Unfortunately, the Author Reports, It Is Not Just a Matter of Time and Clearance of Red Tape Before We Get a Uniform Formula

The Uniform Apportionment Formula

By WALTER CHWALS
Manager, Tax Department,
United States Rubber Company

THE LACK of uniformity in state income taxation has for years been the source of annoying and costly situations to corporations doing an interstate business. State taxing statutes, being individual creations drawn to fit the economy and revenue needs of a particular state, are completely oblivious of their collective impact on the taxpayer. The result has been a sad situation of expensive tax compliance, duplicated and disproportionate taxation, and a plethora of controversial issues to plague the taxpayers and to consume the productive time of tax administrators.

Groups and associations of interested individuals, both taxpayers and tax administrators, have for years been studying and discussing the possibilities of finding a generally acceptable answer to this problem. It is interesting, for example, to note from the reports of the National Tax Association that, as far back as 1920 and 1921, committees were appointed "to consider the allocation problem." The research activities and the efforts of the several groups and associations to get the states to consider a uniform apportionment formula covers a span of well over 30 years—years during which a great deal of effective missionary work was done. But the results obtained were hardly commensurate with the efforts expended. Perhaps this isn't too surprising when it is considered that, in trying to secure uniformity, these groups were indirectly proposing a control or restriction on the sovereign power of each state to tax as it wished. Furthermore, these groups were pleading equity and justice for interstate corporations operating as "foreigners" in all but their home state. That's a small voice to the state legislator who is drafting a bill to fit the needs of his local constituents.

The really surprising thing is that the men who have worked on these committees haven't thrown in the sponge. On the contrary, like hounds on a fresh scent, they are today driving harder than ever toward their goal—a goal which a recent development appears to have moved closer than it has ever been before.

In April, 1954, the Controllership Foundation, Inc., published a research report* under the expansive title "Apportionment and Allocation Formulae and Factors Used by States in Levying Taxes Based on or Measured by Net Income of Manufacturing, Distributive and Extractive Corporations." This report has brought about a renewed and widespread interest in the problem. As is stated in the foreword of that report, the Controllers Institute National Committee on State and Local Taxation has for several years been studying the problems created by the lack of a uniform apportionment formula. As a background for further study and a springboard for future action, the committee asked the Controllership Foundation, Inc., "to undertake and underwrite impartial research on the subject." The foundation engaged the Bureau of Business Research, University of Michigan. Albert H. Cohen, CPA, did the research and the writing under the general direction of the research director of the Controllership Foundation, and with the counsel and technical advice of a Research Project Advisory Committee appointed by the foundation.

* Available from the Controllership Foundation, Inc., 1 East 42nd Street, New York 17, New York, at $1.50 per copy.

for State Income Taxes

About the same time that this report was in preparation, the Council of State Governments (research arm for the Governors' Conference) was considering a resolution adopted at the 1953 meeting of the governors in Seattle requesting the council to study and report back on the problem of attaining uniformity in the apportionment of net income. The council learned of the foundation's research project already in process and requested that, upon publication of the report, copies be made available to it for review and study.

The research report is a thorough and impartial analysis of the facts as they exist today in the field of state income taxation. It is an ably digested and documented confirmation of what a tax man knows from experience: that prescribed apportionment rules are extremely diverse; that there are inconsistencies in treatment of income, construction of apportionment formulae and definitions; and that overlapping and inconsistent tax laws have a compound effect upon corporate taxpayers and make the administration by state officials difficult. (Incidentally, this report is recommended reading for all state tax men, as well as for those interested in the solution of this problem.)

Armed with this unbiased research report, plus the results of a canvas of its membership (covering approximately 3,300 firms representing a major cross-section of American industry), the National Committee on State and Local Taxation of the Controllers Institute presented a report of its findings and recommendations to the Council of State Governments. The council, with a committee of state tax administrators, considered these reports and findings along with its own studies in drafting its report and recommendations for presentation to the Governors' Conference which met in July, 1954, at Lake George, New York.

As a result of the foregoing, there has come out of the Governors' Conference a state tax administrators' recommendation for a three-factor formula (sales, payrolls, tangible property) for manufacturing, merchandising and extractive business. The administrators also agreed that uniform definitions of each of the factors in the formula should be adopted in all states, but choice of specific definitions was deferred pending a check into their impact on the revenues of individual states. The Council of State Governments, with the cooperation of state tax administrators, is now taking steps to carry out this study.

This is the first time in the history of these efforts to accomplish uniformity that action of the crusading taxpayer committees has been joined in a complementary activity on the part of tax administrators at so high a level. This marks an important milestone on the road to uniform and equitable taxation —that long road traveled by the untiring committees of National Tax Association, National Tax Administrators Association and Controllers Institute of America. We cannot pass without a nod of recognition to the pioneers in this work, such men as Leo Mattersdorf, Joseph Martel, Raymond Allen, Claude Hupp, Fred L. Cox, Walter W. Walsh, Henry F. Long, Paul A. Reck, LeBurne Metzger, Henry L. Maggiolo, John McFarland and a host of others who have unselfishly devoted a great deal of time and effort to advance an idea for the common good.

Let us not think for a moment that the main difficulties have been overcome and that it is just a matter of time and clearance of red tape before we get a uniform formula. Unfortunately, that is not so. The clue to the greatest stumbling block is that part of the state tax administrators' recommendations which defers any final agreement on specific definitions of factors until

the impact of such definitions on individual state revenues can be determined. To put it bluntly, the states want to know how much it will cost them to change from the present formulas they employ.

Obviously, there will have to be sacrifices on the part of some states, as well as some taxpaying corporations, if and when a uniform apportionment formula is adopted, as there is bound to be some switching of the apportioned income into different taxing jurisdictions. However, the benefits to be gained from the avoidance of duplicate taxation, the simplification of tax compliance and the facilitation of tax administration are so broad in scope and important in cumulative effect that they are unquestionably paramount.

Some recent trends may aid this situation. The rapidly growing move to decentralize industry is building up the manufacturing facilities of the South and the West. As these grow, there should be less aversion in these sections to the so-called "Massachusetts" formula whose property-payroll-sales elements favor a manufacturing state. Then, too, the rigidity of the "Massachusetts" formula could be overcome by splitting the third element, sales, into equal parts, one of which is determined by reference to the selling office and the other of which is determined by reference to location of the customer. By the same token that growth of manufacturing in the South and West may promote acceptance there for a "Massachusetts" type formula, the relative decline of manufacturing in the Northeast should ease the way for acceptance of the split-sales element giving the customer-state a more favorable weight in the apportionment fraction.

The foundation for a reasonable and equitable uniform apportionment formula has been laid. It is within the power of the states to take a collective and unselfish stand in support of uniformity in income taxation. Admittedly, the local political and economic situation in some instances may complicate and delay the move for a change, but greater difficulties have been overcome when there was a will for it. If, on the other hand, the states fail in this opportunity to voluntarily find a solution to this problem, they will open the door to the only other agent empowered to do so, the Congress of the United States. There is plenty of precedent for Congressional action where interstate commerce is a factor, as it is in the subject matter, and there is adequate power under the Commerce Clause of the Constitution for Congress to deal with the uniformity question here involved. I have a feeling that neither the taxpayers nor the state tax administrators would prefer this alternative solution to the problem of uniform state income taxation. **[The End]**