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Testimony of Walter Hellerstein

on the

Mobile Workforce State Income Tax
Fairness and Simplification Act of 2007
(H.R. 3359)

Before the
Subcommittee on Commercial and Administrative Law
of the
Committee on the Judiciary
United States House of Representatives

November 1, 2007

I am Walter Hellerstein, the Francis Shackelford Professor of Taxation at the University of Georgia School of Law. I have devoted most of my professional life to the study and practice of state taxation and, in particular, to state taxation of interstate commerce and the federal constitutional restraints on such taxation. A copy of my vita is attached to this testimony.

I am honored by the Chairman's invitation to testify today. I welcome the opportunity to share with the Subcommittee my views on the Mobile Workforce State Income Tax Fairness and Simplification Act of 2007. I do not appear here on behalf of any client, public or private, and the views I am expressing here today reflect my independent professional judgment.[1]

My testimony addresses three questions. First, does Congress have the constitutional authority to enact the Mobile Workforce State Income Tax Fairness and Simplification Act of 2007? Second, is there historical precedent analogous to the Mobile Workforce State Income Tax Fairness and Simplification Act of 2007 for congressional legislation restricting state taxing power? Third, would enactment of the Mobile Workforce State Income Tax Fairness and Simplification Act of 2007 constitute an appropriate exercise of congressional power? As explained in more detail below, I believe the answer to all three questions is "yes."

I. CONGRESS HAS CLEAR AUTHORITY UNDER THE COMMERCE CLAUSE TO ENACT THE MOBILE WORKFORCE STATE INCOME TAX FAIRNESS AND SIMPLIFICATION ACT OF 2007

There should be no serious controversy over Congress's broad authority to adopt virtually any rule that it believes is appropriate with respect to matters that substantially affect interstate commerce, as state taxation of workers that cross state lines in furtherance of such commerce plainly does. The Constitution grants Congress the power "[t]o regulate commerce . . . among the several States . . . ."[2] The U.S. Supreme Court has interpreted that power in sweeping terms. Thus in the *Shreveport Rate Case*,[3] which sustained Congress's power to regulate local rates because they affected interstate rates, the Court declared:

> It is unnecessary to repeat what has frequently been said by this court with respect to the complete and paramount character of the power confided to Congress to regulate

[1] In the interest of full disclosure, it should be noted that I am of counsel to Sutherland Asbill & Brennan LLP, which is counsel to the Council on State Taxation (COST), an active supporter of H.R. 3359. As stated in the text, however, the following testimony represents my independent professional judgment, and it does not necessarily represent the views of any institution or organization with which I am affiliated.

[2] U.S. Const. art. I, § 8, cl. 3.

[3] *Houston E&W Tex. Ry. v. United States*, 234 U.S. 342 (1914).

> commerce among the several States. It is of the essence of this power that, where it exists, it dominates. . . . By virtue of the comprehensive terms of the grant, the authority of Congress is at all times adequate to meet the varying exigencies that arise and to protect the national interest by securing the freedom of interstate commercial intercourse from local control.[4]

In construing Congress's "plenary"[5] power to promote interstate commerce under the Commerce Clause, the Court has routinely sustained as legitimate exercises of this power far-reaching congressional legislation, including legislation that (1) regulates the amount of wheat a farmer can grow for his own consumption,[6] (2) bars discriminatory practices in local hotels and restaurants,[7] and (3) proscribes local criminal activity.[8]

The Court has also indicated that Congress has ample power to prescribe rules regarding state taxation in particular. For example, in *Moorman Manufacturing Co. v. Bair*,[9] the Court sustained Iowa's single-factor gross receipts formula for apportioning net income, despite substantial claims that it would lead to multiple taxation. After recognizing that prevention of multiple taxation would require national uniform rules for the division of income, the Court declared:

> While the freedom of the States to formulate independent policy in this area may have to yield to an overriding national interest in uniformity, the content of any uniform rules to which they must subscribe should be determined only after due consideration is given to the interests of all affected States. *It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income.* It is to that body, and not this Court, that the Constitution has committed such policy decisions.[10]

Similarly, in *Quill Corp. v. North Dakota*,[11] which reaffirmed the judicial doctrine that the "negative" or "dormant" Commerce Clause[12] prohibits a state from requiring a

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[4] *Id*. at 350-51.

[5] *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 434 (1946).

