Chapter 13

IMPACT OF PUBLIC LAW 86–272

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A. Introduction

When Public Law 86–272 was enacted in 1959, the need for a thorough study of State income taxation was recognized by both proponents and opponents of the statute's substantive provisions.[1] There appears to have been universal agreement that Congress was not then in a position to reach a definitive decision as to what Federal legislation might be appropriate in this area. But in the absence of the information which a study could provide, a decision had to be made as to what the law should be while the study was being conducted. Congress could leave the matter untouched, or it could adopt a variety of proposals for stopgap legislation.

The decision reached was to enact in statutory form a jurisdictional rule which many had long believed existed prior to the 1959 Court decisions. While the legislation was considered stopgap and Congress thus made no lasting commitment to it, the decision necessarily reflected certain views as to what the impact of such a law would be. In this chapter, an assessment is made of the impact of Public Law 86–272. This is done by comparing experience under the law with the impact anticipated at the time of its passage.

B. Anticipated Impact

The provisions of Public Law 86–272 are discussed in some detail elsewhere in this report and are reproduced in appendix K.[2] Briefly stated, they prohibit a State from imposing income taxes on businesses whose activities in the State are limited to one or more of the following:

1. Solicitation of orders for sales of tangible personal property, when the orders are sent outside the State for approval or rejection and are filled by shipment or delivery from a point outside the State;
2. Solicitation of orders for the benefit of a prospective customer of the business;
3. Sales representation by nonemployee agents who represent more than one principal and who hold themselves out as agents in the regular course of their business.

It is rarely possible to say that all supporters of a particular bill hold identical views as to what its impact will be. Among those who supported Public Law 86–272, however, the measure of agreement on this question appears to have been rather broad. It seems possible

[1] See H. Rept. 936, 86th Cong., 1st sess., pp. 2–3 (1959); S. Rept. 658, 86th Cong., 1st sess., pp. 4–5 (1959); id., pp. 12–13 (minority views); id., p. 14 (individual views of Senator Long); 105 Cong. Rec. 16473 (1959) (remarks of Senator Carroll); id., p. 17772 (remarks of Representative Patman).

[2] Pp. A365–A366.

to derive from the legislative materials a consensus on several major points.

With respect to the impact of the law on business, it seems to have been expected that Public Law 86–272 would not cause a significant reduction in the number of income tax returns which businesses had been filing. It was expected, rather, that the law would prevent a significant increase in the number of such returns. In short, the policy behind the statute was maintenance of the status quo existing prior to the court decisions of 1959.[3] The reason most commonly advanced for this policy was the protection of small- and medium-sized businesses against an expansion in the scope of State income tax liabilities,[4] and it appears to have been anticipated that such businesses would be the primary beneficiaries of the statute.[5]

These views of the law's impact on business carried the implication that its impact on State revenues would be small. If Public Law 86–272 was preserving a pre-existing jurisdictional rule rather than contracting the States' power to tax, it could not result in a material diminution of the States' income tax revenues.[6] Moreover, if small- and medium-sized taxpayers would be the primary beneficiaries of the statutory policy, it would appear that the States would not gain significant amounts of revenue even if permitted to impose income taxes on the basis of the activities protected by the statute.[7]

These, then, were the expectations prior to the conduct of the study for which the statute provided. Now that more factual data is available, how do these expectations compare with the results?

C. Impact on Business

Two approaches have been used to assess the impact of Public Law 86–272 on interstate companies.

One approach was to ask companies what effect the statute had on their State income tax liabilities. This was done in Part III of Business Questionnaire II.[8] While this direct approach represents the obvious way to determine what has happened under the statute, it suffers from the major deficiency that many companies do not possess a high degree of sophistication about legal rules governing jurisdiction to tax. Thus, of the 1,907 respondents to the questionnaire, 1,180 indicated that they were not familiar with the provisions of Public Law 86–272. Yet it cannot be assumed that the law had no application to the operations of these companies; in many cases lack of familiarity with the law may indicate only that the company is so little concerned about its potential State tax liabilities that it feels no obligation to keep abreast of relevant legislation. Moreover, a significant number of respondents furnished answers to Part III of the questionnaire which were incomplete or otherwise unusable. For these reasons, information gained through this direct approach has been supplemented by the use of information which respondents provided regarding the nature of their activities in each of the States.

[3] See 105 Cong. Rec. 16354 (1959) (remarks of Senator Saltonstall); *id.*, p. 16471 (remarks of Senator Talmadge); *id.*, p. 16477 (remarks of Senator Carlson); *id.*, p. 17771 (remarks of Representatives Walter and Miller).

[4] See S. Rept. 658, 86th Cong., 1st sess., p. 4 (1959); 105 Cong. Rec. 16354 (1959) (remarks of Senator Saltonstall); *id.*, p. 17771 (remarks of Representatives Walter and Miller).

[5] See S. Rept. 453, 86th Cong., 1st sess., p. 3 (1959).

[6] See *id.*, p. 12; 105 Cong. Rec. 17773 (1959) (remarks of Representative Miller).

[7] See S. Rept. 453, *supra* note 5, p. 12.

[8] App. D, p. A35.

