce Clause*, 103 VA. L. REV. 309, 351 (2017) ("The Court has long held that the dormant Commerce Clause restrains state sovereignty in taxation."); Walter Hellerstein, *Is 'Internal Consistency' Foolish?; Reflections on an Emerging Commerce Clause Restraint on State Taxation*, 87 MICH. L. REV.138, 140 ("the leeway the Court has accorded the states to design their own apportionment formulas, however, does not extend to formulas that, if adopted generally, will *inevitably* subject a multistate enterprise to multiple taxation.")

[5]*See* John A. Swain, *A Brief History of UDITPA and the Corporate Income Tax Uniformity Movement*, 49 STATE TAX NOTES 759, 763 (2008)[hereinafter *A Brief History of UDITPA]* ("By 1978 nearly all states that imposed a corporate income tax either had adopted UDITPA or used a three-factor apportionment formula very similar to the UDITPA formula.") UDITPA (for "Uniform Division of Income for Tax Purposes Act") was a model law drafted by

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in-state sales versus total sales, one-third on the basis of in-state business property versus total business property, and the final third on the basis of in-state payroll versus total payroll.[6] Thus, if 30% of Acme Corporation's total sales were made to customers in State A, a state which also accounted for 20% of its business property and 10% of its payroll, 20% of Acme's business income would be apportioned to, and taxed by, State A. The other 80% percent would be apportioned to, and taxed by, other states in similar fashion.[7] In the best of all worlds, 100% of its income would be taxed in some state.[8] However, Iowa, a state with few factories and office buildings but disproportionately more consumers, decided to increase its income tax revenues—in a way that would not scare off actual business investors--by adopting another apportionment formula, one which took into account only the location of sales.[9] The difference between the two

NCCUSL (the National Conference of Commissioners on Uniform State Laws, the predecessor of the current Uniform Law Commission). UDITPA was subsequently incorporated into the Multistate Tax Compact, which obligates signatory states to "allocate and apportion income pursuant to UDITPA and undertake other joint activities to lessen the administrative and compliance burdens of the state income tax." Testimony of John A. Swain before the Subcomm. on Comm. and Admin. Law of the Comm. on the Judiciary, U.S. House of Representatives, State Tax Apportionment: Basic Concepts, History, and Prospects, March 11, 2010, p. 7, at https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/other-state-tax-studies-articles-reports/swain-testimony-to-house-judiciary-cal-subcommittee-re-apportionment-hearing-canceled.pdf

[6] *See Location Matters: The State Tax Costs of Doing Business* 10 (Tax Foundation and KPMG) at https://files.taxfoundation.org/20170112211359/TF_LocationMatters_2015.pdf ("States...as a whole adopted the Uniform Division of Income for Tax Purposes (UDITPA), also known as the 'three-factor formula.' This formula apportions profits based on each state's share of the firm's overall property, payroll, and sales (each of the three 'factors' is averaged equally.")

[7] Corporations pay tax on "apportionable" income only to the state to which such income is apportioned. Some types of corporate income are considered "nonbusiness" or "not apportionable" and are "allocated to" and thus taxable only by the corporation's state of residence. The amount of income that falls within the "allocable" as opposed to "apportionable" category has decreased over time, as a counterbalance to taxpayers' efforts to use "allocation" to avoid all state taxation. *See* Richard Pomp, Rep't of the Hearing Officer, Multistate Tax Compact Article IV [UDITPA] Proposed Amendments, October 25, 2013, pp. 43 – 50, at https://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Pomp final final3.pdf (recommending changes to UDITPA to limit the category of allocable income and describing state legislative actions having that effect independent of UDITPA); Jose M. Zambrano, *Opportunities with Nonbusiness Income and State Apportionment*, THE TAX ADVISER, Oct. 1, 2011, at https://www.thetaxadviser.com/issues/2011/oct/clinic-story-14.html (describing how "tax savings opportunities may arise from excluding nonbusiness income from state apportionment").

[8] Of course, the world was never "the best of all worlds." Even if every state utilized the same formula, some income might escape state taxation because it was allocated to a state that did not tax it, either because it did not have an income tax or because the state lacked the jurisdiction to impose a tax on the income allocated to it. *See infra* TAN 24-30 (discussing these situations and their gradual disappearance).

[9] Iowa adopted a single-factor apportionment formula in the 1940s, but continued to allow at least some taxpayers to compute their Iowa tax liability on the basis of the three-factor UDITPA formula until the 1960s. *See* Moorman

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formulas is readily apparent. If Iowa were just like State A, the sales only formula would apportion 30% of Acme's income to Iowa—and if the other states in which Acme did business continued to use the three-factor formula, those other states would continue to claim the right to tax a total of 80% percent of Acme's income. As a result, Acme would be subject to state income taxes calculated with respect to 110% of its actual business income. In short, 10% of its income would be taxed, in full, by two different states, and its overall tax burden would be higher than if it had carried out its business operations in only one state, including Iowa.[10]

Another example of duplicative taxation arises from the disparate state tax treatment of remote working arrangements. These disparities can lead to duplicative state taxation at both the employer and employee level. Although the existence (and effect) of these disparities is not new,[11] the remote working arrangements spurred by the COVID pandemic has drawn renewed attention to them.

At the employer level, a remote worker may provide the state in which the employee is physically present both the "nexus" required to impose a corporate income tax,[12] and a tax apportionment based on the "in state" salary of the remote worker.[13] Meanwhile, the state in

Mfg. Co. v. Bair, 437 U.S.267, 270 (1978) ("the State Tax Commission allowed appellant to compute its Iowa income on the basis of a formula consisting of three, equally weighted factors…rather than the formula prescribed by statute.")

[10] It is worth noting that nonuniformity can lead to undertaxation as well. If only 10 percent of Acme's sales were in State A, and its other factors remained the same, State A would tax 10 percent of Acme's income under its one-factor formula. When added to the 80 percent taxed by the other, three-factor states, Acme would pay state tax on only 90 percent of its income.

[11] *See* Zelinsky v. Tax Appeals Tribunal, 1 N.Y.3d 85, 801 N.E.2d 840 (2003), *cert. denied* 541 U.S. 1009 (2004) (upholding N.Y. tax on portion of law professor's income attributable to work performed at Connecticut residence).

[12] In many cases tax nexus would exist even in the absence of the remote worker. Note that nexus alone would not cause duplicative taxation; it is just that in the absence of such nexus, inconsistent tax rules would have no practical impact.

[13] Salary paid to an "in state" employee appears in the numerator of the fraction used to determine the amount of income apportioned to a state under the payroll factor. Of course, if both states used a single-factor, sales based apportionment formula, this problem would disappear. However, an employer might still find itself under an obligation to withhold two sets of state income taxes from such employees' salaries. *See* Mark Klein, *Tax*

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which the employer's home office is located, using a different definition of an "in state" employee, may include that same salary in the numerator of its apportionment fraction for purposes of determining the corporate income tax owed to that state. The combination would again lead to duplicative taxation.[14]

Differing definitions of the source of salary income also may lead to duplicative taxation at the employee level. Some states claim the right to tax an individual's wage income based on the location of the person performing the services,[15] while others claim the right to tax such income based on the location of the empIoyer's office.[16] Thus, an individual working from a home

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Implications of COVID-19 Telecommuting and Beyond, THE CPA JOURNAL, https://www.cpajournal.com/2021/07/16/tax-implications-of-covid-19-telecommuting-and-beyond/ .

[14] Suppose, for example, that the 33% of the employer's income is apportionable based on the payroll factor, and the employer's payroll totaled $1,000,000, of which $100,000 was attributed to the salary of the remote employee. If both states included that $100,000 as "in state" payroll for apportionment purposes because of differing definitions of "in-state employees," the state in which the remote worker was physically present would claim the right to tax 3.3 percent of the employer's income under the payroll factor, while the employer's "home" state would claim the right to tax 33.3 percent of its income under that factor. The combination of tax claims would amount to 36.6 percent of the employer's overall income, which, when added to the 66.6 percent apportioned based on the other factors, would lead to tax being imposed on 103.3 percent of the employer's income. In short, 3.3 percent of the employer's income would be taxed twice. This problem disappears when both states apportion business income solely on the basis of sales.

[15] *See* WALTER HELLERSTEIN, KIRK J. STARK, JOHN A. SWAIN & JOAN YOUNGMAN, STATE AND LOCAL TAXATION CASES AND MATERIALS 362 (9th ed. 2009) ("In elaborating on the concept of income derived from sources within the state, the state statutes typically point to income derived from compensation earned in the state, services performed in the state, trade or business carried on in the state, or property located in the state."); Walter Hellerstein, *Reconsidering the Constitutionality of the 'Convenience of the Employer' Doctrine*, 99 TAX NOTES 1247, 1248 (2003) ("The most common rule for attributing a nonresident's compensation to the state is based on the proportion of the time that the nonresident spends working in the state.")

[16] There are currently seven states that source income based on the location of the employer's office, excluding only work done elsewhere "for the convenience of the employer." *See* Eric Rosenbaum and Korey Matthews, *How U.S. states tax wage income may be forever changed by remote work*, CNBC, Nov. 5, 2020, https://www.cnbc.com/2020/11/05/how-us-states-tax-wage-income-may-be-forever-changed-by-remote-work.html (New York, Arkansas, Connecticut, Delaware, Nebraska, and Pennsylvania); Jared Walczak, *Teleworking Employees Face Double Taxation Due to Aggressive 'Convenience Rule' Policies in Seven States*, TAX FOUND., Aug. 13, 2020, https://taxfoundation.org/remote-work-from-home-teleworking/ (same). Connecticut's law is the most interesting; it generally sources employee's income to the place of performance, but applies the "convenience of the employer" standard to income derived by employees residing in states with "convenience of the employer" source rules. This benefits Connecticut residents with New York employers, but also has the effect of imposing a Connecticut tax on New York residents working at home rather than their employers' Connecticut offices. *See* Timothy P. Noonan, *The Connecticut vs. New York "Convenience Rule" Battle: After 15 years, Connecticut Blinks!*, Noonan's Note Blog, Hodgson Russ LLP (October 15, 2018), https://www.hodgsonruss.com/blogs-Noonans-Notes-Blog,the-connecticut-vs-new-york-convenience-rule (describing statutory rule). At least some of these "convenience of the employer" states are refusing to treat working at home as being "for the convenience of the

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located in a state other than the one in which her employer's office is found might find her salary subject to tax in two states without any offset for taxes paid to the other state.[17]

There is at present no legal remedy for any of these examples of duplicative taxation. The Supreme Court explicitly blessed Iowa's use of its single factor formula in 1978, in the case of *Moorman Manufacturing Co. v. Bair*,[18] and more recently refused to grant leave to hear a case brought by the State of New Hampshire, challenging Massachusetts' adoption of the location of the employer source rule for apportioning individuals' personal services income.[19]

A solution to this apparent problem would probably require action by Congress.[20] Conventional wisdom is that the federal government, which is to say Congress if not the federal courts, should

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employer" when the employer's office is closed by state law. *See* Richard D. Pomp & Jeffrey A. Friedman, *Why More Employers Are Getting SALT-y on Remote Work Arrangements*, 97 STATE TAX NOTES 1350, 1351 (Sept. 28, 2020) (decrying states that "treat a remote worker's income as having a source at the worker's former office location when that worker is prohibited from working there….")

[17] Individuals, unlike corporations, are typically taxable by their state of residence on their entire income but are allowed a credit against that liability for taxes paid on the basis of source to another state. *See* Pomp & Friedman, *supra* note 16, at 1350 ("Typically, individuals are taxed by their states of residence or domicile on their worldwide income, with credits provided for income taxes paid to other states on the same income.") Thus they end up paying income tax at the higher of the resident or source state tax rate. Residence states do not grant credits for taxes paid with respect to income they believe sourced within their jurisdiction, however. *See* WALTER HELLERSTEIN, ET AL., *supra* note 15, at 397 ("States generally limit their credit to taxes imposed by other states on income from 'sources within' such state."); Morgan L. Holcomb, *Tax My Ride: Taxing Commuters in our National Economy*, 8 FLA. TAX REV. 885, 892 (2008) ("Most states grant credits only to 'source' income taxes paid, and the states have differing definitions of what constitutes source income.")

[18] Moorman Mfg. Co. v. Bair, *supra* note 9. More recently, it refused to grant a motion for certiorari in a case challenging a state's ability to adopt an income allocation formula at odds with its purported obligations under the Multistate Tax Act. *See* The Gillette Co. et al. v. Calif. Franchise Tax Board, 62 Cal. 4th 468 (CA 2015), *cert. denied* 137 Sup. Ct. 294 (October 11, 2016); Kyle O. Sollie, *et al., Three-factor apportionment may still be an option for some CA taxpayers*, REED SMITH LLP LEXOLOGY, January 10, 2022, https://www.lexology.com/library/detail.aspx?g=563b6307-a9dd-44a4-94d1-3eb881cde8fe&utm_source=Lexology+Daily+Newsfeed&utm_medium=HTML+email+-+Body+-+General+section&utm_campaign=Lexology+subscriber+daily+feed&utm_content=Lexology+Daily+Newsfeed+2022-01-12&utm_term= (discussing the availability, after *Gillette*, of statutory relief from the single factor sales formula).

[19] New Hampshire v. Massachusetts, Docket No. 22O154, Motion for leave to file a bill of complaint denied, June 28, 2021.

[20] Congress has considered, but as yet failed to enact, several legislative proposals which would do so. *See* Walczak, *supra* note 16 (describing current proposals to eliminate double taxation of telecommuting employees). UDITPA's adoption was widely regarded as a (successful) attempt to forestall a federal attempt to impose a two-factor apportionment formula on the states. *See* Swain, *supra* note 5, at 7 (discussing Willis Commission's two-factor

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restore some level of tax neutrality between single state and multistate taxpayers.[21] This Article shows, however, that there is no easy solution to this problem, and perhaps simply none worth attempting. Congress could eliminate some instances of double taxation, at the (possible) expense of overall state tax revenues and while re-allocating revenue from some states to others. But any intervention of this kind would be politically tricky and – more interesting – difficult to justify as a theoretical matter. Moreover, there is no guarantee that states would not work around any rules that Congress established; the duplicative taxation problem could well re-emerge in a slightly different (and perhaps less attractive) guises. Congressional intervention may not be worth the candle, especially when one considers existing opportunities for taxpayer self-help.

Part I of this Article explains how judicial decisions loosening Constitutional nexus requirements have increased opportunities for double taxation. Part II details the failure of state efforts—embodied in UDITPA and the Multistate Tax Compact—to standardize state laws for taxing the income of multistate business income. Part III explains the comparable problem faced by telecommuting employees. Part IV explains why federal courts are incapable of eliminating duplicative taxation using their powers under the dormant Commerce Clause. Part V explores the difficulties inherent in designing a "neutral" tax rule eliminating duplicative taxation, leading to questions about the desirability of ameliorating double taxation through Congressional action.

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recommendation and the subsequent attempt to enact a uniform federal apportionment formula for corporate income tax purposes).

[21]*See* Darien Shanske, *Agglomeration and State Personal Income Taxes: Time to Apportion (With Critical Commentary on New Hampshire's Complaint Against Massachusetts)*, 48 FORDHAM URB. L. J. 949, 964 (2021 ("ideally, prompt congressional action"); Holcomb, *supra* note 17, at 929–30 (arguing that Congress should pass bill restricting States' ability to tax workers not physically present in the state); Walczak, *supra* note 16 ; Peter L. Faber, *Should the States Determine Their Own Tax Destinies? Federalism in the 21st Century*, ST. TAX NOTES 111, 134 (April 10, 2006) ("It would make sense for Congress to intervene and mandate a uniform apportionment formula and uniform rules for allocating nonbusiness income."); Katherine L. Moore, *State and Local Taxation: When Will Congress Intervene?*, 23 J. LEGIS. 171, 179 (1997) ("More uniformity in state and local taxation would benefit our economy and society at large…..")

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Parts VI and VII continue this discussion by detailing the actions taxpayers currently take to minimize duplicative taxation, and those that states adversely affected by Congressional attempts to eliminate duplicative taxation are likely to take. Part VIII concludes.

I. Increased Opportunities for Duplicative Taxation: Broadening Taxable Nexus

When the Supreme Court decided *Moorman v. Bair*,[22] the case which upheld Iowa's right to use the single-factor sales formula for apportioning the income of multistate taxpayers, it pointed out that while the taxpayer stressed the unfairness of duplicative, or even double, taxation, the taxpayer had failed to prove that such taxation had occurred.[23] This failure was less likely to be a matter of a poor litigation strategy than the fact that, at the time, prevailing state tax laws did not – in any state – capture large segments of multistate taxpayers' income. Through a combination of careful corporate structuring and the exploitation of restrictive state and federal nexus rules, taxpayers often managed to apportion large segments of their income to states which either lacked the nexus to impose a tax, or did not have an income tax in the first instance.[24]

For example, many states did not tax businesses lacking a physical presence in their jurisdiction.[25] As a result, no state income tax was collected on income apportioned to such states

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[22] 437 U.S. 267.

[23] *See id*. at 276 ("In the first place, this record does not establish the essential factual predicate for a claim of duplicative taxation…. [W]e do not know whether Illinois and Iowa together imposed a tax on more than 100% of the relevant net income.") A contemporaneous article, however, suggests that such evidence was presented in lower court proceedings. *See* Thomas J. Nichols, *Apportionment of Corporate Income to the States for Tax Purposes: Fifty Ways to Lose Your Tax Dollar*, 61 MARQUETTE L. REV. 480, 491 (1978) ("Moorman argued that between Iowa and its domicile, Illinois, which employs the standard three-factor formula, it was being taxed on 141.8 percent of its income.")

[24] *See* Charles E. McLure, Jr., *Understanding Uniformity and Diversity in State Corporate Income Taxes*, 61 NAT'L TAX J. 141, 153 (2008) (describing how failure to require combined reporting was "an open invitation for corporations to use separate entities to shift income from it. This is an especially effective tax-planning tool…"); Eugene F. Corrigan, *Interstate Corporate Income Taxation—Recent Revolutions and a Modern Response, Symposium: State Taxation of Interstate Business*, 29 VAND. L. REV. 423, 429-30 (1976) (describing mechanisms corporations used to produce "nowhere income" for state income tax purposes).

[25] This was not entirely volitional on the part of states. In 1959, Congress enacted P.L. 86-272, §101, 79 Stat. 555 (codified at 15 U.S.C. §381), which "prevents a state from imposing a tax measured by net income on foreign

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on the basis of sales made to customers located in those states.[26] In turn, businesses located, or placed their physical assets, with such rules in mind. Following the playbook established by transnational taxpayers,[27] businesses further reduced their income subject to state tax by isolating large portions of their income in entities located (and apparently operating) only in low- or no-tax states. For example, company X, which manufactured and sold goods protected by a valuable trademark, might have that trademark owned by a related holding company, Y, located in a low or no tax state. X would then pay Y a substantial royalty for its use of the trademark, claiming that royalty as an expense of X 's apportionable income. Meanwhile, Y 's income was taxable

corporations deriving income from interstate commerce in the state if the corporation's only activities in the state amount to solicitation of orders for sales of tangible personal property or the effecting of such sales through independent contractors." Walter Hellerstein, *Construing the Uniform Division of Income for Tax Purposes Act: Reflections on the Illinois Supreme Court's Reading of the 'Throwback' Rule*, 45 U. CHI. L. REV. 768, 774 (1978). In addition, some state courts found that their state's constitutions or statutory law imposed more stringent nexus requirements than did the Federal Constitution. *See 2013 Survey of State Tax Departments: States Specify Nexus Policies on Web Servers Non-U.S. Entities; Address Many Other Gray Areas*, BNA TAX MANAGEMENT MULTISTATE TAX REP'T, April 26, 2013 ("States vary greatly in determining what particular activities performed within their borders might trigger income taxation"; surveying specific differences).

[26]The original version of UDITPA included a "throwback" rule, mandating that sales income apportioned to a non-taxing state would be "thrown back" into the tax base of the state in which the corporation was domiciled. *See* UDIPTA §16, 7A U.L. A. 91 (1978) (citation from Hellerstein, *supra* note 25). However, many states failed to enact such throwback provisions, or had their throwback provisions voided by courts as violative of the dormant Commerce Clause or the underlying tax statutes. *See, e.g.*, Home Interiors & Gifts, Inc. v. Strayhorn, 175 S.W. 3d 856 (Tex. App. 2005), *petition for review denied*, 2007 Tex LEXIS 241 (Tex. Mar. 9, 2007) (throwback provision violated Commerce Clause); Ilya Lipin, *Corporate Taxpayers' Sore Arm: Throw-Out Rule Litigation in State and Local Taxation*, 66 TAX LAW. 901 (2013) (reviewing state cases). While a few opted instead for "throw out" provisions, which excluded untaxed sales from both the numerator and denominator of their apportionment fractions, many states did neither and as a result, much income simply escaped (and continues to escape) tax by becoming "no where income." *See* Katherine Loughead, *Does Your State Have a Throwback or Throwout Rule?* , TAX FOUND., Dec. 5, 2018, https://taxfoundation.org/throwback-rule-throwout-rule/ (chart with status of states as of July 1, 2018); Institute on Taxation and Economic Policy, *'Nowhere Income' and the Throwback Rule*, Policy Brief, August 2011, https://itep.sfo2.digitaloceanspaces.com/pb39throw.pdf ("half of the states have yet to enact this important reform") Moreover, the states that did enact such rules often administered them differently, leading to both under and over taxation. *See* Jared Walczak, *Throwback and Throwout Rules: A Primer*, TAX FOUND., July 2, 2019, https://taxfoundation.org/throwback-rules-throwout-rules-2019/ - :~:text=Throwback%20and%20throwout%20rules%20are,by%20federal%20law)%2C%20producing%20this ("The goal of throwback and throwout rules is 100 percent taxability of corporate income, but the result is a complex, uncompetitive system….."); Andrew D. Grace, *A Tale of Two States: "Throwout/Throwback Nexus" in New Jersey and California*, THE TAX ADVISOR, June 1, 2014, https://www.thetaxadviser.com/issues/2014/jun/clinic-story-07.html (comparing fate of such rules in California and New Jersey.) And throwback rules have little to no effect if the taxpayer's state of domicile is a no-tax or very low-tax state.

