Interstate Tax Uniformity and the Multistate Tax Commission

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Abstract *- Concerns over nonconformity of state tax systems mounted through the 20th century as the multistate presence of businesses expanded. Fearing federal intervention and the loss of state tax sovereignty, the Multistate Tax Commission (MTC) was established in 1967 to help promote uniformity in state taxation. This paper examines the role of the MTC in securing greater uniformity of state corporate income taxes. We discuss the activities of the MTC, the prospect for securing voluntary interstate cooperation, the degree of uniformity achieved by the MTC and alternative mechanisms for achieving greater harmony in state taxation.*

INTRODUCTION

The Multistate Tax Commission (MTC) was established out of concern over the lack of uniformity in interstate taxation and the fear that in the absence of voluntary uniformity the federal government would dictate the nature of uniformity. This paper first considers why the MTC was formed and, second, what it is and does, with a focus on the issue of tax uniformity in the context of the state corporate income tax. In the third section we discuss the case for interstate uniformity. We then turn to a discussion of what might be expected of an interstate compact, based on some basic theoretical considerations. The focus then shifts to the degree of uniformity of state corporate income taxes that has been achieved since the formation of the MTC and the advantages and disadvantages of alternative approaches to achieving uniformity, namely voluntary compacts versus federal mandates. The final section provides a brief conclusion.

PRECURSORS AND PRESSURES

Nonconformity of state tax systems became a major issue following the widespread adoption of personal and corporate income taxes in the early 20th century, a period that coincided with an expanding multistate presence of corporate taxpayers. Wisconsin implemented its income tax in 1911. Corporate income was initially apportioned in Wisconsin on the basis of “business transactions” and property (Hellerstein and Hellerstein, 1998). Sixteen states had adopted a corporate income tax by 1930 (Pomp and Oldman, 2001).

State practice certainly showed wide variation in this early era of corporate income taxation.[1] While some states used the familiar three–factor formula for the apportionment of corporate income, others used single– or two–factor formulas, including sales–only factors and property–only factors. There were also disparities in the way in which sales (i.e., receipts), property and payroll were measured and implemented in the various apportionment formulas.

Through the 1950s the states pushed the limits of apportionment, including more and more income that had previously been subject to allocation. This meant shifting tax burdens for firms and shifting corporate revenue streams for the states. Uncertainties arose regarding state nexus standards and the right to tax corporate income, as well as what income would be apportioned and allocated, and to where this income would be distributed. The Uniform Division of Income for Tax Purposes Act (UDITPA) was adopted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 1957 in an effort to encourage greater uniformity in taxation across the states. While UDITPA offered a common basis for the interstate distribution of corporate income, it did not address other quarrelsome issues like nexus.

An important nexus issue surfaced in 1959 with the decision rendered by the U.S. Supreme Court in *Northwestern Portland Cement v. Minnesota*.[2] The Court ruled that the solicitation of sales was a sufficient basis to enable the state's right to tax corporate income. The business community was outraged and thus engaged Congress, which ultimately passed Public Law 86–272. This law was seen as a temporary measure and offered nexus protection to corporations for which the sole activity in a state was the solicitation of sales of tangible goods. PL 86–272 was "temporary" in the sense that it was accompanied by a mandate for Congress to study the state taxation of business and make recommendations to promote uniformity. The Willis Commission was established to study the issue and its report was released in 1965.[3]

Congress reacted to the Willis Commission Report by proposing a legislated remedy in the form of H.R. 11798.[4] The bill included a physical nexus standard, a two–factor property/payroll apportionment formula, full apportionment of *all* corporate income and federal oversight of state corporate income taxation through the Secretary of the Treasury. The states felt threatened by the proposed Congressional action, generally fearing the loss of sovereignty to the federal government. Market states were disappointed that there was no sales factor in the apportionment formula. Through full apportionment some states would have lost revenue previously derived from allocable income, in particular dividend income. And the states wanted the flexibility to pursue their own policy objectives, especially the promotion of economic development. Some members of the business community objected as well. One specific concern was the potential apportionment of foreign–source income and dividends.

[1] Early commentators bemoaned this evolving structure of corporate taxation. Mudge notes (p. 532) in 1934 that "...the tax methods are almost as numerous as the taxing jurisdictions." Hunter and Allen similarly note (p. 358) in 1940 "There is lack of uniformity not only in the method by which corporations in general are taxed, but also in the taxation of specific types of corporations."

[2] See Peters (1997) and Pomp and Oldman (2001) for a broader discussion of this case.

[3] Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, H.R. Rep. No. 89–952 (1965); H.R. Rep. No. 89–565 (1965); H.R. Rep. No. 88–1489 (1964) (Hereafter referred to as the Willis Commission and the Willis Commission Report).