1. Effect on Pattern of Return-Filing

The effect of Public Law 86–272 on the pattern of income tax return-filing is suggested by some of the data presented in an earlier chapter. When a State asserts jurisdiction on the basis of usual or frequent activity by employees with authority to accept orders, only a handful of the companies with this activity in the State are found to file the returns which the State asserts are due. In the overwhelming majority of cases, the assertion of jurisdiction does not produce an income tax return.[9]

In view of the infrequency with which returns are filed on the basis of this employee activity which is not protected by Public Law 86–272, it would be surprising indeed to find that large numbers of returns had been filed prior to the enactment of the statute on the basis of employee or nonemployee activities which are now within the protected area. Some States never asserted jurisdiction on the basis of such activities, and those that did assert jurisdiction are unlikely to have enforced their claims successfully. On this evidence alone, one might conclude that Public Law 86–272 did little more than codify the pre-existing practice. This conclusion is supported by the available information bearing more directly on the point. In the vast majority of cases in which respondents indicated that Public Law 86–272 protected them from State income taxation, they also indicated that they had not previously filed returns with the relevant State.

a. Method of Study

Each respondent to Business Questionnaire II was asked to indicate those income tax States in which the company might have been required to file a return under State law but in which Public Law 86–272, either clearly or arguably, gave immunity from income taxation as of the time the questionnaire was answered. For each State for which Public Law 86–272 had some relevance to the company's tax picture in this sense, the respondent was also asked to indicate whether a return was filed for the last fiscal year ending before September 1958. The 1958 date was chosen because the statute prohibited the collection of some taxes even though liability had accrued prior to its enactment; taxes accruing for years ending before September 1958 would normally have been collected before the enactment date.

The question whether returns were previously filed in States in which companies are now protected by Public Law 86–272 does not fully measure the effect of the law on the pattern of return-filing. It takes no account of the fact that businesses are dynamic: They expand their operations, contract them, and change their methods of doing business. The fact that a return was previously filed in a State in which a company is now protected does not necessarily indicate that it was filed on the basis of a nexus which consisted only of protected activity. By the same token, the fact that no return was filed in a State in which a company is now protected may reflect nothing more than the fact that the company had no activities at all in the State prior to the effective date of Public Law 86–272. Nevertheless, if the activities protected by Public Law 86–272 were activities

[9] See pp. 302–304.

which commonly caused returns to be filed before enactment of the statute, one would expect to find that returns had previously been filed in most cases in which companies are now protected. In fact, the evidence suggests that returns were previously filed in very few such cases.

b. PREVIOUS RETURN-FILING BY PROTECTED COMPANIES

It has already been noted that many respondents were not familiar with Public Law 86–272, and that others provided incomplete responses. But 109 of the 1,907 respondents affirmatively indicated that their operations either clearly or arguably fell within the scope of the Federal statute in one or more States in which they might otherwise be liable for income taxes. These respondents had, among them, 1,614 instances of potential income tax liability in States in which Public Law 86–272 was relevant, or an average of about 15 instances per company. While 33 of these companies had previously filed returns in one or more of these States, they provided only 52 instances of returns previously filed. No single company had previously filed returns in more than four States in which it reported that the statute gave protection, and 28 of the 33 companies had previously filed in only one or two such States.

Of the 109 respondents reporting that Public Law 86–272 had some applicability to their situations, 22 failed to indicate for any State that they would not be liable under State law in the absence of the Federal statute. In some of these cases, there is reason to suspect that the respondent erroneously treated the Federal statute as relevant in States in which the company had no activities of any variety. If this group is eliminated, there were 87 respondents reporting that Public Law 86–272 was applicable in one or more States, representing 943 instances of potential liability in the absence of the statute. Of these 87 companies 26 reported that they had previously filed returns in one or more States in which the statute was applicable, but the 26 companies provided only 40 instances of returns previously filed.

Thus, among the questionnaire respondents reporting that Public Law 86–272 gave them either arguable immunity or clear immunity in one or more States, a sizable minority reported that they had previously filed returns in at least one of these States. The majority, however, reported that they had not previously filed such returns. Moreover, the total number of previously filed returns reported by this group of respondents was quite insignificant when compared with the number of returns which could have been required if the States had been permitted to assert jurisdiction on the basis of the activities protected by the statute.

In one sense, then, the data obtained from this small group of companies suggests that Public Law 86–272 may have had a significant impact on the pre-existing pattern of return-filing: A substantial minority of the companies affected by the statute may have been relieved of income tax obligations in some States in which they had previously been filing returns. But in a more meaningful sense, the supporters of Public Law 86–272 were almost certainly correct in the belief that the statute would not significantly change the pre-existing pattern. Even on the assumption that Public Law 86–272 is applicable

in all cases in which respondents said that it was only arguably applicable—an assumption that gives the statute a relatively broad scope—the data obtained from these respondents indicates that returns had not previously been filed in the vast majority of instances in which the Federal law provided immunity. If, following the court decisions of 1959, the income tax States had successfully asserted jurisdiction to tax in the circumstances in which Public Law 86–272 now grants exemption, the result would have been a great increase in the number of State income tax returns filed by companies whose selling methods are of the types now protected. By comparison with the radical alteration in the pattern of return-filing that would have been implied by successful assertion of jurisdiction in these circumstances, the effect of Public Law 86–272 on the pre-existing pattern was a small one. Indeed, if the objective of the statute was to preserve the pre-existing pattern, there is every reason to believe that its scope was too narrow. For subject to such limitations as might be imposed judicially, the statute continued to permit the imposition of income taxes in some circumstances in which returns were rarely filed prior to its enactment.

