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A Contract among States: Capturing Income of the World's Multijurisdictional Taxpayers

NATASHA N. VARYANI[†]

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ABSTRACT: Systems for managing multiple taxing jurisdictions in a larger group are working to keep up with the evolution of the modern multijurisdictional taxpayer. Recent decisions from the high courts of several states have brought attention to a meaningful tension in the goals of the Multistate Tax Compact, an agreement between states. Though the federal government has ruled that no congressional approval is necessary based on the Compact Clause of the U.S. Constitution, this agreement between states has taken its place as a significant accord among the vast majority of jurisdictions. Having operated as the most effective solution to the problems identified by Congress in the 1960's Willis Report, the Compact simultaneously disavows its binding authority and relies on States meet its goal of promoting uniformity in state tax administration. With billions of dollars of much needed tax revenue at issue, this article seeks to examine the intricacies of the legal principles applied to this contract among states while understanding its role in the modern economy, both within the United States and beyond.

KEYWORDS: *Multistate Tax Compact; Multi-Jurisdictional Tax; Apportionment; Compact Clause; State Tax.*

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Interstate commerce is a rich tax base.
It has, moreover, special political fascination.
A state or local tax levied upon it falls largely upon people in other states.
Here is a legislator's dream: a lush source of tax revenue,
the burden of which falls largely on those who cannot vote him out of office.[1]

1. MANAGING JURISDICTION IN AN EVOLVING ECONOMY

The way in which businesses conduct themselves across jurisdictional lines both globally and nationally has rapidly evolved alongside technology. The question of how to manage multiple taxing jurisdictions within a group has given rise to some tensions that arise from our form of government. From the inception of the United States,[2] courts and legislatures have grappled with the problem of creating a series of tax rules in various jurisdictions[3] that work together to create a fair, predictable and organized system that will result in the free flow of commerce between and among jurisdictions while appropriately compensating the relevant governments.[4] The European Union, despite many relevant distinctions, may glean some applicable principals about the tension between allowing each jurisdiction the independence to create and administer their own tax laws while seeking conformity with a larger system designed for a group of jurisdictions.

After the U.S. Supreme Court's 1959 ruling in *Northwestern States Portland Cement Co. v. Minnesota*, which held that net income of a foreign corporation may be taxed by a state if that tax is fairly apportioned, Congress commissioned a study which later became known as the "Willis Report" and passed P.L. 86-272. The legislation that was enacted was intended to be a "stopgap" measure until the question could be properly addressed recently

† Visiting Assistant Professor at Boston University School of Law. Special thanks to Leanne Scott, Michael Fatale, Kevin McGrath, and to Boston University Law School, without whose gracious support this article would not have been possible.

[1] Wallace Mendelson, *Epilogue* to FELIX FRANKFURTER, THE COMMERCE CLAUSE UNDER MARSHALL, TANEY AND WAITE 118 (Quadrangle Books 1964)(1937).
[2] *See* THE FEDERALIST NOS. 30-36 (Alexander Hamilton).: balancing authority to tax of individual states. *See also* U.S. CONST. amend. XIV, § 1. *See also* U.S. CONST. art. I, § 8, cl. 3
[3] The Commerce Clause grants authority to Congress to limit the ability of the individual states to impose a tax where such tax would be a burden on interstate commerce. The "Dormant" Commerce Clause has developed by judicial opinion and has become an accepted grant of authority to the Federal government to limit powers of individual states to tax even in the absence of Federal legislation.
[4] *See* U.S. Constitution Commerce Clause, see also International Harvester Co. v. Wis. Dep't of Taxation, 322 U.S. 435 (1944); Northwestern Cement Co. v. Minnesota, 358 U.S. 450 (1959); Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

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celebrated its fiftieth anniversary of being enacted. The specter of Federal Legislation to limit the rights of the States to impose led to the creation of the Multistate Tax Compact (hereinafter Compact), an agreement between and among states with the facially conflicting goals of promoting uniformity and state autonomy.[5] After the Supreme Court considered the authority of the Compact in the case of *U.S. Steel Corp. v. Multistate Tax Commission.*[6] and applied the law as it has stood since the 1960's, the economy has continued to evolve. Understanding the inherent tensions built into the issue, the Multistate Tax Commission (hereinafter Commission), created by the Compact,[7] has managed its Member States since its inception.

The feature of the Compact was the creation of the Model Apportionment Formula, which has influenced the division of income in every jurisdiction.[8] The Compact granted taxpayers of member states to use the state provided apportionment formula or to elect the formula contained in the Compact.[9] As technology pushes a more rapid evolution of the economy than ever, States and taxpayers are attempting to find ways to more efficiently apply existing rules within the bounds of constitutionality. Recent legislation at the highest levels in State courts has revealed a tension between the goals of uniformity and autonomy, and the role of the Compact has faced new constitutional challenges.[10] The Founding Fathers anticipated that the power to impose a tax was central in order to define the role and identity of various jurisdictions and has accordingly been considered by Congress, the Supreme Court and the States throughout this country's history.[11]

This article seeks to explore the applicability of those early principles in determining how to begin shaping a solution that will satisfy constitutional requirements and that is palatable to States and taxpayers alike. While the

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[5] Multistate Tax Compact (effective Aug. 4, 1967), *available at* http://www.mtc.gov/The-Commission/Multistate-Tax-Compact.
[6] *See generally* United States Steel Corp. v. Multistate Tax Comm'n 434 U.S. 452 (1978)
[7] *See* Multistate Tax Compact, art. VI (effective Aug. 4, 1967).
[8] *See* Multistate Tax Compact, art. IV (effective Aug. 4, 1967) (amended 2015).
[9] *See* Multistate Tax Compact, art. III (effective Aug. 4, 1967).
[10] *See infra* I.B.M. v. Department of Treasury, 496 Mich. 642; 852 N.W.2d 865 (2014); Gillette Co. et al. v. Franchise Tax Board, 196 Cal. Rptr. 3d 486 (2015); Kimberly Clark Co. v. Commissioner of Revenue, Minn., 880 N.W.2d 844 (2016)., et al.
[11] *See infra* Northwestern Cement Co. v. Minnesota, 358 U.S. 450 (1959), The Willis Report, United States Steel Corp. v. Multistate Tax Comm'n
434 U.S. 452 (1978) and supra note 10.