[4] The following discussion draws heavily from Peters (1997) and Sharpe (1975), as well as Brunori's (1999) interview with Eugene Corrigan, the first Executive Director of MTC.

The states reacted quickly and in 1966, at the impetus of the Council of State Governments and with the participation of the National Association of Tax Administrators, the concept of a Multistate Tax Compact was developed. The Compact would come into play when seven states adopted its provisions; the Compact included UDITPA as the basis for distributing corporate income. On August 4, 1967 the Compact and its executive body, the MTC was enabled.[5] The Compact was not Congressionally–sanctioned as a formal compact with binding regulatory authority.

Friction soon arose in response to MTC's interstate (joint) audit practices, which relied on world–wide combined reporting methods and a broad approach to income apportionment. World–wide reporting was not consistent with reporting under the federal corporate income tax or practiced in the international community. The business community sought remedy through Congressional action, state action, and litigation. The Committee on State Taxation (COST), originally linked to the Council of State Chambers of Commerce, was formed to represent and lobby on behalf of large multistate taxpayers. None of the bills submitted to Congress passed as they all included elements opposed by some of the respective parties.[6] Pressure from the business community was effective in causing Florida, Illinois and Indiana to withdraw from the Compact.

Litigation culminated with *United States Steel Corp. et al. v. Multistate Tax Commission*, a class–action law suit started in 1972 that ultimately represented 16 large corporations, with funding support provided by COST (Oveson, 2002). The plaintiffs had several concerns, including the constitutionality of the Compact and the legitimacy of multijurisdictional audits. In 1978 the Court stated that it was "reluctant ... to circumscribe modes of interstate cooperation that do not enhance state power to the detriment of federal supremacy." The Court judged that the states were not organized in a way that encroached upon or interfered with national supremacy. Although the Court recognized that states could gain "some incremental increase in the bargaining power" against corporations and that ".... [g]roup action in itself may be more influential than independent actions by the States....[t]his pact does not purport to authorize the member States to exercise any powers they could not exercise in its absence."

Moreover, the Court dismissed claims by taxpayers that the Compact sanctioned a "campaign of harassment" against taxpayers by inducing member states to issue "burdensome requests" for documents and issuing "arbitrary assessments" against taxpayers who refused to comply. As the Court pointed out, only the individual states, not the Multistate Tax Commission, could issue a tax assessment, and, besides, such issues were irrelevant to the facial validity of the Compact. For these and other reasons, the Court upheld the constitutionally of the Multistate Tax Compact despite the lack of Congressional approval. But within the meaning of the Compact Clause of the U.S. Constitution, the Multistate Tax Compact is not an "agreement or compact."

[5] Johnson (2001) provides a history of the MTC.

[6] Cahoon and Brown (1973) call for "uniform federal rules" and discuss the Ribicoff–Mathias Bill, S. 1245, which was introduced in Congress in 1973. For the state corporate income tax the bill would have required a physical presence rule for nexus, allowed for variations in the nature of formulary apportionment, precluded apportionment and allocation of foreign–source income and required allocation of dividend income. Sales would have been assigned on destination basis and throwback rules would not have been allowed. A federal court of claims would have been used to settle disputes.

MULTISTATE TAX COMPACT AND COMMISSION

The Multistate Tax Compact is a model tax law that may be adopted by the states through discretionary legislative action. The Multistate Tax Commission was enabled and its broad parameters for operation defined through creation of the Compact (www.mtc.gov/compact/html). The intent of the Compact is to

- ensure the "equitable apportionment of tax bases and settlement of apportionment disputes,"
- "**promote** uniformity or compatibility in significant components of tax systems" (emphasis added),
- support "taxpayer convenience and compliance" and
- "avoid duplicative taxation."

The preservation of state sovereignty is not mentioned explicitly in the Compact itself though it does appear in statements made by Commission members and in Commission publications (e.g. *Multistate Tax Commission Review*, September 2001).

Neither the Compact nor the positions taken by the Commission, as represented by the revenue secretaries of the member states, are binding on member states. While full members are required to adopt the Compact, including UDITPA, they are not bound to any uniformity provisions or policies, and have no legal responsibility other than payment of dues. In practice member states have deviated from UDITPA, a good example being the adoption of sales–weighted corporate income apportionment formulas rather than UDITPA's recommended three–factor formula.[7] States may formally withdraw from membership by repealing the Compact, inclusive of UDITPA. The voluntary nature of Compact and Commission policy adoption on the part of the states reflects the desire to preserve state sovereignty over tax policy and tax administration. An important practical consequence, however, is the inability to achieve one of the core objectives of the Compact, the uniformity of state tax systems.[8]

In the initial years of the MTC the bylaws only enabled Compact members and Associate members. In 1967/68 there were 13 Compact members and 12 Associate members. By 1993/94 Project member status had been adopted and by 1997/98 Sovereignty members had been enabled by the MTC. There are numerous instances of members withdrawing from the MTC, including Florida, Illinois, Indiana, Nebraska, Nevada, New York, North Carolina, Virginia, West Virginia and Wyoming. In some cases states have subsequently re–joined the MTC.