This conclusion has some bearing on one of the criticisms that has often been made of Public Law 86–272. The opinion has been expressed that many businesses might easily change their operational methods in some States in order to bring themselves within the protection of the statute.[10] Sales offices might be closed or moved across State lines, inventories in public warehouses might be eliminated, or work previously performed by employees might be transferred to nonemployee agents or contractors. If Public Law 86–272 represented merely a codification of a pre-existing pattern, however, its enactment would not be expected to be the signal for widespread changes in methods of doing business. Information obtained from respondents to Business Questionnaire II suggests that no substantial change in business methods has in fact been motivated by the statute.

Business Questionnaire II was answered approximately 3 years after the enactment of Public Law 86–272. Of the 1,907 respondents returning usable questionnaires, only 6 companies indicated that they had made any changes in business methods even partially motivated by a desire to qualify for the benefits of the statute. Although 59 companies furnished unusable responses to the relevant part of the questionnaire and another 100 gave responses that were incomplete, 1,742 companies had clearly made no such changes: 1,180 companies not even familiar with the Public Law, 473 companies reporting that it did not protect them in any State, and 89 of the companies reporting that it did give them protection in one or more States. The inference is clear that it was an exceptional case in which business methods were changed in response to Public Law 86–272 during its first 3 years.

2. EFFECT ON POTENTIAL LIABILITY

In the preceding subsection, it was concluded that Public Law 86–272 did not significantly change the circumstances in which companies filed returns for State income taxes. Such change as was introduced by Public Law 86–272 was very much less radical than the change

[10] *E.g.*, *Income Tax Hearings*, p. 782, supplemental statement of William D. Dexter, Assistant Attorney General, State of Michigan.

b. SCOPE OF PROTECTION PROVIDED

In table 13–1, the 1,431 studied respondents are classified according to the number of income tax States in which they were protected from taxation by Public Law 86–272. The data is shown separately for all respondents as a group and also by size of company. The table thus indicates for companies of different sizes the extent to which income tax obligations could be increased if taxation were permitted on the basis of the activities protected by the statute. While the increase shown would actually occur only if all the income tax States asserted jurisdiction on the basis of the protected activities, the table does not take account of the possible adoption of the income tax by additional States. Indeed, Indiana has not been treated as an income tax State, having enacted its law after the data was tabulated. For convenience in tabulating, however, the District of Columbia has been treated as a jurisdiction subject to Public Law 86–272.

TABLE 13–1.—SCOPE OF PROTECTION GIVEN BY PUBLIC LAW 86–272

1,431 companies, classified by the number of income tax States in which they had protected activity but no taxable activity

Number of States:	Whole group	By size of company (gross receipts): Under $200,000	$200,000 up to $500,000	$500,000 up to $1 million	$1 million up to $5 million	$5 million up to $50 million	$50 million or more
0	890	176	189	176	235	97	17
1	117	21	27	26	32	9	2
2 to 3	115	13	23	21	44	11	3
4 to 6	72	7	21	11	21	10	2
7 to 10	62	9	10	13	20	9	1
11 to 15	38	2	8	6	11	8	3
16 to 20	37	3	7	3	14	9	1
21 to 30	55	2	1	13	17	19	3
31 to 37	45	2	6	6	20	10	1
Total	1,431	235	292	275	414	182	33

Source: Business Questionnaire II (sample of companies engaged in interstate commerce). Resolution of doubtful cases may result in understatement of the number of States for some companies.

The table indicates that 541 of the 1,431 studied companies—about three-eighths of them—received some protection from Public Law 86–272. While companies in all size classes were among those benefiting from the law, the proportion of companies affected was greater in the larger size classes than in the smaller. Of the companies studied with gross receipts under $200,000, only about one-fourth received any benefit. But of those with gross receipts in excess of $5 million, almost one-half received some protection, and this holds true even for those companies reporting gross receipts of $50 million or more. Thus, insofar as the supporters of the statute believed that the law would be beneficial primarily to small businesses, they appear to have been mistaken. On the other hand, some small companies clearly did receive a significant benefit.

The companies represented in table 13–1 include some companies which are affiliated with other businesses. To the extent that this is so, it may be argued that the small companies studied are not necessarily representative of small business. In table 13–2, the scope of protection afforded by Public Law 86–272 to studied companies with gross

receipts of less than $1 million is therefore shown separately for those companies reporting that they were not affiliated with any other business in the sense of being controlled by the same owner or group of owners. The pattern shown for these unaffiliated companies, indisputably representative of small business, is not significantly different from the pattern shown for all companies with gross receipts of less than $1 million. If the legal issues resolved by Public Law 86–272 had been resolved in favor of State power to tax, almost a tenth of the studied companies with gross receipts under $200,000 would have been potentially liable for taxes in seven or more income tax States in which they now are immunized. More than a tenth of the companies with gross receipts between $200,000 and $500,000 would have been potentially liable in seven or more such States, and almost a tenth of those with gross receipts between $500,000 and $1 million would have been potentially liable in eleven or more such States. Thus, Public Law 86–272 provided a very substantial benefit to some small businesses by protecting them from possible income tax liability in large numbers of income tax States. The benefit which these businesses received from the statute was wholly consistent with the intentions of the proponents of the law.