[27] This playbook is in the process of being revised for international taxpayers. The (newly tightened) GILTI regime requires US companies to pay tax in the United States on much lightly taxed foreign income on a contemporaneous basis.

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only in the single state in which it had a physical presence, a state carefully chosen for its low tax rate.[28]

States could block such clever strategies. A few states passed statutes extending tax nexus on the basis of "economic nexus" derived from the use of intangible property in the state even in the absence of physical nexus;[29] some forced related entities to consolidate their income with related entities for tax purposes;[30] and others disallowed deductions for payments made to related entities over which the state did not have tax jurisdiction.[31] For a long time, though, many states were more timid, perhaps because of political considerations, concerns about enforceability, fear

[28] This is precisely the stratagem employed (unsuccessfully) by the taxpayer in the Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E.2d 13 (S.C.), *cert. denied* 114 S. Ct. 550 (1953).

[29] South Carolina, the defendant in the *Geoffrey* case, was one such state. But it was a relative outlier at the time; only a few other states had such rules. *See* Michael T. Fatale, *Geoffrey Sidesteps Quill: Constitutional Nexus, Intangible Property and the State Taxation of Income*, 23 HOFSTRA L. REV. 407, 444 (1994) ("Prior to *Geoffrey*, at least three states asserted nexus based upon the business situs of intangible property, in reliance upon a state court decision which approved this practice.") It is much less of an outlier today. *See* BDO, *The State Income Tax Consequences of Wayfair*, August 2018, at https://www.bdo.com/insights/tax/state-and-local-tax/the-state-income-tax-consequences-of-wayfair (" Beginning in 1993 with the South Carolina Supreme Court's decision in *Geoffrey, Inc. v. South Carolina Tax Comm.*, today approximately 14 states have their own case law confirming that an economic presence is sufficient to establish a substantial nexus under the Commerce Clause for purposes of their corporate income taxes."). Other legal devices were developed to achieve similar results. *See* Corey L. Rosenthal, Arvinder Kaur & Dilnora Isaeva, *Changes to 'Business Activity' on the Horizon?*, CPA JOURNAL (Feb/March 2021) (explaining how the Uniformity Committee of the Multistate Tax Commission proposal to re-define "business activity" for purposes of P.L. 86-272 would reduce the protection it affords taxpayers).

[30] *See* John Rappa, *Adoption of Combined Reporting in Selected States, 2015*, https://www.cga.ct.gov/2015/rpt/2015-R-0163.htm ("about half the states impose combined reporting"). A state with combined reporting could exercise taxing jurisdiction over income ostensibly derived by any member of the group, regardless of the extent (or not) of that member's physical nexus to the jurisdiction, by apportioning that entity's purported income to an in-state entity based on apportionment factors calculated on a group-wide basis. *See* Michael Mazerov, *A Majority of States Have Now Adopted a Key Corporate Tax Reform—"Combined Reporting*," CTR ON BUDGET AND POL'Y PRIORITIES, April 3, 2009, at https://www.cbpp.org/research/a-majority-of-states-have-now-adopted-a-key-corporate-tax-reform-combined-reporting ("By requiring corporate parents and subsidiaries to add their profits together, combined reporting states are able to nullify a variety of tax-avoidance strategies large multistate corporations have devised to artificially move profits out of the states in which they are earned and into states in which they will be taxed at lower rates—or not at all.") Although sixteen states had adopted combined reporting prior to a 1983 Supreme Court decision upholding the constitutionality of such reporting in the international context, *see* Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983), additional states did not begin adopting such rules until 2004. *See* Michael Mazerov, *supra* note 30 (state survey). Currently, twenty-eight states have adopted combined reporting, with another six or so considering its adoption. *See* Michael J. Bologna, '*Sham Transactions' Trigger States to Crack Down on Tax Havens*, BLOOMBERG TAX, DAILY TAX REP'T, Feb. 26, 2021, https://news.bloombergtax.com/daily-tax-report-state/sham-transactions-trigger-states-to-crack-down-on-tax-havens.

[31] *See* Charles L. McLure, Jr., *supra* note 24, at 153 (describing "add-back" statutes).

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of Congressional intervention, or concern about the treatment their laws would receive in the federal or state courts.[32] Some of these fears were well founded. Congress has twice passed statutes to prevent states from exercising taxing jurisdiction over particular types of multi-jurisdictional income received by taxpayers lacking physical nexus.

In 1959, Congress enacted the Interstate Income Act[33] which bars states and their political subdivisions from imposing a net income tax on any taxpayer involved in interstate commerce if the "only business activities within such State by or on behalf of such person…are…(1) the solicitation of orders…for sales of tangible personal property, which orders are sent outside of the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State…."[34] By its terms, the statute only protects sellers of tangible personal property. It does not affect sellers of intangible property, real estate, or services—nor does it provide protection against taxes levied on a base other than net income. To this day, it is unclear whether the statute covers e-commerce as well as mail-order sales.[35] Determined states long ago found ways to minimize the impact of this statute. For example, several states avoided its reach by replacing their taxes on net business income with gross income based taxes. Examples of such taxes include the Michigan business tax, the Texas margin tax, and the Ohio commercial

[32] Although the federal courts never disapproved of any of these techniques (any more than they required physical presence for income tax nexus) some state court interpretations of their own state constitutions were less favorable. *See supra* note 26.
[33] P.L. 86-272, *supra* note 25.
[34] Id.
[35] *See* Stanley R. Kaminski, *Public Law 86-272 and Digital Goods*, ST. TAX NOTES TODAY (Nov. 5, 2018) ("varying positions [by state tax authorities] have resulted in the state income tax landscape becoming a maze of uncertainty when it comes to P.L. 86-272 and digital goods" and arguing for their exemption from state income tax).

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activities tax.[36] But not all states were so determined and, in fact, a kind of under-taxation remained.[37]

Congress' other statutory intervention came in 1996, after six states tried to tax nonresident individuals on retirement income paid with respect to services performed within their borders.[38] The taxing states rationalized their extension of taxing jurisdiction by pointing to the fact that pension payments were for the most part merely delayed wages for work that had performed within the state; these wages would have been taxed by the state earlier in time, absent the deferral advantage granted contributions to retirement plans. Although all states were willing to allow taxpayers the advantage of tax deferral in order to facilitate retirement savings, some states were unwilling to forfeit those revenues entirely when taxpayers moved to other states post-retirement.[39] Swayed in part by the argument that such taxation constituted "taxation without representation"[40] and in part by the lobbying efforts of retirees who had moved to states which did not include pension income from in the base of their state income taxes,[41] Congress enacted a

[36] *See* Kathleen K. Wright, *The Unintended Consequences of Gross Receipts "Taxes"*, 64 TAX LAWYER 901, 926 (2011) ("[t]he most recent attack on Public Law 86-272 has been in the form of legislation"; listing gross receipts taxes enacted to avoid impact of that law); Diana Dibello & Sylvia Dion, *Navigating Nexus*, J. OF ACCOUNTANCY, Nov. 1, 2010, https://www.journalofaccountancy.com/issues/2010/nov/20102904.html (listing gross based business taxes).

[37] Some of this undertaxation may have been remediated by the effects of the throwout rules described *supra* note 26--although that would have reallocated the missing taxes to states other than the state in which customers were located.

[38] *See* FERDINAND P. SCHOETTLE, STATE AND LOCAL TAXATION: THE LAW AND POLICY OF MULTI-JURISDICTIONAL TAXATION 568 (2003) (the six states were California, Colorado, Kansas, Louisiana, New York and Oregon).

[39] *See id.*, at 568 (states "sought to tax the deferred income of former residents.")

[40] *See* Walter Hellerstein & James Charles Smith, *State Taxation of Nonresidents' Pension Income*, 56 TAX NOTES 221, (1992) (calling this argument "ludicrous" since "no principle is more firmly established, both internationally and domestically, than the power of a taxing sovereign to tax income on the basis of source, regardless of the political relationship of the income earner to the taxing jurisdiction.")

[41] *See* Kathryn L. Moore, *supra* note 21, at 183-6 (tracing legislative history of Pub. L. No. 104-95).

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law explicitly limiting states' authority to tax the pension income of nonresidents.[42] Federal law now specifically forbids states from imposing income taxes on nonresidents' retirement income.

State legislatures thus had some reason to fear that attempts to extend their taxing jurisdictions to cover more income derived by "nonresident" taxpayers would lead to being overruled by Congress. Even the success of a few states in doing so could be explained away by their relative lack of salience; once many states started to go down the same path, they might have feared that Congress would intervene. Congress did not intervene in the pension area, for example, until several states started to enforce their rules taxing non-residents on their pension income and other states were considering such actions.[43]

States legislatures may also have had reason to fear judicial obstacles to more effective taxation. For many years, the Supreme Court took the position that states could not require out-of-state sellers, with no in-state physical presence, to withhold and pay use-tax revenues to their customer's state of residence on both Due Process and Dormant Commerce Clause grounds. In *National Bellas Hess v. Department of Revenue*,[44] the Court struck down an Illinois statute imposing use-tax obligations on vendors effecting sales to Illinois customers solely through the

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[42] Pub. L. No. 104-95, § 114(a) ("No State may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such State).")

[43] Although a number of states had statutes which allowed them to tax the pension income of nonresidents, few attempted to enforce these provisions. *See* Amy Hamilton, *Pension Source Taxation Leading to "Economic War Between the States,' Witness Tells Congress*, ST. TAX NOTES (1995) (Harry Duncan, executive director of the Federation of Tax Administrators, testified that "[t]here are 13 states whose statutes permit them to tax some portion of deferred income from a nonresident….Of those, nine states generally, if not exclusively, tax income from nonqualified deferred compensation plans….Only one state—California—has any program in place to enforce tax compliance by nonresidents…."); Hellerstein & Smith, *supra* note 40, at 223 ("state taxing authorities generally make no effort to tax the federally deferred gain of taxpayers who are former residents at the time of federal recognition"). It was apparently California's attempt to enforce its tax that led to the lobbying efforts that eventually led to enactment of Pub. Law No. 104-95. *See* Kathryn L. Moore, *supra* note 21, at 183 n. 92 (speculating on why the issue became salient in 1988).

[44] 386 U.S. 753 (1957).

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mail[45] and invoked both Due Process[46] and Dormant Commerce Clause concerns. The Court explicitly expressed concern that the imposition of such a burden on businesses lacking a physical presence in the state would negatively affect interstate commerce.[47] Although the Court never extended the same solicitude to the income tax context, [48] state legislatures may have worried that it would.[49]

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[45] The statute would have required mail-order sellers to collect Illinois' use tax from Illinois customers, and remit the funds collected to the Illinois state treasury.

[46] 383 U.S. at 758 (holding that a "seller whose only connection with customers in the State is by common carrier of the United States mail" lacked requisite minimum contacts with the State justifying taxation); *id* at 760 (describing such jurisdictions as having "no legitimate claim to impose [on the appellant] 'a fair share of the cost of the local government.'")

[47] 383 U.S. at 759-60 ("And if the power of Illinois to impose use tax burdens upon National were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote….The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions….") (footnote omitted).

[48]On several occasions, the Supreme Court was asked to overrule state court decisions upholding the extension of state income tax jurisdiction on the basis of substantial economic nexus, but denied certiorari each time. *See* Thimmisch, *supra* note 2, at 346 ("The Supreme Court was repeatedly asked to weigh in on those [nexus] standards, but the Court denied certiorari in each case. The signal seemed clear.") State courts seemed comfortable restricting *National Bellas Hess* and the cases that followed it to state sales and use contexts. *See* Thimmisch, *supra* note 2, at 346 (state courts "nearly universally held that Quill applied only to states' consumption taxes and that states could impose other taxes, most notably corporate income taxes, based upon firms' economic connections….") The enunciated rationale for distinguishing between the consumption tax and income tax contexts was the degree of practical burden imposed on businesses. Businesses charged with collecting sales and use taxes would have had to calculate and collect the applicable tax for each sale. Before widespread computerization, this could be a crushing task. Even now, the number of jurisdictions levying such taxes, the differences in their tax rates and bases, and the frequency with which those rates and bases change make life difficult for vendors. *See* Thimmisch, *supra* note 2, at 350 ("[T]here are thousands of sales tax jurisdictions in the United States. Sales tax bases are also notoriously complex and inconsistent. . . . Quite frankly, states' sales taxes are 'nutty' in their design and implementation.")

[49] It is notable that the Multistate Tax Commission did not share these worries. In 2002, the Multistate Tax Commission adopted a proposed model statute for a factor-presence nexus standard for business activity taxes (encompassing both gross receipts and income taxes) which would have provided nexus whenever a taxpayer made more than $500,000 of sales into a state, even in the absence of in-state payroll or property. *See* Multistate Tax Commission, Commission Proposes "Simple, Certain" Standard for Business Taxes, Doc. 2002-23818, Oct. 22, 2002, at https://www.mtc.gov/MTC/media/Uniformity/MTC-Press-Release-on-Factor-Presense-Model.pdf (announcing new standard); Dan Bucks & Frank Katz, *Explanation of the Multistate Tax Commission's Proposed Factor Presence Nexus Standard*, ST. TAX NOTES 1037, (Sept. 30, 2002) ("The Commission's proposal …will make a strong and positive contribution to curbing excessive corporate tax sheltering activity that in recent years has seriously undermined the certain and equitable payment of corporate income taxes.") The MTC would hardly have made this proposal had it believed it fell short of federal constitutional standards. Nine states subsequently adopted similar factor-presence nexus standards for their business activity taxes. *See* BDO, *The State Income Tax Consequences of Wayfair*, Aug. 2018, https://www.bdo.com/insights/tax/state-and-local-tax/the-state-income-tax-consequences-of-wayfair (listing states).

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The Court began backtracking in the sales tax context in *Quill Corp. v. North Dakota*,[50] a case which also revolved around a state's attempt to require an out-of-state seller to collect and remit use taxes imposed on in-state customers. This time around, the Court held that mere economic nexus between the state and the vendor was enough to meet the Due Process Clause's nexus standards; physical presence was not required.[51] However, relying on a combination of stare decisis and the benefits of bright line rules, the Court refused to overrule *National Bellas Hess* and opined that physical presence remained the touchstone for determining "substantial nexus" under the dormant Commerce Clause.[52] By limiting its rationale for striking down the tax statute to the dormant Commerce Clause, the Court opened the door for Congressional action to reverse the outcome of the case. Indeed, the Court's opinion practically invited Congress to use its power under the Commerce Clause to legislatively determine the circumstances under which a state or locality could require out-of-state vendors to collect sales or use taxes from in-state customers.[53]

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[50] 504 U.S. 298 (1992).
[51] 504 U.S. at 308 ("Thus, to the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State for the imposition of duty to collect a use tax, we overrule those holdings as superseded by developments in the law of Due Process.")
[52] *See id.* at 317-18 ("To the contrary, the continuing value of a bright-line rule in this area and the doctrine and principles of *stare decisis* indicate that the *Bellas Hess* rule remains good law…. [W]e disagree…that the time has come to renounce the bright-line test…")
[53] *Id.* at 318 ("Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.")

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But Congress declined the invitation[54] and in 2018, in the case of *South Dakota v. Wayfair, Inc.*[55], the Supreme Court overruled its decision in *Quill* and held that economic nexus, defined as "'avail[ing] itself of the substantial privilege of carrying on business in [a] jurisdiction," would henceforth be deemed to meet the Dormant Commerce Clause's "substantial nexus" requirement.[56] Accordingly, a vendor's lack of physical presence would no longer protect it from a duly enacted obligation to collect and remit use taxes from in-state customers.

The *Wayfair* decision has had quite an impact on state tax policy. Most states subsequently enacted use taxes (and mandated use tax collection) of the sort initially held illegal in *Quill*.[57] It has had a similar effect on state income taxes. In the years following the decision, a large number

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[54]Though, in the words of noted academics, "the de facto exemption for remote sellers was a major thorn in the side of state tax authorities (and non-remote sellers) for at least the past 40 years," John A. Swain & Walter Hellerstein, *The Political Economy of the Streamlined Sales and Use Tax Agreement*, 58 NAT'L TAX J. 605, 605 (2005), serious attempts to develop a workable taxation plan arose only after the advent of electronic commerce. *See id.* at 606. The Communications and Electronic Commerce Tax Project, sponsored by the National Tax Association in 1997, was the first institutionalized attempt to develop rules for combining tax simplification and an expanded duty to collect use tax. It terminated without a comprehensive agreement. *See id*. at 606-08 (describing areas of consensus and disagreement). A contemporaneous Congressionally-established Advisory Commission reached the same non-result. *See id.* at 608. Following those failures, several states organized a joint "Streamlined Sales Tax Project" with the aim of "draft[ing] a fundamental 'constitutional' document," which would "set[] forth the substantive, administrative, and governance rules to which states that are parties must adhere." *See id.* at 610. Over the course of two years, the SSTP managed to draft what amounted to a model law, the Streamlined Sales and Use Tax Agreement, or SSUTA, which (if implemented through conforming state legislation) "require[ed] state and local tax base uniformity, a single local rate, and state-level tax administration." *See id*. at 613. By March of 2020, twenty-three states had adopted the SSUTA. *See* Remote Sales Tax Collection, NCSL, 3/13/2020, at https://www.ncsl.org/research/fiscal-policy/e-fairness-legislation-overview.aspx. The group of adoptees, however, did not include the "top six sales tax collection states by population." *Id.* Although numerous bills have been introduced over the years, Congress has neither enacted legislation requiring states to adopt legislation incorporating the SSUTA nor legislation pre-empting provisions found in the SSUTA. *See id* (listing legislative efforts to limit or delay the ability of states to collect sales taxes from remote sellers); Swain & Hellerstein, *supra* note 54, at 615-16 (describing Congressional refusal to act).

[55]585 U.S. ___, 201 L.Ed. 2d 403 (2018).

[56] Slip op at 22.

[57]*See* Jamie Yesnowitz, *The Pandemic's Effect on Sales Tax Post Wayfair*, TAX EXEC., Mar. 9, 2021, https://taxexecutive.org/the-pandemics-effect-on-sales-tax-post-wayfair/ (in the eighteen months following the *Wayfair* decision, "almost every state…adopted remote seller and marketplace facilitator legislation"); Jared Walczak, *State Sales Taxes in the Post-Wayfair Era*, TAX FOUND., Dec. 12, 2019, at https://taxfoundation.org/state-remote-sales-tax-collection-wayfair/ ("Following the 2018 *South Dakota v. Wayfair* U.S. Supreme Court decision eliminating the physical standard for sales tax nexus, 43 of 45 states with statewide sales taxes have adopted collection and remittance obligations for remote sellers, and 38 have implemented marketplace facilitator regimes.")

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of states expanded the reach of their income taxes to include businesses lacking in-state physical presence on the basis of their "economic nexus."[58] It is unclear whether these new assertions of taxing jurisdiction resulted from the fact that *Wayfair* lessened legislators' concerns about Congressional interference, or simply made the prospects for additional tax revenues more salient to state legislators looking to increase tax revenues. In addition to extending the reach of their normal income taxes to cover more multistate taxpayers, states also began imposing taxes on internet sales and internet advertising revenue associated with in-state consumers.[59] In short, there are now more states seeking to extract taxes from multistate taxpayers and, as a result, there are more opportunities for such taxpayers to be covered by overlapping (and conflicting) tax rules. There are also fewer opportunities for taxpayers to create "nowhere" income to offset (or more than offset) the duplicative taxation caused by the use of different formulas for apportioning the income of multistate taxpayers. Unfortunately for taxpayers and their lawyers,

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[58] An additional seven or so states have broadened the reach of their income tax since *Wayfair* was decided. *See* Brian Kirkell, David Brunori, and Mo Bell-Jacobs, *Wayfair nexus turns three by celebrating near universal adoption*, RSM INSIGHT ARTICLE, June 21, 2021, https://rsmus.com/what-we-do/services/tax/state-and-local-tax/wayfair-nexus-turns-three-by-celebrating-near-universal-adoption.html ("a flurry of activity around non-sales and use taxes occurred after the decision as states expand economic nexus beyond sales taxes"; listing "some of that activity"); Tom Blaze, Mo Bell-Jacobs, James Barash & Matt W. Loczkowski, *Nexus in a Post-Wayfair World*, RSM INSIGHT ARTICLE, January 11, 2021, https://rsmus.com/what-we-do/industries/business-and-professional-services/5-considerations-for-business-and-professional-services-post-way.html ("Beginning in 2019, a number of states adopted sales thresholds for non-sales and use taxes. Hawaii, Massachusetts, Pennsylvania, Texas and Washington all adopted new or revised sales thresholds for a non-sales and use tax purpose. Hawaii and Texas adopted the same threshold used for each state's economic sales tax nexus determination for the corporate income tax and the franchise tax, respectively. Massachusetts and Pennsylvania both adopted a $500,000 threshold for the corporate income tax; Washington lowered its economic nexus threshold or the business and occupation tax to $100,000"); Louis Mancini, *The Growing Reach of Wayfair and Economic Nexus for State and Local Income and Gross Receipts Taxes*, A & M , Jan. 28, 2020 at https://www.alvarezandmarsal.com/insights/growing-reach-wayfair-and-economic-nexus-state-and-local-income-and-gross-receipts-taxes (listing states); Corey Rosenthal, *et al.*, *supra* note 29 ("the landmark decision in *Wayfair* is causing states to carefully evaluate adopting economic factor-based presence nexus provisions" and listing states "emboldened to adopt economic nexus standards for income and gross receipts taxes" "[i]n light of Wayfair").

[59] *See* Jeff Dorris & Lee Fritts, *Three years after Wayfair: Future impact and lingering issues*, THE TAX ADVISOR, September 1, 2021, at https://www.thetaxadviser.com/issues/2021/sep/wayfair-future-impact-lingering-issues.html (describing Maryland's gross receipts tax on digital advertising).