[6] *Wickard v. Filburn*, 317 U.S. 111 (1942).

[7] *Katzenbach v. McClung*, 379 U.S. 294 (1964); *Heart of Atlanta Motel v. United States*, 379 U.S. 241 (1964).

[8] *Perez v. United States*, 402 U.S. 146 (1971).

[9] 437 U.S. 267 (1978).

[10] *Id.* at 279-80 (emphasis supplied).

[11] 504 U.S. 296 (1992).

vendor without physical presence in the state to collect a sales or use tax on sales to in-state customers, the Court declared that "Congress is . . . free to decide whether, when, and to what extent the States may burden interstate mail-order sales with a duty to collect use taxes."[13]

In *Arizona Public Service Co. v. Snead*,[14] Congress had enacted a statute prohibiting discriminatory state taxation of the generation or transmission of electricity. In a challenge to a New Mexico tax that allegedly violated the statute, the state contended that "if the federal statute is construed to invalidate the New Mexico tax, it exceeds the permissible bounds of congressional action under the Commerce Clause."[15] The Court summarily dismissed the argument, observing:

> In view of the broad power of Congress to regulate interstate commerce, this argument must be rejected. Here, the Congress had a rational basis for finding that the New Mexico tax interfered with interstate commerce, and selected a reasonable method to eliminate that interference. The legislation thus was within the constitutional power of Congress to enact.[16]

It is true that a few of the Court's recent decisions construing Congress's affirmative power under the Commerce Clause have taken a narrower view of that power than that reflected in some of the Court's more sweeping earlier pronouncements. Thus, in *United States v. Morrison*,[17] the Court held that Congress lacks the power under the Commerce Clause to provide a civil remedy for victims of gender-motivated violence because gender-motivated crimes do not substantially affect interstate commerce. Likewise, in *United States v. Lopez*,[18] the Court held that Congress lacks the power under the Commerce Clause to prohibit possession of firearms in school zones because possession of a gun in a local school zone does not substantially affect interstate commerce. But these decisions do not seriously

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[12] As noted above, the Commerce Clause by its terms is simply an affirmative grant to Congress "[t]o regulate commerce . . . among the several States . . . ." U.S. Const. art. I, § 8. However, since the early nineteenth century, the U.S. Supreme Court has read this affirmative grant to carry with it certain implied limitations on state authority, even in the absence of affirmative congressional action. These implied, judicially developed Commerce Clause restraints are frequently referred to as the "negative" or "dormant" Commerce Clause.

[13] *Quill*, 504 U.S. at 318.

[14] 441 U.S. 141 (1979).

[15] *Id*. at 150.

[16] *Id*. (citations to *Wickard v. Filburn, Katzenbach v. McClung, and Heart of Atlanta Motel v. United States* omitted).

[17] 529 U.S. 598 (2000).

[18] 514 U.S. 549 (1995).

inhibit the extensive power that Congress clearly possesses to deal with the problems raised by state taxation of interstate commerce, and, in particular, state taxation of employees who temporarily work in a state in pursuit of interstate commerce.[19]

II. THERE IS SUBSTANTIAL HISTORICAL PRECEDENT FOR THE ENACTMENT OF FEDERAL LEGISLATION ANALOGOUS TO THE MOBILE WORKFORCE STATE INCOME TAX FAIRNESS AND SIMPLIFICATION ACT OF 2007

Although Congress has never enacted comprehensive legislation limiting state taxation of interstate commerce, there is a considerable body of federal legislation directed at specific problems raised by such taxation. These targeted federal statutory restraints on the exercise of state tax power are in many respects analogous to the Mobile Workforce State Income Tax Fairness and Simplification Act of 2007, because they constitute a particularized federal response to an identifiable problem that, in Congress's view, threatened to burden interstate commerce. I describe these targeted federal statutory restraints below.