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tension between the Federal government and the States with regard to the power to tax has a long and complicated history, this article will seek to uncover only the parts of that story that may color our understanding of the narrow subject at hand, and conclude with an exploration of how States and Taxpayers might continue to refine the place of this agreement between states.

2. THE MULTISTATE TAX COMPACT

At the January 1966 meeting of the National Association of Tax Administrators, the idea of creating the Multistate Tax Commission was unanimously approved.[12] Created in 1967 by Article III of the Multistate Tax Compact, the Commission was created "as an effort by states to protect their tax authority in the face of [...] proposals to transfer the writing of key features of state tax law from the state legislature."[13] Today, the voting members that manage the Commission are tax officials from member states, who work to serve both state governments and taxpayers. The prevalence of the standards set by the Commission and the impact it has on the system of taxing multijurisdictional taxpayers reveals that it is the most successful solution to the problems identified in the Willis Report that this country has seen to date.

2.1 MISSION AND GOALS

Created by the Multistate Tax Compact, the Commission is charged with:

> "Facilitating the proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes; Promoting uniformity or compatibility in significant components of the tax systems; facilitating taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; and avoiding duplicate taxation."[14]

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[12] *See generally* EUGENE F. CORRIGAN, MULTISTATE TAX COMM'N, SECOND ANNUAL REPORT (1969),
[13] http://www.mtc.gov/The-Commission.
[14] Multistate Tax Compact, art. I (Original Model 1966), http://www.mtc.gov/getattachment/The-Commission/Multistate-Tax-Compact/Original-Model-Multistate-Tax-Compact.pdf.aspx.

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The stated objective of the Commission has been and is "to achieve and provide maximum uniformity in the administration of state taxes as they affect companies engaged in multistate business.".[15] In its early stages, the Commission believed that proposed federal legislation posed a "direct threat to the independent authority and political integrity of every state as a direct result of inevitable Federal dictation of state tax administration…"[16] and was charged with opposing such legislation, which it did successfully by providing an alternative solution in the form of the Compact. From the early stages of the organization, balancing the competing principles of uniformity and autonomy for states has been central to the purpose of the Commission, and that tension continues to underlie actions taken.

States quickly responded to the Willis Report and proposed Federal legislation regarding the regulation of interstate commerce through state tax. The Multistate Tax Compact became effective on August 4, 1967.[17] At the first organizational meeting, eleven states were represented and involved in conceiving the Compact, which by its terms, would be effective when it had seven member states.[18] As directed by those early members, States became members by enacting the Compact into the laws of their state. By December 31, 1968, fifteen states had passed legislation that enacted the Multistate Compact into state law, and by 1972, there were twenty-one member states.[19] By the early 1970's, the Compact had such an influence on State's tax policies, that multi-jurisdictional taxpayers challenged its validity in what has become a landmark case in the history of the Multistate Tax Commission. Gathering members to the compact is essential for its existence: in order for a uniform system to work, it is necessary for states to agree. The status of the relationship between members, however, and the extent to which the Compact binds states to that uniformity, is the question that State courts are visiting

[15] CORRIGAN, *supra* note 12, at 16.
[16] *Id.* 17.
[17] http://www.mtc.gov/getattachment/The-Commission/Multistate-Tax-Compact/About-the-Compact-and-Suggested-Enabling-Act.pdf.aspx.
[18] *See* S. ED TVEDEN, MULTISTATE TAX COMM'N, FIRST ANNUAL REPORT 3 (1968). The original states present were: Arkansas, Idaho, Illinois, Kansas, Missouri, Nebraska, Nevada, New Mexico, Oregon, Texas and Washington. An additional twenty-two states and the District of Columbia had present "discussion participants" at the organizational meeting.
[19] *Id.*, at 14. *See also* U.S. Steel Corp. v. Multistate Tax Commission, 434 U.S. 452 (1978).

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today. Preserving the autonomy of states and protecting their power to tax is as central to the goal of the Compact as is providing uniformity.

2.2 CONGRESSIONAL CONSENT AND THE AUTHORITY OF THE COMPACT

At the inception of the Compact, before even the first meeting of the members, creators were aware that it was necessary to examine the ways in which the agreement between states should be structured in order to achieve their purposes. Accordingly, a select committee was appointed to consider the question of whether the consent of Congress must be secured to make the Compact legally effective.[20] In its grant of congressional authority in what has come to be known as "The Compact Clause," the U.S. Constitution says that "No state shall, without the consent of Congress [...] enter into any Agreement or Compact with another state [...]".[21] The Commission noted the U.S. Supreme Court's interpretation that the intent of this particular provision was a "prohibition is directed to the formation of any combination tending to the increase of political power in the states, which may encroach upon or interfere with the just supremacy of the United States.".[22] The group noted that the Court has consistently held that only a small fraction of agreements entered between states require approval of Congress in the form of Federal Legislation.[23] Nevertheless, they sought to determine whether congressional approval was necessary both to determine whether public funds could be used in furtherance of the mission of the Compact and because three states had conditioned their membership on congressional approval in those early stages.[24] Congressional approval of a Compact results in it being considered both a contract and a federal law. Having the force of federal law allows access to federal courts, while those Compacts without congressional approval have

[20] *See* TVEDEN, *supra* note 18, at 3. There are a number of "Compacts" that exist in the United States currently, including the Interstate Civil Defense and Disaster Compact, which is operational in all fifty states; the Vehicle Equipment Safety Compact, enacted in forty-four states; the Interstate Compact on Juveniles, which is in force in forty-two states; and the Interstate Compact to Conserve Oil and gas, which is operational in thirty states.
[21] U.S. CONST., art. I, §10 cl. 3(Compact Clause).
[22] Virginia v. Tennessee, 148 U. S. 503 (1893). In this case the Court considered a boundary dispute between two states and in attempting to resolve the dispute by agreement between the two states, considered the Compact Clause.
[23] *See* TVEDEN, *supra* note 18, at 3.
[24] *Id.* Subsequently, those three states removed that conditional language and became members without congressional approval after the Special Committee concluded its legal analysis.