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the number and extent of variations in these formulas and the definitions of the terms used in the formulas may even be increasing.[60]

II. The Undermining of UDITPA and the Multistate Tax Compact

As far back as 1911, when Wisconsin adopted the first state corporate income tax, tax policy experts began worrying about the problems that could be caused by the use of inconsistent state laws for apportioning multistate income.[61] They understood that such inconsistencies could lead both to under-taxation and over-taxation, and they urged the adoption of a uniform state apportionment formula.[62] After some false starts,[63] the National Conference of Commissioners on Uniform State Laws took on the project of drafting a model law which it hoped would be widely adopted at the state level. Designing the law turned out to be difficult and politically contentious. The organization did not adopt the model Uniform Division of Income for Tax Purposes Act, or "UDITPA," until 1957.[64] Even then, it struggled to find political purchase.[65] It took the threat of federal legislation in 1964 (which would have incorporated a different and widely reviled apportionment formula)[66] to get most states to enact UDITPA, and to enter into

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[60] For example, the pandemic (and the accompanying growth in remote work) caused additional states to assert taxing jurisdiction over income earned by employees with no physical presence in the state. *See* Monte Silver, *et al.*, *Displaced Employees and COVID-19: The New Tax Obligations*, 97 ST. TAX NOTES 1350, 1351 (2020) (describing Massachusetts' "emergency rule that continues to treat a nonresident—ordinarily working in that state, but who now works remotely for the same employer—as nonetheless continuing to generate in-state taxable income").

[61] *See* Swain, *supra* note 5, at 4 ("The problem of nonuniform allocation and apportionment rules was identified as soon as states began adopting a corporate income tax.")

[62] *See id*. at 5 (describing "uniformity movement" spearheaded by the National Tax Association "[a]s early as 1920").

[63] *See id*. at 5-6 (describing earlier efforts by the National Tax Association ("NTA"), the Controllership Foundation and the Council of State Governments).

[64] *See id.* at 6 ("In 1957 UDITPA was promulgated by NCCUSL and approved by the American Bar Association.")

[65] *See id.* at 7 ("During the period of 1957 through 1964, only three states—Alaska, Arkansas, and Kansas—adopted UDITPA.")

[66] Congressional concern about the effect of state taxes on interstate commerce led to the formation of a congressional committee (known as the Willis committee) to "study the problem"; it issued a report in 1964 "concluding that the lack of uniform division of income rules was doing substantial harm to the national common market." *See id*. at 7. However, because the apportionment formula contained in the proposed federal legislation did

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the related Multistate Tax Compact, which obligated signatories to "allocate and apportion income pursuant to UDITPA and undertake other joint activities to lessen the administrative and compliance burdens of the state corporate income tax."[67] However, as detailed below, this "uniform law" failed to provide true uniformity in the apportionment of corporate income.

A. The Continued Use of Different Apportionment Formulas

The choice of an apportionment formula was controversial from the outset. Indeed, differences in opinion as to the appropriate apportionment formula held up the development of a model (uniform) statute for many years. Views ran from a single factor, sales based formula,[68] to formulas which excluded the sales factor entirely.[69] However, drafters of UDITPA eventually coalesced around the three-equally-weighted factor "Massachusetts' formula".[70]

Even at UDITPA's most popular moment, some states demurred and relied on their own rules for apportioning income.[71] This limited "consensus" eroded further once Iowa's strategic single-

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not contain a sales factor, "[t]he bill was met immediately with 'uproarious dissent from both business and state government'" leading state governments to swiftly adopt UDITPA and enter into the Multistate Tax Compact. *See id*. at 7 ("by 1967, 19 states and the District of Columbia had adopted UDITPA. Additionally, most of these states entered into the Multistate Tax Compact.").

[67] Swain, *supra* note 5, at 7.

[68] Fred Cox, a Georgia tax administrator, was the "most enthusiastic and effective advocate" for the primacy of the sales factor, arguing that "persons with payroll and property in the state were already making a contribution to the economic development of the state and paying other taxes such as property taxes, but persons outside the state making sales into the state were exploiting the market while giving nothing in return." *A Brief History of UDITPA*, *supra* note 5, at 760-61.

[69] Prior to UDITPA's adoption, 20 states used the three-factor Massachusetts' formula, five states used a formula based on sales, property and manufacturing costs, two states used a sales-factor only formula and two used a two-factor property and gross receipts formula. *See id.* at 760. Indeed, it was Congress' threat to enact a two-factor formula apportionment formula, per the recommendation of the Willis Commission Report, Special Subcomm. On State Tax'n of Interstate Commerce of the Comm. On the Judiciary, H.R. Rep. No. 89-952 (1965); H.R. Rep. No. 89-565 (1965); H.R.Rep. No. 88-1480 (1964), that caused a critical mass of states to adopt the UDITPA/MTC's three-factor "Massachusetts formula." *See* Swain, *supra* note 5, at 7.

[70] *See A Brief History of UDITPA*, *supra* note 5, at 759 (describing three-factor apportionment formula).

[71] *See* John Huddleston & Shirley Sicilian, *The Project to Revise UDIPTA*, NYU INST. ON STATE AND LOCAL TAX'ON, 2009, 6, https://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Minutes/The Project to Revise UDITPA.pdf ("Of the forty-seven states with a corporate income tax, thirty-six have adopted all or substantial parts of the Act. The remaining eleven states employ at least some of its concepts.")

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factor apportionment rule prevailed before the Supreme Court in *Moorman Manufacturing*.[72] Iowa had many farmers (acting only locally) and consumers, but few multistate businesses of other types. The Iowa legislature correctly thought that its share of the income and tax revenues paid by out-of-state businesses would be greater if it employed an exclusively sales-based apportionment formula, rather than one that also took the location of the taxpayers' property and payroll into account.[73] Only later did other states come to realize another effect of a heavily-sales-weighted formula: it encouraged businesses to invest within their borders. Economists had no trouble showing that the inclusion of business property and payroll in an apportionment formula was the economic equivalent of imposing a direct tax on those factors; states maintaining relatively high tax rates risked scaring off potential investors.[74] Inasmuch as

[72] 437 U.S. 267 (1978).

[73]Thomas J. Nichols, *supra* note 23, at 493-94 ("Each state is motivated by a desire to adopt the formula which is most advantageous, taxwise, to itself. For example, Iowa, considered an unindustrialized consumer state, has utilized an apportionment formula based entirely upon sales by destination ever since it adopted the corporate income tax in 1934. On the other hand, New York, a heavily industrialized state, adopted a three-factor formula in 1944….[B]oth states adopted formulas which were designed to assign the largest possible fraction of corporate income to themselves.")(footnote omitted); *id*. at 496 (noting that "[i]n the 1950's a number of consumer or market states adopted more sales-oriented approaches to income apportionment….motivated, in part, by revenue concerns.")

[74] *See* Charles E. McLure, Jr. & Walter Hellerstein, *Does Sales-Only Apportionment of Corporate Income Violate the GATT*, NBER Working Paper 9060 (2002) ("Formula apportionment has the economic effect of converting a tax on corporate income into a set of taxes on the factors in the apportionment formula….[T]he shift in weights that is occurring reduces the weight on the *origin* of interstate sales used to assign income and increases the weight on the *destination* of such sales, thereby increasing the state's competitive position in both in-state markets and out-of-state markets…."); Austan Goolsbee & Edward L. Maydew, *Coveting Thy Neighbor's Manufacturing: The Dilemma of State Income Apportionment*, 75 J. PUB. ECON. 125, 126 (2000) (payroll eight affects in-state employment which might outweigh revenue losses); Bharat N. Anand & Richard Sansing, *The Weighting Game: Formula Apportionment as an Instrument of Public Policy*, 53 NAT'L TAX J. 183, 184 (2000) ("Compared to the [equally weighted formula], the [double weighted sales formula] decreases the tax burden on firms producing within that state and exporting to another state, while increasing the tax burden on firms that produce in other states and import into that state….[A] state using the DWSF will be a more attractive place to locate the property and payroll of a business enterprise operating in multiple states than a corresponding EWF state."). However, empirical support for this theory (that is, for the ability of a single-factor sales based allocation formula to attract businesses and increase state tax revenues) has fallen short of its proponents' promises. *See* Jamie Bernthal, Dana Gavrila, *et al*., *Single Sales-Factor Corporate Income Tax Apportionment: Evaluating the Impact in Wisconsin*, Robert M. LaFollette School of Public Affairs Workshop in Public Affairs, May 2012, pp. xi – xii, at https:..lafollette.wisc.edu/images/publications/workshops/2012-DOR.pdf (extending the Goolsbee & Maydew model and finding manufacturing and manufacturing employment gains much smaller than expected); Susan C. Morse, *Revisiting Global Formulary Apportionment*, 29 VA. TAX REV. 593, 617-18 (2010) ("the empirical evidence on the extent of the movement of business investment to a jurisdiction that increases the sales weighting of its formula is mixed"); Michael Mazerov, *The "Single Sales Factor" Formula for State Corporate Taxes: A Boon to Economic*

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customers are less mobile than business investments, states have less concern about customer defections. In a world with tax competition, the argument went, emphasizing the sales factor would make sense for many states.[75] Put differently, tax rate differentials cease influencing the location of business investments when the location of business investments ceases to affect the amount of tax liability imposed.

As many (but not all) states emulated Iowa by moving to a single factor or double-weighted sales formula for the allocation of income,[76] the Multistate Tax Commission took note. It

Development or a Costly Giveaway?, Center on Budget and Policy Priorities, 2005, at p. 35, https://cbpp.org/sites/default/files/archive/3-27-01sfp.pdf (arguing that many states would lose tax revenues by adopting single sales factor apportionment with questionable effects on business investment); McLure, Jr., *supra* note 24 , at 156 (describing move to increase the weight on the sales factor "to gain a competitive advantage—or to avoid a competitive disadvantage" as a "beggar-thy-neighbor" policy).

[75]Similar arguments have been made in the international arena, *See* Alan Auerbach, Michael P. Devereux, Michael Keen & John Vella, *Destination-Based Cash Flow Taxation*, Oxford University Centre for Business Taxation, WP 17/01, January 2017, https://eml.berkeley.edu/~auerbach/CBTWP1701.pdf (a DBCFT "improve[s] economic efficiency by taxing business income in a relatively immobile location—that is, the location of final purchasers of goods and services…. The DBCFT should not distort either the scale or the location of business investment"); & Reuven S. Avi-Yonah & Kimberly A. Clausing, *Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment*, in Path To Prosperity: Hamilton Project Ideas on Income Security, Education and Taxes 319, 319-20 (Jason Furman & Jason E. Bordoff eds., 2008), http://www.brookingsedu/papers/2007/~/media/Files/rc/papers/2007/06corporatetaxes-clausing/200706clausing_aviyonah.pdf (advocating the taxation of the corporate income of multinational firms based on the share of worldwide sales destined for customers in the United States). Others are less sanguine about sourcing sales income to the location of the customer, pointing to ways taxpayers (particularly business taxpayers) could defeat the intent of such statutes by rearranging the way in which they operate their businesses. *See* Roseanne Altshuler & Harry Grubert, *Formula Apportionment: Is It Better Than The Current System And Are There Better Alternatives?*, 63 NAT'L TAX J. 1145, 1172-73 (2010) (describing techniques for locating sales in low-tax countries); Julie Roin, *Can the Income Tax Be Saved? The Promise and Pitfalls of Adopting Worldwide Formulary Apportionment*, 61 TAX L. REV. 169, 233-34 (2008) (same). Intermediate goods pose a particular problem. *See* Stanley R. Kaminski & Lauren A. Ferrante, *Sourcing of Tangible Personal Property: When Destination and Delivery Dovetail*, DUANE MORRIS TAX NOTES STATE, January 25, 2021, https://www.duanemorris.com/articles/sourcing_tangible_persona_property_destination_delivery_dovetail_0121.html (discussing destination disputes when deliveries made to intermediary entities); *The Ultimate Destination Rule—Keeping Ohio's CAT in Check*, FROSTBROWNTODD LLC, https://frostbrowntodd.com/the-ultimate-destination-rule-keeping-ohios-cat-in-check/?utm_source=Mondaq&utm_medium=syndication&utm_campaign= (same).

[76] By 2008, only ten states continued to use the equally-weighted three factor formula, while twenty-six states double weighted the sales formula and eleven used a single sales factor formula. *See* Huddleston & Sicilian, *supra* note 71, at 20. Many of the states that persisted in using an equally weighted three-factor formula were mining or other natural-resource extraction states. *See* Anand & Sansing, *supra* note 74, at 193 ("Our theory that states that have retained EWF have done so in an effort to tax immobile capital is also consistent with the decisions by certain states … to allow manufacturing firms to use DWSF, while requiring other corporations to use EWF"). By 2021, the number of three-factor states was reduced to six, while 27 used a single-factor sales test and the remainder double or triple weighted the sales factor. *See* Federation of Tax Administrators, *State Corporate Income Tax Apportionment Formula for Multi-State Taxpayers* (2021), https://www.taxadmin.org/assets/docs/Research/Rates/apport.pdf.

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adopted a revised version of its suggested law in 2015.[77] To some extent, though, this revision merely recognized pre-existing differences in state law rather than imposing uniformity. The 2015 version of UDITPA recommends but does not require the double-weighting of the sales factor. It now reads "All apportionable income shall be apportioned to this State by multiplying the income by a fraction, [State should define its factor weighting fraction here. Recommended definition…."]. [78] And indeed, although there has been continued movement towards state adoption of single-sales-factor formula apportionment, substantial diversity continues to exist,[79] leaving open opportunities for under- and over- taxation.

B. The Continued Use of Different Factor Definitions

Even states which appear to use the same apportionment formula may generate inconsistent results because they have adopted different definitions of the factors employed in that formula. For example, if two or more states claim to be the location of a given "receipt"[80] or "sale" for purposes of calculating their share of the sales factor, such income will be taxed twice. When both State A and State B claim that a single $100,000 sale (by a taxpayer with $500,000 of sales overall) is attributable to their jurisdiction, the combined numerators of the sales fractions will be

[77] *See* Jamie C. Yesnowitz, Dale Busacker, Chuck Jones & Lori Stolly, *Multistate Tax Compact Amendments May Have Major Effect on States*, THE TAX ADVISOR, Jan. 31, 2015, https://thetaxadviser.com/issues/2015/feb/tax-clinic-12.html (describing amendments approved by the Multistate Tax Commission at its annual meeting on July 30 and July 31, 2015).
[78] Model Compact Article IV. Division of Income. [UDITPA] As revised by the Multistate Tax Commission, July 29, 2015 ¶9, https://www.mtc.gov/getattachment/Events-Training/2017/Special-Meeting/FINAL-APPROVED-2017-Proposed-Amendments-to-General-Allocation-and-Apportionment-Regulat.pdf.aspx.
[79] *See supra* note 76.
[80] The 2015 revisions to UDIPTA changed many references in the statute from "sales" to "receipts." *See* Yesnowitz, *et al.*, *supra* note 77 (describing 2015 changes).

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$600,000. If both states use a single factor sales apportionment formula, the taxpayer would be subject to tax at the state level on 110 percent of its income.[81]

As an historical matter, rules for determining each state's portion of sales (the numerator of the sales factor) have been the most problematic, generating the most variance across states.[82] The original version of UDITPA incorporated some of the preexisting cacophony of rules when it adopted a different rules for determining the location of sales of tangible personal property and sales or receipts from the sale or license of other types of property or services. Section 16 of UDITPA employed a destination test for purposes of attributing receipts from the sale of tangible personal property.[83] By contrast, most other receipts, such as those from the sale of intangible property or services, were covered by Section 17 of UDITPA, which attributed them to the state in which "'the income-producing activity is performed' or, if performed in more than one state, to the state in which 'a greater proportion of the income-producing activity is performed…based on costs of performance.'"[84] This latter (all-or-nothing) rule was roundly criticized both for its failure to pro-rate the receipts on a time or cost basis,[85] as well as its tendency to simply duplicate the effect of the property and payroll factors rather to provide a return to the market

[81] Both State A and B would claim the right to tax 20 percent of the taxpayer's income, while the remaining states presumably would claim the right to collect the 90 percent of the sales not claimed by other states. Thus, the taxpayer would end up paying tax on 110 percent of its income. The effect would be reduced if the apportionment formula took other factors into account.
[82]*See A Brief History of UDITPA, supra* note 5, at 760 (outlining the "theoretical and practical reasons" underlying the fact that "[t]he diversity of approaches was most pronounced with the sales factor"); Hellerstein, *supra* note 25, at 772 ("It is the sales factor that has generated the most conflict in this context.")
[83] *See* Hellerstein, *supra* note 25, at 773 (citing UDITPA §16).
[84] *See id*. at 772 (citing UDITPA §17).
[85] *See id*.

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state.[86] Nor was any explanation provided for employing different rules in the different contexts.[87]

In 2015, the MTC voted to amend UDITPA to apply the market-based or destination principle for attributing all sales, including sales of services.[88] However, not all states have adopted the new rule, and even the ones that have do not necessarily agree on how it should be applied. [89]

Nor is the definition of the sales factor the only area of disagreement among states. Those states still apportioning income in part based on a property factor do not always agree on how to calculate the amount of in-state—or even total—property. Indeed, the Multistate Tax Commission acknowledged the existence of such disparities when it promulgated suggested amendments to its model allocation and apportionment regulations in 2017. The proposed regulations provided that when "the returns or reports filed by the taxpayer…are not uniform in the valuation of property and in the exclusion of property from or the inclusion of property in the

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[86] *See* JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION ¶9.18[3][a], p. 9-220 (2001 ed.) ("the rule often fails to serve the purpose of the sales factor to reflect the contribution of the market state to the taxpayer's income").

[87] *See* Pomp, *supra* note 7, at 57-8 ("[T]he difference between Act Art. IV.16's destination principle and Act Art. IV.17's COP—destination v. origin—does not reflect any rigorous, analytical thinking by the Uniform Law Commissioners in 1957."); McLure, Jr., *supra* note 24, at 148 (the "gross inconsistency between attributing sales of tangible property to the state of destination and attributing other sales…to the one state where the most income producing activity occurs….makes no sense…")

[88] *See* Yesnowitz, *et al*, *supra* note 77, https://www.thetaxadviser.com/issues/2015/feb/tax-clinic-12.html (describing 2015 changes).

[89] *See* Richard Goldstein, *Market-Based Sourcing vs. Cost of Performance for Apportioning Receipts from Services*, BERDON ACCOUNTANTS AND ADVISORS CLIENT ALERT, Jan. 22, 2021, https://www.berdonllp.com/market-based-sourcing-vs-cost-of-performance-for-apportioning-receipts-from-services/ (market-based sourcing is "ubiquitous" but "[i]dentifying the location where the taxpayer's customer received the benefit of the taxpayer's service is at times far more complicated than determining COP"); Kenneth Laks, *Sales Allocation Methods: Cost of Performance vs. Market-Based Sourcing*, CPA JOURNAL, Nov. 2019, at https://www.cpajournal.com/2019/12/06/sales-allocation-methods/ (chart of city and state laws); Yesnowitz, *et al.*, *supra* note 77 (describing 2015 changes).

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property factor, the taxpayer shall disclose in its return to this state the nature and extent of the variance."[90]

The recent rise in telecommuting brought another disagreement to renewed light: whether the performance in-state of services by an employee of an otherwise out-of-state business generates not only tax nexus (perhaps not so important in the wake of *Wayfair*'s expansion of the economic nexus construct) but also should be treated as generating in-state payroll for apportionment purposes for those states employing the payroll factor in their apportionment formula.[91] State rules differ, with some states looking to the physical location of employees and others to the location of the office through which work is assigned or controlled. Section 14 of UDITPA, which is supposed to deal with such situations, leaves room for multiple interpretations. It provides that compensation will be treated as paid within a state if:

(a) The individual's service is performed entirely within the state; or

(b) The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

(c) Some of the service is performed in the state and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is

[90] Multistate Tax Commission, Model General Allocation and Apportionment Regulations With Amendments Submitted for Adoption by the Commission February 24, 2017, Reg. IV.10.(c)(2) (2017), https://us.eversheds-sutherland.com/portalresource/2017-Proposed-Amendments-to-General-Allocation-and-Apportionment-Regulations-FINAL.pdf..

[91] Grant Thornton, *Tax challenges expected from widespread remote work*, July 29, 2021, https://www.grantthornton.com/library/alerts/tax/2021/SALT/general/tax-challenges-expected-from-widespread-remote-work-07-29.aspx ("And for those states that continue to utilize payroll factor for apportioning income, employers will need to make payroll sourcing decisions based on either the employee's traditional base of operations or the location where the work is performed.") This would also impact the employer's state income tax withholding obligations. *See id.*

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> not in any state in which some part of the service is performed, but the individual's residence is in this state.[92]

Consider, for example, an employee who works from home three or four days a week while commuting to her employer's office in another state one or two days a week. The state in which she resides could well contend that the work performed at the employer's office is only "incidental" to the work performed in her home state, because her primary business location (based on hours) is her home office. Meanwhile, the state in which the employer has an office has two potential arguments for including this portion of payroll in its numerator. It can contend that the tele-working days are "incidental" to the one or two days of work per-week performed in the employer's in-state office. In addition, some states' laws provide that employees will be treated as present at the employer's office (regardless of their actual physical presence) unless the alternate location is "for the convenience of the employer." The compensation paid to an employee who is constructively "present" under state law in an office located in the state presumably would be included in that state's numerator when determining the payroll factor for purposes of allocating the firm's business income—even if such employees never set foot in the state at issue.[93] Although a number of states issued temporary business tax nexus relief during the course of the pandemic, those relief provisions are beginning to expire,[94] and there is no reason to expect such forbearance to continue if (as seems likely) remote working arrangements persist after the end of the pandemic. As a result, employers with remote workers working in several states may find themselves coping with duplicative tax burdens, that is, paying state income taxes on a tax base consisting of more than 100 percent of their income.