A. Taxes on Employees Engaged in Interstate Transportation

Perhaps the most pertinent historical precedent for the Mobile Workforce State Income Tax Fairness and Simplification Act of 2007 is federal legislation that currently restricts the power of states to tax the compensation of nonresident employees engaged in interstate transportation within the state. Federal statutes prohibit a state, other than the state of the employee's residence, from taxing the employee's compensation from an interstate rail carrier, motor carrier, or merchant mariner.[20] Federal law limits the states'

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[19] *See generally* Walter Hellerstein, "Federal Constitutional Limitations on Congressional Power to Legislate Regarding State Taxation of Electronic Commerce," 53 *National Tax Journal* 1307 (2000). Indeed, even though the Court in *Lopez* made it plain that Congress's power to legislate under the Commerce Clause is not unlimited, it did so in an opinion that reaffirmed, rather than discredited, the essential contours of the Court's affirmative Commerce Clause doctrine. Thus, after summarizing the "era of Commerce Clause jurisprudence that greatly expanded the previous defined authority of Congress under that Clause," *Lopez*, 514 U.S. at 556. the Court identified "three broad categories of activity that Congress may regulate under its commerce power" (*id*):

> First, Congress may regulate the use of the channels of interstate commerce. . . . Second, Congress is empowered to regulate and protect the instrumentalities of interstate commerce, or persons or things in interstate commerce, even though the threat may come only from intrastate activities. . . . Finally, Congress' commerce authority includes the power to regulate those activities having a substantial relation to interstate commerce, . . . *i.e.*, those activities that substantially affect interstate commerce.

Id. at 567. As noted above, the Mobile Workforce State Income Tax Fairness and Simplification Act of 2007 falls comfortably within the third category of those activities over which Congress may exercise its Commerce Clause authority.

[20] See 49 U.S.C. § 11502 (railroad employees); 49 U.S.C. § 14503 (motor carrier employees); 46 U.S.C. § 11108(b) (merchant mariner employees).

power to tax the compensation of employees who perform regularly assigned duties on interstate air carriers in more than one state to the state of the employee's residence and to the state in which the employee earns more than 50 percent of the compensation paid by the carrier to such employee.[21] Federal law also imposes limits on the states' authority to require withholding of income taxes from certain employees of water carriers.[22]

B. Taxes on Nonresidents' Retirement Income

In 1996, Congress enacted legislation prohibiting a state from imposing "an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such state)."[23] The legislation defines "retirement income" as distributions from qualified plans under the Internal Revenue Code as well as distributions from certain nonqualified plans that mirror qualified plans. As a consequence, the states are now substantially restrained in their ability to tax nonresidents on their retirement income on a "source" basis.

C. Net Income Taxes on Sellers of Tangible Personal Property Whose Activities in the State Do Not Exceed "Solicitation of Orders"

The most important piece of legislation that Congress has enacted limiting the states' power to tax interstate business is Public Law 86–272.[24] The legislation was enacted in 1959 as a specific response to the U.S. Supreme Court's decision in *Northwestern States Portland Cement Co. v. Minnesota*,[25] which explicitly held for the first time that the states possessed power to impose a fairly apportioned corporate net income tax on taxpayers engaged exclusively in interstate commerce. Congress feared that expanded state taxing authority over interstate business would burden interstate commerce. Public Law 86-272 prohibited the states from imposing a net income tax upon persons whose activities within a state do not exceed "solicitation of orders" for sales of tangible personal property fulfilled from outside the state – precisely the type of activity that was at issue in *Northwestern*.

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[21] 49 U.S.C. § 40116(f)(2).

[22] 46 U.S.C. § 11108(a) provides that wages due or accruing to a master or seaman on a vessel in the foreign, coastwise, intercoastal, interstate, or noncontiguous trade or an individual employed on a fishing vessel or any fish processing vessel may not be withheld under the tax laws of a state or a political subdivision of a state. However, the statute does not prohibit withholding wages of a seaman on a vessel in the coastwise trade between ports in the same state if the withholding is under a voluntary agreement between the seaman and employer of the seaman. Moreover, the law does not affect the liability of these employees for state income taxes.

[23] Pub. L. No. 104-95, 109 Stat. 979 (1996), codified at 4 U.S.C. § 114.

[24] 73 Stat. 55 (1959), codified at 15 U.S.C. § 381 *et seq*.

[25] 358 U.S. 450 (1958).