Commission powers are specified in the Compact and include studying state and local tax systems and taxes, developing

[7] From a review of MTC annual reports, it appears that Minnesota was the first full–member state to deviate from UDITPA's uniform three–factor formula for income apportionment as it adopted a 70 percent sales factor in 1987. Florida was a compact member in 1971 when it implemented its corporate income tax, but it deleted UDITPA (1971/72 MTC *Annual Report*) and later withdrew from the Compact. There is no bright–line test on how far a state can stray from the Compact and no mechanism to sanction a member state for any deviations from UDITPA. In the context of UDITPA, Pomp and Oldman (2001, pp. 10–12) note that "Nonsubstantial deviations are permitted." Nonmember states that have adopted UDITPA don't necessarily adopt all of its provisions. For example, West Virginia adopted UDITPA but used a sales–only factor in 1971 (MTC *Annual Report*, 1971/72). MTC notes that the "optional feature" of UDITPA adoption in the context of multistate taxpayers who may benefit from deviations from the three–factor formula. States can choose to offer unique formulas, but they can also make "…uniformity available to taxpayers where and when desired" (MTC *Annual Report*, 1969/70, pp. 3).

[8] The Compact (Article 6, paragraph (c)) notes that "...no action shall be *binding* unless approved by a majority of the total number of members" (emphasis added) The bylaws go one step further by requiring not only a majority of states, but also a majority of the population represented by the member states.

uniformity or compatibility proposals and providing information to facilitate compliance with state and local tax laws. The Compact specifically spells out the general parameters for development of uniformity provisions, the conduct of interstate audits and dispute resolution through arbitration. The Joint Audit Program began in 1969 with the completion of three pilot audits, two covering the corporate income tax and one covering the sales tax.[9] MTC has a formal system in place for the development of uniformity recommendations, including input through public hearings and a history of *public participation working groups* which include as members various affected parties, notably the states and representatives of the business community. [10] In practice the range of Commission activities is rather extensive and goes well beyond the parameters of the Compact.

IS THERE A NEED FOR STATE CORPORATE INCOME TAX COORDINATION?

The Willis Commission conducted perhaps the most extensive study of interstate taxation. The Willis Commission concluded:

> It has been found that the present system of State taxation as it affects interstate commerce works badly for both business and the States. It has also been found that the major problems encountered are not those of any one of the taxes studied but rather are common to all of them. This is not surprising in that all of these problems reflect the pervasive conflict between the approach of the taxation of interstate companies as it appears in State and local law, and the practical difficulties of realistic compliance expectations and effective enforcement. Increasingly the States, reinforced by judicial sanction, have broadened the spread of tax obligations of multistate sellers. As the principle of taxation by the State of the market has been accepted, the law has prescribed substantially nationwide responsibility for more and more companies. The expanding spread of tax obligations has not, however, been accompanied by the development of an approach by the States which would allow these companies to take a national view of their tax obligations. The result is a pattern of State and local taxation which cannot be made to operate efficiently and equitable when applied to those companies who activities bring them into contact with many States. (pp. 1127–1128.)

More recent observers have made stronger comments. For example McLure notes "Though substantial progress has been made toward uniformity since the landmark *Northwestern Portland Cement v Minnesota* case was decided in 1959, states taxation of the income of multistate/multinational corporations **remains a mess**" (emphasis added, McLure 1986; p. 131).

McLure and Hellerstein (2004) list three general problems associated with the lack of uniformity: adverse economic effects; excessive compliance costs; and revenue loss from increased opportunity for tax planning. In addition, the existence of multiple state tax systems can lead to more litigation, and more legislative time devoted to tax law changes (Shaviro, 1993).

[9] Individual states pay for the audits on a fee–for–service basis. In fiscal year 1993/94 MTC completed 13 sales tax audits and 9 income tax audits entailing 229 contacts with the states; total audit fees were nearly $1.7 million, or $77,193 per audit. The number of audits conducted in any given year has never been particularly large. Through the decade of the 1990s a peak of 12 completed income tax audits took place in 1993 and encompassed 132 state contacts. Between 1983/84 and 1993/94 assessments plus collections for the income and sales taxes totaled $290 million, benefiting 24 states. Audit productivity has shown considerable variation. In 1984/85 there was $29 in assessments for every dollar spent on auditing; a low of 7:1 was recorded in 1973/74.