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[92] Multistate Tax Commission, Multistate Tax Compact
[93] Grant Thorton, *supra* note 91.
[94] *Id.*

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Nor is this the only ambiguity in the operation of the payroll factor; states disagree about the inclusion (or not) of independent contractors. By its terms, UDITPA includes only amounts paid as "compensation" or wages in the payroll factor.[95] This language effectively excludes payments to independent contractors.[96] This rule has come under increasing attack because it can distort decisions as to when to use employees and when to use independent contractors.[97]

Even if (and it is a big "if"), UDITPA is amended to eliminate these possibilities for duplicative taxation, a critical underlying feature of UDITPA will not change. It is a "model statute" rather than an actual "law." Any amendments must be enacted by state legislatures before they can be effective. At present, many states have failed to adopt the newest version of UDITPA. Some remain outside of the UDITPA fold entirely, some continue to apply the pre-2015 version, and others have adopted some but not all of the 2015 amendments[98] and the regulations subsequently

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[95] *See* UDITPA Art. IV §13, 14.,

[96] *See* WALTER HELLERSTEIN, ET AL., *supra* note 86, at 580 ("Most states exclude payments to independent contractors from the payroll factor"); Michael Schadewald, *Apportionment Issues: Payroll Factor—Leased Employees*, 25 J. ST. TAX'N 9, 9 (2006) (Under the Multistate Tax Commission regulations…any payments made to an independent contractor or any other person not properly classifiable as an employee are excluded.")

[97] An employer may prefer independent contractors to employees in high tax states—and the opposite in low-tax states. Failure to plan ahead can lead to messy litigation. *See* City of Seattle v. KMS Financial Services, 12 Wash. App. 2d 491 (2020) (successfully arguing for the use of an "alternative apportionment" mechanism to permit inclusion of amounts paid to independent contractors for purposes of calculating Seattle's business and occupation tax).

[98] *See, e.g.* Laks, *supra* note 89 (chart showing states using market-based sourcing vs. cost of performance as of January, 2017); Tax Exec. Staff, *Cost-of-Performance Versus Market-Based Sourcing*, TAX EXEC., May 21, 2019, https://www.taxexecutive.org/cost-of-performance-versus-market-based-sourcing/ ("States are continuing to creep toward a world in which the general concept of market-based sourcing, along with single-sales-factor sourcing, predominates. But full uniformity won't happen…."); Shirley Sicilian, *Multistate Tax Compact Article IV: Recommended Amendments*, MULTISTATE TAX COMMISSION REP'T 3 (2012), https://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Events/2013-14_Committee_Meetings/Exhibit%202%20Memo%20from%20Shirley%20Sicilian%20to%20Cory%20Fong%20Art%20IV%20%20(05-03-2012).pdf ("Today, of the forty-seven or so states with a corporate income tax, thirty-seven follow all or parts of the Act.") Moreover, even states adopting UDITPA's rules have the ability to stray from them at a later date. *See* The Gillette Co. *et al* v. Calif. Franchise Tax Board, *supra* note 18 (denying certiorari to review a California Supreme Court decision granting California the right to change its apportionment formula in contradiction of its obligations under the Multistate Tax Compact).

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adopted by the Multistate Tax Commission interpreting those changes.[99] In short, it is highly unlikely that the problem of duplicative taxation of business enterprises will simply disappear. Instead, given the combination of relaxed nexus rules and fiscal pressures on states makes it likely that duplicative taxation will increase rather than decrease over the near term. But as the next section of the paper makes clear, the problem is not limited to the allocation of business income; it also affects individual taxpayers.

III. The Unfortunate Situation of (Some) Telecommuters

UDITPA was developed for purposes of apportioning the income tax base of multistate corporations.[100] Its language—and underlying rationale--is broad enough to cover multistate business activities carried out in noncorporate form, such as partnerships and LLCs and many states apply UDITPA-like rules to these other forms of multistate business activities.[101] Few states, however, have extended its rules to apportion the wage income of individuals.[102]

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[99] *See* Multistate Tax Commission, Model General Allocation & Apportionment Regulations With Amendments Submitted for Adoption by the Commission, February 24, 2017, https://www.mtc.gov/getattachment/Events-Training/2017/Special-Meeting/FINAL-APPROVED-2017-Proposed-Amendments-to-General-Allocation-an

[100] *See* Timothy P. Noonan, Doran J. Gittelman, and Jeffrey S. Gold, *Setting the Table on Allocation and Apportionment in New York*, 96 ST.TAX NOTES 475, 475 (2020) ("Apportionment rules apply for entities and entity-level taxes…."); Joe Huddleston & Shirley Sicilian, *Should UDITPA be Revisited?*, ST. AND LOC. TAX LAW., Symposium Edition 191, 192 (2009 – 2010) (UDITPA's "purpose is to provide a model formula for apportioning a multistate corporation's taxable income…among the several jurisdictions in which the corporation does business.").

[101] *See* MTC Project—state taxation of partnerships issue outline, September 23, 2021, ¶2.3.7 at 22, https://mtc.gov (listing states that use and do not use UDITPA rules for sourcing income from partnerships); HELLERSTEIN & HELLERSTEIN, *supra* note 86, at Vol. II ¶20.05[3] ('Most states tax nonresidents on income from a trade or business carried on within the state….[T]the portion of the income taxable by the state is generally determined by the same methods that are employed for dividing the income of a multistate corporate enterprise among the states.); Timothy P. Noonan, *et al.*, *supra* note 100, at 475 ("New York's apportionment rules are also extremely relevant for nonresident owners of flow-through entities—including noncorporate forms—doing business in New York"); *id*. at 480-481 (describing differing allocation rules applicable to different forms of business entities).

[102] Some states have expressed interest in extending UDITPA to such wage income. *See* State of Calif. Franchise Tax Board, Response of the California Franchise Tax Board to UDITPA Issues to Consider For Revision UDITPA Drafting Committee, April 2008, at 9 https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=c6b397ec-

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However, natural persons also can find themselves facing the problem of duplicative taxation due to inconsistencies between the tax laws of various states. The underlying issue is the same: when multiple states provide services to taxpayers, the question becomes how much tax ought to be imposed on such individuals and which jurisdiction should be entitled to the associated revenue.

One such overlap is created when an individual lives in one state, but works in another. Traditionally, the "source" jurisdiction has been granted the primary right to tax, while the "residence" jurisdiction credits the source tax against its own residence-based tax.[103] Whether this allocation makes sense from a benefits perspective is uncertain; after all, many of the most expensive benefits provided at the state and local level (such as public education) are provided in and by the state of residence.[104] Although such benefits can be funded by other state and local taxes such as property taxes and sales taxes, a substantial amount of the funding for these benefits currently can be traced to state income taxes.[105] In many cases, of course, the

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b559-f600-93a2-c936aaeb977a&forceDialog=0 ("Is there any reason to bring individuals within UDITPA? **Response:** Is there any reason not to do so?).

[103] *See* WALTER HELLERSTEIN, ET AL., *supra* note 15, at 359 ("To deal with the problem of double taxation resulting from the overlapping claims of power to tax on the basis of residence and source, all states with broad-based personal income taxes provide a credit for taxes paid by their residents to other states.") This rule accords with the international norm applicable when a taxpayer is a resident of one country but earns in other countries. *See* CHARLES H. GUSAFSON, ROBERT J. PERONI & RICHARD CRAWFORD PUGH, TAXATION OF INTERNATIONAL TRANSACTIONS MATERIALS, TEXT AND PROBLEMS 17 (2011) ("in order to mitigate international double taxation, the country of residence grants the domestic taxpayer a dollar-for-dollar credit for foreign income taxes paid by the domestic taxpayer on foreign source income.)

[104] *See* Urban Institute, *Elementary and Secondary Education Expenditures, State and Local Finance Initiative*, https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/state-and-local-backgrounders/elementary-and-secondary-education ("In 2018, state and local governments spent $668 billion, or more than one-fifth (21 percent) of direct general spending, on elementary and secondary education. As a share of direct state and local general spending, elementary and secondary education was the second-largest expenditure in 2018, only slightly trailing spending on public welfare (which includes Medicaid). ….If federal transfers are excluded (that is, if only won-source funds are counted), elementary and secondary education is still the largest state and local spending item.")

[105] Thirty-two percent of local general revenue comes from state governmental transfers versus forty two percent from local tax sources. *See* TAX POLICY CENTER, URBAN INST. & BROOKINGS INST., BRIEFING BOOK: THE STATE OF STATE (AND LOCAL) TAX POLICY, Chapter 5, https://www.taxpolicycenter.org/briefing-book (2017 figures). Those intra-state transfers in turn are funded to a significant extent from state income tax revenues. *See How States Raise*

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reallocation of income tax revenues from residence to source state is of relatively little fiscal consequence because states are both source and residence jurisdictions and gain as much from exercising their source taxing jurisdiction as they lose on the residence side.[106] But this is not always true,[107] and on occasion, one hears complaints from politicians and others representing states that are on the losing end of such revenue exchanges.[108]

As long as one state credits taxes paid to the other state, taxpayers are appear relatively unaffected by these overlapping tax claims. They pay taxes on their salaries at the rate of the higher taxing state, but they do not pay two full sets of state income taxes. Their actual state tax burdens may be higher than they appear because their state of residence may have to increase other taxes to make up for revenue shortfalls caused by lower income tax receipts, or they may

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Their Tax Dollars FY 2020, State Fiscal Health, Pew Charitable Trusts, May 13, 2021, https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2021/how-states-raise-their-tax-dollars-fy2020 ("Taxes make up about half of state government revenue" with 36.5% coming from levies on personal income).

[106]Perhaps in recognition of that fact, many states sign treaties allowing residents of neighboring states to pay income taxes where they live rather than where they work. *See* Tonya Moreno, *Reciprocity: States That Don't Tax Nonresident Workers*, THE BALANCE, October 23, 2021, https://www.thebalance.com/state-with-reciprocal-agreements-3193329 - :~:text=Reciprocal%20tax%20agreements%20allow%20resid (describing 17 states' reciprocity agreements); E.J. McMahon, *Why N.J. commuters are N.Y.'s economic development cash cows*, NJ.COM, January 16, 2019, https://www.nj.com/opinion/2017/08/why_nj_commuters_subsidize_nys_economic_developmen.html (giving example of New Jersey and Pennsylvania); Virginia Tax, Reciprocity, https://www.tax.virginia.gov/reciprocity (states that have reciprocity with Virginia are: District of Columbia, Kentucky, Maryland, Pennsylvania, West Virginia).

[107] *See* Rivkin Radler, *Like A Good Neighbor, New York Is Still Free To Tax You—Sorry For The Inconvenience*, JDSUPRA, July 6, 2021, https://www.jdsupra.com/legalnews/like-a-good-neighbor-new-york-is-still-1349006/ ("the New Jersey Legislature directed the State Treasurer to prepare and submit a report concerning New York's taxation of the income earned by New Jersey residents, to determine how much credit New Jersey gives its residents for taxes paid to New York, and to make recommendations for how New Jersey may resolve the 'inequitable tax treatment' of New Jersey residents who commute to work for employers in New York."); McMahon, *supra* note 106 (New York collected $3.1 billion in income tax payments from New Jerseyans in 2014, while New Yorkers commuting to jobs in New Jersey paid total income taxes of $616 million to Trenton).

[108]*See id.* (complaining that New York uses the excess revenues to subsidize upstate New York communities rather than improve transit facilities used by New Jersey commuters).

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enjoy a lower level of state and local governmental benefits in their state of residence,[109] but they do not obviously face a duplicative tax burden and in fact may remain largely unaware of it.

The situation changes, however, when an individual is claimed as a resident by more than one state, or when more than one state claims to be the source of the same item(s) of his or her income. In both situations, taxpayers may find themselves paying income taxes on the same income to more than one state with no offset for those taxes paid to other states—true double taxation. There have always been limited instances of individuals deemed under state laws to be residents of more than one state, or to have earned the same income in more than one state. But the explosive growth in remote work due to COVID has vastly increased the number of situations in which individuals may find two or more states claiming to be the source of their income (and in some cases, their residence).[110] The problem results from the same state law discrepancies discussed in Section II.B above dealing with the payroll factor: whereas some states source wages to the location(s) in which an employee is physically located when performing those services, others claim the right to tax wages based on the location of the worker's employer. In those states, employees are treated as earning wages at the location of the employer's home office, regardless of how much time (if any) they spend at that office, unless their work at an alternate location is "for the convenience of the employer."[111] Thus, an

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[109] *See infra* Sec. VIII.
[110] Opportunities for defaulting into duplicate residence situations have also increased, as people fled what had been their primary residences for less urban (usually) secondary residences. Such problematic situations can often be avoided with careful planning. *See* Donna Scaffidi & Frank Czekay, *Dual State Residency can result in dual taxation*, BAKERTILLY, August 4, 2021, https://www.bakertilly.com/insights/dual-state-residency-can-result-in-dual-taxation (explaining how to avoid dual residency). Although the problems associated with dual residency are (very) analogous to the problems of dual source, in the interests of brevity, this Article restricts its discussion to problems involving dual-sourced income.
[111] At present, seven states have such "convenience of the employer" source rules. *See supra* note 16. Note that this "convenience of the employer" rule largely replicates for individual taxpayers the movement to destination-based sourcing of personal services income in the corporate context, although allowing an exemption from tax for remote work that is for the "convenience of the employer" is actually at odds with destination based sourcing of personal

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employee working (often but not always from home) in a state sourcing wage incomes by the physical location of the employee, for an employer located in a state sourcing wages to the location of the employer's office[112] will find himself or herself subject to tax in two different states on such wages without any offset. Particularly when coupled with extreme definitions of "the convenience of the employer,"[113] opportunities for duplicative taxation abound.

It is worth noting that this discordance in the rules for taxing individuals' income from the performance of personal services is analogous to the discordance in the rules for allocating corporate income under UDITPA. The "convenience of the employer" rule—and more generally, the sourcing such income to the location of the employer's office—is consistent with the principle underlying the single-factor sales allocation formula. What matters is the location of the customer, the employer; no attention is paid to where the services are actually performed (which may-or may not—reduce the administrative burdens placed on taxpayers). By contrast, taking where services are performed into account for tax purposes is like including payroll and property in the allocation formula.

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services income. To be completely consistent with that principal, the location of the employer's office would always control the source of income.

[112] The number of states with "convenience of the employer" statutes grew as a result of the pandemic. For example, Massachusetts, faced with a loss of tax revenues as workers who had formerly commuted into Boston from neighboring states, speedily enacted a "convenience of the employer" taxing statute. New Hampshire unsuccessfully challenged the new tax rule. *See* New Hampshire v. Massachusetts, Sup. Ct. Docket No. 220154, *motion for leave to file a bill of complaint denied* June 28, 2021.

[113] New York, for example, has taken the position that an employee whose office has been shuttered due to health and legal concerns is not working from home "for the convenience of the employer." New York State Dept. of Finance and Tax'n, *Frequently Asked Questions about Filing Requirements, Residency, and Telecommuting for New York State Personal Income Tax*, July 30, 2021, https://www.tax.ny.gov/pit/file/nonresident-faqs.htm - telecommuting ("If you are a nonresident whose primary office is in New York State, your days telecommuting during the pandemic are considered days worked in the state unless your employer has established a bona fide employer office at your telecommuting location.") Other states with "convenience of the employer" statutes have taken similar positions. *See* Timothy P. Noonan & Doran J. Gittelman, *Taxing Times to Be a Telecommuter: Convenience Rules During COVID-19*, ST. TAX NOTES (Sept. 17, 2020) (Delaware, Nebraska, Pennsylvania)

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In the short term, most taxpayers working from home during the COVID pandemic were saved from such duplicative taxation by the generosity of their states of residence or temporary workplaces. Many states waived their statutory rights to income derived from work performed within their borders when another state which, pre-pandemic, had taxed such employees on a source basis, continued to assert a right to tax this income on a source basis.[114] However, such relief was temporary, and it is not clear whether it will even last to the end of the newly-worsening (or never-ending) pandemic.[115] Further, although many employees will return to office work once conditions improve, it is becoming increasingly clear that substantial numbers of workers prefer remote working to daily commuting, and that at least some employers will allow them to do so, at least part of the time.[116] As a result, increasing numbers of individual taxpayers, like business taxpayers, will find themselves subject to dual claims of source-based taxation on significant portions of their income.

[114] *See* Emma M. Savino & Timothy P. Noonan, *State Guidance related to COVID-19: Telecommuting Issues*, June 9, 2021, https://www.hodgsonruss.com/assets/htmldocuments/Telecommuting_5.22.20.pdf (chart listing state guidance related to COVID-19 telecommuting issues). Not all states provided such relief, however. Day Pitney LLP, *Update: Increased Telecommuting Raises State Tax Issues*, DAY PITNEY ALERT, Jan. 11, 2021, https://www.daypitney.com/insights/publications/2021/01/11-update-increased-telecommuting-raises-state-tax ("More than nine months into theCOVID-19 emergency, some states have not provided clear guidance on the state tax issues that arose as a result of increased telecommuting, and even the states have released guidance have failed to address all relevant issues.")

[115] *See* Mark Klein & Joseph Endres, *Tax Implications of COVID-19 Telecommuting and Beyond*, CPA J., July 2021, https://www.cpajournal.com/2021/07/16/tax-implications-of-covid-19-telecommuting-and-beyond/ ("But the operative word is *temporary*"; listing jurisdictions with expired relief provisions).

[116] Remote work was growing even before the pandemic. *See* Kate Lister, Global Workplace Analytics, updated June 22, 2021, https://globalworkplaceanalytics.com/telecommuting-statistics ("Regular telecommuting grew 216% between 2005 and 2019, more than 11 times faster than the rest of the workforce…and 54 times faster than the self-employed population…) At present, about 82 percent of U.S. employees want to work remotely at least one day after the pandemic is over; their average preference is to work remotely half the time. *See* Vivian Chen, *What's Ahead for Big Law in 2022? Here Are My 7 Predictions*, BLOOMBERG L, BUS. & PRAC., January 6, 2022, https://news-emails.bindg.com/v1/newsletter/0000017e-2f62-def3-abff-6f6638e40000?product=BBUNW&utm_source=newsletter&item=web-version&region=header ("Lawyers will never, ever return to the office full time."); Kate Lister, *What is your work-from-home forecast for after Covid-19*, Global Workplace Analytics, https://globalworkplaceanalytics.com/work-at-home-after-covid-19-our-forecast ("25-30% of the U.S. workforce will be working-from-home one or more days a week after the pandemic").

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The question is what, if anything, to do to ameliorate the phenomenon and, if something is to be done, by what institution. As there is little doubt that duplicative taxation will affect taxpayer behavior and to some extent distort interstate commerce, many have suggested that the Supreme Court step in under the rubric of the dormant Commerce Clause. As the next section makes clear, it is highly unlikely that the Supreme Court would—or should—take this responsibility upon itself.

IV. The False Promise of the Dormant Commerce Clause

As every beginning law student learns, the Federal Constitution does not explicitly constrain State taxing powers. State taxing powers are, however, subject to the Constitution's general constraints on State actions. Any tax explicitly imposed on a protected class, would surely be held to violate the Fourteenth Amendment's prescription of "equal protection….of the laws."[117] Similarly, a tax explicitly imposed only on nonresidents might (or might not) be deemed to run afoul of that clause or of the Privileges and Immunities Clause.[118] But the most significant Constitutional restriction on duplicative taxation caused by overlapping taxing jurisdictions has come from the dormant Commerce Clause.[119] As presently interpreted, however, the Clause fails

[117] U.S. CONST. AMEND. XIV, §1.
[118] *See id.*
[119] The "dormant" Commerce Clause is not, in fact, literally a clause of the Constitution. The words of the actual Commerce Clause contained in the written Constitution grant Congress the right to regulate commerce between the states. *See* U.S. CONST. ART. I, § 8, CL. 3. That language does not explicitly disallow independent State actions which also have the effect of regulating or interfering with interstate commerce, as long as those actions do not contravene a specific Congressional command. This language seems to allow concurrent jurisdiction between the state and national legislatures. However, the Supreme Court long ago engrafted the judicial doctrine known as the "dormant" Commerce Clause to "respect states' reserved powers under the Tenth Amendment while still protecting the negative implications of Congress's affirmative Commerce Clause power (i.e. that states, if left alone, would subvert the common national market to their own economic interests.)" Thimmesch, *supra* note 2, at 333. The Court has used the latitude granted it by the dormant Commerce Clause powers to invalidate some state taxes.

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to prevent many instances of duplicative taxation, even though such taxation undoubtedly has an adverse effect on interstate commerce relative to purely in-state commerce.

As a doctrinal matter, the Supreme Court applies a four-factor test first enunciated in Complete Auto Transit, Inc. v. Brady[120] to determine whether a state or local tax statute complies with the strictures of the Dormant Commerce Clause. This test requires that such taxes (1) apply only to taxpayers with "substantial nexus" to the taxing jurisdiction, (2) be fairly apportioned, (3) be nondiscriminatory, and (4) "be fairly related to the services provided by the jurisdiction".[121] Although this doctrinal formula has remained unchanged since its appearance in 1970s,[122] its application has not. Indeed, the first and fourth factors have been essentially eliminated. The "substantial nexus" test was all but eliminated by the *Wayfair* case,[123] and the "fair relationship" test lost most of its bite due to the 1981 decision of Commonwealth Edison Co. v. Montana,[124] in which the Court announced its withdrawal from this field. This abdication is hardly surprising given that relatively few taxing schemes are explicitly benefit-based, with the quantum of the

[120]430 U.S. 274 (1977).

[121]Thimmesch, *supra* note 2, at 333-34 (reciting test). Although first announced in the context of the corporate income tax, this four-factor test has been applied to determine the legitimacy of taxes levied on natural persons as well as legal entities. *See id.*

[122] *See id*. at 334 "[t]hat test has stood since the 1970s, and the Court has never publicly considered rejecting that formulation").

[123] South Dakota v. Wayfair, Inc., 558 U.S. (2018); *see* Thimmesch, *supra* note 2, at 334 ("the Court effectively gutted that [nexus] requirement in *Wayfair*").

