
Current and Quotable

Explanation of the Multistate Tax Commission's Proposed Factor Presence Nexus Standard

by Dan Bucks and Frank Katz

Dan Bucks is executive director and Frank Katz is chief counsel with the Multistate Tax Commission (MTC). They explain the MTC's proposed factor presence nexus standard (see p. 1035).

The Multistate Tax Commission has been in the process of developing a uniform, fair, simple, certain, and constitutional standard of jurisdiction for state imposition of apportioned business activity taxes. The Commission has based its work on the insights of Professor Charles E. McLure Jr. of the Stanford University Hoover Institute delineating the obvious correspondence between the states *in* which a company is “doing business” and the states *to* which its income is apportioned. The Commission has also benefited from many helpful comments at several public hearings and continues to refine the proposal.

The proposal contains four essential provisions: (1) establishing the standard that finds nexus where a taxpayer has a threshold dollar amount in the state of any one of the familiar apportionment factors of property, payroll, or sales, (2) setting threshold levels, (3) defining property, payroll, and sales, and (4) aggregating property, payroll, and sales of unitary business entities to measure against thresholds. In addition there is a provision that explains the effect of Pub. L. 86-272.

The first section has two subsections. The first recognizes the traditional bases for nexus — residence of an individual and the organization or commercial domicile of a business. Subsection two sets out the factor presence nexus standard for out-of-state businesses — a dollar amount of property, payroll, or sales exceeding stated thresholds.

The second section sets the thresholds of \$50,000 of property, or \$50,000 of payroll, or \$500,000 of sales, or 25 percent of total property, of total payroll, or of total sales. It provides a mechanism for regular cost-of-living adjustments.

The third section defines property, payroll, and sales for nexus purposes. The definition of property and payroll are identical to the apportionment definitions under UDITPA, requiring no additional bookkeeping burden on taxpayers. The definition of sales varies from the UDITPA definition in the same way that a number of states have already varied their apportionment definition from UDITPA — to be entirely destination based. The sales definition corresponds to the sourcing rules from the Streamlined Sales Tax Project, which should again mean that the taxpayer will have already developed the

data necessary to make the nexus determination at the time of sale. The nexus determination itself will generally be easy. Only a few companies will cluster around the threshold amount of \$500,000. Most will be way above or way below, alleviating the need for any close figuring.

The fourth section requires aggregating the amount of property, payroll, and sales of entities that are part of a unitary business doing business within the state to prevent tax avoidance by entity isolation. The mathematical determination required here will be straightforward since companies will be using the unitary business groupings they already most commonly use for filing combined reports in states where required. Their only burden will be totaling three columns of figures representing property, payroll, and sales for each unitary business entity that has a minimum connection to the state. That level of burden on unitary businesses seems appropriate since it is the companies themselves, after all, that have chosen separate entities status, which requires the separate figuring.

The final section recognizes that P.L. 86-272 currently preempts state jurisdiction to tax certain taxpayers and that lack of jurisdiction means that such taxpayer's sales within the State will be thrown back to those sending States with throwback requirements.

The current draft of the proposal, now modified for greater clarity and to remedy problems identified at several public hearings, is set out on p.1035.

Policy Basis for the Proposal

The Commission's proposal is designed to achieve greater clarity, certainty, and equity in the administration of the state business activity taxes. In particular, it 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 proposal focuses on the use of the factors of apportionment for determining jurisdictional authority. States have the authority to tax income earned within their borders. Thus, the authority to tax income flows with the attribution of income to a state. The Supreme Court has approved the use by states of property, payroll, or sales — singly (for sales) or in combination with each other — to attribute income being earned within a state. If the authority to tax flows with the attribution of income to a state, it follows logically that the factors for income attribution should also be used for determining jurisdictional

authority. Thus, the proposal establishes threshold levels, both in absolute and relative terms, of property, payroll, and sales beyond which a company is considered to have nexus with a state.

1. Clarity, Certainty, and Equity

The factor presence standard of nexus will provide taxpayers and tax agencies alike with greater clarity in determining when a business is subject to a state's business activity tax. Simple mathematical standards eliminate the ambiguity inherent in applying qualitative standards of nexus. The result will be greater understanding, improved voluntary compliance and a lower level of litigation over whether a company has nexus with a state for business activity tax purposes.