[10] See: http://www.mtc.gov/UNIFORM/9STEPS.HTM

The lack of uniformity can result in economic inefficiency. Differences across states in corporate income tax systems lead to interstate differences in effective tax rates on the return to capital. Revenue neutral (in the aggregate) tax reform that equalized effective marginal tax rates across states would be welfare enhancing (assuming the aggregate capital stock does not change as result of the reform). In addition, the interstate differences in state corporate tax systems can result in differences in effective marginal tax rates by industry and perhaps by type of firm.

There is little empirical evidence on this issue. Sørensen (2001) has estimated the welfare loss from differences in effective corporate tax rates across countries in the European Union. He analyzed a within–country revenue neutral tax reform that eliminated differences across countries in effective corporate tax rates and replaced them by a uniform rate throughout the EU, namely the population weighted current marginal tax rates. He finds that such uniformity would increase welfare by 0.16 to 0.35 percent of GDP, an amount he notes to be "disappointingly small." Given that effective marginal tax rates within the EU are much larger than those for U.S. state corporation income taxes, and that differences in tax rates across the EU are likely to be larger than interstate differences within the U.S., the welfare gain from such a reform in the U.S. would likely be even smaller than what Sørensen estimates for the EU.[11]

A second economic effect from the lack of coordination of state corporate income taxes is tax competition. Wildasin and Wilson (2004) and Zodrow (2003) provide reviews of this literature. As Zodrow points out, the implications of the tax competition literature are mixed, and thus "it is difficult to draw unambiguous conclusions regarding their implications for corporate tax coordination…" (p. 660). The implications of the basic tax competition model, for example, Oates (1972), is that tax competition leads to a "race to the bottom" in terms of tax rates on capital. Thus, in the absence of tax harmonization public services would be underprovided. This result is driven by the assumption that the stock of capital is fixed. Other tax competition models yield contrary implications.

These two economic effects of tax harmonization depend on equalizing effective marginal tax rates across states. But the uniformity that has generally been sought in the U.S. focuses on features of state corporate income taxes other than the tax rates. If states are free to set their own tax rates or even to provide subsidies, outside the state corporate income tax structure, to businesses, then any potential welfare improvement from uniformity is likely to be very small.

A second major concern regarding the lack of uniformity is the cost of tax compliance. While it is generally assumed that the lack of conformity leads to unreasonable compliance costs, we were unable to identify much evidence. The Willis Commission found a wide range of cost, but for 75 percent of the 100 firms in their sample the range of compliance cost was from 0.01 percent to 0.2 percent of receipts (p. 356). The report concludes that compliance costs, when compared to gross receipts "do not appear to be very significant for most companies" (p. 383). The Commission further states "Indeed, there has been some business acknowledgement that the present operation of the income tax system is not too expensive" (p. 383).

More recent state corporate income tax compliance costs estimates are provided by Gupta and Mills (2003). They find for a small sample of firms that compliance cost is 2.9 percent of taxes and 0.022 percent of sales; aggregate compliance cost for the

[11] This conclusion needs to be tempered since the use of an apportionment formula complicates the effect of corporate taxes on the return to capital and other factors (McLure 1981).

state corporate income tax for the largest 1,000 firms in the Compustat database is $334 million for 1995. Gupta and Mills note that the compliance cost for the federal corporate income tax is 1.4 percent of tax liability, or less than half the percentage for state corporate income taxes. They state that this provides "prima facie evidence of the impact of disconformity in state tax rules" (p. 363).

The common view is that the lack of uniformity is a serious problem. This conclusion is based on the assertion of critics, the long–standing concern over the lack of uniformity and that great effort has been made over a long period to achieve uniformity. Certainly uniformity of state corporate income taxes would be preferred to non–uniformity. But the evidence does not seem to suggest that the system is "debilitating," as Henderson (1990) suggests. The empirical evidence is sparse and not comprehensive, but it does suggest that the rhetoric may need to be toned down and that more research needs to be conducted to help guide policy.

IS COOPERATION FEASIBLE? A THEORETICAL FRAMEWORK

Analysis of a voluntary tax compact and its effectiveness begs the question of whether states would cooperate with respect to the design of a corporate tax system. Based on some basic theoretical considerations the results are not encouraging. For simplicity, assume that a state will either adopt, denoted *A*, or not adopt, denoted *NA*, a proposed provision and it does so based on the net benefits from adopting relative to not adopting the provision. Not adopting a proposed provision means the state will maintain the status quo. Consider a state *j* and let *k* represent the other state (or all other states). We consider whether the states will mutually agree on the tax provision by framing the decision in a 2 × 2 payoff matrix assuming Nash behavior.