[124] 453 U.S. 609, 628 (1981) ("[I]t is doubtful whether any legal test could adequately reflect the numerous and competing economic, geographic, demographic, social, and political considerations that must inform a decision about an acceptable rate or level of state taxation….[T]he nature of the factfinding and judgment that would be required of the courts merely reinforces the conclusion that questions about the appropriate level of state taxes must be resolved through the political process.") Although the *Commonwealth Edison* case did not expressly overrule an earlier case, Hans Rees' Sons, Inc. v. North Carolina ex rel Maxwell, 283 U.S. 123 (1931), in which the Court struck down the state's use of a one-factor apportionment formula relying solely on the taxpayer's ownership of tangible property, later cases have made clear that the Court would intervene only when a formula reached an "outrageous" result. *See* Container Corp. of Amer. v. Franchise Tax Board, 463 U.S. 159, 183 (1983) (pointing out that in *Hans' Rees*, the apportionment formula allocated 66-85% of the taxpayer's income to North Carolina while only 21% would be so allocated based on separate accounting principles).

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levy corresponding directly to the cost (or value) of the governmental benefits provided through the expenditure of the funds so raised.[125] Indeed, many taxing instruments are intended to redistribute money from one group of taxpayers to another.[126] Determining the proper extent of such redistribution is generally perceived as a political rather than judicial function. This is not to say that granting states unfettered control over the quantum and allocation of tax burdens—particularly given the obvious political incentives to shift as much of the burden as possible onto unpopular groups, including non-voters such as nonresidents—is not problematic, but it is hard for courts to police such behavior under a generalized "fairness" standard.[127] The precise problem of picking on non-voting outsiders has been the focus of the more narrowly targeted second and third prongs of the *Complete Auto Transit* test.

As a practical matter, then, the ability (or not) of the dormant Commerce Clause to constrain state taxation of multistate taxpayers and constrain duplicative taxation, comes down to questions of "fair apportionment" and "nondiscrimination." Obviously protectionist and facially discriminatory laws are, as one commentator noted, "virtually per se illegal."[128] When double taxation results from discrepancies between various state taxing regimes rather than an inherent defect or over-reach by one of the affected states, however, the Court refuses to grant relief to

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[125] Indeed, the lack of a relationship between payors' costs and payors' benefits is precisely what distinguishes "taxes" from "fees." *See New State-by-State Report: Understanding the Difference Between Taxes and Fees*, TAX FOUND., March 28, 2013, taxfoundation.org/new-state-report-understanding-difference-between-taxes-and-fees/ ("A tax has the primary purpose of raising revenue. By contrast, a fee recoups the cost of providing a service from a beneficiary.")

[126] *See* Richard M. Bird & Eric M. Zolt, *Redistribution via Taxation: The Limited Role of the Personal Income Tax in Developing Countries*, 52 U.C.L.A. L. REV. 1627, 1629 (2005) ("In developed countries, the income tax, especially the personal income tax, has long been viewed as the primary instrument for redistributing income and wealth.")

[127] This is not to say that some sort of fairness standard may not be resurrected. Some recent state tax proposals—such as a California proposal to impose a wealth tax on all the wealth of any person who resided in California within the ten year period preceding the taxable year, regardless of whether that wealth was earned while the taxpayer was so resident—might, if enacted, cause courts to reconsider their decision to abdicate this area.

[128] Thimmisch, *supra* note 2, at 339.

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adversely affected taxpayers.[129] As explained earlier, it is these discrepancies that are the cause of duplicative taxation.

The Court identifies instances of defective or overreaching tax statutes—statutes that fail to meet the fair apportionment and nondiscrimination requirements--through its application of the "internal consistency test." This test asks whether a taxpayer engaged in interstate commerce would face a higher tax burden than a solely in-state taxpayer if every state employed the challenged tax rule (or combination of tax rules). If not, then any duplicative taxation stems from inconsistencies in tax rules (a feature of federalism) rather than an inherently defective tax rule, and thus lies beyond the scope of the dormant Commerce Clause.[130] This internal consistency test has been widely promoted in the recent academic literature by Ruth Mason and Michael Knoll,[131] whose work was cited in a Supreme Court opinion, *Comptroller of the Treasury of Maryland v. Wynne*,[132] striking down a Maryland tax,[133] but it long predated both those academics and that case.[134]

[129] This refusal to grant relief is generally consistent with its treatment of other inconsistent state regulatory rules which have the effect of disadvantaging multistate businesses. *See* Ruth Mason & Michael Knoll, *Unbundling Undue Burdens,* . As this pair of academics has pointed out, the Court does not use the dormant Commerce Clause to eliminate state-to-state regulatory diversity, even when such diversity imposes significant burdens on interstate commerce" unless "interventionist justices are in the majority." *Id*.

[130] *See* Comptroller of the Treasury of Maryland v. Wynne, 575 U.S. 542, 562 (2015) (the internal consistency test allows courts "to distinguish between (1) tax schemes that inherently discriminate against interstate commerce without regard to the tax policies of other States, and (2) tax schemes that create disparate incentives to engage in interstate commerce (and sometimes result in double taxation) only as a result of the interaction of two different but nondiscriminatory and internally consistent schemes.")

[131] Michael S. Knoll & Ruth Mason, *Comptroller v. Wynne: Internal Consistency, a National Marketplace, and Limits on State Sovereignty to Tax*, 163 U. PA. L. REV. ONLINE 267 (2015); Ruth Mason, *Made in America for European Tax: The Internal Consistency Test*, 49 B.C. L. REV. 1277, 1310 (2008).

[132] 575 U.S. at 562 (citing Brief for Michael S. Knoll & Ruth Mason as *Amici Curiae*); *id*. at 563 (citing Ruth Mason, *supra* note 131).

[133] 575 U.S. at 564 ("Maryland's income tax scheme fails the internal consistency test.")

[134] The opinion in *Wynne* listed several cases in which the Court struck down taxes that failed to meet this test "[a]lthough we did not use the term in those cases…" as well as others in which it had upheld state taxes precisely because they satisfied the internal consistency test. *See id*. at 550-51 (listing as exemplars J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938); Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434 (1939); Central Greyhound Lines, Inc. v. Mealey, 334 U.S. 653 (1948)); *see also* Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S.

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Both types of statutes dictating the source of wage income described in the previous section meet the test of internal consistency as enunciated by the Court. Certainly, statutes determining the source of income based on the physical location of the employee lead to income being subject to tax only once no matter the number of states involved, inasmuch as individuals cannot be physically present in two places at once. If such a rule was uniformly adopted, the tax revenues would be split among states based on the relative length of the taxpayer's working hours spent in each state, and no more than 100 percent of the taxpayer's income would be taxed by any combination of states. There might be some difficulties generated by individuals spending one portion of a day in one state and another portion in another, but those minimal conflicts could be (and might have to be) resolved by allocating income on an hourly basis for mixed-presence days. "Convenience of the employer" statutes would also meet the test of internal consistency, as long as states used the same definition of "convenience of the employer" for employees of foreign employers working within their state as for employees of local employers working outside their state.[135] Indeed, states could go even further than the "convenience of the employer" rule and provide that employees' wages are always sourced to the state in which their employer is located. Such a rule would in fact mimic the single-factor sales rule used by many states for allocating corporate income,[136] not to mention the destination based source rule adopted by

175, 185 (1995) ("A failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction…. There is no failure of it in this case, however.")

[135] That is, for example, New York would have to forego source-based taxation of employees of New Jersey companies telecommuting from New York under circumstances it would regard as falling outside the "convenience of the employer" test were the individual employees of New York companies telecommuting from New Jersey. New York cannot have it both ways, claiming source taxation rights over both the New York based employees and the New Jersey based employees because that would lead to the systematic double taxation of some taxpayers, disadvantaging them relative to purely intrastate taxpayers. Of course, duplicative taxation could arise if New York and New Jersey maintained different interpretations of "for the convenience of the employer" just as duplicative taxation could arise if one state used a physical location rule and the other a "for the convenience of the employer" rule.

[136] *See supra* TAN 72-77.

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UDITPA for services income.[137] If every state adopted such a rule, wage income would be subject to only one set of source taxes, and those taxes would have to be credited against any income taxes levied by the state of residence. Interstate commerce would not be distorted.

The same test of internal consistency prevents the Court from mandating a uniform allocation formula for corporate tax purposes—or uniform definitions of the factors used in those formulas. As long as those formulas and definitions would, if uniformly adopted, generate a combined tax base of no more than the taxpayer's total income, the state rules are valid. That was, after all, the message of the *Moorman* case,[138] a holding that was implicitly reaffirmed by the Court's denial of a petition for *writ of certiorari* in the *Gillette* case in 2016.[139]

The Court's use of this internal consistency test makes institutional sense. When multistate taxpayers are disfavored because of the interaction of two equally plausible, and facially neutral, tax rules, granting relief would require the Court to choose between two legitimate rules.[140] In the absence of a theory as to what constitutes the right allocation of tax revenues when more than one state is involved in the generation of income (or whatever other tax base is at issue), the Court lacks any basis for making this choice.[141] It is, in fact, a political or economic choice, of the sort better suited for (more explicit) political institutions, such as Congress. At any rate, the Supreme Court Court's recent refusal to hear the State of New Hampshire's challenge to Massachusetts' pandemic-induced adoption of a statute extending source tax jurisdiction

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[137] *See supra* TAN 83-89.
[138] *See supra* TAN 70-74.
[139] *See* 137 Sup. Ct. 294, *supra* note 18 (denying review of California Supreme Court decision allowing California's use of a double-weighted sales factor apportionment formula in violation of its obligations under the Multistate Tax Compact).
[140] *See* Mason & Knoll, *supra* note 131, at (relief entails "[i]mposing national uniformity" at the expense of "the federal interest in legal pluralism).
[141] This is not meant as a criticism of the Court. There probably is no "correct" answer to this question. *See infra* Sec. 5.A (discussing impossibility of allocating source of income in an economically meaningful sense).

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employees located in New Hampshire but working remotely for Massachusetts' employers[142] signals its continued unwillingness to intervene in the area.

Congress, though, could mandate uniform rules for the allocation of income derived from interstate commerce. As recounted earlier, it has done so on more than one occasion. On the corporate side, it forbade states from asserting taxing jurisdiction over interstate businesses based merely on a business' in-state mail order sales.[143] On the individual side, it forbade states from exercising source tax jurisdiction over pensions paid to out-of-state residents with respect to in-state employment.[144] The question is whether it should go further, and eliminate the opportunities for double taxation that remain, and if so, what should be the content of those uniform rules. Those questions are dealt with in the next section of the Article.

V. Should Congress Get Involved?

Although Congress could eliminate the appearance of double taxation[145] by mandating the use of uniform rules for the apportionment of corporate (and other business) income, as well as uniform rules for residence and source of individuals' income, doing so would have two politically problematic effects. The first is that it would (at least in the first instance) reduce state tax revenues. It would reduce state tax revenues because it would eliminate current instances of double taxation, thus reducing the amount of taxes paid by some taxpayers, to the detriment of those state governments currently enjoying revenues generated by those duplicative tax burdens.

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[142] *See* New Hampshire v. Massachusetts, 141 S.Ct. 2848 (2021) (Supreme Court denial of motion for leave to file a bill of complaint; Justice Alito dissents).

[143] *See* TAN 33-36 (discussing Pub. L. 86-272). Whether its intervention was beneficial is another question entirely. . Pub. L. 86-272 has been widely criticized. *See* Christopher T. Lutz, *What to Do With Public Law 86-272?,* 93 ST. TAX NOTES 781, 782 (Aug. 26, 2019) ("Nobody today likes the lines Congress drew in 1959."); McLure, Jr., *supra* note 24, at 157 (calling Pub. Law 86-272 "misguided legislation").

[144] *See supra* TAN 38-42 (discussing Pub. L. No. 104-95 §114(a)).

[145] *See infra* Sec. V.C for a discussion of whether such an appearance merely hides a more distressing (to some) economic reality.

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In addition, such allocations may redirect income streams from one state to another—that is, from a state that had been levying a tax on the income to a state that had not previously tried to exert its power to tax that income. Or it may generate opportunities for tax avoidance. For example, when Congress prevented states from exercising source jurisdiction over pensions derived from services performed within their states, other states (primarily the states in which taxpayers resided when such pension payments were received) gained an unfettered right to tax such pension income. Some states exercised this right, while others decided to forego it, thereby allowing taxpayers to escape paying state tax on their pension income.[146] In the longer term, it might encourage states to use less efficient or attractive revenue raising devices to make up for their lost revenue. There is also no question that such federal intervention would reduce state autonomy by imposing a constraint on state budgetary and fiscal decisionmaking. The Commerce Clause provides Congress with the power to do exactly that to further the interests of a national marketplace, but before it decides to exercise this power, Congress should consider carefully whether doing so would in fact generate enough benefits to offset both political and institutional concerns. The following analysis suggests it might not be.

An initial question is whether there is a "right" set of source rules. If so, then one might plausibly argue that such a set of rules should be implemented, and whatever consequences follow from that dealt with. As part V.A of this Article makes clear, as both an economic and philosophical matter, the "source" of income is impossible to determine—if "source" has a meaning at all. But

[146] For example, New Yorkers can eliminate state taxation of their pension income by retiring to Florida, a state with no income tax. This particular Congressional interference can justly be criticized for allocating taxing rights on the basis of the location of an exceptionally mobile group of taxpayers—retirees. Unsurprisingly, many chose (and choose) low-tax states. Indeed, this Congressional legislation may have caused other states to reduce their taxation of pension income. *See* Julie Roin, *Changing Places, Changing Taxes: Exploiting Tax Discontinuities*, 22 THEORETICAL INQUIRIES IN LAW 335, 554 n. 60 (2021) ("Competition (or the fear of competition) with other states may be one reason why so many states provide preferential tax treatment for retirees.")

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that does not necessarily mean that adoption of uniform rules would be unwise, just that whatever rule Congress would adopt would be arbitrary (albeit no more arbitrary than the state laws that preceded it). The additional question, dealt with in part V.B of this Article, is whether a uniformly adopted arbitrary rule would be preferable continuing to allow the use of nonuniform rules. And the answer to that question turns in part on whether (and to what extent) double taxation is actually harmful, a question that is dealt with in part V.C.

A. The Slipperiness of "Source"

Although economists do not agree on many issues, they are united in disparaging the belief that income has a "source."[147] When income generating activities are spread over several jurisdictions (the only time source becomes relevant), every part of the enterprise plays some role in the generation of the resulting income; separating out their individual contributions has been analogized to "slicing a shadow."[148] Not only is it difficult to assign the correct rate of return for "routine" activities,[149] it is impossible to determine a source for the synergies created

[147] *See, e.g.*, Hugh J. Ault & David F. Bradford, *Taxing International Income: An Analysis of the U.S. System and Its Economic Premises* 11, 30, in Assaf Razin and Joel Slemrod (eds), TAXATION IN THE GLOBAL ECONOMY (1992) ("the source of income is not a well-defined economic idea"); Mitchell Kane, *A Defense of Source Rules in International Taxation*, 32 YALE J. REG. 311,318-19 (2015) (describing adherents to position that assigning a source to income is a "category mistake" and describing it as "the dominant view in current academic analysis of international tax policy in the United States"); Edward D. Kleinbard, *Stateless Income*, 11 FLA. TAX REV. 99, 149 (2011) ("More fundamentally, many scholars have concluded that the concept of 'source' ultimately is meaningless when applied to a wide range of group activities…"); R.M. Bird & D.J.S. Brean, *The Interjurisdictional Allocation of Income and the Unitary Taxation Debate*, 34 CAN. TAX J. 1377, 1383 (1986) ("[T]here is no clear, objective economic basis for the allocation of revenues and costs to the particular units that comprise parts of a multijurisdictional enterprise. Joint products and nonmarketed intermediate goods, for example, involve costs that typically cannot be defined with certainty even within a single firm; for example, technology and management services are intangible factors that may be applied to one division of the firm without detracting from their value elsewhere. Nor can the financial costs incurred by closely related businesses easily be labelled as costs of particular units or divisions.")

[148] Container Corp. of Amer., 463 U.S. at 192 (Justice Brennan); *see also id.* at 164 ("arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice").

[149] The more involved one gets in the area, the harder it is to believe that many transactions fall within the description of "routine."

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by the interaction of related business opportunities.[150] Some types of income, particularly income derived from intangible assets, can (as a formal matter) be transferred through meaningless paper transactions. The resulting income allocations are questionable at best.

This problem can be most clearly illustrated through the tortured history of attempts to allocate the income of multinational enterprises. Unlike the states of the United States, which decided relatively early on to allocate taxing authority on the basis of a formula, countries have valiantly tried to allocate income on an economic basis, with the source of income determined on an item-by-item, and entity-by-entity basis.[151] Complicated statutory rules, sometimes adjusted by treaty, assign the source of taxpayers' income based on the type of income at issue, the identity of the taxpayer, and the circumstances surrounding the transaction, such as the physical location of actors involved in deriving the income.[152] Again unlike the situation in the states of the United States, the income of related enterprises generally are not consolidated for tax—or sourcing—purposes. An entity which purchases goods from a related entity for sale to another (related or unrelated) party is taxed on the income that it derives from such sales, based on the prices at which it purchases and then re-sells the goods. Businesses engaged in that purchase products or services, or sell products or services, to related entities are supposed to do on the same terms as they would had done had the parties been unrelated.[153] Tax authorities have the right to police these transfers to ensure that they meet this arm's-length standard and to readjust income figures

[150] The importance of such synergies is one of the central insights of Ronald Coase's famous article 1937 article, *The Nature of the Firm*, 4 ECONOMICA 386, 392 (detailing sources of costs savings from forming an organization rather than relying on individual market transactions).
[151] This may be changing. *See infra* TAN 167-73 (describing OECD's BEPS and Pillar 1 and Pillar 2 projects).
[152]*See* I.R.C. §§ 861-865 (statutory source rules). Many have decried the arbitrary nature of these rules. See MICHAEL J. GRAETZ, FOUNDATIONS OF INTERNATIONAL TAX LAW 40 (2003) ("Our taxing system therefor depends critically on identifying the source of income. Unfortunately, current law performs this task poorly. Many of our source rules are open to substantial manipulation.")
[153]This is known as the "arm's-length standard." *See* Reuven S. Avi-Yonah, *Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation*, 2 WTJ 3 (2010).

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when they do not.[154] Unfortunately, many of these internal transfers have few if any true market counterparts.[155] There were (and are) constant disagreements over whether the transactions used (by taxpayers or tax authorities) as comparators were truly comparable, as well as the scale of adjustments necessary to compensate for differences between them.[156] In addition, taxpayers learned how to structure their enterprises and their transactions to isolate income in low tax countries. The widespread phenomenon of "stateless income"[157] or income that avoided all tax, coupled with the knowledge that many of the world's most profitable corporations were able to exploit these gaps in the tax laws to pay tax at absurdly low rates[158] led to the development of a variety of competing reform proposals, both at the national[159] and the supra-national level.

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[154]*See* I.R.C. § 482 (allowing the Secretary to distribute,, apportion, or allocate gross income, deductions, credits, or allowances between or among" related entities "to reflect the income of any such organizations"); U.S. Model Income Tax Convention, Art. 9 (2016) (providing signatories with the right to tax profits which "would have accrued" to an enterprise had the conditions between the related enterprises "been those that would have been made between independent enterprises"); J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Formulary Apportionment in the U.S. International Income Tax System: Putting Lipstick on a Pig?*, 36 MICH. J. OF INT'L LAW 1, 4 (2014) ("The present U.S. international income tax system addresses the problem of aggressive transfer pricing through the so-called arm's-length method of income allocation.")

[155] Indeed, Coase regarded the elimination of the need to make such difficult pricing decisions as one of the benefits of relying on an integrated firm structure. *See* Coase, *supra* note 150, at 390-91.

[156]Many commentators regard the transfer pricing rules as unadministerable. *See* Fleming, Jr., *et al.*, *supra* note 154, at 15-6 (explaining why "[v]arious leading commentators…disparage the arm's-length approach").

[157]This term was coined by the late Edward Kleinbard, and refers to income the source of which has been relocated from a high-tax to a low-tax source "that is not the location of the firm's customers or the factors of production through which the income was derived…[and] without shifting the location of externally supplied capital or activities involving third parties." Kleinbard, *supra* note 147, at 699.

[158]*See id.* at 740-41 (estimating Microsoft's effective foreign tax rate "in the neighborhood of 4 percent" and Google's at "roughly 2.4 percent"). Subsequent legal changes have increased their tax rates to the low teens.

[159] In response to the low tax rates of many internet based services, several countries enacted gross revenue based "Digital Services Taxes" aimed specifically at such companies. *See* Elke Asen & Daniel Bunn, *What European OECD Countries Are Doing about Digital Services Taxes*, TAX FOUND., November 22, 2021, https://taxfoundation.org/digital-tax-europe-2020/ (about one-half of European OECD countries have "either announced, proposed, or implemented a DST"). Many of these taxes will be repealed or reformed if the reforms discussed *infra* TAN 167-73 are implemented. *See* David M. Ward, Stephen Pevsner & Martin T. Hamilton, *A step closer to agreement on taxation of the digital world*, PROSKAUER TAX TALKS, October 22, 2021, https://www.proskauertaxtalks.com/2021/10/a-step-closer-to-agreement-on-taxation-of-the-digital-world/ -:~:text=The%20first%20(%E2%80%9CPillar%201%E2%80%9D,which%20their%20sales%20take%20place.&text=An%20important%20reason%20for%20this,previously%20opposed%20to%20Pillar%202. (The recent OECD statement confirms that a multilateral convention will require countries to remove DSTs and similar measures and commit not to unilaterally introduce such measures.")