TABLE 13–2.—SCOPE OF PROTECTION GIVEN BY PUBLIC LAW 86–272

580 unaffiliated companies reporting gross receipts under $1 million, classified by the number of income tax States in which they had protected activity but no taxable activity

Number of States:	Size of company (gross receipts): Under $200,000	$200,000 up to $500,000	$500,000 up to $1 million
0	139	134	112
1	17	26	16
2 to 3	10	17	15
4 to 6	6	15	6
7 to 10	9	9	10
11 to 15	2	6	4
16 to 20	3	3	1
21 to 30	2	1	8
31 to 37	2	4	3
Total	190	215	175

Sources: Business Questionnaire II (sample of companies engaged in interstate commerce). Resolution of doubtful cases may result in understatement of the number of States for some companies.

The benefits received by some of the larger companies, however, were also very substantial. Not only were some of them protected from assertions of liability in large numbers of States, but some were protected in States in which the volume of business done was substantial. Of the 215 studied companies reporting gross receipts of $5 million or more, 97 furnished a geographical breakdown of their sales on a destination basis. Of these 97, 14 companies were immunized from taxation by Public Law 86–272 in one or more income tax States in which their sales volume exceeded $1 million. This fact is indicated by table 13–3, in which the 97 companies are classified by the number of income tax States in which they were immunized from taxation but had $1 million or more of sales. The sales volume

in some of these cases was substantially in excess of $1 million, and in one case exceeded $10 million. Furthermore, of the 14 companies showing some States in which they were immunized from taxation with sales of $1 million or more, 5 companies had gross receipts of $50 million or more.

TABLE 13–3.—SALES INTO INCOME TAX STATES IN WHICH SELLING COMPANY WAS PROTECTED BY PUBLIC LAW 86–272

97 companies reporting gross receipts of $5 million or more, classified by the number of such States in which they made sales of $1 million or more

Number of States:	*Number of companies*
0	83
1	6
2	4
3	2
4 to 5	1
6 to 7	1
Total	97

Source: Business Questionnaire II (sample of companies engaged in interstate commerce). Resolution of doubtful cases may result in understatement of the number of States for some companies.

The pattern of protection indicated by tables 13–1 through 13–3 does not change greatly even if a more restrictive interpretation of Public Law 86–272 is employed. The effect of employing a more restrictive interpretation has been tested by examining in greater detail the activities reported by some of the companies in tables 13–2 and 13–3. In this examination, it was assumed that advertising is the only activity not explicitly mentioned by Public Law 86–272 that may be conducted without negating the statute's protection. Qualification to do business, the conduct of occasional activities of unprotected types, and a variety of other contacts were thus treated as disqualifying. If table 13–2 had been prepared on the basis of this restrictive interpretation, 18 companies with gross receipts of less than $200,000 would still have been shown as protected by the statute in four or more States, and 9 of those companies would still have been shown as protected in eleven or more States. If table 13–3 had been prepared on the basis of this interpretation, 8 companies would still have been shown as protected in some States in which they had sales of $1 million or more, 3 companies would have been shown as protected in two or more such States, and 1 company would have been shown as protected in four or more such States. While use of the restrictive interpretation reduces the number of companies shown as receiving significant protection from the statute, it does not affect the conclusion that substantial benefits were conferred on both large companies and small ones.

Analysis of respondents' own evaluation of the impact of the statute is, as has already been noted, colored by the fact that most of the respondents were not familiar with its terms. This was true of more than 70 percent of the respondents reporting less than $1 million in gross receipts in the sample of companies engaged in interstate commerce. The responses of those companies which were familiar with the law, however, confirm the conclusion that both large and small companies received significant protection. Some companies with $50 million or more of gross receipts, for example,

reported that the statute clearly protected them in more than twenty of the income tax States. Of the smaller companies indicating that they were familiar with the law, the proportion indicating that they were protected was quite small. But a few of the unaffiliated smaller companies did indicate that they were protected in a significant number of States. One such company, for example, with gross receipts barely over $1 million, reported that it was clearly protected in twelve income tax States and possibly protected in an additional fourteen.

C. SCOPE OF UNPROTECTED ACTIVITIES

To the degree that it gave exemption to some of the larger companies, Public Law 86–272 may well have gone beyond the results anticipated by its supporters. For some of the smaller companies, it has been seen that the protection given was wholly consistent with the objectives. Some small companies, however, were left with a broad scope of potential income tax liability even after the enactment of the statute. In this respect, it can be argued that the statute failed to give protection in cases in which protection was appropriate.

In table 13–4, the 580 unaffiliated companies with gross receipts under $1 million are classified by the number of income tax States in which they had activities which are not protected by Public Law 86–272. The activities considered are those included in the list of taxable activities on page 427, except that the "certain miscellaneous unclassified activities" have been excluded. Some of the activities on the list are clearly sufficient to confer jurisdiction to tax, while the relevance of others has not been clearly determined by the courts. The conduct of any of these activities in a State, however, is sufficient to raise a substantial possibility that the jurisdiction to tax would be upheld. Indeed, the list falls short of including all activities which might reasonably be argued to constitute a basis for taxation. It omits, for example, occasional activities of unprotected types even when combined with usual or frequent activity of protected types. Table 13–4 thus presents a conservative view of the scope of liability which could be imposed on the studied companies even when Public Law 86–272 is taken into account.

