Multistate Business Entities

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The binary legislative choice between state and federal regulation of a firm's internal affairs is deeply entrenched in the existing literature and policy discussions. Alas, this regulatory menu contains a false and distortive dichotomy. The state-federal dichotomy is false because multistate formation and regulation of business entities are possible as well. This dichotomy is distortive because it deprives policymakers of the advantages of multistate corporations and other business entities. In this Article, we demonstrate that a multistate business entities regime can resolve multiple predicaments that presently bring about unfairness and inefficiencies in both business entities law and business entities taxation.

A multistate business entities regime promises to be beneficial for both the participating states and the business entities themselves. For example, by choosing to co-compete, states that have so far lost in the market for corporate charters would be able to generate—and divide among themselves—substantial business and tax revenues by offering the corporations formed under their regime unique tax and corporate law benefits. In this way, for example, a "tri-state" co-op, offered by New York, Connecticut, and New Jersey, could compete with Delaware; and a "rust belt" coalition could retain industry charters within its multistate jurisdiction.

The hitherto unnoticed potential for a multistate entities regime aligns with the Framers' vision for state cooperation under the Constitution's Compact Clause. Furthermore, setting up this regime would vastly improve the functioning of the market for both corporate charters and other business entities. This regime would allow states to vigorously compete for both managers and investors, boost stakeholder advocacy, and accomplish environmental, social, and governance (ESG) goals to the benefit of their constituents.

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INTRODUCTION

The Framers of the Constitution envisioned our union to include meaningful interstate cooperation that is independent of federal action.[1] In tune with this vision, multistate agreements are commonplace in many legal and commercial areas.[2] Surprisingly, however, state cooperation has, thus far, bypassed what is perhaps its most natural domain: the regulation of business entities. In the realm of business entities, state separatism and fierce interstate competition is the lay of the land. While this separatist approach has produced a myriad of shortcomings, scholars and policymakers alike have only considered and utilized one alternative—the federalization of business entities law.[3] This Article shows that multistate business entities are also an option and that this option is, in fact, preferable to both state separatism and federalization.

When entrepreneurs (or their investors) choose the state in which they want to form their business, they provide that state with franchise taxes and other monetary and nonmonetary benefits.[4] In return, the state provides the entrepreneurs (or their investors) legal benefits that include limited liability, anonymity, pass-through taxation, and many other sophisticated bundles of

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1. *See, e.g.*, Felix Frankfurter & James M. Landis, *The Compact Clause of the Constitution—A Study in Interstate Adjustments,* 34 YALE L.J. 685, 692 (1925).

2. *See infra* Section I.B.

3. *See*, *e.g.*, Joel F. Henning, *Federal Corporate Chartering for Big Business: An Idea Whose Time Has Come*, 21 DEPAUL L. REV. 915, 915 (1972) (arguing for federal chartering as a solution to state law shortcomings); William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 663 (1974) (arguing for federal intervention as a solution to Delaware's controlling and problematic state corporate law); Mark Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 588 (2003) (analyzing both the existing impact of the federal government on corporate law and the impact of the threat of further federalization). As part of this literature, many scholars argue for the benefits of Delaware's success: see Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 533 (2001) (finding that Delaware law is a good thing for the firms themselves); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 841–49 (1995) (arguing that Delaware's success can be attributed to the network benefits it provides); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1909–10 (1998) (arguing that Delaware provides network benefits due to its success). Two scholars that did mention the advantages of regional corporate codes and transboundary filing systems have stopped short of advocating for the formation of a fully-fledged multistate formation regime. The benefits and the costs of that regime as an alternative to both state separatism and federalization have consequently been left unanalyzed. *See* Christi Davis & Douglas M. Branson, *Interstate Compacts in Commerce and Industry: A Proposal for "Common Markets Among States*,*"* 23 VT. L. REV. 133, 152 (1998).

4. *See, e.g.*, Stephen M. Bainbridge, *Fee-Shifting: Delaware's Self-Inflicted Wound*, 40 DEL. J. CORP. L. 851, 869–70 (2016) ("Delaware gets a significant percentage of state revenues from incorporation fees and franchise taxes"); Omari Scott Simmons, *Delaware's Global Threat*, 41 J. CORP. L. 217, 224–28 (2015) (analyzing the impact of brand recognition on state competition for charters).

legal default provisions that streamline the firm's formation, governance, and dealings.[5]

This beneficial exchange between states and entrepreneurs engenders a competition between the states over how many firms they can attract. This competition has winners and losers. The outright winner of this competition is, of course, the State of Delaware, which encompasses the majority of all U.S. publicly traded corporations, as well as many private corporations and LLCs.[6] Other states that have recently been able to generate notable competitive spirits include Nevada and Wyoming.[7]

The impact of this interstate rivalry is a matter of great debate. Some see it as mostly a good thing, while others see it as mostly a bad thing.[8] For example, many scholars have described the interstate race for attracting corporations as a "race to the top," while other scholars have described it as a "race to the bottom."[9] Regardless of one's opinion on this race, scholars and policymakers alike have noted that this horizontal state competition is not carried out in a vacuum.[10] Indeed, the federalization of business entities law also impacts, and threatens to further impact, the formation and governance of the firm.[11] Whether this federal intervention is a good or a bad thing is also a highly contested issue.[12]

Enter multistate agreements. The Compact Clause of the United States Constitution allows states to cooperate in many contexts, both with and without the federal government's involvement.[13] The Compact Clause does

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5. *See generally* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 1 (1993).