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Some academics began advocating for replacing the arm's-length method with a formulary method—and increasingly a single-factor, destination based method[160]--in the 1980's if not before.[161] The European Union considered moving to a formulary system for the allocation of intra-EU income.[162] Over time, both the United States and other nations began incorporating limited instances of formulary approaches within their arm's-length framework.[163]

Meanwhile, the OECD, as part of its multi-year Base Erosion and Profit Shifting project,[164] pushed to replace the "arm's length" standard with a "value creation" concept[165] but determining

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[160] *See* Avi-Yonah & Clausing , *supra* note 75, at 328-29 (proposing the use of a destination based formulary method). It is worth noting that there are many dissenting views. *See, e.g.,* Harry Grubert and Rosanne Altshuler, *Fixing the System: An Analysis of Alternative Proposals for the Reform of International Tax*, 66 NAT'L TAX J. 671, 707 (2013) ("In summary, the taxation of business income based on the location of ultimate consumption presents both conceptual and practical difficulties."); Morse, *supra* note 74, at 595 ("incremental reform is generally a better approach for reforming the international division of jurisdiction to tax business income"); James R. Hines Jr., *Income Misattribution Under Formula Apportionment*, 54 EUR. ECON. REV. 108, 110 (2009) (outlining problems including redistribution and revenue effects); Julie Roin, *infra* note 75, at 174 ("Skepticism is warranted…")

[161] *See* Bird & Brean, *supra* note 147, at 1382 ("'[P]erhaps the most important outcome of the unitary debate in the international forum may be to stimulate further interest in the feasibility and implications of various formula-based allocation systems….'"); *id.* at 1416 (forecasting "a considerably larger component of the unitary and formula apportionment approach than the current state of professional thought appears to suggest"); Stanley Langbein, *The Unitary Method and the Myth of Arm's Length*, 30 TAX NOTES 625 (1986).

[162] *See* Estafania Lopez Llopis, *Formulary Apportionment in the European Union*, 45 INTERTAX 631 (2017) (criticizing the European proposal for a Common Consolidated Corporate Tax Base and its formulary sharing mechanisms); Joann Martens-Weiner, *Company Tax Reform in the European Union: Guidance from the U.S. and Canada on Implementing Formulary Apportionment in the EU* (2006); Joann Martens Weiner, *Formulary apportionment and group taxation in the European Union: Insights from the United States and Canada*, Working Paper no. 8/2005, European Commission Taxation, Brussels, Belgium (March); Charles E. McClure, Jr. *Replacing Separate Entity Accounting and the Arm's Length Principle with Formulary Apportionment*, 56 BULL. FOR INT'L FISCAL DOCUMENTATION 586, 588-89 (2002) (describing EU formulary proposals).

[163] *See* Reuven Avi-Yonah, *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation*, 15 VA. TAX REV. 89, 147 (1995) (analyzing changes in transfer pricing rules as movement in the direction of formulary taxation). Formulary methods are used to allocate and apportion many of the deductions used to reduce gross income to taxable income under both statutory and regulatory law. *See, e.g,*. I.R.C. §864(e)(2) (interest deductions); Treas. Reg. §1.861-8(a)(2) (requiring formulary allocation of certain deductions).

[164] The project, aimed at reaching an international consensus on methods for counteracting corporate tax avoidance, began in 2013. *See* Mindy Herzfeld, *The Case Against BEPS: Lessons for Tax Coordination*, 21 FLA. TAX REV. 1, 5 (2017) ("[T]he project was intended to facilitate the coordination of international tax rules to ensure higher effective corporate tax rates….The coordinated nature of the project was key to make sure that rogue countries did not attract additional corporate investment at the expense of other countries looking to plug the leaks in their own domestic revenue losses."); Press Release, OECD launches Action Plan on Base Erosion and Profit Shifting, July 19, 2013, http://www.oecd.org/ctp/beps/closing-tax-gaps-oecd-launches-action-plan-on-base-erosion-and-profit-shifting.htm

[165] *See* Mike Devereux & John Vella, *Value Creation as the Fundamental Principle of the International Corporate Tax System*, European Tax Policy Forum, July 31, 2018 (the value creation principle "was certainly articulated and put center stage in the Base Erosion and Profit Shifting (BEPS) project led by the G20/OECD between 2013 and 2015. The value creation principle was adopted as the guiding principle of the BEPS project…"); Mindy Herzfeld,

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the location of "value creation" promised to be just as ambiguous or indefinite in operation as "arm's length pricing."[166] The BEPS project continued, first with the development of an "Action Plan"[167] laying out specific areas where new or revised rules would be needed. For the most part, these recommendations were initially honored in the breach,[168] but the OECD persevered. In October of 2021, 130 member nations joined the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy which "pave[s] the way for a new framework for international tax reform.[169] Among other things,[170] this Statement calls for the imposition of a layer of formulary allocation on top of the traditional arm's length income determinations. It requires 25 percent of a covered multinationals'[171] "residual profits" (defined as profits in excess of 10 percent of revenue) to be allocated to market jurisdictions based on their relative revenue shares, regardless of the enterprise's physical presence (or absence thereof) in those jurisdictions.[172] The allocation of residual profits should not exceed, however, a

supra note 164, at 32 ("The BEPS project charted new territory in focusing on value creation as the determinant for profit allocation….")

[166] *See* Allison Christians, *Taxing According to Value Creation*, 90 INT'L TAX NOTES 1379 (2018); Mindy Herzfeld, *supra* note 164, at 32 ("value creation is an incoherent and ill-defined notion"); Devereux and Vella, *supra* note 165, at ("We criticized this principle in an article written in 2013 and published in 2014….This policy paper extends and develops this criticism.")

[167] Action Plan on Base Erosion and Profit Shifting, OECD (2013), http://dx.doi.org/10.1787/9789264202719-en

[168] *See* Mindy Herzfeld, *supra* note 164, at 3 ("But the volume of paper published by the OECD glosses over its poor results.")

[169] OECD/G20 Inclusive Framework on BEPS, Progress report July 2020-September 2021 at 2, https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-progress-report-july-2020-september-2021.pdf.

[170] Those other things include a relaxed nexus standard allowing countries to tax income of enterprises on the basis of substantial sales (1 million euros in revenue) into a jurisdiction in the absence of physical presence and a minimum tax rate of 15 percent. *See* OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, October 8, 2021, (describing the two-pillar solution).

[171] The regime only applies to multinational enterprises with global revenues in excess of 20 billion euros and profitability above 10 percent.

[172] Implementation of the agreement will amendment existing tax treaties, almost all of which require physical presence as a condition of extending taxing jurisdiction. An annex to the OECD statement says that these amendments will be "implemented through a Multilateral Convention (MLC), and, where necessary by way of correlative changes to domestic law, with a view to allowing it to come into effect in 2023." *Id.* That MLC has yet to be drafted.

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"marketing and distribution profits safe harbor" for entities already taxed in a market jurisdiction."[173]

Although some academics have tried to explain the tortuous twists and turns of the BEPS process as a gradual move towards the taxation of "rents" as opposed to "source,"[174] describing the objective as the taxation of "rents" rather than according to the "source of income" (or "value creation") does not solve the underlying problem. There is no more agreement on the location of "rents" than there is of "source." Whether described as attempting to locate "rents" or "income" or "value creation" for purposes of determining the government which should have primary taxing rights, the continuing international debate merely replays the debate surrounding the formulation of UDITPA.[175] Countries in which production facilities or labor are located (countries of origin) are battling against market states (destination countries) for tax revenues.[176] It is absolutely unclear, as a factual matter, which country is more responsible for (if one wants to go with an all-or-nothing approach) or how to fairly split the amounts between contending countries, and thus establish in some moral sense the entitlement to tax these amounts. The contenders include both government(s) whose services made production (whether of physical goods or intellectual property) possible and the government(s) which provide a market. Take the case of iPhones, for example. China, as a producer, claims the right to tax Apples' profits

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[173] *See id.* at 2 (noting that work must be done on the design of the safe harbor).
[174] Daniel Shaviro, *Mobile Intellectual Property and the Shift in International Tax Policy from Determining the Source of Income to Taxing Location-Specific Rents, Part I,* 2020 SING. J. OF LEG. STUD. 681, 685-86 (2020) (the issue of "genuine normative interest…that of deciding and coordinating where and how to tax rents"); Wei Cui, *The Digital Services Tax: A Conceptual Defense*, 73 TAX L. REV. 69, 72 (2020) ("The main case in support of the DST is that it would allow location-specific rent (LSR) earned by digital platforms to be captured by the countries in which such rent arises.")
[175] *See* Richard D. Pomp, *What Can the OECD Learn From The States?*, ST. TAX NOTES 1296, 1297 (2020) ("The OECD should design its own formula, factors, and their respective weighting, but the MTC has done the heavy intellectual lifting.")
[176] In addition, there are disputes as to which of several candidates should be considered the countries of origin.

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because Apple benefits from location savings—China's large, relatively low-cost and talented work force—while the United States claims most of the value derives from the intellectual firepower developed and exercised in Silicon Valley and its offshoots, without which that work force would have no products to produce—and at the same time market countries claim that no profits could be made in without the buyers found in their markets. Note that that leaves out entirely the country in which the entity claiming to own the intellectual property is resident, and to which (under current law) many treaties assign the corresponding income. Each country or set of countries has a unique characteristic that plays a role in Apple's ability to profit from the sale of iPhones, which can be variously construed as a "rent" or as a "source" of income or as leading to the creation of value. But how to evaluate the relative amounts (of whatever metric) attributable to each? And of course, it is hardly likely that the "correct" distribution for iPhones would provide much information about the "correct" distribution of taxing authority for other products and services.

In short, whether one calls it "income," "rents" or "value creation," determining the precise economic contribution of particular locations seems an impossible task in the international as well as the inter-state context. Given this impossibility, the attraction of formulary methods—which foreswear any attempt at such precision, at least at the level of an individual taxpayer--is obvious. Formulary methods are capable of (though not guaranteed to) reducing administrative costs, and if all the affected jurisdictions can agree on a single formula, will ensure that all income is subject to income tax somewhere, and in only place, ending both taxpayer bonanzas and overtaxation. However, the choice of formula (and for that matter, other types of source rules) have significant distributive effects on the participating jurisdictions, and in a world of differing tax rates, on taxpayers as well. It is to those consequences that this Article turns next.

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B. How Should Congress Choose Among Formulas?

The reason it took states so long to adopt UDITPA—and the reason it has seen so many defections over time—is that the choice of formula or source rule matters. Different formulas have different revenue consequences, and different economic effects, for different jurisdictions because those jurisdictions' economies are different. Some states have more manufacturers or mines or other producers of physical goods,[177] others have more consumers. Some states have more offices. Some have physical or governmental attributes that make it hard or expensive or unlikely for taxpayers to move to other jurisdictions for tax purposes, others do not (i.e. the capital located within their borders is "mobile capital"). These differential economic features are no secret either to outsiders or to the jurisdictions themselves. Jurisdictions can determine relatively easily whether they will be they will win or lose from moving (or adopting in the first instance) one source rule or another.[178] New York would lose, and New Jersey win, for example,

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[177] *See* Anand & Sansing, *supra* note 74 (correlating choice of apportionment formula with location of extractive industries).

[178] *See* Joann M. Weiner, *Redirecting the Debate on Formulary Apportionment*, TAX NOTES 1164, 1167 (2007) ("Although it is true that a large number of states have moved toward a sales-based formula, not all states have made this move because some states view a more balanced formula as better reflecting their policy choices or industrial composition.") Of course, such cost estimates may change over time, along with changes in a state's underlying economy. West Virginia, for example, may once have thought it would be better off under a three-factor formula than a single-factor, destination based formula, but the near-death of its coal mining industry may well have changed that calculation. However, the contention of advocates of a single-factor, destination-based formula that all jurisdictions would naturally gravitate towards the use of such a formula because failing to do so would discourage business investment, *see* Avi-Yonah & Clausing, *supra* note 75, at 328 ("if some countries adopt sales-based formulas, other countries will have an incentive to adopt sales-based formulas as well, in order to avoid losing payroll or assets to countries in which these factors are not part of the formula"), this has not been borne out as a factual matter. Though only six states continue to utilize the equally-weighted three-factor test, another thirteen overweight sales while continuing to take other factors into account. *See* State Apportionment of Corporate Income, https://www.taxadmin.org/assets/docs/Research/Rates/apport.pdf. Economic studies have failed to show significant increases in business investments or corporate income tax revenues following adoption of single-factor apportionment formulas. *See* Galina Petrova, *State Corporate Income Tax: A Stance on the Sales Factor*, 35 TAX ASSESSMENTS 1, 4, October 2015, http://schellbray.com/wp-content/uploads/2017/02/Stance-on-the-Sales-Factor.pdf (listing business losses after enactment of more sales-heavy formulas); Sanjay Gupta, Jared Moore, *et al*., *Empirical Evidence on the Revenue Effects of State Corporate Income Tax Policies*, 62 NAT'L TAX J. 237, 240 (2009) (states with a double weighted sales factor have 16-18 percent lower corporate income tax revenues than states with three-equally-weighted factor formulas); Joann M. Weiner, *supra* note 178, at 1167 ("because states often change the tax rate at the same time as they change the formula, the evidence on how super-weighting the sales factor affects economic growth is mixed").

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if Congress decided against allowing states to use a "convenience of the employer" rule and mandated that the source of labor income follow the physical location of a taxpayer—just as New York lost (and arguably Florida won[179]) when Congress prevented New York from taxing non-residents on the pensions received with respect to work performed in New York.[180]

Given the absence of a legitimate theory for where income is earned, choosing among the many plausible apportionment formulas (as well as the source rule for personal services income derived by individual taxpayers) necessarily devolves into a political contest, in which states will advocate for their preferred formulas and source rules.[181] Whether Congress should spend its limited political capital on adopting a uniform formula for the taxation of corporate income or for determining the source of labor income should depend on the benefits to be gained from providing this supervisory role. The scope of those benefits derive from the answers to two questions: first, how bad is double taxation? Second, would moving to a uniform system actually get rid of it? Those questions are faced in the next parts of this Article.

VI. How Bad is Double Taxation?

People generally have an almost instinctive revulsion against "double taxation." The term suggests that certain taxpayers are being singled out to pay more than their "fair share" of the burden of defraying governmental expenses. Duplicative source taxation seems on its face to be

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[179] Since Florida does not have an income tax, its fiscal benefits would have been indirect, stemming, for example, from luring more retirees to the jurisdiction in pursuit of lower tax burdens. Those retirees would then spend their money at local businesses, generating both sales tax revenues and economic growth, which might itself have some revenue-generating potential for the state.
[180] *See supra* notes 38-42 (discussing 42 Pub. L. No. 104-95 §114(a)).
[181] The struggle to develop norms for the taxation of transnational income has been described in exactly these terms. *See* Daniel Shaviro, *supra* note 174, at 694 (describing "history of the corporate income tax" as "a divide between countries that are primarily exporters, and those that are primarily importers"); Mindy Herzfeld, *supra* note 164, at 30 ("Achieving consensus is challenging because the different roles that countries play in the world economy mandate that they advocate for competing international tax policies.")

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particularly pernicious, both because it is readily noticed and because its burden often falls disproportionately on people and organizations which have limited political voice. Nonresidents, after all, do not vote in state or local elections; they thus seem like easy targets for revenue extraction. As another scholar put it, taxing outsiders looks like a clearly beneficial "transfer of resources from 'them' to us'."[182] It strains credulity to argue that the rather unattractive principle of "don't tax you, don't tax me, tax the fellow behind the tree"[183] plays no role in states' decisions as to the content of their source rules, including their choice of apportionment formulas and the like.

And yet, some amount of duplicative taxation of multijurisdictional taxpayers is likely justifiable—indeed, its absence might lead to "too much" interstate activity, or at least systematic unfairness. To understand why, one must consider why most multistate taxpayers are multistate taxpayers to begin with. The obvious reason is that no one state offers all of the benefits or characteristics that they desire;[184] picking and choosing from several states' offerings allows both individuals and businesses the ability to customize their preferred package.

For example, one state might spend its tax revenues providing physical infrastructure (or subsidies) that make manufacturing activity cheaper, while another spends its tax dollars enticing tourists eager to spend dollars in local stores, or otherwise subsidizing distribution and sales, by

[182] Daniel Shaviro, *Mobile Intellectual Property and the Shift in International Tax Policy from Determining the Source of Income to Taxing Location-Specific Rents, Part II*, 2021 SING. J. OF LEG. STUD. 128, 130 (2021).

[183] The verse is commonly attributed to Senator Russell Long, the late chairman of the Senate Finance Committee. *See* Quote Investigator, *Don't Tax You. Don't Tax Me. Tax That Fellow Behind the Tree*, https://quoteinvestigator.com/2014/04/04/tax-tree/ - :~:text=There%20is%20a%20saying%20that%20goes%20something%20like,when%20that%20tree%20falls%2C%20where%20will%20you%20be.

[184] One of the benefits of federalism, of course, is that states (and localities) have the freedom to offer different packages of governmental goods and services at differing tax costs. Competition for residents is supposed to lead to more efficient benefit provision as well as grant individuals (and businesses) the ability to choose the package that best accords with their needs. However, the limited number of jurisdictions means that few are able to find a perfect match between their desires and any one jurisdiction's offerings, hence the desire to "mix-and-match."

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constructing a convention center and beautifying retail outlets. A manufacturing enterprise can achieve the best of both worlds by doing it manufacturing in the first state and locating its sales activities in the other state, something that a purely intrastate business could not attain.

Such picking and choosing leaves open the possibility, if not the probability, that absent some level of double taxation, many multijurisdictional taxpayers will derive more in the way of governmental benefits than they would have enjoyed had they operated solely within any single jurisdiction—and at a total tax cost of no more than the taxes they would have paid had they operated solely within the highest taxing of the impacted states.[185] In short, they may get a financial "deal" which leads them to prefer operating in more than one jurisdiction to operating in a single state. A tax bonus, just like a tax detriment, can distort economic behavior.

We are quite accustomed to requiring compensation for such double-dipping through the extraction of fees or other explicitly benefit-linked payments. For example, state universities often charge higher tuitions to out of state students, and yet many students (or their parents) agree to pay these sums despite having "paid" for lower tuition at in-state universities through their home state taxes. They would not do so unless they believed that the academic programs offered by the non-residence state were more valuable than those provided by their home state institutions; the home state might have been unwilling to invest more in its universities in the interest of lower tax rates or the desire to spend money on other government programs. It might even have been influenced by the ability of its residents to study out of state, albeit with some user fee. Such duplicative tuition payments, in the form of taxes in one state and direct (high) tuition in another, are not regarded as a form of "double taxation." There is no general move to

[185] In addition to the benefits gained by "picking and choosing," dual jurisdiction taxpayers may simply impose greater costs on the combination of jurisdictions than if they operated in just one since they may be taking advantage of a wider variety of services.

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refund previous tax paid by residents who choose to pay high out-of-state tuition, nor is credit given for the implicit tax collected out of state in the form of tuition.[186] Many government programs, however, are not so easily financed through user fees directed at individuals (or corporations) who benefit.[187] In these cases, the choice is between allowing some degree of free riding or coming up with a mechanism to bring them into the tax net. One method of doing so is through careful crafting of tax rules, including the choice of source rules.

Of course, taxes always distort behavior; there is no such thing as a non-distortive tax.[188] Indeed, both academics and politicians routinely praise at least some tax motivated distortions. Competition for residents effected through differential offerings of taxes and benefits is widely assumed to lead to more efficient sorting of residents as well as more efficient governmental behavior.[189] The point here is not that tax distortions are necessarily bad, but rather that a world with some double taxation may not be any more distortive—or lead to systematically worse distortions--than one without it. Another way of making the same point is to note that when comparing a taxpayer's tax to benefit ratio, a taxpayer bearing some measure of double taxation from operating in multiple states may not exceed the tax to benefit ratio they would have born

[186] Several states, however, do have reciprocal tuition reduction arrangements with neighboring states, particularly for students enrolled in programs not offered at their home-state schools. *See* Career Vision, *"Out-of-State" Colleges Not "Out-of-Reach": Tuition Reciprocity Programs*, https://careervision.org/state-colleges-reach-tuition-reciprocity-programs/ (providing links to programs); Farran Powell & Emma Kerr, *How to Get In-State Tuition at Out-of-State Colleges*, U.S. NEWS & WORLD REPT., Apr. 2, 2021, https://www.usnews.com/education/best-colleges/paying-for-college/articles/2018-04-04/how-to-get-in-state-tuition-at-out-of-state-colleges (describing reciprocity arrangements and regional exchange programs).
[187] It is unclear how often the question is one of "cannot" and how much is "will not". For example, it may be impossible to find a jurisdiction which charges nonresident visitors a fee for availing themselves of the benefit of local police protection, but there is increasing discussion (and more than discussion) of charging outsiders for back-country rescues and other extremely costly remediation services. Of course the decision as to which services to finance through fees and which through taxes always involves an element of choice.
[188] *See* DAVID RICARDO, THE PRINCIPLES OF POLITICAL ECONOMY AND TAXATION 95 (1817)
[189] *See* Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418-20 (1956). Of course, such self-selection is often accompanied by less attractive characteristics, such as economic selfishness and exclusionary behavior.

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had they operated in only one of those states. The additional taxes borne may well be offset (or more than offset) by the additional benefits conferred by operating in more than one state.

Though this analysis suggests that it may well be both fair and efficient for multijurisdictional taxpayers to pay some additional tax, in total, than taxpayers operating in only one state, one might be concerned that unfettered double (or more) taxation will exceed any justifiable amount of additional taxation. After all, there is rarely a tight linkage between income taxes paid by a given taxpayer and the governmental benefits they receive. Income taxes (even more than most other taxes) are meant in part to be redistributive, not mere user fees.[190] One could legitimately question why multijurisdictional taxpayers should be forced to redistribute a higher percentage of their income than either state deems proper for wholly intrastate taxpayers (whether corporate or individual). For example, an individual working in both New York and New Jersey, and fully taxed in both states on that income due to divergent source rules, might find themselves contributing twice as much (as a percentage of income) towards social services provided to others as taxpayers in similar economic situations but working/operating in only one jurisdiction. The question is which component of "double taxation" is more prominent, the desirable component traceable to benefit increases or the undesirable component of double charging for redistributional expenses.[191] Double exaction of the redistributional component of the tax might overwhelm the beneficial aspects of (limited) double taxation.[192]

[190]*See* Bird & Zolt, *supra* note 126.

[191] This assumes, of course, that the taxpayers' benefit from such redistribution does not exceed the benefit it would receive had it operated entirely in only one state. The line between "redistribution" and "additional benefit" may be hard to discern in the real world.