TABLE 13–4.—SCOPE OF ACTIVITIES NOT PROTECTED BY PUBLIC LAW 86–272

580 unaffiliated companies reporting gross receipts under $1 million, classified by the number of States in which they had usual or frequent unprotected activities

	Size of company (gross receipts)		
Number of States:	*Under $200,000*	*$200,000 up to $500,000*	*$500,000 up to $1 million*
0	44	43	23
1	111	117	89
2 to 3	25	34	44
4 to 7	9	15	11
8 to 15	1	6	7
16 to 23	—	—	—
24 to 31	—	—	1
32 to 37	—	—	—
Total	190	215	175

Source: Business Questionnaire II (sample of companies engaged in interstate commerce). Resolution of doubtful cases may result in understatement of the

While the vast majority of the companies in the table either did not have these unprotected activities in any income tax State or had such activities in only one such State, a few had a rather broad scope of potential liability even after the enactment of Public Law 86–272. Moreover, this broad spread is not explained by a broad spread of places of business. If one of the objectives of Public Law 86–272 was to protect small businesses against a broad scope of liability, table 13–4 suggests that it fell somewhat short of achieving the objective.

D. Impact on State Revenues

In evaluating the revenue impact of Public Law 86–272, it is again relevant to distinguish between the experienced impact and the potential. On the one hand, were the States' revenues materially diminished by the enactment of the statute? On the other, did the statute bar access to a significant revenue source?

1. Experienced Impact

A reasonable estimate of the experienced diminution of revenue would appear to be possible on the basis of data available to the States. Most of any such diminution would be expected to be the result of loss of taxpayers previously on the rolls. Since tax collectors customarily do not permit taxpayers to drop out of sight without some explanation of the reasons, the files of the various revenue departments should contain data which would permit identification of taxpayers lost because of Public Law 86–272.

It may be conceded that the loss of taxpayers previously on the rolls is not a complete measure of the revenue loss actually experienced. At any given level of enforcement, the composition of the tax rolls changes as businesses change their operating patterns, and the failure to gain taxpayers which would have been gained at the pre-existing level of enforcement also contributes to an experienced reduction in the tax take. In the short run, however—in the first few years of the statute's operation—the impact resulting from this factor would presumably be relatively small.

Only a limited number of States could conceivably have suffered significant revenue losses through loss of companies which were on the tax rolls prior to the enactment of the Federal statute. In the first place, it is hard to conceive of any significant losses accruing to States whose sales factors were not destination-oriented. The statute provides no exemption in cases in which property is maintained in the State, except perhaps for property—such as company-owned automobiles—whose use is incidental to the protected employee activity and which is unlikely to be a significant proportion of a company's total property. Although some payroll might be attributable to States in which a company is protected under Public Law 86–272, depending on the rule used for assignment of payroll, it does not seem likely that this would in many cases be a significant proportion of the total payroll of the company. Particularly for manufacturers, which account for the major portion of the net income of mercantile and manufacturing concerns, the payroll of salesmen will not commonly represent a significant portion of the total payroll. Finally, when sales are attributed according to criteria which are not destination-oriented, they will not often be assigned to States in which a company is protected from taxation by the statute.

In the second place, even among the States with destination-oriented sales factors, revenue losses will have been actually experienced only by those which asserted jurisdiction prior to 1959 in cases in which the company's activities were confined to those protected by the Public Law. The Pennsylvania Director of Corporation Taxes, for example, has indicated that the law had no material effect in that State because Pennsylvania had not previously asserted jurisdiction on the basis of solicitation alone.[11]

These facts may explain why only a few States responded to the Subcommittee's invitation to present estimates of the revenue impact of Public Law 86–272. Even those States which did respond, however, evidently found it impracticable to conduct a thorough review of their files in a search for the relevant data. The evidence presented to the Subcommittee was thus in some cases derived from fragmentary data and in others from estimating procedures unrelated to actual experience with the operation of the law. For this reason, it is impossible to estimate with any accuracy even the revenue impact which resulted from companies withdrawing from the tax rolls by claiming exemption under Public Law 86–272. Nevertheless, a review of the evidence does provide a basis for drawing some conclusions about the extent of this impact.

a. California

Although the California Franchise Tax Board was unable to give specific details on the revenue impact of Public Law 86–272, its representative at the Income Tax Hearings testified that "a number of substantial taxpayers are claiming the exemption, and we are receiving new claims for exemption regularly."[12] He concluded that it was obvious that the revenue loss would run into "many hundreds of thousands of dollars each year," and indicated that it "may well" reach $1 million or more.[13] The basis for the estimate is not entirely clear, and the figures may include some estimates of revenue lost from companies which had not filed returns in California prior to the enactment of the statute. Even the figure of $1 million does not appear to be very great in terms of the total financial resources available to California's government. In its fiscal year ending in 1961, the year in which the Income Tax Hearings were held, California collected some $273 million of taxes based on the net income of corporations and $2.2 billion in taxes of all kinds.[14] Thus, a revenue loss of a million dollars would amount to less than one-half of 1 percent of corporate net-income tax revenues, and less than four one-hundredths of 1 percent of total tax revenues.