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the binding force of a contract.[25] It was clear that the question of congressional approval needed to be addressed.

In October of 1967, still in the initial stages of the Compact, a meeting was held in Washington D.C. for planning a response to the Willis Bills and further refining the proposed solution of the Multistate Tax Compact.[26] An important agenda item on that meeting was a presentation of the analysis of the special committee appointed to study the extent to which congressional approval was necessary.[27] The Committee chairman reported that "an analysis had been made of each article of the Compact to determine whether consent was needed for that part, and that since there was found no part for which congressional consent was needed, the Compact as a whole did not require such consent."[28] Despite this, however, the report encouraged obtaining congressional approval "because the Compact is of the type for which consent traditionally has been sought and obtained, and for policy reasons it would be desirable to have a declaration of the support of Congress for this cooperative state action."[29] This is an understandable position in the early days of the Compact, when the effort to attract member states to an enterprise must have required some showing of validity and importance. In the end, the Multistate Compact did not require the consent of Congress to demonstrate or achieve its goals. [30]

Approximately a decade later, the Supreme Court ruled directly on the validity of the Compact with regard to the language contained in Article I of the Constitution in *U.S. Steel Corporation v. Multistate Tax Commission*.[31] In 1972, there were twenty-one member states of the Multistate Tax Compact, which had received no form of approval from the federal Congress. On behalf of all multistate taxpayers that were subject to or threatened by audits of the

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[25] *See* Michael Herbert & Bryan Mayster, *The journey of the MTC's Joint Audit Program,* 69 ST. TAX NOTES 845 (2013).
[26] *Id.* at 3.
[27] *Id.* at 4 (Item 8).
[28] *Id.*
[29] *Id.*
[30] *See generally* Matthew Pincus, *When should Interstate Compacts Require Congressional Consent?*, 42 COLUM. J. OF L. AND SOC. PROBS., 511 (2009).
[31] *See generally* U.S. Steel Corp. v. Multistate Tax Commission, 434 U.S. 452 (1978). Justice Powell delivered the opinion of the court joined by Justices Burger, Brennan, Stewart, Marshall, Rehnquist and Stevens joined. Justice White delivered a dissenting opinion in which Justice Blackmun joined.

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Multistate Tax Commission, U.S. Steel Corporation brought this suit on three grounds: first, it challenged the validity of the Compact under Article I §10 of the U.S. Constitution as the Compact had not received congressional approval; second, it challenged that the Multistate Tax Compact was invalid because it was an unreasonable burden on interstate commerce; and third, it challenged that it violated the due process of multi-jurisdictional taxpayers as provided for in the Fourteenth Amendment to the Constitution.[32] In holding that the Multistate Tax Compact was not invalid under the standard set in *Virginia v. Tennessee*,[33] the Court articulated a modernized standard for when an agreement between states required congressional approval. As "encroaching on" or "interfering with the supremacy of the United States" was not the same concern in 1972 as it was in 1893, the update of this standard was a welcome addition to the Court's jurisprudence.

The first part of the Court's analysis focused on whether the agreement in question (the Multistate Tax Compact in the case at hand) enhanced the power of states "at the expense" of federal supremacy.[34] The majority decided that no power was granted to the states by the Compact that each state could not exercise by themselves, nor was there any delegation of sovereign power that was delegated by the M.T.C., so agreement could not be categorized as an impermissible grant of power that the Compact Clause was designed to protect against. In addition, the Court noted that participation in the Multistate Tax Compact was voluntary and that each state maintained the power to adopt or reject any regulations of the M.T.C., or to withdraw entirely at any time.[35]

In considering the argument that activities of the Multistate Tax Commission placed an unreasonable burden on interstate commerce and encroached on federal authority in doing so, the Court also rejected that argument on the grounds that there was no procedure or requirement that the

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[32] *Id.* As the third argument of the taxpayers related to Due Process was held to be "irrelevant to the facial validity of the Compact" this argument is beyond the scope of this article.
[33] *Supra* the standard set forth in the late 19th century by this case concerned itself with whether the agreement between states increased the political power of the states such that it threatened, encroached or interfered with the supremacy of the Federal government.
[34] *See U.S. Steel Corp.*, 434 U.S. at 472.
[35] *Id.* at 473-474.

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M.T.C. granted that any individual state could not enact on its own.[36] Further, the court held, if it was conceded that there was some "enhancement" in the power of states, it was not at the expense of Federal authority.[37] Since this decision was promulgated in 1978, the Multistate Tax Compact has enjoyed confidence that their endeavor is safely within the bounds of the U.S. Constitution. The question of the extent to which the member states are bound to one another, however, was beyond the scope of the Court, and is being addressed by States today.

2.3 ARTICLES III AND IV: ELECTION AND THREE FACTOR APPORTIONMENT

As the purpose of the Multistate Tax Compact is to deal with taxpayers that conduct business in more than one state, its primary feature can be found in Article IV, entitled "Division of Income". [38] This was created in response to the legislation that came out of the Willis Committee which used the factors of property and payroll to divide the income of multi-jurisdictional taxpayers. The major distinction between those proposals and the formula contained in the Compact today is the addition of the Sales Factor, which allows taxpayers to consider where their sales are made in dividing their income in addition to just whether their property and payroll are located.