[192]Note that this sort of double taxation, like other double taxation, arises only when two states claim to be the source of the same income. When a taxpayer is merely a resident of one state who generates income in the other (under both states' rules), the residence state typically allows a full credit against its own tax for amounts paid to the source state, eliminating the possibility of double taxation and effectively leaving the redistributive portion of the tax with the source state. Whether this is an appropriate division of redistributive (or other) tax revenues is separate question which is not dealt with in this Article.

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There is unfortunately no easily administrable way to determine the relative amount of "desirable" double taxation and undesirable taxation. Indeed, it is likely to differ from one taxpayer to the next. Taxpayers are not a homogenous group. Some taxpayers may derive substantial additional governmental benefits from their interstate existence, while others derive none at all, or may even be left worse off. Complicated working arrangements may spring from dual career families (or individuals working multiple jobs) seeking to reduce joint commuting times. Business may also have reasons for operating in multiple jurisdictions that have nothing to do with attempts to stack government benefits, such as proximity to customers, to raw materials, or other factor inputs. Any general statement about the desirability of duplicative taxation, or its amount, is surely impossible.

Thus, from a practical point of view, it looks like the choice facing Congress is whether to allow some amount of overtaxation (by failing to unify source rules) or to allow some amount of undertaxation (by allowing disunity to continue). The question is which of these alternatives is preferable.

One factor militating in the direction of Congressional inaction is the fact that taxpayers are not powerless pawns in this taxing game. They can change their behavior in ways that reduce their tax burdens, such as by moving all of their activities to one or the other state.[193] Although such behavioral changes undoubtedly impose costs on taxpayers, such decisions can also have an adverse impact on the state being left behind. Not only will those states lose the right to levy

[193] Indeed, the major argument made by proponents of the one-factor, sales formula is that the location of sales is less likely to be manipulated by taxpayers than the location of payroll or property. *See* Avi-Yonah & Clausing, *supra* note 75, at 328 ("The key advantage of a sales-based formula is that sales are far less responsive to tax differences across markets, because the customers themselves are far less mobile than are firm assets or employment.") Others have questioned this underlying factual premise. *See* Morse, *supra* note 74, 618-23 (exploring situations in which taxpayers would both have an incentive to, and could, manipulate sales destinations).

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income taxes on departing taxpayers, but they will often also lose the ability to levy user fees and other sorts of taxes imposed on activities undertaken within their borders—not to mention possible losses of economies of scale from providing certain governmental services, and also parts of their economic base. Their potential for inflicting these harms provide taxpayers with another option: voice. They may threaten (sometimes creditably) to move themselves or their business activities to another jurisdiction to encourage states to change their tax rules to reduce the amount of overtaxation. As described below, that can even work—maybe not always, but maybe often enough to justify Congressional inaction.

VII. Taxpayer Self-Help

Taxpayers are famous—and often criticized-- for re-arranging their activities to minimize their tax burdens. The instances of duplicative taxation identified in this Article are susceptible to tax planning devices. The fact that they are so susceptible likely means that the cases of duplicative taxation that we continue to see involve taxpayers who derive greater benefits from operating in multiple jurisdictions than they would if they restricted their operations to a single, or simply different, jurisdictions. In that case, it is possible that the seemingly excess taxation merely compensates for the additional costs they impose, or the additional benefits they derive, from such multijurisdictional activities, and that the additional taxation makes their operational choices "more neutral". That does not mean that allowing for the possibility of duplicative taxation always advances the goal of economic neutrality (or the development of an economic market relatively free of internal barriers), but rather that it is all but impossible to define the term "neutrality" in a world in which different jurisdictions have different packages of governmental goods, services and tax burdens, let alone other (perhaps not governmentally-

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linked) characteristics.[194] The most one can hope for is to keep the distortions within politically acceptable bounds. As described below, taxpayer self-help (combined with the limits on state behavior imposed by current dormant Commerce Clause jurisprudence) might be enough to do that, forestalling the need for Congressional action.

A. Corporate Self-Help

This Article has identified two sources of duplicative corporate taxation, both resulting from inconsistencies in the way states implement their formulary tax systems. One is that different states assign different weights to factors used in their allocation formulas. The other is that they measure the factors differently. Neither of these inconsistencies is hidden, nor should they be a surprise to potentially affected taxpayers. As a result, many taxpayers have the opportunity to avoid encountering these problems through advance tax planning. Although such planning may not be costless, some of the costs fall on the jurisdictions with the inconsistent rules, which may cause them to avoid creating such problems to begin with.

Duplicative taxation can occur whenever a taxpayer operates in one jurisdiction allocating income solely on a destination basis and in another jurisdiction which allocates income in part on the basis of payroll or property, or if they assign different weights to such factors.[195] Taxpayers can avoid falling into such tax traps by carefully choosing the jurisdictions in which they operate. They can, for example, reduce or eliminate taxes allocated on the basis of property or payroll by moving their physical operations to states utilizing purely destination based allocation

[194] *See* Michael J. Graetz & Alvin C. Warren, Jr., *Income Tax Discrimination: Still Stuck in the Labyrinth of Impossibility*, 121 YALE L.J. 1118, 1222-23 (2011) (describing the impossibility of achieving nondiscrimination across jurisdictions).

[195] Note that mismatched formulas do not always lead to duplicative taxation. If the multi-factor state's proportion of overall payroll and property is greater than its ratio of in-state sales to overall sales, double taxation results. If the state's proportion of payroll and property is less than its proportion of the sales ratio, the taxpayer will end up undertaxed as the sum of the numerators will fall below the denominator, generating a fraction of less than one.

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formulas.[196] Alternatively, they may change the way in which they distribute their product. Instead of selling directly to customers in a high-tax state, they may sell to middlemen in low-tax jurisdictions, leaving those middlemen to sell into high tax jurisdictions.[197] Both strategies may impose costs on taxpayers. However, they may also impose sufficient costs on jurisdictions to prevent them from operating too opportunistically.

Once a taxpayer has a physical plant and/or a workforce located in a jurisdiction, uprooting and moving operations to a tax-friendlier jurisdiction can be costly. The existing physical assets may not be particularly saleable; after all, the very tax considerations that may be impelling its move would likely also affect the likelihood (or not) that another, similar taxpayer would want to take over the operations. The need to renovate the facilities for another use would undoubtedly decrease their market value. The existing workforce also may be resistant to relocating. Personal preferences and family concerns may militate in the direction of staying at the original location and looking for another job rather than moving.

Such obstacles are not trivial, and may dissuade many from following the most tax-efficient plan. However, taxpayers may be able to access relief another way—by making a creditable threat to

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[196] Indeed, as noted earlier, some proponents of single-factor sales formulas tout the likelihood of such shifts in real investment as an incentive for jurisdictions to adopt them. *See* McLure, Jr., *supra* note 24, at 152 ("The *Moorman* decision opened the floodgates for states wanting to change their apportionment formulas for competitive reasons…."); Nichols, *supra* note 23, at 495 ("states are still attempting to encourage domestic business development through the adoption of sales-oriented apportionment formulas"); Avi-Yonah & Clausing, *supra* note 75, at 328 ("State incentives to move toward a sales-based formula are well documented.") The extent to which taxpayers actually do this is open to question. *See supra* note 74 (discussing theory and empirical results).

[197] *See* Altshuler & Grubert, *supra* note 75, at 1172 ("There would therefore be a clear tax incentive to divert transactions through independent resellers."); Morse, *supra* note 74, 621-22 (semi-conductor example); Fleming, Peroni & Shay, *supra* note 154, at 128-31 (describing incentives to find "truly independent resellers" to route sales to high tax country); Roin, *supra* note 160, at 207-08 ("the delivery rule is far from foolproof"). Although the middleman's income will be sourced to the state in which their customers are located—which may include high-tax states—the middleman's income could well be a small fraction of the income generated by the producer of the goods or services. Taxpayers have honed their skills in isolating highly profitable income from, for example, intellectual property and returns, in low tax entities in the international context. *See* Kleinbard, *supra* note 147, at 735 (explaining transfer pricing strategies). There is no reason these techniques could not be adapted for domestic use if the tax stakes are big enough.

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leave the jurisdiction for greener tax pastures. Such a threat might lead the government either to change the offending tax rule or to provide alternative economic incentives for its retention. The state, after all, usually benefits from the taxpayer's presence and loses if it moves. Such businesses almost by definition employ a local workforce; the members of that workforce are taxpayers (and valuable citizens) in their own right. Moreover, local corporations likely purchases some supplies or services from other local enterprises, which again add to local employment and the local tax base. Businesses do impose costs on jurisdictions, but most politicians seem to be sure that the benefits of retaining old and attracting new businesses —in the form of increased employment or the attraction of other businesses or the like—outweigh those costs.[198] They are eager to host or even subsidize new businesses. One does not have to look hard for examples of financial incentives provided by states and localities to retain or encourage new business investment within their borders. The recent competition for Amazon headquarters is just one example.[199] Looking solely at income tax liabilities, in short, may well overstate the amount of duplicative taxation that exists because apparently excessive liabilities may be offset by other governmental financial incentives. The fact that so few businesses have

[198] *See* Edward A. Zelinsky, *Ohio Incentive Decision Revisited*, TAX NOTES 1569, 1571 (2005) ("When a large employer threatens to leave a state unless the employer is given tax breaks offered elsewhere, it can be difficult for elected officials to resist. Similarly, it can be hard to say 'no' to a prospective employer…only if the state grants tax subsidies available elsewhere.").

[199]*See* Weng Cheong, *New York offered Amazon nearly $1 billion more in tax credits than previously known for its HQ2 deal*, BUS. INSIDER, January 4, 2020, https://www.businessinsider.com/ny-amazon-hq2-nearly-1-billion-more-than-known-for-2020-1 (describing bidding war); Lauren Feiner, *Amazon will get up to $2.2 billion in incentives for bringing new offices and jobs to New York City, Northern Virginia and Nashville*, CNBC, Nov. 13, 2018, https://www.cnbc.com/2018/11/13/amazon-tax-incentives-in-new-york-city-virginia-and-nashville.html ("The amount illustrates how local officials have tried to lure Amazon with copious incentives….") Although New York City eventually backed out of the proposed deal, work on the Virginia project went ahead. Scott Cohn, *Amazon reveals the truth on why it nixed New York and chose Virginia for its HQ2*, CNBC, July 10, 2019, https://www.cnbc.com/2019/07/10/amazon-reveals-the-truth-on-why-it-nixed-ny-and-chose-virginia-for-hq2.html.

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actually changed locations in response to changes in formulary allocations may, in part, reflect the ubiquity of such defensive maneuvers. [200]

Nor is self-help limited to bargaining with states with multi-factor formulas. Corporations have more freedom to alter the destination of their sales than it is comfortable for many proponents of destination-based formulas to admit. It may require altering business practices by selling to an independent middleman located in a tax-favorable state rather than to a direct consumer.[201] Whether such a change is financially worthwhile (after all, it involves diverting some profit to that middleman, which would not be willing to distribute the good for free) would depend on the circumstances, including the difference in tax rates, and thus the potential tax savings.

Businesses can also work around conflicts created by differing definitions of where their employees are located.[202] As discussed in more detail in the next section, states rarely if ever contest employers' decisions to relocate employees to an out-of-state office. An employee assigned to an out-of-state office is generally regarded as an employee located outside of the state "for the convenience of the employer." Thus, a business can avoid the reach of the convenience of the employer rule by establishing such an office for employees regularly working

[200]*See* Peter D. Enrich, *The Rise—and Perhaps the Fall—Of Business Tax Incentives*, THE FUTURE OF STATE TAXATION, 73, 75 Urban Institute Press (1998) ("Even the businesses that are the beneficiaries of state tax breaks repeatedly acknowledge, after the fact, that their location decisions were not guided by the available incentives.").
[201] *See supra* note 197 (sources discussing techniques)
[202] It is also unclear how many corporations would be directly affected by these discrepancies, as it would require both states in which the taxpayer operates to use the payroll factor in its allocation formula, and for one to use the convenience of the employer rule while the other looks to the location of the employee. At present, only one state (Massachusetts) both includes the payroll factor and employs the convenience of the employer rules; the other states utilizing the convenience of the employer rule use a single factor sales allocation formula. *See State Apportionment of Corporate Income*, *supra* note 178 (listing state allocation formulas); Anja Simic, *Convenience of the Employer Test: What It Is & How It Impacts Workers*, August 12, 2021, https://www.letsdeel.com/blog/convenience-of-the-employer-test - :~:text=There%20are%20quite%20a%20few,%2C%20New%20York%2C%20and%20Pennsylvania. (listing states with convenience of the employer rules). Corporations may be affected indirectly, however, because of the effect of convenience of the employer rules on taxation of their employees, and their willingness to absorb the extra tax burden. *See infra* TAN 207-09.

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outside of the state. Again, employing such a strategy is not costless, but it does reduce the opportunity for states to impose excessive (joint) exactions.

Of course, it is not only corporations that can suffer from inconsistent state tax rules. As detailed in Section III, individuals whose work spans multiple jurisdictions can also find themselves subject to duplicative taxation. The potential for duplicative taxation was made clear by the growth of telecommuting due to the ongoing pandemic. Though temporary relief saved most individual taxpayers from having to confront the issue last year, there is no guarantee that this state of affairs will continue. Taxpayers who became enamored of working from home, or working from elsewhere, may soon find that there may be a price for taking advantage of that flexibility. Once again, the question is what, if anything, Congress should do to reduce or eliminate that price—or if taxpayers have sufficient ability to deal with the problem on their own.

B. Individual Self-Help

Some states source wages and other personal services income earned by individuals to the state of performance; others source them to the location of the employer's office, unless the employee is at another location "for the convenience of the employer."[203] Most states explicitly or implicitly temper their rules with a de minimius exception; most employees do not file tax returns allocating portions of their income to states to which they have traveled on short business trips, even though such travel probably meets the definition of "for the convenience of the employer." However, when significant amounts of money are at stake, states can fiercely defend

[203] As pointed out earlier, *supra* TAN 110-14, these differences mimic the discordance over the role (or the right to tax) accorded to states other than the market state in the UDITPA apportionment formula.

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their tax claims.[204] That can create problems for individuals performing services in a state with a location of performance rule for employers located in "convenience of the employer" states. This has always created problems for a few, unlucky individuals.[205] However, many employees became enamored of telecommuting during the pandemic, and desire to continue such behavior even after the pandemic ends (if it ever does).[206] They regard the time and monetary savings from eliminating their commute as more offsetting any increase in social isolation or decrease in interactions with their co-workers and supervisors. Whether that desire will survive the duplicative state taxation of their salary income is, of course, another matter.

But like corporations facing such taxation, most individuals have opportunities to avoid such a fate. They may not be the choices they want—but given the possibility that, multistate corporations, they derive benefits from their multi-state existence, they may not deserve better.

One option, of course, is to work within the same jurisdiction as their employer's office. This can be achieved in one of two ways. The first is fully within the control of the employee: they can

[204]Athletes and entertainers are regularly taxed by all the states in which they play games or put on performances. *See* Andrew Osterland, *State tax departments set their sights on pro athletes' earnings*, CNBC, January 11, 2021, https://www.cnbc.com/2021/01/11/state-tax-departments-set-their-sights-on-pro-athletes-earnings-.html (in a normal season, NFL players file between eight and 12 non-resident state tax returns and NBA players file 16 to 20 such returns); Scott C. Cashman, *Understanding the "Jock Tax,"* BOWDITCH BLOG, January 24, 2019, https://www.bowditch.com/estateandtaxplanningblog/2019/01/24/understanding-the-jock-tax/ -:~:text=As%20a%20general%20rule%2C%20nonresident,their%20home%20state%20as%20well.&text=However%2C%20athletes%20who%20are%20nonresidents,their%20in-state%20source%20income. (summarizing rules for athletes). Executives and other highly paid corporate employees are as well. *See* Victor Flores, Sinead Kelly & Michael Poland, *California Proposes to Tax Nonresident, Non-Employee Director Compensation based on Corporation's Domicile*, BAKER MCKENZIE, September 29, 2020, https://www.thecompensationconnection.com/2020/09/29/california-proposes-to-tax-nonresident-non-employee-director-compensation-based-on-corporations-domicile/ (directors); Gregory A. Bergmann, Timothy P. Noonan, & Frank A. Yanover, *Nonresident Withholding on Executive Compensation and Mobile Employees*, MEGA-TRENDS IN ST. TAX'N, 2014, https://www.hodgsonruss.com/media/event/366_Nonresident Withholding on Executive Compensation and Mobile Employees.pdf (detailing source taxation of executive compensation).
[205]*See* Zelinsky v. Tax Appeals Tribunal, *supra* note 11 (upholding New York's tax on professor's salary earned from work performed at Connecticut home).
[206] *See Free Exchange|Remote Prospects*, THE ECONOMIST, January 15, 2022, p. 66 ("Based on the survey results from December, the researchers reckon that 28% of hours might ultimately be worked from home""). Of course, many of the telecommuting workers may be telecommuting from within a jurisdiction, rather than across jurisdictional lines.

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move to the jurisdiction in which their employer's office is located. This can be done in one of two ways. They can either move their residence (from which they are telecommuting) to the state in which their employer is currently located, or they can switch jobs and work for an employer located in the jurisdiction from which they want to telecommute. A resident of New Jersey, for example, could move to New York (or for that matter, to Connecticut, which credits the New York taxes paid by telecommuting workers and enjoy both telecommuting and a single tax burden. Alternatively, they could move to an employer with an office in the same jurisdiction as their residence.

The second option requires the cooperation of their employer. The employer can move its offices to—or create a new office in--jurisdictions from which its employees want to telecommute, and assign such employees to that office.[207] As long as the office itself has some physical reality, the employees' physical presence in that office should be irrelevant to a "convenience of the employer" jurisdiction[208]—just as the employee's presence or absence in the original office was

[207] *See* Roy Stern, *King & Spaulding Follows Wall Street to Open Miami Office*, BLOOMBERG L. BUS. & PRACT., January 11,2022, https://www.bloomberglaw.com/bloomberglawnews/exp/eyJjdHh0IjoiQlVOVyIsImlkIjoiMDAwMDAxN2UtNGEwMC1kZmIxLWFmN2UtNWYwMjg1YTQwMDAxIiwic2lnIjoiWjM5TkR1dno2T2dhTWwwQTNnRU5uYllnRkNzPSIsInRpbWUiOiIxNjQxOTI4MzQ4IiwidXVpZCI6InR6QzNmN1Y3eW9DeUluSUJKaFhMWlE9PXUvMkJqTHV1TGlGL28rK0V0bEtxU2c9PSIsInYiOiIxIn0=?bwid=0000017e-4a00-dfb1-af7e-5f0285a40001&cti=LSCH&emc=bblnw_nl%3A8&et=NEWSLETTER&isAlert=false&item=read-text&qid=7229258&region=digest&source=newsletter&uc=1320027729&udvType=Alert&usertype=External (law firm relocating 12 partners to the city that has become an alternative Wall Street workplace during the Covid-19 pandemic); Marcia Watson Wasserman, *Virtual Is the New Law Firm Reality*, ABA L. PRACT. MAG., May/June 2019, https://www.americanbar.org/groups/law_practice/publications/law_practice_magazine/2019/MJ2019/MJ19Wasserman/ (discussing the growth of virtual firms with no offices as well as satellite offices). Depending on the location of the new offices, they may serve to eliminate solely New York City income tax or both New York City and New York State income tax.

[208] However, the employee could not regularly work in the original office without risking the arrangement being disregarded as a sham.

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irrelevant to their tax status. What matters is the location of the customer for whom the services being performed, and the employee's "customer" is the employer.[209]

It is an open question whether and to what extent employers will participate in such arrangements. Although establishing additional offices might enable firms to reduce costs by reducing the size of some offices and replacing the lost space with (perhaps) smaller spaces in less expensive jurisdictions,[210] businesses may worry about the business consequences of encouraging not only telecommuting but also spreading out their physical footprint. They may place more value on physical interactions between employees, and see their absence as interfering with morale, the transmission of information and training opportunities, and overall work efficiency.[211] Whereas some employers seem to have embraced employees' desire to

[209] There is of course an element of unreality to all of this, because (at least in the case of law firms) the services are performed for clients who may well be located in another jurisdiction. However, the services provided by employees are analogous to the sale of intermediate products sold for incorporation into other products. Sellers of intermediate products are treated for tax purposes as selling their goods to the customer performing the next stage of production, not that customer's customers. *See, e.g.*, Walter Dorwin Teague Assoc., Inc. v. Washington Dept. of Rev., 2021 Wash. App. LEXIS 2983 (Wash. Ct. App. 2021) (income for airplane design apportioned to Washington, the location of the taxpayer's direct customer, Boeing, rather than the location of Boeing's customers).

[210]Whether this is possible will depend on the specifics of any return to work or hybrid plan. If an employer allows fully remote working, the size of the original office can be reduced. The effects of hybrid work arrangements would depend on the circumstances. If everyone has to show up to work on the same day(s), the office will have to be large enough to accommodate them; if attendance is more dispersed, "hot desking" in a smaller office would suffice. Of course, the more often employees are required (or decide) to report to an office, the greater the risk they (and the company) will run that that office will be determined to be their "employer" leading to the loss of the tax benefits of being assigned to another office.

[211] Although some say that the experience of the last two years proves that working from home does not cause a drop in productivity and may even increase it, *see* Ben Popken, *Full return to office is 'dead,' experts say—and remote is only growing*, NBC NEWS, January 7, 2022 https://www.nbcnews.com/business/economu/full-return-work-dead-experts-say-remote-only-growing-rcna11323; *Surprising Working From Home Productivity Statistics* (2022), APOLLOTECHNICAL, January 2, 2022, https://www.apollotechnical.com/working-from-home-productivity-statistics/#:~:text=Several%20studies%20over%20the%20past.and%20are%202047%25; Aaon Raj, *Will employees return to work in the metaverse in 2022?*, T_HQ REMOTE WORKING, December 29, 2021, https://techhq,com/2021/12/will-employees-return-to-office-or-work-in-the-metaverse-in-2022/ (describing productivity studies), others are more dubious. *See* Rani Molla, *Remote work isn't the problem. Work is*., VX RECODE, February 1, 2022, https://www.vox.com/recode/22904758/remote-work-innovation-workload (citing survey and reports about employers belief that remote work arrangements "lead to a variety of ills, diminishing the company's collaboration, creativity and culture"); Rebecca Stropoli, *Are We Really More Productive Working from Home?*, CHI. BOOTH REV., August 18, 2021, https://www.chicagobooth.edu/review/are-we-really-more-productive-working-home ("JPMorgan CEO Jamie Dimon said of exclusively remote work: "It doesn't work for those who want to hustle. It doesn't work for spontaneous idea generation. It doesn't work for culture.").