b. Georgia

Largely on the basis of a study of the returns of 33 corporations which had claimed exemption under Public Law 86–272, Mr. Fred L. Cox, Conferee of the Georgia Revenue Department, indicated that Public Law 86–272 would very likely deprive Georgia of more than

[11] *Income Tax Hearings*, p. 207, testimony of William H. Smith.
[12] P. 166, testimony of Bruce W. Walker, Assistant Executive Officer, California Franchise Tax Board.
[13] Pp. 166–67.
[14] U.S. Bureau of the Census, Dept. of Commerce, Compendium of State Government Finances in 1961, table 5 (1962).

$1 million in revenue each year.[15] Mr. Cox stated, however, that he did not believe that the 33 corporations were entitled to the claimed immunity under the terms of the statute,[16] and indeed expressed the opinion that "there would not be enough at stake to pursue it" in the case of a company whose activities did fall wholly within the provisions of the law.[17] The figure of $1 million thus represented the estimated loss if the claims of exemption were upheld, with a negligible loss anticipated if the State's position should be sustained.

The 33 corporations studied were estimated to be about one-tenth of all those that had claimed the exemption in Georgia. While they were thought to be representative of the entire group, their selection was not made on a scientific basis.[18] Assuming, however, that a valid estimate of the tax liabilities of all companies claiming the exemption in Georgia can be based on projection of the data of these 33 companies, it is nevertheless difficult to evaluate the revenue impact on the basis of this evidence. In the first place, there is little doubt that some companies protected by the statute would be worth pursuing if they were subject to Georgia's jurisdiction; as has already been seen, substantial volumes of business are sometimes done in States in which the statute gives protection. In the second place, although Georgia evidently challenged the claims of exemption of the 33 companies studied, most of the claims presumably have some rational basis; it would be reasonable to infer that, even after litigation, some of these companies would be lost from the tax rolls. Thus, it may safely be assumed that Georgia does suffer to lose revenue from companies previously on the tax rolls whose Georgia activities fall within the Public Law. Whether this amount approaches the million-dollar mark, however, is very much in doubt.

Any revenue loss suffered by Georgia can be compared to total revenues from corporate net income taxes of $24 million, and total tax revenues of $393 million in the fiscal year ending in 1961.[19] Although a revenue loss of $1 million would represent more than 4 percent of corporate net-income tax revenues, even a loss of this magnitude would represent less than three-tenths of 1 percent of total tax revenues in Georgia.

c. LOUISIANA

Although the basis for the estimate is not known, a Louisiana official has estimated that Public Law 86–272 would cause a revenue loss of approximately $1 million.[20]

In its fiscal year ending in 1961, Louisiana collected $17 million in corporate net-income taxes and $463 million in taxes of all kinds.[21] A revenue loss of $1 million would thus represent a substantial percentage of the corporate net-income tax revenue, but only slightly more than two-tenths of 1 percent of total tax revenues.

[15] *Income Tax Hearings*, p. 83.
[16] *Id.*, p. 101.
[17] *Id.*, p. 99.
[18] See *id.*, pp. 82-83.
[19] U.S. Bureau of the Census, Dept. of Commerce, Compendium of State Government Finances in 1961, table 5 (1962).
[20] Memorandum from Roland Cocreham, Collector of Revenue, Louisiana (in Subcommittee files).
[21] U.S. Bureau of the Census, Dept. of Commerce, Compendium of State Government Finances in 1961. table 5 (1962).

d. MARYLAND

Maryland, a State which uses a sales-office standard in its sales factor, has not traditionally sought to base jurisdiction on solicitation alone. Public Law 86–272 was thus estimated to have had no revenue impact.[22]

e. MICHIGAN

Although Michigan's law is not strictly an income tax law, estimates of revenue loss to Michigan were offered on the assumption that Public Law 86–272 would be construed to apply to its Business Activities Tax. Mr. William D. Dexter, Assistant Attorney General, indicated that the Michigan tax had been "temporarily construed" as being within the purview of the Federal statute.[23] The revenue estimates were not based on actual experience under the law, but on a review of about 550 of the 3,051 returns filed by businesses classified as "out-of-State".[24] On the basis of information shown on the tax returns, an attempt was made to classify each business according to its status under Public Law 86–272. Mr. Dexter suggested that actual experience of revenue losses might prove a misleading guide to the impact of Public Law 86–272, since businesses in a position to change their methods of doing business in response to the statute might well refrain from doing so as long as the permanence of the legislation remains in doubt.[25]

Since tax returns do not show whether a taxpayer's activities are restricted to those protected by Public Law 86–272, the Michigan estimates involve certain assumptions. It was concluded that about $850,000 of tax revenue for the year 1960 was received from taxpayers reporting no property at all within Michigan, about $1.6 million was received from those reporting no property at all or property valued at $5,000 or less, and about $3 million was received from taxpayers reporting either no property at all or property valued at $25,000 or less. On the assumption that taxpayers with $5,000 or less of Michigan property are all exempt under Public Law 86–272, the revenue lost from such taxpayers would be about $1.6 million annually. On the assumption that taxpayers with $25,000 or less of property within Michigan could easily change their operations to come within the purview of Public Law 86–272, the revenue loss was estimated at $3 million annually. And on the assumption that all taxpayers classified as "out-of-State" could do so, the revenue loss would be about $13.5 million annually.[26]