The Three-Factor Apportionment system outlined in Article IV, if not in its pure form, is the base of a great many state laws for taxation of multi-jurisdictional corporate taxpayers. In short, it outlines a formula that averages three rations: that of property in state to property everywhere; payroll in state to payroll everywhere; and finally sales in state to sales everywhere[39]. The average of those three ratios is taken to determine the percentage of income of the taxpayer that should be "apportioned" to and therefore subject to the tax of that particular jurisdiction. It can be illustrated as follows:

(See Table in the next page)

[36] *Id.* at 473-478.
[37] *Id.*
[38] *See* Multistate Tax Compact, art. IV (effective Aug. 4, 1967) (amended 2015), http://www.mtc.gov/The-Commission/Multistate-Tax-Compact.
[39] *Id.*

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Table 1

Property Factor	**Payroll Factor**	**Sales Factor**		**Apportionment**
Property in State	Payroll in State	Sales in State	Total ÷ 3	Average In State
Total Property	Total Payroll	Total Sales	Total ÷ 3	Average Everywhere

Though each factor is nuanced in its application,[40] his general formula was designed by the Multistate Tax Compact both to respond to the proposals contained in the legislation introduced from the Willis Committee and to address the lack of uniformity among the various state apportionment schemes.[41]

The Compact allows taxpayers in member states that are subject to a net income tax in other member states to elect the formula contained in Article IV. When States enact the entire Compact, it includes this provision that allows taxpayers to choose what may be an alternative apportionment formula. It is for states to manage the remaining alternatives for apportioning income in their statutes.

2.4 MODERN USE OF THE MULTISTATE TAX COMPACT

From the time of its creation to current day, the apportionment formula contained in Article IV of the Compact has, indeed, addressed the lack of uniformity in state tax laws and improved the administrative burden for multistate taxpayers while strengthening the system of collecting revenues for states. As was anticipated by Alexander Hamilton, courts, legal scholars, legislators, drafters of the Multistate Tax Compact and members of the Multistate Tax Commission, a common thread of balancing the usefulness of uniformity of states laws with the autonomy of states has been and continues to be present in the evolution of the application of these rules.[42] The usefulness of the Compact, and indeed the Commission that it created, is rooted in the faith and agreement given to it by member states. Despite the

[40] *See* Multistate Tax Compact, art. III (effective Aug. 4, 1967).
[41] *See* EUGENE F. CARRIGAN, MULTISTATE TAX COMM'N, THIRD ANNUAL REPORT 2 (1970), http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Resources/Archives/Annual_Reports/FY69-70.pdf.
[42] *Supra*.

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encouragement of early members to gain congressional approval in order to strengthen validity and force, the fact that the Compact does not have the force of Federal law has come to be an important attribute to the way that it is currently used both by member states and well as multijurisdictional taxpayers.

In order to understand the role of the Compact and the Commission among member states, it is important to understand the mechanics of membership. Membership to the Multistate Tax Commission has evolved. Today, there are different types of members: Compact Members, Sovereignty Members, Associate Members and Project Members.[43] Fifteen states[44] and the District of Columbia are Compact Members, which is defined as states (as represented by Commissioners or head of those agencies that administer corporate tax) that have enacted the Multistate Tax Compact into their state law.[45] These states are charged with and have the authority to govern the Commission created by the Compact.[46] Seven states[47] are Sovereignty Members i.e. those that provide financial support for and general participation in the activities of the Commission.[48] Though these members may participate in shaping in the tax policy and administration efforts of the Commission, they are not governing members. Lastly, there are twenty-six states[49] that are Associate and Project Members, which participate in meetings of the Commission, consult and cooperate with the Commission and other member states.

In total, forty-eight states are in some form members of the Multistate Tax Compact which holds itself out to be a body with no regulatory authority. The Commission views the Compact or any part of it, including the formula

[43] *See* http://www.mtc.gov/The-Commission/Member-States.
[44] Alabama, Alaska, Arkansas, Colorado, Hawaii, Idaho, Kansas, Missouri, Montana, New Mexico, North Dakota, Oregon, Texas, Utah and Washington.
[45] *See* http://www.mtc.gov/The-Commission/Member-States.
[46] *Id.*
[47] Georgia, Kentucky, Louisiana, Michigan, Minnesota, New Jersey and West Virginia.
[48] *See* http://www.mtc.gov/The-Commission/Member-States.
[49] Arizona, California (Franchise Tax Board and Sales Tax Board), Connecticut, Delaware, Florida, Illinois, Indiana, Iowa, Maine, Maryland, Massachusetts, Mississippi, Nebraska, New Hampshire, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, Wisconsin and Wyoming.

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contained in Article IV as a model rule.[50] While state legislatures may choose to enact or modify any or all parts of the Compact, no such changes will alter the Compact itself. In other words, while states are free to enact whatever apportionment formula they wish, they are not free to modify the Compact itself.[51] Indeed, member states have modified the versions of the Compact's apportionment formula that are enacted and applied to multi-state taxpayers. Not only do various states offer alterations to three factor apportionment, but a single state may allow different types of taxpayers to use varied methods of apportionment.[52] The freedom to tailor and modify an apportionment formula is a right that has been protected through the history of the United States. States are vested in preserving their right to create a tax scheme that is consistent with the culture and goals of the state, so long as they can be considered "fairly apportioned" by the standards set forth in Northwestern States Portland Cement Co. v. Minnesota.[53] In the modern economy, the ability to create a system of corporate tax that may provide an incentive for large, multistate taxpayers to establish a presence in a state is an important tool for states to manage both their revenues and the general economic health of the state and its residents. While the goal of uniformity that the Multistate Tax Compact has come a long way to achieving it is a worthy one for administration of corporate tax filings, the protection of a state's right to choose is an equally important goal. As rapidly changing technology has a significant impact on all three of the apportionment factors,[54] states and taxpayers are increasingly seeking ways to manage the amount of tax paid. Most recently, large multi-jurisdictional corporate taxpayers have taken to questioning the role of the Compact in light of the decision in *U.S. Steel Co. v. M.T.C.* Taxpayers are seeking to rely on their ability to select an apportionment

[50] The three factor apportionment formula contained in Article IV is very similar to the one contained in the Uniform Division of Income for Tax Purposes Act ("U.D.I.T.P.A.") which was drafted by the National Conference of Commissioners on Uniform State Laws. *See* Uniform Division of Income for Tax Purposes Act, §§ 1-18 (Proposed Official Draft 1957) (comments amended 1966), available at http://www.uniformlaws.org/shared/docs/uditpa/uditpa66.pdf.
[51] *See* Herbert & Mayster, *supra* note 25.
[52] Some common alterations to the apportionment formula include "Double Weighted Sales" in which the sales factor is counted twice in the apportionment formula, and "Single Sales Factor" in which neither the property nor payroll factor are considered.
[53] *Supra*.
[54] Electronic commerce and the rise of digital goods has changed the fundamental nature of a sales factor and has encouraged a recent proposed amendment to the "sourcing" of sales. In addition, the question of where intangible property is "used" and where employees work are also becoming increasingly complex.