One key feature of the proposal is its assumption that if a company is making substantial sales into a state, it is doing business in and earning income from that state. (*De minimis* amounts of sales are not relevant to this proposal because of the threshold values incorporated in the proposal.) This feature is supported by elementary economics: a business cannot earn income without making sales. Supplying a product or service is not sufficient by itself to produce income. Sales are essential to the earning of income. Hence, making substantial sales into a state means that a company is earning income from within that state and should be subject to the state's jurisdiction for business activity tax purposes.

Beyond the economic logic of this feature, using substantial sales as a determining factor for business activity taxes also helps achieve equity and certainty in the application of these taxes. Two businesses doing business and competing in a state's market — one by physical means and the other by remote means — should, under principles of equity, pay a tax in proportion to their income earning capacity within a state. A company operating in a state by physical means will pay a higher tax burden, proportionately, than the company doing business by remote means due to its payment of property taxes and the operation of apportionment formulas that rely on property, payroll, and sales. While typically enjoying a lower tax burden on its economic activity within a state, a company operating by remote means should not, in the interests of equity, be exempt from paying taxes on the income earned within the state into which it sells.

In practice, using substantial sales as a means of determining nexus also ensures greater certainty in the application of business activity taxes and by that means also contributes to greater equity. Requiring a physical presence for the application of business activity taxes is simply a trigger for tax-sheltering activity that shifts income from where it can be reasonably identified as having been earned to tax haven locations. To use one common tax shelter example, the shifting of income via the transfer of intangible assets to tax haven affiliates is aided by a physical presence standard of nexus for business activity taxes. A physical presence standard is essentially a tool for tax avoidance. The factor presence nexus standard would help curb tax sheltering activity and would restore greater certain and equity to business activity taxes. We will return to the topic of corporate tax sheltering later.

2. Recognition of Significant Market State Contribution

Some critics of the factor presence standard have argued that a company that makes substantial sales into a state without a

physical presence does not benefit from the services of the state into which sales are made. An elementary review of the services provided by state and local governments, however, reveals this argument to be wrong. Let us begin with some simple cases. If a customer in the state fails to pay for the goods or services that he has purchased from an out-of-state company operating by remote means, the company making the sale typically avails itself of the structure of laws of the market state and the court system to collect that debt. To use another example, the consumer protection laws of a state create an environment of trust and goodwill that facilitates remote commerce. Consumers are more likely to make purchases from a company knowing that they can seek recourse through their state's laws and courts if they are harmed by the company or its products. The company benefits from a higher level of sales due to the consumer confidence created by the consumer protection laws and services provided by the state.

The flow of interstate commerce — including remote commerce — benefits from the public order secured through the services of state and local government. The economic aftermath of the tragic events of September 11 provide, unfortunately, a strong historical example of how a loss of a sense of security by the public depresses economic activity and the flow of commerce. When people feel less secure, economic activity suffers. All businesses making substantial sales into a state, regardless of the means of making those sales, benefit from the services of state and local government that maintain public order. In many instances, state and local governments directly protect from harm the flow of goods into a state from outside its borders. When public order is maintained, the flow of goods and services in interstate commerce expands.

Instances occur in which companies sell products into the state that may cause harm to consumers directly or may adversely impact the environment in a manner that requires a governmental response to correct the situation. In that instance the company that is marketing into the state has imposed a cost on the state that require a regulatory response. The flow of commerce, including remote interstate commerce, benefits from corrective state and local action in these instances.

These examples, by themselves, illustrate that state and local governments provide significant services to interstate commerce, including commerce conducted by remote means. We have not yet considered, however, the greatest benefit that state and local government provide to commerce including businesses selling into a state: the public educational system. State and local governments spend over \$500 billion a year in providing for a public educational system from preschool through the university graduate and professional education levels. The economic literature on human capital has established very clearly that investments in education increase productivity and, thereby, the level of incomes in society. When incomes increase, individuals and households purchase more goods and services. More sales are made. Companies that are marketing into a state benefit directly, in the form of increased sales, from the higher incomes generated in that state through its educational system.

In summary, in our federal system state and local governments provide services of national significance that benefit not simply the residents and local businesses, but also the out-of-state businesses making substantial sales into a state regardless of the means of making those sales. The fact that states and their

subdivisions provide services of national significance that benefit businesses selling into a state is an additional reason why it is appropriate to use indicators of market participation in a state as a basis for nexus.