D. Taxes on Air Travel and Transportation

In 1970, Congress enacted legislation designed to assist states and localities in improving the nation's air transportation system (including the imposition of several federal aviation taxes to fund local airport expansion and improvement).[26] In 1972, the U.S. Supreme Court held that neither this legislation nor the Commerce Clause prevented states or localities from imposing charges designed to recoup the costs of airport construction and maintenance.[27] Congress responded to this decision by enacting a statute providing that "[n]o State…shall levy or collect a tax, fee, head charge, or other charge, directly or indirectly, on persons traveling in air commerce or on the carriage of persons in air commerce or on the sale of air transportation or the gross receipts derived therefrom."[28]

E. Discriminatory Taxes on Rail Carrier, Motor Carrier, and Air Carrier Transportation Property

1. Rail Carrier Property

In response to widespread complaints of state and local tax discrimination against railroads, Congress in 1976 adopted a special statute prohibiting the states from taxing rail transportation property at a higher ratio to its true market value than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction bore to the true market value of such other commercial and industrial property.[29] The statute also prohibits ad valorem property taxation of rail transportation property at a higher rate than that applicable to other commercial and industrial property.

2. Motor Carrier Property

In 1980, Congress extended to motor carriers protection against discriminatory state property taxes that is similar to protection it had previously enacted for railroads.[30] The principal difference between the statutes is that the motor carrier statute does not contain any provision prohibiting the states from imposing nonproperty taxes that discriminate against motor carriers.

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[26] See *Aloha Airlines, Inc. v. Director of Taxation*, 464 U.S. 7, 8-9 (1983).

[27] *Evansville-Vanderburgh Airport Authority District v. Delta Airlines*, 405 U.S. 707 (1972).

[28] Pub. L. No. 93-44, § 7(a), 87 Stat. 88, 90 (1973), codified in slightly different language at 49 U.S.C. § 40116(b).

[29] Pub. L. No. 94-210, § 306, 90 Stat. 31, 54 (1976), codified at 49 U.S.C. § 11501(b).

[30] See 49 U.S.C. § 14502.

3. Air Carrier Property

In 1982, Congress extended to air carriers protection similar to that which it had provided for motor carriers, except for federal court jurisdiction.[31]

F. Taxes Affecting Employee Benefit Plans Protected by the Employee Retirement Income Security Act (ERISA)

In enacting the Employee Retirement Income Security Act (ERISA),[32] Congress preempted state taxes affecting employee benefit plans, by providing that the Act "supersede[s] any and all State laws insofar as they may now or hereafter relate to any employee benefit plan."[33]

G. Energy Taxes Discriminating Against Interstate Commerce

In 1976, Congress enacted legislation prohibiting the states from imposing taxes on or with respect to the generation or transmission of electricity that discriminate against out-of-state manufacturers, producers, wholesalers, retailers, or consumers of electricity.[34] The history of the legislation indicated that it was directed specifically at a New Mexico tax, which the U.S. Supreme Court ultimately invalidated under the legislation.[35]

H. Taxes Interfering With Federal "Superfund" Legislation

The Federal Comprehensive Environmental Response, Compensation, and Liability Act,[36] the so-called Superfund legislation, preempts state taxes whose "purpose" is to provide "compensation for claims for any costs of response or damages or claims which may be compensated under this [Act]."[37]

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[31] See 49 U.S.C. § 40116.

[32] 29 U.S.C. § 1001 *et seq.*

[33] 29 U.S.C. § 1144(a).

[34] Tax Reform Act of 1976, § 2121(a), 90 Stat. 1914 (1976), codified at 15 U.S.C. § 391.

[35] *Arizona Public Service Co. v. Snead*, 441 U.S. 141 (1979).

[36] 42 U.S.C. § 9614(c).

[37] *Id.*

I. Taxes on Internet-Related Activities

In 1998, Congress enacted the Internet Tax Freedom Act (ITFA).[38] The Act imposed a three-year moratorium on three types of taxes: (1) taxes on Internet access; (2) discriminatory taxes on electronic commerce; and (3) multiple taxes on electronic commerce. In 2001, Congress extended the moratorium without change for two more years. Although the moratorium technically expired in 2003, Congress retroactively reextended the moratorium in 2004 for another four years through November 1, 2007. A further proposed extension is currently pending before Congress.

J. Taxes on Interstate Passenger Transportation by Motor Carrier

In response to the U.S. Supreme Court's decision in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*,[39] which sustained a state tax on the purchase of interstate transportation services, Congress passed legislation in 1995 effectively overruling the decision.[40] The legislation bars a state or political subdivision thereof from imposing a tax or other charge on (1) a passenger traveling in interstate commerce by motor carrier; (2) the transportation of a passenger traveling in interstate commerce by motor carrier; (3) the sale of passenger transportation in interstate commerce by motor carrier; or (4) the gross receipts derived from such transportation.[41] After an Illinois court held that this statute did not bar a tax on commercial vehicle operators who transported passengers within Illinois when the passengers had prearranged such transportation in connection with an interstate journey by air,[42] Congress once again legislated and overruled the decision by providing that "[n]o State or political subdivision thereof…shall enact…any law…requiring a license or fee on account of the fact that a motor vehicle is providing pre-arranged ground transportation service"[43] when the service involves transportation from one state to another or transportation within a state with intermediate stops in another state.