There are four cases of the relationships between net benefits that should be considered. For Case 1, $B_{NA,A} > B_{A,A} > B_{NA,NA}$. If this condition holds for both states, then we have a classic prisoner's dilemma game, and equilibrium will be characterized by non–adoption.

Case 2 is the one for which $B_{A,A} > B_{A,NA} \geq B_{NA,NA}$. In this case benefits are higher if both states adopt the provision then if either or both do not adopt. If this condition holds for both states, we expect that states would agree to adopt the provision. And, if $B_{A,NA}$ is strictly greater than $B_{NA,NA}$ for both states, then the adoption of the proposed policy is the dominant strategy for both states.

For Case 3, $B_{NA,A} = B_{A,A}$, the state is indifferent between adopting and not adopting the provision. Case 4 is the situation for which $B_{A,A} < B_{NA,A} \leq B_{NA,NA}$. In this case not adopting the proposed provision would be the preferred option.

If the ranking of benefits is the same for both states, then only for Cases 2 and 3 will both states agree to adopt the provision. In the other two cases, neither state will adopt. If the ranking of benefits differs for the states, then both states will adopt only if Case 2 represents the ordering of benefits for one state and Case 3 represents the ordering for the other state. A state represented by Cases 2 or 3 will adopt regardless of the decision of the other state; a state represented by Cases 1 or 4 will not adopt the provision under any circumstance.

The economic benefits to a state from adopting a provision consist of changes in tax revenue, in state tax administrative expense, and in compliance cost for firms, or changes in economic conditions (e.g., employment). There are also more political or psychic factors that may affect the decision of whether to adopt. For example, it is possible that a state views changing its regulations or policies as undesirable because the bureaucracy does not want to be bothered with having to change

procedures or the state might simply put a relatively high value on maintaining its autonomy. It is not clear how the state will aggregate the different benefits. For example, while states should prefer lower compliance cost for firms, it is not clear that the state would weight this benefit the same as, say, increased revenue.

Finally, net benefits will depend on the nature of the tax provision, and in particular whether the proposed provision involves tax policy or tax regulations. An example of the former would be a proposal for a specific apportionment formula, while an example of the latter would be a proposal for a common sales tax reporting form. We expect tax policy proposals to involve larger benefits (either positive or negative) and larger political pressure than tax regulation proposals.

Consider a proposal to adopt a common apportionment formula, say, the 3–factor formula and that initially all states agree. Suppose that state *j* determines that it could increase revenue by shifting to a different formula, say a single factor sales formula. This suggests that the state is described by Case 1 or Case 4 and is a "market region." But it is not feasible for all states to be market regions and thus benefit from shifting to the same formula. Assuming two formulas, then state *k* must be reflected by Case 2. Thus, state *k* retains the 3–factor formula, while state *j* switches to the single factor formula. Of course the switch to another formula may instead be driven by economic development considerations (Edmiston, 2002). This is an example of Case 1, a prisoner's dilemma.

Proposed regulations are unlikely to have much effect on revenue, but could make compliance easier for firms or reduce the state's administrative burden. Such proposals probably fall into Case 2, where there is significant benefit if all states adopt the proposal. It seems that obtaining uniformity on tax policy issues will be much harder than on tax regulations.

There is a substantial literature on the theory of cooperation within a game–theoretic framework. Suppose that for a proposed provision one state falls into Case 1 or Case 4, while the other state falls into Case 2 or Case 3. In this case there is no common policy adopted. There are two possible approaches to reaching agreement in this situation, including compensation to the state for which the benefit of adopting the proposed provision is negative and bundling provisions that include components with positive benefits.

The more difficult situation is when both states are represented by Case 1. Under what conditions will cooperation emerge in this case? Certainly for a prisoner's dilemma game that is played one time by selfish individuals not cooperating is the dominant strategy. Axelrod (1984) argues that cooperation can occur if the players in such a game might meet again, i.e., the game is played repeatedly. In such iterated prisoner's dilemma games experiments have shown that cooperative behavior is possible. For example, a Tit–for–Tat strategy yields cooperative behavior.

What does this suggest about how cooperation among states might be increased? Since cooperation is premised on reciprocity, it would be important for the players to have frequent interactions, even outside the "game." The problem here in the context of the MTC is that there is not a "player" from each state. Rather, the decision of whether to adopt a proposed policy provision is made by the state's elected representatives, not the revenue secretaries most closely engaged with the MTC.