6. *About the Division of Corporations*, DEL. DIV. OF CORPS., https://corp.delaware.gov/aboutagency/ [https://perma.cc/R2FU-X3HX].

7. *See* Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935, 935 (2012) (describing Nevada's challenge to Delaware); Pierluigi Matera, *Delaware's Dominance, Wyoming's Dare: New Challenge, Same Outcome?*, 27 FORDHAM J. CORP. & FIN. L. 73, 73 (2022) (describing Wyoming's challenge to Delaware).

8. *Compare* Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1443, 1450 (1992) (arguing that state competition for charters is a bad thing), *with* William J. Carney, *The Political Economy of Competition for Corporate Charters*, 26 J. LEGAL STUD. 303, 303 (1997) (arguing that state competition for charters is a good thing).

9. *Id.*

10. *See* Roe, *supra* note 3.

11. *See id.*

12. For a paradigmatic illustration of how this contested point plays out in particular legal issues, see Christopher M. Bruner, *Managing Corporate Federalism: The Least-Bad Approach to the Shareholder Bylaw Debate*, 36 DEL. J. CORP. L. 1, 2 (2011) ("[T]he least-bad approach would be to remove the SEC from the process entirely, leaving these matters to Delaware in the first instance, subject to potential intervention by Congress.").

13. The Compact Clause states, in relevant part, "No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State . . . ." U.S. CONST. art. I, § 10, cl. 3. The intent and scope of the Compact Clause is discussed in detail in Section I.B, *infra*.

so in two ways. First, the Compact Clause leaves many multistate agreements outside the purview of the federal government.[14] Second, and equally important, the Compact Clause functions as an enabling mechanism that allows the states to bind one another into long-term commitments backed by the authority of Congress.[15] Multistate agreements are not just constitutionally permitted; they have also been a source of great collaborative benefits. Notable collaborations run the gamut from environmental initiatives such as the tri-state environmental commission (New York, New Jersey, and Connecticut), to transportation initiatives such as the Kansas City Area Transportation Authority (Missouri and Kansas), and children protection initiatives such as the Interstate Compact on the Placement of Children (all 50 states).[16] Interstate agreements also include business and tax-related collaborations, such as the Multistate Tax Commission (MTC) and the Streamlined Sales and Use Tax Agreement (SSUTA).[17] It is therefore perplexing that the regulation of business entities has not produced interstate cooperation.[18] As surprising, this rich and potentially transformative source of social benefits has evaded both scholarly and legislative attention.[19]

In the pages ahead, we rectify this startling omission. We show that the regulation of business entities can and should be the next frontier of multistate cooperation. Allowing firms to be formed in a multistate regime would be highly beneficial to the participating states, the firms themselves, and the various stakeholders of the states. As an illustration, consider the benefits that can be generated if the "rust belt" states—states that rely most heavily on manufacturing—came together and decided to form a multistate business

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14. *See infra* Section I.B and accompanying notes.

15. *Id.*

16. *See* Dan Logsdon, *Multistate Problem Solving with Interstate Compacts*, NAT'L CTR. FOR INTERSTATE COMPACTS (NCIC), https://compacts.csg.org/wp-content/uploads/2020/11/Compact-Resource-Guide-1-1.pdf [https://perma.cc/N5AX-YD3Z].

17. *Member States*, MULTISTATE TAX COMM'N, https://www.mtc.gov/The-Commission/Member-States [https://perma.cc/88NN-JWVU]; *Streamlined Sales and Use Tax Agreement*, STREAMLINED SALES TAX GOVERNING BD., https://www.streamlinedsalestax.org/docs/default-source/agreement/ssuta/ssuta-as-amended-through-12-21-21.pdf?sfvrsn=19cb2ba1_12 [https://perma.cc/2NFT-N3YS]. The MTC provides a Multistate Tax Compact, which serves as an advisory compilation of model laws. *Multistate Tax Compact*, MULTISTATE TAX COMM'N, https://www.mtc.gov/The-Commission/Multistate-Tax-Compact [https://perma.cc/E7VG-ASSL].