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formula that optimizes their tax liability based on the status and validity of the Compact as a multi-lateral contract among states.

In 2015, the Multistate Tax Commission passed a resolution modifying the Compact to allow the adopting member state to use, instead of the previous three factors apportionment formula, any apportionment method the state sees fit.[55] The motivation underlying this amendment as well as the potential ramifications are best considered after a review of some recent state case law on the subject of the election provision contained in Article III of the Compact.

3. STATE COURTS RESPOND TO TAXPAYER ELECTIONS

Recently, large multi-jurisdictional corporate taxpayers have taken to questioning the role of the Compact. Taxpayers are seeking to rely on their ability to select an apportionment formula that optimizes their tax liability based on the status and validity of the Compact as a multi-lateral contract among states. Three major decisions made by the highest state courts have been published on this topic beginning in July of 2014 with *International Business Machines Corp. v. Department of the Treasury*[56] decided in the Michigan Supreme Court. Subsequently, on December 31, 2015, the California Supreme Court published an opinion in the matter of *The Gillette Company (with five other plaintiffs) v. Franchise Tax Board*.[57] Most recently, on June 22, 2016, the Supreme Court of Minnesota weighed in on the matter of in the decision of *Kimberly-Clark Corporation & Subsidiaries v. the Commissioner of Revenue*.[58] Though similar cases are pending in other states, this article will focus on these three as seen through the lens of the tensions, principles and actions that have brought us to this point, and will conclude with a brief exploration of a few of the most likely potential outcomes in this area of litigation.

[55] *See* Multistate Tax Compact, art. IV, § 9 (as revised on Jul. 29, 2015).
[56] *See* I.B.M. v. Department of Treasury, 496, Mich. 642 (2014).
[57] *See* Gillette Co. v. Franchise Tax Bd., No. S206587, JUSTIA US Law (Cal. Dec. 31, 2015).
[58] *See* Kimberly-Clark Corp. v. Comm'r of Revenue, LexisNexis, No. A15-1322 (Minn. Jun. 22, 2016).

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3.1 I.B.M. IN MICHIGAN

The central question in this case was whether the taxpayer, International Business Machines, Corp. ("I.B.M.") which had had business operations and revenue in a number of different states, was entitled to elect the three factor apportionment formula contained in the Multistate Tax Compact[59] instead of using the single sales factor apportionment formula codified into Michigan's law.[60] Central to this question is whether Michigan's enacted Business Tax Act (hereinafter B.T.A.),[61] which contained an apportionment formula distinct from the Compact's three factor formula, served to ***implicitly*** repeal the election to be a part of the Multistate Tax Compact (emphasis added). In order to fully understand the ways in which Michigan's membership in the Compact related to the enacted B.T.A. and the impact of that on taxpayers, it is important to briefly review the history of corporate tax statutes in Michigan, as well as its membership to the Multistate Tax Compact.

After adopting its first corporate income tax three years earlier,[62] Michigan became a member of the Multistate Tax Compact in 1970[63] recognizing that traditional tax administration was inefficient and burdensome to both states and taxpayers. In joining the Compact, Michigan included those provisions that were required to be enacted in order to become a member state. In 1976, Michigan replaced the corporate income tax with the Single Business Tax Act, which taxed activity instead of income and functioned as a "value added tax" instead of the more traditional income tax that it replaced.[64] In enacting the Single Business Tax Act, the Legislature expressly amended or

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[59] I.B.M. used the election provision contained in Article III of the Multistate Tax Compact that was codified into Michigan Law at MCL 205.581, which states that a taxpayer may use the three factor apportionment formula contained in Article IV of the Compact, or "may elect to apportion and allocate his income in the matter provided by the laws of such state ... without reference to the Compact..." Multistate Tax Compact of 1969, Pub. Act No. 343, art. III (codified as amended in MICH. COMP. LAWS § 205.581(2014)).
[60] *See generally I.B.M,* 496 Mich., 642.
[61] *See* Michigan Business Tax Act of 2007, Pub. Act No. 36, MICH. COMP. LAWS §§ 208.1101-208.1601 (*repealed* by Act of 2011, Pub. Act No 39).
[62] The Income Tax Act of 1967, Pub. Act No. 281 (codified as amended in MICH. COMP. LAWS § 206.61 (2014)) was measured by net income activities of the taxpayer.
[63] *See* Multistate Tax Compact of 1969, Pub. Act No. 343 (codified as amended in MICH. COMP. LAWS §§ 205.581-205.589 (2014)).
[64] *See* Single Business Tax Act of 1975, Pub. Act No 228, MICH. COMP. LAWS §§ 208.1- 208.145 (*repealed* by Act of 2002, Pub. Act. No 531).