Obviously, the assumptions underlying the Michigan estimates are subject to great doubt. Very little is known about the ease with which businesses change their methods of operation. In the first 3 years of Public Law 86–272, very few businesses appear to have made changes for the purpose of qualifying for the benefits of the statute. Moreover, when it is assumed that Public Law 86–272 will induce widespread changes in methods of doing business in order to avoid State income tax liability, it is implicitly assumed that similar changes prior to the enactment of the statute would not have had the effect of

[22] *Income Tax Hearings*, pp. 180–81, testimony of Benjamin F. Marsh, Chief, Income Tax Division, State of Maryland.
[23] *Income Tax Hearings*, p. 374.
[24] *Ibid.*
[25] *Id.*, p. 373.
[26] *Id.*, pp. 381–82 (supplemental statement).

relieving companies of tax liability. Thus, Mr. Dexter supposes that companies having property of $25,000 or less within Michigan "maintain limited inventories and/or sales offices that could easily be maintained by independent contractors," [27] and thus could escape the Michigan tax by making only relatively minor changes in their methods of doing business. But they could almost certainly have escaped the Michigan tax by making the same changes in their methods of doing business prior to the enactment of Public Law 86–272, and did not choose to do so. The assumption that Public Law 86–272 constitutes a new invitation to tax avoidance seems largely unwarranted.

For the fiscal year ended June 30, 1960, Michigan's revenues from the Business Activities Tax were about $72 million and total tax revenues were about $914 million.[28]

f. MISSISSIPPI

Public Law 86–272 was reported to have had no revenue effect in Mississippi, a State which does not use a destination-oriented sales factor.[29]

g. PENNSYLVANIA

Mr. William H. Smith, Director of Corporation Taxes for the Pennsylvania Department of Revenue, indicated that Public Law 86–272 had not had a material effect on Pennsylvania's revenues.[30] It had previously been Pennsylvania's policy not to assert jurisdiction on the basis of solicitation alone. However, Mr. Richard H. Wagner, Chief Counsel of Pennsylvania's Bureau of Sales and Use Tax, expressed some concern that businesses would change their methods of operation to take advantage of the statute.[31]

h. WISCONSIN

No significant revenue effect was experienced by Wisconsin, a State which uses a sales-office standard in its sales factor.[32]

i. SUMMARY

Public Law 86–272 had the potential of causing significant diminution of revenues only for those States which had previously asserted jurisdiction on the basis of the activities now protected by the statute. In addition, this potential was restricted to States with destination-oriented sales factors. Thus, four of the income tax States—Maryland, Mississippi, Pennsylvania, and Wisconsin—informed the Subcommittee that no significant revenue loss had in fact been experienced. Only three income tax States—California, Georgia, and Louisiana—provided estimates of the statute's revenue impact in response to the Subcommittee's invitation to do so. Since these three States all have sales factors with a destination orientation and are all reputed to have been aggressive in seeking to extend their

[27] *Id.*, p. 382.
[28] U.S. Bureau of the Census, Dept. of Commerce, Compendium of State Government Finances in 1960, table 5 (1961).
[29] Letter from H. N. Eason, Chief, Division of Income Tax, Mississippi State Tax Commission, Sept. 17, 1962 (in Subcommittee files).
[30] *Income Tax Hearings*, p. 207.
[31] *Income Tax Hearings*, p. 426 (supplemental statement).
[32] *Sales Tax Hearings*, p. 570, testimony of John A. Gronouski, Commissioner of Taxation, State of Wisconsin.

jurisdiction prior to 1959, they are among the States in which the experienced revenue impact might be expected to be relatively large.

Representatives of all three States mentioned $1 million as a possible figure for revenue lost because of Public Law 86–272. For California, this figure was offered as a high estimate. For Georgia, the figure was offered as a "conservative" estimate, but was computed on the assumption that taxpayers would prevail in all cases in which they had claimed immunity under the statute even though Georgia officials considered most of the claims invalid. For California, $1 million represents less than four one-hundredths of 1 percent of total tax revenues; for Georgia, less than three-tenths of 1 percent; for Louisiana, slightly more than two-tenths of 1 percent.

Estimates of revenue losses were also presented on behalf of Michigan, a non-income-tax State, on the assumption that its Business Activities Tax would be treated as an income tax within the meaning of Public Law 86–272. The Michigan estimates, however, were not based on actual experience under the Federal statute. They were based largely on the assumptions that taxpayers reporting $5,000 or less of Michigan property were all exempt under Public Law 86–272 and that out-of-State taxpayers reporting more than $5,000 of Michigan property could easily adapt their methods of operation to qualify for the protection of the statute. Indeed, it was argued that "it would be comparatively easy for all out-of-State taxpayers to convert their operations within the State of Michigan to an exempt status . . . ." [33] These assumptions appear to be largely unwarranted, and the estimates of large revenue losses for Michigan cannot be considered persuasive.