For cooperation to result in an iterative prisoner's dilemma game, the threat of retaliation (defecting) must be effective. With a Tit–for–Tat strategy if one defects, then the other player will also defect, resulting in lower payoffs for both. The first player "learns" that cooperation is better. But with 50 states the threat of retaliation is not likely to be very effective since to

have real retaliation, the other 49 states would have to defect. If only one state defects, the benefits to the other 49 states from maintaining cooperation may fall as a result, but the benefits may be much higher than if they all defect. This situation is not like the traditional prisoner's dilemma where the payoff to the person who does not defect is much lower than if they both defect.

The threat could also come from an external force. In particular, if the federal government threatened significant action if states did not cooperate then the payoff matrix could change in such a way that not adopting a proposed policy is no longer a dominant strategy. However, if the federal government would not act if a few states did not adopt the proposed policy, then some states might decide they could free–ride and thus not adopt the policy.[12]

What is implied by the above discussion is that cooperation is difficult to achieve for most of the major tax policy proposals, and that significant non–uniformity in state corporate tax systems exists should not be a surprise. The problem is not that all proposed provisions are represented by a prisoner's dilemma. Rather, for many proposed policies some states would benefit from adoption while others would not.

HAS THE MTC LED TO GREATER UNIFORMITY?

A primary goal of the Compact is the uniformity of state tax systems and the MTC has actively pursued this goal since inception. There is good evidence that state corporate tax systems have moved toward greater uniformity in the last 40 years. At the same time significant differences remain across the states.

There are at least six major ways that state corporate income tax systems may differ: (1) apportionment formula factor weights; (2) definition of factors and use of the throwback rule; (3) definition of allocable income; (4) definition of the taxable firm, i.e., combined versus separate reporting; (5) the statutory tax base; and (6) administrative procedures and forms.

Because of its broad scope—encompassing many elements of the six features noted above—UDITPA represents the most important uniformity initiative a state may adopt. While compact members are expected to adopt UDITPA, other states have adopted UDITPA but have chosen not to be a member of the MTC. By 1963, which is 6 years after the introduction of UDIPTA, only 3 of the 38 states with a corporate income tax had adopted the model tax law. The tally was 29 out of the 45 states with the tax by 1975 and to 31 out of 45 states in 1989 (ACIR, 1990). For 2004, Healy and Schadewald (2004) reported that 24 out of the 46 states with a corporate income tax had adopted UDIPTA. Of the 24 only nine adopted it without modification. The implied decrease between 1989 and 2004 is probably due to how the various authors categorized partial adoptions of UDIPTA and not actual changes in adoptions.

Another measure of increased uniformity is the change in the number of states that have adopted the three–factor apportionment formula, although not necessarily with equally–weighted factors. In 1929 (see Table 1) only two of the 16 states with a corporate income tax used the three factor formula. There was a steady upward trend and by 1989 44 of 46 states (96 percent) used the formula. In 1993, 43 states used a three factor formula, with 24 states equally weighting the factors and

[12] It is possible that players do not behave as selfish utility maximizers. For example, players may be altruistic, or engage in what Fehr and Falk (2002) refer to as "reciprocal fairness." Fehr and Falk show that participants in experiments show evidence of reciprocal fairness and that cooperation is possible within a prisoner's dilemma game.

TABLE 1
APPORTIONMENT FORMULAE IN USE, VARIOUS YEARS

	Number of states using each formula					
	1929	1948	1953	1963	1977	1989
Three factors[1]						
Property–payroll–sales	2	15	16	26	41	44
Property–manufacturing cost–sales	1	5	3	–	–	–
Two factors[1]						
Property–sales	1	4	3	1	1	–
Property–business	1	2	1	–	–	–
Property–manufacturing cost	–	3	–	–	–	–
Property–payroll	1	–	1	1	1	–
One factor						
Property	4	–	–	–	–	–
Manufacturing cost	1	1	–	–	–	–
Sales	2	3	4	2	2	1
Other	3	n.a.	5	5	–	1
No formula	3[3]	–	–	–	–	–
Number of taxing states[2]	17	34	35	38	46	46

Note: If the state uses multiple formulas, the formula is given for manufacturing companies. Some states may be listed more than once. Since alternative formulas may be available. Manufacturing costs include labor, raw materials and other manufacturing costs.

n. a. = not applicable

[1]Not all states weight each factor equally.
[2]Including Hawaii (tax adopted in 1901), the District of Columbia (1947), and Alaska (1949), Michigan, which taxes on value added instead of income, uses an apportionment formula for purposes of the state corporate value–added tax.
[3]Montana required separate accounting in 1929. Georgia and Oregon had recently adopted the state income tax and had not yet specified the formula.

Source: Weiner, 1999.