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repealed the provisions of the prior tax to the extent that was in conflict, but did not expressly repeal the Multistate Tax Compact.[65]

In 2008, the Michigan Legislature enacted the Business Tax Act, and in doing so, expressly repealed the Single Business Tax Act but again did not expressly repeal the Compact.[66] The B.T.A., the statute in effect during the tax periods at issue in this case, was in effect only until January 1, 2012, when Michigan expressly repealed the B.T.A. and returned to a Corporate Income Tax. From the time that Michigan has imposed a tax on business, it has always required the apportionment of income for multi-jurisdictional taxpayers in order to keep from violating the limits of the U.S. Constitution.[67] Another consistency in the system of corporate taxation in Michigan has been the presence of the Compact on the statutes. From the time that it was enacted through the tax periods at issue, through repeals of prior and inconsistent tax statutes, the Compact has remained in effect.[68] Since the Compact was not expressly repealed in 2008, the Michigan Supreme Court was charged with deciding whether the Compact's election provision was repealed by implication when the B.T.A. was put into effect. The majority decided that there was no repeal by implication because it can be read in pari materia[69] the B.T.A. and prior tax statutes with which the Compact has coexisted. Accordingly, I.B.M. maintained the right to elect to use the three factor apportionment formula instead of the sales factor apportionment outlined with apparently mandatory language in the B.T.A..[70]

In 2011, the Michigan legislature expressly amended the provision of the enacted Compact that allowed taxpayers to elect to use the three factor apportionment formula contained in Article IV of the Compact and required taxpayers to use the apportionment formula contained in the B.T.A..[71] This

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[65] *See* Income Tax Act of 1967, Pub. Act No. 281, Mich. Comp. Laws §§ 206.61-206.81 (repealed by Act of 1975, Pub. Act No 233).

[66] *See* Michigan Business Tax Act of 2007, Pub. Act No 36, MICH. COMP. LAWS §§ 208.1101, 208.1201 (*repealed* by Act of 2011, Pub. Act No 39).

[67] *Supra*; *see also* Malpass v. Department of Treasury, 494, Michi., 237 (2013).

[68] *See* I.B.M. v. Department of Treasury, 496, Mich. 642 (2014) at 7.

[69] A designation that applies to statutes that were enacted at different times but apply to the same subject matter.

[70] *Id.*

[71] *See* Multistate Tax Compact of 1969, Pub. Act No. 343, § 1 (codified as amended in MICH. COMP. LAWS § 205.581 (2014)).

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amendment to the statute was made retroactive and applied beginning January 1, 2011.[72] The Michigan Supreme court, in its holding, recognized that the "Legislature could have – but did not – extend this retroactive repeal to the start date of the B.T.A.".[73] The court held that by repealing the election provision of the Compact to the beginning of the year instead of to the effective date of the B.T.A., "it created a window in which it did not expressly preclude use of the Compact's election provision for B.T.A. taxpayers.".[74] Based on this reasoning, the majority of the Court did not reach the issue of whether the Multistate Tax Compact was a binding contract between and among states.[75]

In response to this ruling, on September 11, 2014, the Michigan Legislature once again repealed the election provision contained in the Compact as codified in Michigan law, but did so back to the effective date of the B.T.A..[76] Though taxpayers have challenged this retroactive repeal of the election on constitutional grounds, the Michigan Courts have held the legislature's appeal to be effective and have denied taxpayers appeals. On September 29, 2015 the Michigan Appellate Court upheld the state's retroactive repeal of its membership in the Multistate Tax Compact, holding that the Compact was not a binding contract under state law and retroactive repeal did not violate state or federal contract clauses. The court also held that the retroactive repeal did not violate state or federal due process clauses on a number of grounds, including the determination that taxpayers did not have a vested right in the state's tax laws. In that decision, the Appeals court held that the Multistate Tax Compact was an advisory agreement, not a binding compact or a contract, and accordingly, removal from the Compact was not prohibited by its terms. Most recently in June of 2016, the Michigan Supreme Court declined to review the Appeals Court decision that consolidated claims of over

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[72] *Id.*
[73] *I.B.M.*, 496 Mich. at 16.
[74] *Id.*, 17.
[75] The Concurring opinion in this case agreed that I.B.M. was entitled to use the Compact's apportionment formula, and that the tax base at issue was an income tax, but said it would not have reached the question of whether there was a repeal by implication. The dissenting opinion in this case understood an "unambiguous directive" from the state legislature. The majority read the dissent's argument as "tantalizingly simple" but countered that it relied on a reading of the B.T.A. without regard to similar statutes or context.
[76] *See* Act of Sep. 12, 2014, Pub. Act No. 242 (repealing MICH. COMP. LAWS §§ 205.581-205.589 (2008)).

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fifty multijurisdictional taxpayers.[77] A dissent was filed with the refusal opining that the constitutional issues raised by the taxpayers should be heard by the Court. Though taxpayers have exhausted their options in Michigan courts, a writ of certiorari may be filed by taxpayers with the U.S. Supreme Court.

3.2 GILLETTE IN CALIFORNIA

California became a member state of the Compact in 1974 when it enacted the entire text of the Compact in its statutes.[78] At the time, the law that existed prior to California becoming a member state was identical to the formula contained in the Compact. In 1993 the California Legislature adopted a new apportionment formula[79] which, since the first time since becoming a member state, varied from the Compact formula.[80] The legislation passed in 1993 did not in modify or amend the election provision set forth in the Compact, or the apportionment formula contained therein, nor did it in any way change the member status of California to the Compact. In this appeal, Gillette and five other multijurisdictional entities sought to establish that the Legislature is bound to permit the taxpayer to choose the three factor apportionment formula contained in the compact, notwithstanding the existence of a different apportionment formula contained elsewhere in the corporate tax code.[81]

In its decision, the California Supreme Court does not reach the issue of whether the Compact takes precedence over State law because of its holding that the Compact is NOT a binding contract among member states.[82] In its analysis, the court takes into account the Multistate Tax Commission's view of the Compact that it is not binding but an "advisory compact [....] which is more

[77] *See* Gillette Commercial Operations North America & Subsidiaries v. Department of Treasury, No. 152588(Jun.24, 2016), http://publicdocs.courts.mi.gov:81/SCT/PUBLIC/ORDERS/152588_97_01.pdf.
[78] *See* 1974 Cal. Stat., ch. 93, § 3, at 193.
[79] A "double weighted sales" apportionment formula, in which the sales factor accounts for half of the apportionment formula.
[80] *See* CAL. REV. & TAX. CODE §25128 (West 1992), *amended by* 1993 Cal. Stat. 5441, § 1.
[81] *See Gillette Co. et al.* v. Franchise Tax Board, 196 Cal. Rptr. 3d 486 (2015), at 7-8.
[82] *Id.*, at 8-9.