3. Prevention of Tax Sheltering Activity.

Returning to the subject of corporate tax sheltering, as noted earlier the use of a physical presence standard of nexus undermines the equitable accounting for income and reporting of income that is earned within a state. The benchmark for determining what constitutes "equitable accounting" is the individual citizen and the ordinary wage earner. The ordinary wage earner is expected to report all of his or her income where it is earned. Likewise, that is true of local businesses. Since corporations enjoy in our society the rights of individuals, they should have equal responsibilities with individuals. Thus, it is appropriate to insist that corporations be accountable for reporting their income to the same degree that individuals must account for their income. If a physical presence standard for determining nexus were imposed on states, the degree of income accountability required of multijurisdictional enterprises would be much lower than is required of individuals. A physical presence standard of nexus enables companies to use sophisticated tax planning methods to unhook or disconnect income earned from sales into a market state so that same income can be shifted to tax haven locations. Disconnecting income from market locations is the starting point for many tax shelter mechanisms. Thus maintaining a reporting connection between the income earned from sales and the market jurisdiction is essential to maintaining a system of income accountability for corporations that has integrity and is equitable in comparison to the degree of income accountability required of individuals.

The extent of corporate tax sheltering is a major problem in our society. Between 1980 and the year 2000, the effective rate of state corporate income taxes declined nearly by half from 9.6 percent to approximately 5.2 percent according to estimates made by Elliott Dubin, the Commission's Director of Policy Research. Mr. Dubin further estimates that it is possible to account for only about 20 percent of that decline as having arisen from explicit statutory decisions of state legislatures during that period of time to cut rates or grant credits or other reductions of some type to explicitly reduce the level of the tax. But that leaves roughly 80 percent of the decline that is unexplained by legislative action. The likely candidates for the causes of that decline are twofold: (1) the flow through to the states of the erosion of the federal tax base due to tax sheltering, much of it aimed at shifting income internationally, and (2) tax sheltering activity directed explicitly at states in terms of avoiding state taxes.

In the past year, the press has devoted considerable attention to the mechanisms and extent of corporate tax sheltering. David Cay Johnston, writing on Apr. 16, 2002 in *The New York Times*, in an article entitled, "Tax Treaties With Small Nations Turn Into a New Shield for Profits," describes how holding companies are placed in locations such as Barbados and Luxembourg. Enterprises transfer intangible assets to these holding companies, and through payments of royalties or management fees to those companies income is transferred out of the United States to these international tax havens. Another article by David Cay Johnston in *The New York Times* on Feb. 18, "U.S. Companies File in Bermuda to Slash Bills" describes how the

"corporate inversion" technique is used to shift income out of the United States to avoid taxes.

Glenn R. Simpson, writing in the *Wall Street Journal Europe* on June 24, 2002, in an article entitled, "Exporting Intellectual Assets Is New Way to Avoid U.S. Taxes," also describes the use of the "holding company for intellectual property" mechanism to shift income out of the United States. The article even includes a chart from a tax shelter "how-to" manual prepared by one of the major accounting firms.

In terms of other types of strategies that have been used, we cite two articles by April Witt and Peter Behr on May 22nd and 23rd in *The Washington Post*: "Enron's Other Strategies: Taxes" and "Enron Tax Deals Widen Disclosure Debate." Internal papers reveal how several complex tax sheltering deals boosted profits by \$1 billion from 1995 through 2001. The tax sheltering activity of Enron helped inflate its book income at the same time that it deflated its taxable income.

In terms of articles describing tax sheltering aimed directly at state taxes, Avrum Lank and Steven Walters writing in the *Milwaukee Journal Sentinel* in the article, "Tax on Profits Has No Teeth," describe again how tax sheltering is achieved by using the transfer of intangible assets and payments to holding companies to shift income away from the state in which the income was originally earned. Other articles in this vein include "Delaware Shuffle Saps NJ Tax Bucks," by Beth Fitzgerald in the *Newark Star Ledger* on Sunday, Apr. 7, 2002, and "Tax Services Draw Fire" by David S. Hilzenrath in *The Washington Post* on Feb. 7, 2002. The latter article describes the use of the intangible holding company mechanism in the *KPI* case now under litigation in the State of New Mexico.