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[38] Pub. L. No. 105–277, §§ 1101–04, 112 Stat. 2681–719 to 2681–726 (1998).

[39] 414 U.S. 175 (1995).

[40] Pub. L. No. 104–88, 109 Stat. 803 (1995), codified at 49 U.S.C. § 14505.

[41] *Id*.

[42] *Tri-State Coach Lines, Inc. v. Metropolitan Pier and Exposition Authority*, 732 N.E.2d 1137 (Ill. App. 2000), *appeal denied*, 738 N.E.2d 936 (2000), *cert. denied*, 532 U.S. 994 (2001).

[43] Pub. L. No. 107-298, 116 Stat. 2342 (2002), codified at 49 U.S.C. § 14501(d).

K. Local Taxes on Direct-to-Home Satellite Service Providers

Congress has prohibited localities from imposing taxes on providers of direct-to-home satellite services.[44]

L. Stock Transfer Taxes

Congress prohibits states from imposing stock transfer taxes based solely on the in-state physical location of facilities of registered clearing agencies or registered transfer agents.[45]

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In sum, there is substantial historical precedent for the type of targeted congressional legislation limiting state taxing authority under the Commerce Clause that is reflected in the Mobile Workforce State Income Tax Fairness and Simplification Act of 2007.

III. ENACTMENT OF THE MOBILE WORKFORCE STATE INCOME TAX FAIRNESS AND SIMPLIFICATION ACT OF 2007 WOULD CONSTITUTE AN APPROPRIATE EXERCISE OF CONGRESSIONAL POWER

In my opinion, enactment of the Mobile Workforce State Income Tax Fairness and Simplification Act of 2007 would constitute an appropriate exercise of congressional power. In expressing this opinion, I wish to make it clear that I believe the states have a legitimate interest in assuring that workers who earn income in the state pay their fair share of the state tax burden for the benefits and protections that the state provides to them. The states' legitimate interest, however, must be balanced against the burdens that are imposed on multistate enterprises, and on the conduct of interstate commerce, by uncertain, inconsistent, and unreasonable withholding obligations imposed by the states. Indeed, it is telling that a number of states themselves have implicitly recognized these burdens by adopting reciprocal provisions exempting income, or certain classes of income, earned by nonresidents in their state if the nonresident's home state grants a similar exemption to residents of the exemption-granting state.[46]

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[44] Pub. L. No. 104-104, tit. VI, § 602(a), 110 Stat. 144(a) (1996) (reprinted at 47 U.S.C. § 152, historical and statutory notes).

[45] 15 U.S.C. § 78bb(d).

[46] The following states have entered into reciprocal agreements exempting compensation paid in their states to residents of other states:

STATE	AGREEMENT WITH
Illinois	IA, KY, MI, WI
Indiana	KY, MI, OH, PA, WI

In the end, although there may well be room for additional fine-tuning of the statutory language to assure that the right balance is struck between the states' legitimate interests in revenue raising and the nation's interest in preserving our national common market, I believe that a targeted response to the specific problem reflected in the proposed Mobile Workforce State Income Tax Fairness and Simplification Act of 2007 is an appropriate exercise of the congressional commerce power.

(note 46, continued)

STATE	AGREEMENT WITH
Iowa	IL
Kentucky	IL, IN, MI, OH, VA, WV, WI
Maryland	DC, PA, VA, WV
Michigan	IL, IN, KY, MN, OH, WI
Minnesota	MI, ND, WI
Montana	ND
New Jersey	PA
North Dakota	MN, MT
Ohio	IN, KY, MI, PA, WV
Pennsylvania	IN, MD, NJ, OH, VA, WV
Virginia	DC, KY, MD, PA, WV
West Virginia	KY, MD, OH, PA, VA
Wisconsin	IL, IN, KY, MI, MN

See RIA State and Local Tax Services for individual states, available at www.checkpoint.riag.com (¶¶ 55,205, 55,325, and 55,875 for individual states).