19 double weighting the sales factor. Of the other three states, two used just sales. In 2005, 14 states used equally weighted factors and 23 states used double weighed sales; of the other nine states, four used only sales, while the other five states more than doubled the weight on the sales factor (see www.taxadmin.gov). The share of states using the three–factor formula stood at only 30 percent in 2005, falling precipitously from its peak of 96 percent in 1989. Other state policy objectives, notably economic development, have interfered with achieving the goal of uniformity. While there has been deviation from the three–factor formula specified by UDITPA there is now greater uniformity around sales–weighted apportionment.

Uniformity trends for several dimensions of corporate tax structure are reported in Table 2 for those states with a corporate tax. The first panel of the table emphasizes trends in state conformity with the federal corporate income tax between 1967 and 2005. In all but one instance—the adoption of federal bonus depreciation—there is clear evidence of greater uniformity across states. While most states no longer adhere to federal bonus depreciation provisions, there remains considerable uniformity but now in terms of nonadherence. Movement toward uniformity is not so apparent in the lower panel of Table 2 where the focus is on state–specific tax provisions. In only two cases have the states become more uniform: the use of original cost in defining the property factor and the inclusion of 401(k) earnings in the payroll factor. There has been slight movement away from UDITPA in defining non–business income.

TABLE 2
STATE ADOPTION OF CORPORATE INCOME TAX PROVISIONS:
PERCENT OF CORPORATE INCOME TAX STATES

Corporate Tax Provision	Percent in 1967	Percent in 2005
Loss Carryover	56.1	100
Federal Tax Deductible	31.7	10.9
Federal Income as Base	56.1	93.4
Federal Depletion Allowance	58.5	93.1
Federal Bonus Depreciation	78.0	28.3
Corporate Tax Provision	**Percent in 1994**	**Percent in 2005**
Original Cost, Property Factor	84.8	86.0
Officer's Comp. in Payroll Factor	80.4	76.3
401(k) Earnings in Payroll Factor	54.3	63.0
Throwback Rule for Sales Factor	56.5	54.3
UDITPA for Nonbus. Income	56.5	54.3
Combined Reporting	65.2	50.0

Note: *For apportionment factors, applies only to those states that use the respective factor.*
Source: *2005 State Tax Handbook*, CCH Inc.; *State Tax Handbook*, December 31, 1994, CCH Inc.; and *State Tax Handbook*, 1967, CCH Inc.

It is clear from looking at the MTC's model regulations, statutes and guidelines that member states are far more willing to pass uniformity recommendations at the Commission level than legislatively adopt them at the state level.[13] Most (full) compact members have adopted uniformity guidelines regarding income allocation and apportionment. But for the vast majority of other initiatives—including apportionment of income for special industries—only a small number of member states have adopted the MTC policy. In one instance (collection of taxes on fundraising transactions, a relatively new guideline) not a single state has adopted the provision. Thirty–eight states have adopted the uniform sales tax exemption form.

Over time there is some tendency toward increased adoption of model guidelines. MTC reports in its 1985/86 *Annual Report* that 20 states had formally or informally adopted its guidelines on apportionment and allocation, while the number was 25 states in 2002. For airline apportionment there were seven adopting states in 1985/86 versus 11 in 2002; for railroads there were seven states in 1985/86 and 12 in 2002; for contractors there was no change over this time period (ten states in both years).

There is certainly greater uniformity in the structure of the corporate income tax today than there was when UDITPA was promulgated by NCCUSL and at the time of the Willis Commission. MTC deserves some credit for this change in tax structure, but just how much will never be known. While progress has been made, total uniformity will likely never be realized absent federal intervention given the self interest of the states. Options for achieving greater uniformity are discussed below.

OPTIONS FOR ACHIEVING UNIFORMITY

The alternative approaches to achieving uniformity fall along a continuum. At one end is complete state autonomy and at the other complete federalization of the state corporate tax (e.g., an add–on to the federal corporate tax with the revenues distributed to states on a formula basis). Between these extremes are a voluntary compact (like the MTC model) and a federal mandate (e.g., the Willis Commission

[13] Information acquired directly from the MTC.

approach) that falls short of complete federal preemption. The trade–off is between the degree of uniformity achieved and the loss of state autonomy.

While there have been numerous and frequent calls to achieve uniformity, it is not clear that either states or interstate businesses will press for uniformity, a point made by Lindholm (1991). Businesses want to minimize the sum of tax payments and compliance costs, not just compliance cost; to minimize taxes firms exploit differences in state tax structure. Thus, businesses are not likely to lobby intensively for complete uniformity. This is in part reflected in the positions of business groups such as COST that have been critics of the MTC.

Many states have not been supporters of the MTC, as reflected by the number of states that are not MTC members and the number that have not adopted uniformity provisions. Some states regard the MTC as an equal threat to their sovereignty (Sharpe, 1975), and this is one reason that states like New York and Arizona have either withdrawn from or not joined the MTC as full members. A second reason why states have not agreed on uniformity is that some provisions may lead to a reduction in a state's tax revenue or less economic development.