These articles are a sample of the extensive literature appearing in only the past six months on the increasing use of tax sheltering to shift income away from where it can reasonably be identified as having been earned to a tax haven location. This tax sheltering activity is growing rapidly and accounts for a significant portion of the decline of the state corporate income tax. Many tax-sheltering mechanisms begin as discussed earlier by "unhooking" income from where the market activity occurred so that income can be shifted to other locations. Some may argue that the income will be transferred back to production or headquarters locations, but sophisticated tax shelter schemes are used to prevent that result.

The basic problem with tax sheltering is that it is unfair to those who are expected to report all of their income where it is earned. It is also unfair to businesses that do not engage in those activities and are more prudent and cautious in their filing. It puts the prudent taxpayer at a disadvantage with respect to those who are engaged in the more sophisticated tax planning activities. Further, tax sheltering harms the economy by distorting the allocation of capital and thereby adversely affecting economic growth. Corporate tax sheltering makes it more difficult for investors to determine the real value of a business enterprise by artificially inflating earnings statements. Companies engaging in extensive tax sheltering thus attract capital that is not justified in real economic terms. Tax sheltering has a variety of adverse effects from an equity and economic standpoint, and a physical presence standard of nexus is simply a trigger for extensive tax sheltering activity. The factor presence approach to nexus, therefore, is superior to a physical presence standard because it helps ensure the proper reporting of income in a reasonable relationship to where the income was

earned and because it helps curb excessive and inappropriate tax sheltering activity.

Constitutional Basis for the Proposal

By basing nexus on the presence in a state of a threshold amount of property, payroll, or sales, the Commission's proposal is clearly intended to allow nexus based on sales alone under circumstances where the company has no physical presence in the state. Certain representatives of the business sector have challenged the proposal as constitutionally flawed for that reason. The Commission believes there is sound constitutional basis for imposing an income or franchise tax on an out of state business that has no physical presence in a state.

The Due Process and Commerce Clauses of the U.S. Constitution limit a state's authority to impose tax on an out-of-state business. They require that a business have sufficient connection — called nexus — with a state to justify that state's assertion of its taxing or judicial power. Until the decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), everyone presumed that the nexus requirements under the Due Process and Commerce Clauses were the same. We will therefore first discuss the development of the nexus standard up to *Quill*, and then discuss how *Quill* may have affected the nexus standard for income and franchise taxes.

1. Early Nexus Cases

Even back in the 19th century, the Court authorized a local property tax on notes and mortgages belonging to a person whose only contact with the state was the presence of that intangible property in the state. *City of New Orleans v. Stemple*, 175 U.S. 309 (1899).

In *Shaffer v. Carter*, 252 U.S. 37 (1920), Oklahoma assessed income tax on a nonresident businessman who was extracting oil and gas from properties in the state. The taxpayer argued that although the state could tax the nonresident's property located in the state, it could not tax the income of the nonresident. The Court disagreed and upheld tax on the income earned by the nonresident from engaging in business in the state. In that case, the taxpayer had physical presence in the state through his ownership interest in real and tangible property.

In *New York ex rel. Whitney v. Graves*, 299 U.S. 366 (1937), the Court applied the principle that a state can tax the income of a nonresident from engaging in business in the state to a factual situation where the nonresident had no physical presence in the state. Mr. Whitney was a Boston stockbroker with no presence in New York but who owned an intangible — a seat on the New York Stock Exchange. New York imposed tax on his income from the sale of his intangible rights to an additional quarter of a seat distributed by the NYSE. In response to Whitney's due process challenge, the Court concluded that the source of the income had a business situs in New York, and "that in laying the tax upon the profits derived by [Whitney] from the sale of the right appurtenant to his membership the State did not exceed the bounds of its jurisdiction." *Id.* at 374.

Seven years later, the Supreme Court upheld another state tax imposed on non-residents with no physical presence within the State. *International Harvester Co. v. Wisconsin Dept. of Taxation*, 322 U.S. 435 (1944). The tax was for the privilege of receiving dividends measured by the Wisconsin portion of distributed earnings. The Court began with the fact that "the

tax is thus, in point of substance, laid upon and paid by the stockholders." *Id.* at 440. While the corporation filed the challenge to the tax, the Court ruled with reference to the nonresident shareholders: "We conclude that appellants' stockholders can have no constitutional objection . . ." *Id.* at 445. The Court found no problem with Wisconsin's laying this tax on persons who had no physical presence within the state.