2. POTENTIAL IMPACT

The degree to which Public Law 86–272 has barred the States from sources of potential revenue is largely a matter of speculation. The States have little knowledge of companies which have never been on their tax rolls, and the sample of companies to which Business Questionnaire II was sent was not designed to provide a basis for estimating revenues. There is thus no factual data available from which an estimate can be made of the volume of business done in States in which the selling companies have only protected activities.

On the one hand, it has been observed that Public Law 86–272 does protect some companies in States in which they have substantial volumes of business. This fact suggests the possibility that States with destination-oriented sales factors are barred by the Federal statute from reaching significant amounts of tax base. On the other hand, in spite of observed exceptions, it is still true that a firmer nexus exists in the vast majority of cases in which large volumes of sales are made into particular States. It may thus be the case, in spite of the fact that Public Law 86–272 insulates some potentially large taxpayers from income taxation, that the total amount of revenue involved is relatively small. Whatever the potential tax liabilities of companies protected by the statute may be, it seems clear that the full potential could not have been realized at present levels of State income tax enforcement.

[33] *Income Tax Hearings*, p. 382, supplemental statement of William D. Dexter, Assistant Attorney General, State of Michigan.

As was noted earlier, a significant impact on revenue might be anticipated only for those States which use destination-oriented sales factors in their apportionment formulas. In the absence of assignment of sales to the State of destination, it would be a rare company indeed that could incur a large tax liability in a State in which its activities were restricted to those protected by Public Law 86–272. This fact suggests that the objections to the Federal statute are closely related to the apportionment formulas used by the States. But for the widespread and growing use of the destination test, neither considerations of revenue nor considerations of equity would create strong pressure in the direction of sustaining jurisdiction to tax on the basis of solicitation or similar activities.

E. Summary and Conclusions

Public Law 86–272 was enacted as stopgap legislation to forestall what was viewed as a possible expansion of the taxing jurisdiction of the States. Its purpose was not to change the pre-existing jurisdictional rules, but rather to resolve some jurisdictional issues which had not been finally resolved through the litigation process. The statute may or may not have resolved these issues differently from the way in which they would ultimately have been resolved by the courts, and in this sense it may have had no effect at all on the legal obligations of interstate companies.

In practical terms, it is clear that widespread assertions of jurisdiction on the basis of the activities protected by the statute would have called for a radical increase in the scope of income tax return-filing by interstate companies. Prior to 1959, many States had not asserted jurisdiction on the basis of these activities. Others had not aggressively sought to enforce their assertions. And those States that were aggressive in their enforcement had met with a notable lack of success. Thus, returns were rarely filed by companies in States in which their activities were limited to those now protected by the Federal statute. While the statute did relieve some taxpayers of income tax obligations which they had previously recognized, its effect for the most part was to provide a clear legal justification for a practice which taxpayers had already been following without a clear basis in law. This result was wholly consistent with the expectations of the statute's supporters.

The policy of forestalling a threatened expansion of the taxing jurisdiction was justified largely in terms of the effect that the expansion would have on small- and medium-sized businesses. While many such businesses did receive substantial protection from the statute, the jurisdictional line drawn is not one that distinguishes between the large and the small. Many large businesses also received substantial protection, some of them in States in which their sales volume exceeds $1 million. And a number of small businesses were left with a rather broad scope of potential tax liability. At present levels of State income tax enforcement, this scope of potential liability is unlikely to become a reality. But these companies have been left with uncertainties similar to those which Public Law 86–272 was designed to resolve.

The jurisdictional issues dealt with by Public Law 86–272 are significant primarily in the context of a system in which destination-oriented sales factors are widely used. The statute's potential for significant revenue impact is limited to those States which now use, or may in the future adopt, the destination test. In addition, significant impact is likely to have been actually experienced after the enactment of the Public Law only by those States which were previously aggressive in asserting claims of jurisdiction on the basis of the protected activities.

No evidence is available to the Subcommittee which permits a reliable analysis of the revenue impact of the statute. Even on the question of experienced diminution in revenues, no State has offered an estimate based on systematic analysis of taxpayers lost from the rolls as a result of the Federal statute. The available estimates suggest that some States did experience a loss of revenue which was more than nominal. However, the magnitude of the losses experienced is small when compared with the total tax revenues of the States involved. While it seems possible that the statute also barred the States from access to considerable revenue sources which were previously untapped, it is unlikely that these sources would have been tapped effectively even in the absence of a legal barrier.

In summary, in terms of its stopgap function Public Law 86–272 achieved very much what it was designed to achieve. It held the line, and thereby protected interstate businesses from possible claims of jurisdiction in circumstances in which State income tax returns had not traditionally been filed. Indeed, in terms of this objective it can be argued that the statute did not go as far as it might have. To the extent that its purpose was primarily to protect smaller businesses, the statute's success was more limited. While many small businesses were protected against a broad scope of tax liability, others were left unprotected. Moreover, many large businesses received benefits which were perhaps unintended by the statute's supporters. In the context of a system in which income is widely attributed on the basis of the destination of shipments, the exemptions given to some of the larger companies may be difficult to defend. Whether retention of Public Law 86–272 as permanent legislation is desirable, however, depends largely on the alternatives available. Some of these alternatives are discussed in chapter 15.[34]

[34] Pp. 481–516.