If substantially greater uniformity is desired but will not be achieved by voluntary action on the part of the states, then federal action is required. The scope of a federal mandate could range from the extreme of converting the state corporate income tax into a federal add–on with revenue allocated back to the state, to mandating uniformity of everything but the tax rate, to mandates over selected features of the tax, e.g., the apportionment formula. The federal government has the power through the Commerce Clause to impose controls on state taxation. The Supreme Court has stated that the federal government can require states to use uniform rules for apportioning or allocating income (see *Moorman Manufacturing v. Bair*, 437 U.S. 267, 280 (1978)). And the Federal government has taken action to limit the taxing authority of states, including, the Internet Tax Freedom Act and Public Law 86–272.

Is there federal interest at stake? The dissent in the definitive case of *United States Steel Corp. v. Multistate Tax Commission* (1978: 489) found ample federal interest given the "Willis Report, the Willis Bills, the successor bills, and the dozen shelvings of compact ratification bills." Federal preemption is likely only in the presence of intense political pressure. If states or interstate businesses lobbied the federal government for uniformity, Congress may well act. But states oppose intervention since it would result in a loss of sovereignty. And businesses are not likely to demand complete uniformity, although they might push for further controls on state taxing authority. We should not look to the federal government to impose uniformity, particularly if this expands the state power to tax.

The principal argument against federal action is that the power to tax is seen as essential to the existence of state sovereignty (McLure and Hellerstein, 2004). It is argued that there are at least three reasons why it would be insufficient for states to have the power to spend with only the federal government having the power to tax and distributes revenue to states: the federal government is likely to impose constraints on how states spend the revenue; the ability of the state to shape its public sector would be substantially limited; and state spending of federal funding is likely to be "bloated and wasteful." Hellerstein states "Absent some pressing need for federal intervention…the states should be free to go their own way" (cited in footnote 5 of Shaviro 1993).

There are many arguments advanced in support of autonomy for state and local governments, such as the efficiency inherent in providing public services at

the right scale and that match differences in tastes. Support for a more decentralized governmental structure is also found in the Madisonian view that by dividing political authority the potential to do great harm is reduced. Other arguments include allowing state governments to exploit and develop the resources they already possess and promoting experimentation with different kinds of tax rules or tax policy. Shaviro (1993) argues that while these points have some validity they have "limited consequences" (p. 78). A final argument is that federal intervention may be a slippery slope as the federal government has already taken steps to restrict state taxation.[14]

Sharpe (1975) argued that, "UDITPA and the Willis Commission represent polar extremes, volunteerism and coercion. Neither offered the delicate uniformity needed to restore a balance among sovereignty, fairness, and federalism." But what is that balance? The level of uniformity achieved through a voluntary compact will be imperfect. Federal mandate might achieve greater uniformity and lower efficiency costs, but at the cost of reduced state control. In both situations, states lose some individual sovereignty. Clearly, there is a difference between voluntarily giving up sovereignty and having the federal government mandate it, even if the resulting corporate tax structure is the same in both cases. So, the basic issue is whether the cost imposed by non–uniformity is sufficiently high to warrant the loss of control to the federal government. It is unfortunate that there is so little empirical evidence to guide this decision.

CONCLUDING REMARKS

The issue examined in this paper is whether the MTC has been effective in promoting uniformity of the state corporate income tax. The MTC falls short of achieving uniformity, but one can certainly "promote" without having to show any results. Perhaps it is presumptuous to have assumed that an institution like the MTC is all that it takes to achieve tax uniformity given the pronounced and desirable competitive nature of states in a federal system. To the credit of the member states united by the Compact, the MTC has faithfully pushed the need for uniformity and cooperation against the competitive nature of states and the forceful challenge of corporate taxpayers. This has been achieved in part by redefining success—as in finding a way to get as many states as possible at the discussion table even if it takes expanding the terms of participation to include different member classifications.

There are alternatives to the current situation of non–uniformity of corporate taxation. The federal government could simply assert its rights over interstate commerce. This is unlikely given the political pressure that would be forthcoming from the states and the business community. The alternative is for the states to voluntarily give up sovereignty, something that is unlikely to provoke a positive response from states absent a tangible carrot, such as the assurance of revenue streams. The self interest of Congress, the states and multistate businesses is not likely to yield greater uniformity of the state corporate income tax.

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[14] A practical issue with a federally–mandated state corporate income tax base is whether such a mandate could be enforced. Would states, for example, simply adopt yet another tax on corporations? The answer is likely yes.

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