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in the nature of model uniform laws.”.[83] As the taxpayers point out, the Compact’s fundamental goal of uniformity distinguishes the Compact somewhat from a model law. Though both can be enacted and repealed according to the will of the legislature, the Compact’s fundamental purpose of uniformity can only be achieved if a critical number of member states use its provisions, and that “member states commitment to the U.D.I.T.P.A. [Compact] formula” is what prevented congressional intervention, the specter of which gave rise to the compact in the first place.[84]

The court considers the origins of the Compact, and distinguishes the status of state laws at the time of the creation of the Compact from present day, and separates that wholly from the question of whether the Compact creates any reciprocal binding obligation among members. Whether or not the goal of uniformity is better served if more states enact the formula is a separate question from whether or not a binding, multi-lateral contract has been created. The court finds no evidence of the creation of such contract. After a brief discussion of how the amendment of the corporate tax does not violate the “Reenactment Rule” in California,[85] the Court goes on to conclude that the Legislature had both the authority and intent to eliminate the Compact’s election provision. Though the authority is clear from a review of the state constitution which gives broad and plenary authority to the legislature when it comes to the powers of taxation,[86] it relies both on the mandatory nature of the language in the statute as enacted—as well as the legislative history that

[83] *Id.*, at 9. The M.T.C. relies on the factors set forth in Northeast Bancorp v. Board of Governors, 472 U.S. 159, which, after the holding in *U.S. Steel v. M.T.C.*, identified the “classic indicia” of a Compact, including the establishment of a body to regulate, no conditioning of action on another state, and that each state is free to modify or repeal its law unilaterally. Though arguably the Multistate Tax Commission can be viewed as a body, there has been some discussion among scholars about the level of regulatory authority the Commission exerts, in particular with regard to its joint audit program. While no action is conditioned upon the action of another member state, the entire goal of uniformity, while not requiring any specific action, rests on the assumption that some critical number of states will agree to standardize at least terms, if not formulas. The last indicator is the strongest and best argument in favor of the state that the Compact itself is designed to allow states to modify and appeal any provisions at any time and therefore functions more like a model law than a binding contract between states.

[84] *See Gillette Co. et al.*, 196 Cal. Rptr. 3d at 11.

[85] A procedural rule designed to ‘make sure legislators are not operating in the blind when they amend legislation and to make sure the public can become apprised of changes in the law’. *See* Gillette at 17-18 citing St John’s Well Child and Family center v. Schwarzenegger, 50 Cal 4th. 960 and Hellman v. Shoulters, 114 Cal. 136 at 152.

[86] *Id.*, at 8, 18.

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indicates a preference to require taxpayers to use the new apportionment formula.[87]

3.3 KIMBERLY – CLARK IN MINNESOTA

In Minnesota, the Supreme Court considered whether the state's membership in the Compact bound it to make available to taxpayers the three-factor apportionment formula contained in Article IV despite having repealed Articles III and IV of the Compact.[88] During the tax years at issue the parties agreed that taxpayers, when apportioning their income, had the option to (1) use the formula set forth in the Minnesota statute[89] or (2) to petition the Commissioner to permit the use of an alternative formula. Kimberly-Clark~~,~~ argued that there was a third option: to use the apportionment formula contained in the Multistate Tax Compact that was enacted in Minnesota's statute in 1983, but repealed in 1987.[90] Despite the repeal of the section of the Compact that contained the apportionment formula, Kimberly-Clark argued that the election provision that was enacted in 1983 (and repealed in 1987) was part of a binding multi-state compact and accordingly, Minnesota was obligated to make that formula available to taxpayers until it fully withdrew from the Compact.[91] Kimberly-Clark contends that by enacting the Compact and becoming a member state, Minnesota relinquished a bit of its autonomy "in order to benefit from the collective action of multiple states" and that, by enacting the Compact in 1983, Minnesota created a binding obligation that would only be terminated by a complete withdrawal from the Compact.[92]

Minnesota Supreme Court held that there was no commitment binding Minnesota that was violated when the election provision was repealed. The Court based its holding on the grounds that the Compact was enacted into the Minnesota code and the Legislature had the authority and intent to amend it without violating any agreement that the State had entered when it became a member. The Multistate Tax Commission holds itself out to be advisory and

[87] *See Gillette Co. et al.*, 196 Cal. Rptr. 3d, at 19.
[88] *See* Kimberly Clark Co. v. Commissioner of Revenue, Minn., 880 N.W.2d 844 (2016).
[89] *See* MINN. STAT. §290.191(2) (2008).
[90] *See Kimberly-Clark* , Minn., 880 at 5.
[91] *Id.*, at 5. Minnesota repealed the remaining provisions of the Compact from its statues in 2013, after the tax periods at issue in this case.
[92] *Id.*, at 10.

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non-binding in nature, and prides itself on allowing the states to modify and repeal the provisions of the Compact at will.