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continue telecommuting,[212] others have done the opposite.[213] Those who oppose telecommuting may well applaud the existence of double taxation, as it may encourage more employees to return to the office.

Another option, of course, would be for affected taxpayers to lobby states to coordinate their source rules. State legislatures, like the federal government, have the power to change their source rules to accord with rather than conflict with those of their neighbors. Just as many (but not all) states moved to overweight (or exclusively weight) the sales factor in their apportionment rules for corporate income in hopes that it would attract more business investment, states with physical presence rules might adopt a convenience of the employer rule for sourcing the personal services income of individuals or vice versa) out of fear that disgruntled taxpayers would take advantage of one of the self-help methods laid out above. After all, from a revenue perspective, moving from a physical presence rule to a "convenience of the employer" rule would leave a physical presence jurisdiction no worse off than if their residents had continued to actually commute, rather than telecommute, to their offices in "convenience of the employer" states.[214] Likewise, a state may prefer to switch from a "convenience of the

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[212] *See* Alex Christian, *For two years, employees have been waiting for 'the day' when everyone goes back to the office. But it's probably never coming*, BBC WORKLIFE, January 14, 2022, https://www.bbc.com/worklife/article/20220113-why-a-wide-scale-return-to-the-office-is-a-myth("[I]n finance, executives have been aggressive in their timelines to bring people back"); Emma Goldberg, *The Worst of Both Worlds: Zooming From the Office*, N.Y.TIMES, Sec. A, p. 1, Nov. 16, 2021 (giving examples of companies "articulating that at some point most people will be expected back at their desks").

[213] *See* Christian, *supra* note 212 ("Some companies have already switched permanently to remote work or hybrid models"); Tom Acitelli, *Return-to-Office Plans: When Companies Are Planning to Go Back*, COMMERCIAL OBSERVER, January 12, 2022, https://commercialobserver.com/2022/01/return-to-office-plans-companies-labor-day-october/ (listing return and hybrid policies of companies); Goldberg, *supra* note 212 (giving examples of companies calling themselves "remote first").

[214] This assumes that telecommuting does not impose costs on the jurisdiction beyond those imposed by residence. That assumption may be wrong—there is probably some additional daytime traffic, etc. given that more people are around at lunch hour—but those costs might be offset by a reduction in costs associated with commuting, such as twice daily traffic tie-ups and the need for commuter parking, as well as an increase in sales tax revenues when employees eat and shop locally.

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employer" rule to a "physical presence" rule if convinced that the alternative is an exodus of offices.

The underlying economic trade-offs may be somewhat different in the personal services context than the corporate income tax context, however. States with physical presence rules may be less anxious to appeal to telecommuting employees by enacting a destination based rule because the positive externalities of such employees' presence may be less significant than those of a manufacturing plant (though their negative externalities may be lower as well[215]). States may not care if they lose residents whose income taxes would (under an alternate rule) be paid to another state because they might hope to replace them with new residents working for employers located in (and paying taxes to) their state. Or they might hope that the result of overtaxation would be a migration of actual offices away from convenience of the employer states to their state.

Whether states with convenience of the employer rules would be worried about the possible migration of significant numbers of employees to offices in other jurisdictions is also unclear. Certainly, if such a migration occurred, it could be harmful—though it might be better than having employees work part-time at their employers' offices and part-time from home, a work pattern that might follow from switching from "convenience of the employer" or other destination-based rule to one which takes physical presence into account (especially on a pro-rata basis). Unless employers can convince their employees to stagger the days in which they come

[215] *See supra* note 214. On balance, a jurisdiction may not be any worse off if it cedes taxing jurisdiction to the employer's state than it would be if the employee actually commuted to the employer's out-of-state office, when it would have to cede its residence-based tax claims to the source jurisdiction. Prioritizing the source tax claims over residence tax claims closely replicates the revenue effects of a single-factor, sales based apportionment formula does. The location of the factory becomes irrelevant despite the fact that the existence of the factory likely imposes real costs on the jurisdiction; all revenues are directed to the market state, where the taxpayer's physical footprint may be minimal.

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into the office (which may of course reduce the benefits of having them in the office at all), they will need to maintain their current office footprint (which will reduce their cost savings). Meanwhile, the jurisdictions in which those offices are located will need to maintain something close to their current transportation infrastructure because of the need to continue to service "peak load" of commuters. Jurisdictions might prefer an "all-in or all-out" pattern to one where employees split their location and tax revenues, as provided under a physical presence based allocation rule.

In the end, whether a state decides to focus on actual physical presence or on the location of the employer's office may have more to do with the relative number (and compensation) of employees who telecommute into, as opposed to out of, the jurisdiction, and projections of future changes.[216] There is again no axiomatically correct answer to the question of what the apportionment formula should look like. It is worth noting, however, that in 2020, Connecticut changed its rule for granting tax credits to prevent the double-taxation of income earned from services performed in Connecticut for New York employers.[217]

One way of looking at the fact that state laws remain divergent and some taxpayers face duplicative taxation because they are unable or unwilling to rearrange their affairs to avoid it is that such self-help opportunities are insufficient and that Congressional action is needed. Given the discussion in Part __ above about the desirability of some amount of duplicative taxation, though, that is far from the only possible interpretation of the facts. Another possible interpretation is that taxpayers are willing to pay duplicative taxes because they are the cost of

[216] If a relatively even exchange, of course, uniformity looks good—and nonuniformity does not.
[217] *See* Kevin J. Delaney, *US States are taxing people who barely spent time in them this year on their full 2020 income*, RESET WORK, October 24, 2020, https://www.charterworks.com/us-states-are-taxing-people-who-barely-spent-time-in-them-this-year-on-their-full-2020-income/ (interview with Prof. Edward Zelinsky).

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reaping the additional benefits conferred by a multistate existence. Far from interfering with a "national marketplace," the additional taxation makes it financially (and possibly politically) possible for states to offer different packages of goods and services which appeal to different taxpayers. It cuts down on what amounts to "free-riding" by forcing taxpayers to contribute to the costs of providing benefits in all the jurisdictions in which they operate. If that is the case—that taxpayers prefer a multi-jurisdictional existence with duplicative taxation to a one state existence without such taxation, the next section suggests that even Congressional action is unlikely to do more than eliminate the appearance of double taxation. As a substantive matter, states might simply substitute other taxes for the "missing" income taxes, leaving most taxpayers in approximately the same economic position as before the Congressional action.

C. Jurisdictional Self-Help

In the first instance, unifying the rules for the apportionment of multistate income will help (some[218]) taxpayers and hurt (some[219]) states. But avoiding duplicative taxation necessarily involves reducing some states' income tax revenues. The question is what adversely affected states will do in the face of this reduction in tax revenues. Will they make up the lost revenues with additional tax revenues—and if so, will those revenue increases come from the same taxpayers who benefit from the reduction in duplicative taxation, or will they come from other sources? If they come from other sources, will that shift in tax burdens be socially beneficial as compared to duplicative income taxation? Or will they reduce services, and if so, which ones?

[218] As noted in footnote 10 *supra*, inconsistent rules can help some taxpayers while hurting others.
[219] A rule might apportion more income to some states, and less to others; the total amount of income tax revenue in the first instance, though, would decrease.

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The answers depend on two factors. The first is the extent to which taxpayers provided relief from duplicative taxation derive special benefits from operating in multiple jurisdictions, that is, the extent to which they enjoy rents from operating in the state which has had its tax reduced or eliminated. To the extent that those benefits exist, the disadvantaged state has the fiscal room to enact other taxes or fees to offset the revenue lost due to the change in tax rules.[220] Stated simply, as long as the amount of any new exaction falls below the benefits gleaned by the taxpayer, the taxpayer will prefer absorbing those additional costs to exiting the jurisdiction. The second is the ability of the state (or locality) to craft a tax or fee that falls on those taxpayers, and preferably only those taxpayers. Shifting the tax burden to others risks not only political blow-back, but the possibility that newly-affected taxpayers will exercise their own self-help opportunities to the detriment of the state. States' ability to engage in such self-help depends on the circumstances of each state and taxpayer.

Most jurisdictions employ several taxing instruments at once. If their use of one is limited, they may try to replicate both its revenue-raising and its distributional effects with another, or some combination of other, tax and fee arrangements. In some instances, such replication may be relatively easy. For example, if a mining state is forced to use a single-factor sales formula to apportion income for purposes of the corporate income tax, the state could introduce or increase the rate of state excise taxes on mineral (or oil) extraction to raise revenue from mining companies exempted from the state's income tax because they sell their products to out-of-state customers. Alternatively, a state could impose a fee on such extraction, with the proceeds used to cover mining-related costs such as road maintenance or environmental remediation, costs

[220] As discussed *supra* Part VII.2, most currently double-taxed taxpayers presumably fall in this category, or they would have moved their base of operations either to a single state or one with more favorable tax rules.

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previously covered from general state revenues. Such revenue raising devices could be designed to raise the same amount of revenue as is lost due to changes in the apportionment formula. Those devices on their own, though, would be unlikely to replicate the distributional effects of the prior tax. Even if the amount raised from the industry as a whole did not change, the amount borne by each taxpayer could change substantially. For example, a barely (or not at all) profitable mining firm could end up paying substantially more in extraction taxes and fees than it would under a three-factor corporate income tax. However, such adverse distributional consequences might be averted by placing an income-based cap on such fees or taxes [221]

It is obviously easier to design such a substitute revenue source if the formerly double-taxed (and now exempt from income tax) taxpayers share characteristics that are distinct from those operating in only one state. A jurisdiction worried about its failure to collect income taxes from taxpayers with local business operations but few in-state customers could enact a non-income based business tax, perhaps in the guise of a license fee. It might even allow this tax or fee to be credited (on a non-refundable basis against such taxpayer's state income tax obligations—a design guaranteed to fall primarily against entities favored by the change in tax rules.[222]

States can also alter the mix of taxes in order to target non-favored groups. For example, the sales taxes imposed on hotels, restaurants and other tourist-centered activities often exceed general sales tax rates.[223] Some tourists are undoubtedly "locals," but most are not. They do

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[221] Some jurisdictions provide income caps for property tax levies. *See The State of State (and Local) Tax Policy*, TAX POL. CTR. BRIEFING BOOK, URB. INST. & BROOKINGS INST. , updated May, 2020, https://www.taxpolicycenter.org/briefing-book/how-do-state-and-local-property-taxes-work (describing circuit breaker programs maintained by 33 states and the District of Columbia).

[222]*See* Cuno v. DaimlerChrysler, Inc. 547 U.S. 332 (2006) (dismissing Dormant Commerce Clause challenge to allowance of targeted tax credits due to lack of standing).

[223] For example, the combined state, county and city tax rate on restaurant food in Chicago is 10.75%, or 11.75% for restaurants located within the McCormick Place special restaurant district, *see Increased City of Chicago Restaurant Tax In Effect*, ILL. RESTAURANT ASSOC, https://www.illinoisrestaurants.org/events/EventDetails.aspx?id=1314020 (describing taxes imposed on restaurant meals), while Chicago hotel guests pay a combined 17.4% tax on rooms.

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impose costs on publicly provided police and other services, but outsiders pay sales taxes and are generally good for the economy of the states they visit and work in. Similarly, many states impose higher property tax rates on second homes, many of which are owned by out-of-staters who do not vote in the state in which they vacation or spend weekends. It is doubtful that owners of such property impose higher costs than other property owners in the jurisdiction.[224] Finally, industrial and commercial property – more likely owned by outsiders than are single family residences – are generally subject to property tax at a higher rate than is residential property (although such taxes are often abated through special deals).[225]

Even the relative balance of income, property, and sales taxes may be established to disproportionately burden certain groups. For example, a state with a very large tourist industry may have higher sales tax rates and lower income tax rates. A state with many in-coming commuters may rely more on income taxes paid by those commuters than on the property taxes paid by local residents. Net exporters of commuters are more likely do the opposite. Individuals may find themselves paying a full income tax to one state alongside very high property taxes in another state; the combined burden of the two taxes may exceed the combined burden of

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See Brendan Bakala, *Chicago has some of the highest taxes on travelers in the nation*, ILL. POL'Y BLOG, Dec. 20, 2017, https://www.illinoispolicy.org/planes-trains-and-automobiles-chicagos-high-travel-taxes/ - :~:text=Chicago%20hotel%20guests%20pay%20a,and%20Exposition%20Authority%2C%20or%20MPEA. In New York City, the combined sales tax rate on restaurant food is 8.875%, *see* Daniel Barlow, *Restaurant Sales Tax NYC*, COOKING BLOG, https://www.tathrabeachcafe.com.au/restaurant/restaurant-sales-tax-nyc.html, while hotel transactions taxes amount to 15% plus $3.50 per day. *See Understanding Hotel Taxes, Resort Fees & Deposits for Incidentals*,YOUR MILEAGE MAY VARY, July 18, 2020, https://yourmileagemayvary.net/2020/07/18/understanding-hotel-prices-hotel-taxes-resort-fees-deposits-for-incidentals/ (aggregating applicable hotel taxes and fees). [this source also lists a number of jurisdictions imposing both regular sales taxes and tourist/resort taxes]

[223] Formalism plays a role, here. Many of these taxes by their terms apply to residents as well as nonresidents, which is enough (even though very few residents may engage in the activities subject to such taxes) to avoid the characterization of the tax as singling out nonresidents, which might lead to a dormant Commerce Clause or Privileges and Immunities claim.

[224] Indeed, the opposite is likely the case. [Find articles about tourist jurisdictions asking second home owners to stay away during pandemic to avoid crowding schools and hospitals].

[225] *See supra* TAN 199-200.

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property and income taxes paid by an otherwise identical taxpayer working and living in only one jurisdiction. From an economic perspective, such individuals are "double taxed" even though each tax is imposed only once.

Nor are such excess burdens limited to direct financial extractions by a state. A jurisdiction can also design its expenditures to, for example, provide benefits to certain groups while leaving others to finance services out of private money. [226] Again, there may be a disconnect between the appearance of "single taxation" and the actual burdens placed on multijurisdictional taxpayers. An optimist might believe in perfect markets, and insist that these subtle forms of duplicative taxation will be reflected in higher salaries and then in higher costs to employers who will relocate and in this way penalize the strategic state. But if there are efficiency reasons why employers are located in some places, if some locations provide employers or other taxpayers with "rents," strategic revenue extraction is both possible and perhaps even justifiable.

Some states may find themselves in the opposite position, of being forced to use a tax apportionment formula that increases taxes on a group they are trying to entice to operate in their jurisdiction. Politicians might prefer to adjust tax burdens through apportionment formulas than through transfer payments or tax abatements—or targeted tax or fee extractions. Voters may notice transfer payments and abatements when states use them to attract new businesses.[227] They

[226]*See* Dan T. Coenen & Walter Hellerstein, *Suspect Linkage: The Interplay of State Taxing and Spending Measures in the Application of Constitutional Antidiscrimination Rules*, 95 MICH. L. REV. 2167, 2167 (1997) (examining "n important and recurring question….whether taxing and spending measures should be viewed together when a state imposes a nondiscriminatory tax but also affords relief to some taxpayers through government spending").

[227] New York City voters certainly noticed the tax breaks offered to Amazon. *See supra* note 199 (political pressure forced New York to withdraw from proposed deal). The effectiveness (or not) of explicit development subsidies and tax abatements are widely studied. *See, e.g.*, Cailin Slattery & Owen Zidar, *Evaluating State and Local Business Incentives*, 34 J. ECON. PERSPECTIVES 90 (2020), at https://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.34.2.90; Katherine Loughead, *Illuminating the Hidden Costs of State Tax Incentives*, TAX FOUNDATION, July 22, 2021, at https://taxfoundation.org/state-tax-incentives-costs/; Louise Story, *As Companies Seek Tax Deals, Governments Pay High Price*, NYT, December 1, 2012, at https://www.nytimes.com/2012/12/02/us/how-local-taxpayers-bankroll-corporations.html

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are much less likely to notice a tax break hidden in the operation of a tax apportionment statute.[228] It is unlikely that many journalists or voters will ever notice that a business enterprise operating wholly within their state but selling its products worldwide pays income tax locally on only a small fraction of its income. They are more likely to notice the new jobs than the taxes that might have been captured under a different apportionment formula. Likewise, multistate businesses and individual taxpayers may find it easier to identify and attack narrowly focused revenue raising devices than more generally applicable (and thus apparently less singling out) taxes or other revenue raising devices. In short, by forcing jurisdictions to rely on funding instruments other than the income tax—funding instruments that are by definition their second choice—such attempts may decrease the efficiency of the entire revenue-raising enterprise while running the risk of political blow-back.[229]

The point is not that states are already doing these things, but that states have the ability to do so and thus to end run any future Congressional decision to eliminate duplicative taxation by taking away the states' power to apportion as they like, just as states enacted gross basis income taxes to

[228] This is a restatement of the oft-noted point that "tax benefits embedded in a standing code are more secure politically than, and thus preferable to, a direct appropriation…." Edward A. Zelinsky, *Are Tax "Benefits" Constitutionally Equivalent to Direct Expenditures?*, 112 HARV. L. REV. 379, 404 (1998).

[229] One can, of course, put a different spin on this argument. One can argue that state legislatures use apportionment formulas to hide tax favors to politically favored group from an unsuspecting public, undercutting possibilities of democratic accountability. Forcing such aid into more visible mechanisms thus might advance both political accountability and economic efficiency. *See supra* TAN 227 (criticisms of state tax subsidies and abatements). There are certainly numerous advocates of limiting the ability of states and localities to offer such incentives. *See, e.g.*, Slattery & Zidar, *supra* note 227, at 112 ("A prisoner's dilemma perspective in which every location acting in its own self-interest, leading to a suboptimal equilibrium for all, helps reveal why some policymakers have called for subsidy bans in the United States…and has led to bans on such subsidies within the European Union."); James R. Rogers, *The Effectiveness and Constitutionality of State Tax Incentive Policies: A Simple Game Theoretic Analysis*, 53 TAX LAWYER 431 (2000); Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, (1996); Philip P. Frickey, *The Congressional Process and the Constitutionality of Federal Legislation to End the Economic War Among the States*, THE REGION, June 1996, at 58; Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORN. L. REV. 789 (1996); Melvin L. Burstein & Arthur J. Rolnick, *Congress Should End the Economic War Among the States*, 10 ST. TAX NOTES 1895 (1996). The problem, of course, is distinguishing between "business development incentives" and other legislative decisions.

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end-run Pub. L. 86-272.[230] Once we define duplicative taxation broadly, and include revenue-raising schemes that lead to higher tax burdens on multi-jurisdictional taxpayers, compared to what would have been borne by operating and living in only one jurisdiction, much more would be required than merely mandating conformity in tax apportionment formulas and other source rules. Such rules are, in the end, just a small slice of the pie. Attempts to eliminate obviously duplicative taxation thus may be an exercise in public relations rather than an economically meaningful reform.

D. Conclusion

There is little doubt that obvious cases of duplicative taxation are on the rise, and with them, some measure of taxpayer discontent, not to mention taxpayer avoidance behavior. The question is what Congress can and should do about it. Congress has the power to provide some measure of uniformity in the apportionment of state corporate income taxes, and in the assignment of tax revenues from employee income. Whether the benefits of such uniformity are worth the inevitable political costs are another matter entirely. Past federal forays in the area have not been particularly successful. Virtually every tax expert regards the nexus limitation on mail order sales as misguided and ripe for repeal, and its earlier attempt to mandate a uniform UDITPA formula succeeded only in unifying states around a formula different from the one it had proposed.[231]

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230 *See supra* TAN 35-36. One of the mysteries of state and local tax law is why states did not attempt similar end-runs around the proscription of source state taxation of retirement income. There was certainly a good bit of discussion about the possibility of such behavior when the law was under consideration. *See* Amy Hamilton, *Pension Source Taxation Leading to 'Economic War Between the States,' Witness Tells Congress*, ST. TAX NOTES , July 3, 1995 (citing testimony of University of Georgia Law School professor James Smith); Carolyn Joy Lee, *Limitation on State Taxation of "Retirement Income"*, N.Y. ST. BAR ASSOC. TAX SEC. REP'T #854 p. iii (Nov. 9, 1995), at https://nysba.org/NYSBA/Sections/Tax/Tax Section Reports/Tax Reports 1995/No. 854 Letter on Limitation.pdf ("States to whom the eventual taxation of deferred income is important (now or in future) could legitimately avoid the exemption effects of the pension limitation be simply eliminating the deferral of tax on vested deferred compensation.") Instead, the predominant response seems to have been a general reduction in the taxation of such income.

231 Whether that different formula was an improvement on the Congressional proposal is unclear.

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Perhaps (if it decides to intervene at all) that should be its intent: to develop a sufficiently unacceptable rule to bring wandering state legislatures into agreement on a common formula and definition of factors. But the longevity of such an agreement, as the *Moorman* case shows, would be far from certain. As the last part of the Article argues, the apparent effects of uniformity and "fairness" may be just that. When states are determined to collect the "right" amount of revenues from their residents and workers and businesses, they can rely on a number of different fiscal tools.

All the same, obvious "double taxation" rankles in ways that less obvious burden shifting may not. Particularly in this political climate, appearances may matter more than substance and provide justification for greater apparent uniformity and the absence of explicit duplicative taxation. But the path to apparent uniformity will not be easy. States, like nations, continue to disagree over the proper split of tax revenues between market and origination jurisdictions. Even if, over time, the choice of formula and factor definitions can be undone by rearranging fiscal systems, the initial choices will determine which jurisdictions will be faced with the need to make such rearrangements. It is unlikely that any jurisdiction will willingly take on the burden of such political and other costs and uncertainties. Ultimately the question is whether the game is worth the candle.

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