Personal presence within the state of the stockholder-taxpayers is not essential to the constitutional levy of a tax taken out of so much of the corporation's Wisconsin earnings as is distributed to them. A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are subject to state regulation and which are within the protection of the state and entitled to the numerous other benefits which it confers.

Id. at 441-442. The Court was unequivocal that physical presence was not required. "And the fact that the stockholder-taxpayers never enter Wisconsin and are not represented in the Wisconsin legislature cannot deprive it of its jurisdiction to tax. It has never been thought that residence within a State or country is a *sine qua non* of the power to tax." *Id.* at 443.

2. Modern Nexus Standard

The following year, the Supreme Court set the modern standard for due process nexus in its landmark decision in *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). At issue was whether the shoe company was engaging in business in Washington sufficient for the state to impose unemployment insurance tax and to sue the company for that tax. Thus the case linked the issues of jurisdiction to sue with jurisdiction to tax. The Court upheld both: "due process requires only that in order to subject a defendant to a judgment *in personam*, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" *Id.* at 316.

The Court's subsequent interpretation of the "minimum contacts" test has evolved into the modern formulation of nexus that a foreign corporation that "purposefully avails" itself of the benefits of the economic market in the forum state is subject to jurisdiction even if it has no physical presence in the state. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985).

From these holdings, North Dakota argued in *Quill* that when Quill purposefully availed itself of the economic market of North Dakota by sending its products into the state, it created nexus with the state. North Dakota argued that this modern due process jurisprudence had superceded the 1967 holding of *National Bellas Hess v. Illinois*, 386 U.S. 753 (1967) that a mail-order seller had no nexus.

3. *Quill Corp. v. North Dakota*

The *Quill* decision proved North Dakota was right in its view that the company's economic presence in the state satisfied modern due process nexus standards.

In this case, there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State. We

therefore agree with the North Dakota Supreme Court's conclusion that the Due Process Clause does not bar enforcement of that State's use tax against Quill.

504 U.S. at 308. But, for the first time, the Court drew a distinction between nexus for due process purposes and nexus for commerce clause purposes. In drawing the distinction, the Court noted that due process nexus concerns the fundamental fairness of governmental activity while commerce clause nexus focuses on structural concerns about the effects of state regulation on the national economy. Three times the Court referenced avoiding an *undue burden* on interstate commerce as the animating thrust of a separate commerce clause nexus requirement. 504 U.S. at 312-313.

The majority gave two principal reasons for retaining the bright-line physical presence requirement from *Bellas Hess*.

First, the Court relied on *stare decisis*, on the settled expectations of the mail order industry. It was almost apologetic in this regard. "While contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today . . ." 504 U.S. at 311. But absent a guarantee that states would not impose tax on sales already made, the court was reluctant to disturb the sellers' settled expectations. *See Quill*, 504 U.S. at 316 ("a bright-line rule in the area of sales and use taxes also encourages settled expectations"); *id.* ("it is not unlikely that the mail-order industry's dramatic growth over the last quarter century is due in part to the bright-line exemption from state taxation created in *Bellas Hess*"); and at 317 ("the *Bellas Hess* rule has engendered substantial reliance and . . . therefore counsels adherence to settled precedent.").

Second, the Court used the "substantial nexus" requirement to "ensure that state taxation does not unduly burden interstate commerce," citing the 6,000 plus taxing jurisdictions and quoting from *Bellas Hess* concerns about complexity of the "many variations in rates of tax, in allowable exemptions, and in administrative recordkeeping requirements that could entangle [a mail-order house] in a virtual welter of complicated obligations." 504 U.S. at 313.

4. Does *Quill's* Physical Presence Requirement Extend to Income Tax?

Does the physical presence requirement in *Quill* extend beyond sales and use taxes? The Court twice made clear that the requirement has not been applied to other taxes. "Although we have not, in our review of other types of taxes, articulated the same physical presence requirement that *Bellas Hess* established for sales and use taxes . . ." 504 U.S. at 314. "In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical presence requirement . . ." 504 U.S. at 317. The Council On State Taxation dismisses these statements, alleging that the Court simply has not had occasion to deal with the physical presence requirement with regard to these other taxes (see p. 1043). But that is not what the Court said. It said, "we have not, in our review of other types of taxes, articulated the same physical presence requirement" not "we have not had occasion yet to review other types of taxes." Nor is it how courts have interpreted that language. *See Borden Chemical & Plastics v. Zehnder*, 726 N.Ed. 2d 73, (Ill. App. 2002) (Supreme Court in *Quill* did not "leave open" the issue, citing the above language.)