The Minnesota Court further held that even if Minnesota did enter into a binding agreement when enacting the Compact, the Legislature did not and could not relinquish any of its authority on the subject of tax.[93] The Minnesota Constitution states that the "power of taxation shall never be surrendered, suspended or contracted away.".[94] Lastly, the Court considers the function of the "unmistakeability doctrine" to support the finding that the legislature gave up no authority when becoming a member of the Compact, and acted within the scope of its power in repealing Sections II and IV of the Compact. Under this doctrine, sovereign powers remain intact unless relinquished in unmistakable terms. The court found no clear indication that the Legislature intended to relinquish any authority to amend the system of taxation when becoming members of the Compact. In holding for the Commissioner that the taxpayer did not have the option to elect the apportionment formula in the Compact, the Court relied on federal and state constitutional principles, state legislative history and construction, and a very particular evolution of the corporate tax statutes.[95]

3.4 AMICI CURIÆ AND OTHER STAKEHOLDERS

The Multistate Tax Commission (created by Article VI of the Compact) has filed Amicus briefs in the three above mentioned cases as well as others in the country.[96] Decisions in Oregon and Texas have also supported the position of the State and the Multistate Tax Commission though on grounds specific to each jurisdiction.[97] The Multistate Tax Commission has maintained the

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[93] *Id.,* at 11.
[94] *Kimberly-Clark* , Minn., 880 at 11 citing Minn. Const. art X § 1.
[95] Kimberly-Clark has sixty days from the date of decision to file a motion for reconsideration to the Minnesota Supreme Court. At the date of submission of this article, Kimberly-Clark has not filed such a motion, but sixty days from the filing of the opinion have not passed.
[96] Other cases include Health Net, Inc. & Subsidiaries v. Department of Revenue, T.C. 5127, Or. Tax Sept. 9, 2015) which held that the Legislature in Oregon "effectively disabled" the taxpayer from making the election to use the three factor apportionment formula contained in the Compact. This case is currently being reviewed by the Oregon Supreme Court which selected it for direct appellate review; *see also* Graphic Packaging Corp. v. Comptroller, Tx App. Ct., 3d Dist. No. 03-14-00197-CV (July 28, 2015) in which the court ruled that the Texas Franchise tax was not an income tax pursuant to the definition in the Compact, and so the taxpayer was unable to elect to use the M.T.C.'s apportionment formula.
[97] *Id.*

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position that it is a non-biding Compact, and its member states are free to amend and repeal the Compact at will. While on first blush it may seem antithetical for the Commission to argue that it lacks authority, but when its twin goals of uniformity and autonomy are considered, the logic of the position is revealed. The balance of promoting uniform state laws while preserving the rights and powers of the states is a difficult one to strike. Though the system among states created by the Compact is constantly growing and adjusting along with the economy, the mission and purpose of the M.T.C. conceived in 1967 has been fulfilled. The issues identified by the Willis report are no longer present, taxpayers not only respect and comply with multiple taxing jurisdictions, but there is also a respect for the law that is consistent.

The Council on State Taxation (hereinafter C.O.S.T.) has also filed a number of Amicus briefs in support of the taxpayers on this issue, and argued state by state that taxpayers have the right to elect the apportionment formula. Whether based on constitutional principles, theories of Contract law, or the history of the M.T.C. legislation in state, C.O.S.T., in representing large multijurisdictional taxpayers, argues for the strength of authority of the M.T.C. in order to protect the right to elect the optimal apportionment formula.

4. THE FUTURE OF THE MULTISTATE TAX COMPACT

The revenue impact of these decisions alone is sufficient to result in continuing efforts on both sides to shape the issue. While taxpayers are more anxious than ever to lower their effective tax rates, states, after years of budget shortfalls, are equally concerned about collecting sufficient revenue to maintain operating budgets. The Supreme Court is unlikely to grant a writ of certiorari to on the Gillette case.[98] Though the U.S. Supreme Court would be the proper arbiter of the constitutional issues at stake, including interpretation of the Commerce Clause, Due Process Clause and agreements among states, the holdings across states and response of state legislatures may lead the Court to decline to review the issue on the grounds that the system is

[98] The petition for writ of certiorari in Gillette was filed on May 27, 2016 and placed on the docket May 31, 2016 as No. 15-1442.

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continuing to function. It may rely on its precedent in U.S. Steel Corp v. Multistate Tax Compact and allow State courts to continue to apply the principles contained therein. Federal intervention in the form of legislation seems even less likely than action by the courts. In a time of historically low productivity from the federal senate, with unprecedented partisan divide, neither chamber is likely to take up a tax matter that will not result in any revenue for the federal government.

Given the slim prospect of federal intervention, and the nature of the question as it currently exists, this issue should be resolved by the States. The decision about the extent to which each state is bound to the Compact is not a large question for the Commission, but depends on the specific history of each state. The Commission has plainly articulated its intent to be non-binding. Yet the success of the entire endeavor that began in response to the Willis report depends on the willingness of the States to work with one another in a committed, if not binding way.

Stakeholders in this debate, including large multi-jurisdictional taxpayers, state courts and legislatures, each have a distinct and substantial way of impacting policymakers. The leadership of the Multistate Tax Commission is made up of Commissioners of Revenue and other high-ranking figures in the tax administration of each state, which results in an alignment of the goals of the states and the Commission.[99] The goal of autonomy for states remains a fundamental tenant for the Commission, and each state seeks to optimize its revenue position for its citizens. Some jurisdictions attempt to optimize their revenues by creating a system of tax that attracts large, multijurisdictional taxpayers, while others seek to maximize revenue from those taxpayers that operate in state. It is the ability to make this choice in the context of all the other variables considered by states that is the heart of the reason for maintaining autonomy, and not far from what Hamilton predicted in the Federalist Papers.

On the other hand, it is notable that all of the states that have found the Compact not to be binding on the states hold elections for judges in the highest

[99] *See Multistate Tax Commission, Commission Officers & Executive Committee Members (2016-2017)*, http://www.mtc.gov/The-Commission/Officers-Executive-Committee.

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state courts.[100] Despite the distinction between politics and policymaking, those taxpayers with the most at stake may also have the resources and capability to exert political influence on policymakers – both in the legislatures as well as state courts. As Oregon and other states continue to grapple with the legal history on this issue and the intricacies of the laws as enacted and applied in each state, this debate will be one that has the potential to shift. Taking a long view through the lens of history at this agreement between states, the Multistate Tax Compact, shows past success in managing goals, but may also demonstrate the need for some adjustment of course.

[100] *See, e.g.*, American Bar, Fact Sheet Judicial Selection Methods in the States (Dec. 2016), http://www.americanbar.org/content/dam/aba/migrated/leadership/fact_sheet.authcheckdam.pdf