What, then, would the Court do if faced with an income tax case? The best one can do is to analyze the basis of the Court's decision in *Quill* and determine whether that analysis applies to income taxes. In conducting that analysis, it is evident that neither of the two reasons the Court cited for retaining a bright-line physical presence test for use tax collection from mail order sellers applies to income and franchise taxes.

First, the state corporate income tax went through its "streamlining" in the 1960s with the enactment of the Multi-state Tax Compact and the Uniform Division of Income for Tax Purposes Act. State corporate income tax is imposed by only 46 jurisdictions, using various aspects of the same federal tax base, similar apportionment methods and a yearly filing requirement. The Supreme Court ruled — after the *Quill* decision — that California's corporate income tax did not impose an undue administrative burden on a multinational corporation in figuring the tax. *Barclays Bank v. Franchise Tax Board*, 512 U.S. 298 (1994). It is important to remember that the "undue burden" the Court was talking about is the administrative burden of determining the tax amount and filing the tax returns. In finding due process nexus, the Court had already decided that it was fair to require the payment of the tax because North Dakota, by supporting the market for Quill's products, had given something for which it could ask Quill for a return.

Second, as noted above, there can be no settled expectation that a corporation doing business in a state will not owe income tax unless it is physically present in the state. *Stare decisis* goes the other way with income tax. The longstanding rule on nexus for imposition of state income tax is nicely encapsulated by the formulation quoted in *Exxon v. Wisconsin*, 447 U.S. 207, (1980): "The nexus is established if the corporation 'avails itself of the 'substantial privilege of carrying on business' within the State.'" quoting *Mobil Oil Corp. v. Commissioner of Taxes* quoting *Wisconsin v. J.C. Penney*, 311 U.S. 435, 444-445 (1940).

Indeed, the Court in *J.C. Penney* set out at length the fundamental conceptual basis for nexus to impose income tax.

Constitutional provisions are often so glossed over with commentary that imperceptibly we tend to construe the commentary rather than the text. We cannot, however, be too often reminded that the limits on the otherwise autonomous powers of the states are those in the Constitution and not verbal weapons imported into it. "Taxable event," "jurisdiction to tax," "business situs," "extraterritoriality," are all compendious ways of implying the impotence of state power because state power has nothing on which to operate. These tags are not instruments of adjudication but statements of result in applying *the sole constitutional test* for a case like the present one. That test is whether property was taken without due process of law, or, if paraphrase we must, *whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return.* The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax, and the state has not given the less merely because it has conditioned the demand of the exaction upon happenings outside its own borders. The fact that a tax is contingent upon events brought to pass without a state does not

destroy the nexus between such a tax and transactions within a state for which the tax is an exaction. (Emphasis added.)

The market state surely gives the remote seller “opportunities” to earn substantial income through sales into the state, for which the state “can ask a return.”

In determining what “carrying on business” or “doing business” means, it is instructive to look at U.S. Supreme Court cases that have identified factors indicative of “doing business.” For over 60 years, the Court has explicitly recognized that property, payroll, and sales are the benchmarks for determining where a corporation is earning income and doing business. In affirming the validity of the three-factor formula for apportioning income for income tax purposes, the Court stated

“We read the statute [California’s three factor apportionment formula] as calling for a method of allocation which is ‘fairly calculated’ to assign to California that portion of the net income ‘reasonably attributable’ to the business done there.” *Butler Bros. v. McColgan*, 315 U.S. 501, 506 (1942). What clearer statement can one want of what constitutes the factors that fairly represent where a company is doing business? COST accuses the Commission of combining two prongs of the *Complete Auto Transit* test into one. But it is not surprising that the same considerations animate the standard for determining the states in which a company is doing business and the states to which its income should be apportioned. Indeed, that is the penetrating insight of Charles McLure’s suggestion. ☆