18. It is perhaps doubly surprising given the recent scholarly attention and analysis of quasi-federal cooperation amongst the states. *See* Bridget A. Fahey, *Federalism by Contract*, 129 YALE L.J. 2326, 2326 (2020). This scholarly attention also tracks problems that arose since at least the turn of the 19th Century, which adds to the perplexing nature of this gaping hole. *See* Louisville, N.A. & C. Ry. Co. v. Louisville Trust Co., 174 U.S. 552, 552 (1899) (debating the legal possibility, merits, and demerits of concurrent state formation without legislation).

19. *See supra* note 3 and accompanying text.

entities regime.[20] Such a regime could benefit the participating states because it would allow them to form a competitive coalition that could win over significant revenues from franchise taxes and other formation benefits. Furthermore, such a regime could benefit the firms because it would provide them with a streamlined and unified body of business entities and tax law that suits their needs. Last but not least, this regime could capitalize on its newly found regulatory powers to better protect stakeholders such as workers, the environment, and local communities. The benefits of a multistate business entities regime thus include business entities law and tax law advantages for the participating states, for the entities themselves, and for stakeholders at large.

The advantages of a multistate regime in the realm of business entities law consist of both administrative and legislative benefits. The administrative benefits include the ability to form multistate tribunals, the ability to set up centralized filing and compliance centers, and the ability to streamline the conduct of a multistate business by obliterating the need to file and pay for foreign qualifications or for the formation of subsidiaries. The legislative benefits come in both heterogeneous and homogeneous varieties. Heterogeneous benefits will accrue from the bundling of the varying state menus of business entity options.[21] For example, if state X offers the option for an entity that maintains the anonymity of its equity owner, but state Y has not done so thus far, the collaboration between the states would allow firms to choose the anonymity feature without emigrating from their formation domicile. The resulting ability to aggregate the menu of business entity choices can outperform the expensive and uncertain process of individualized adoptions that would require long legislative discussions and judicial interpretations. The opposite legislative strategy—namely, the adoption of a homogeneous multistate regime—could also be beneficial. Homogeneity benefits occur when there are advantages in guaranteeing consistent and predictable legal treatment across various jurisdictions.[22] For example, under the existing state separatist structure, firms often find themselves in the tenuous position of not knowing whether they are bound by a foreign state's long-arm statute that attempts to circumvent the internal affairs doctrine,

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20. James Chen, *Rust Belt: Definition, Why It's Called That, List of States*, INVESTOPEDIA, https://www.investopedia.com/terms/r/rust-belt.asp#:~:text=The%20states%20considered%20to%20be,%2C%20West%20Virginia%2C%20and%20Wisconsin [https://perma.cc/P3L3-SBB6].

21. Scholarly discussion of the costs and benefits of bundling versus uniformity approaches to multistate regimes is more typically present in the context of International Law. For an illuminating illustration, see Anu Bradford, *How International Institutions Evolve*, 15 CHI. J. INT'L L. 47, 47 (2014).

22. *Id.*

which generally guarantees that the governing laws of a firm's internal matters are those of their state of formation.[23] Under a homogeneous strategy, however, such uncertainties could be reduced, if not altogether eliminated.

The ability of the states to cooperate and offer firms both administrative and legislative business law benefits can improve the market for business entities. The market for the formation of business entities would improve because it would become more competitive. For example, as we already mentioned, the current market for corporate charters has Delaware as its unequivocal winner.[24] If states can co-compete, however, they will stand a fighting chance at attracting a substantial number of corporate charters. This renewed competition would, in turn, force the states to invest significant efforts into attracting owners and business managers.[25]

The multistate regime would also benefit other stakeholders. Since the states would be providing firms with enhanced benefits, they will also have an enhanced ability to enforce meaningful and expensive stakeholder initiatives. As far as incentives are concerned, politicians running the state's affairs will be motivated to promote such initiatives to cater to the local voters, the initiatives' immediate beneficiaries.

One of the most important questions in business law today is whether firms should pursue the interests of stakeholders, such as employees, local communities, and the environment, even when it runs against the pursuit of economic value for the firm itself.[26] Those who answer this question in the affirmative call for private actions by the firms, for legal actions by legislatures and judges, or for both.[27] From an economic and practical standpoint, states implementing such stakeholder initiatives create a chilling effect on firm formation. When states provide greater benefits for firms, however, they are able to increase their taxes without losing these firms. This is because the net result for the firm might still be better than the alternatives. By the same token, therefore, setting up a multistate business entities regime would allow participating states to increase their stakeholderism initiatives.

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23. For a comprehensive account of the internal affairs doctrine and its limitations, see generally Ann Lipton, *Inside Out (or, One State to Rule them All): New Challenges to the Internal Affairs Doctrine*, WAKE FOREST L. REV. (forthcoming 2023).

24. *See supra* note 6 and accompanying text.

25. The literature on the competition for corporate charters questions whether the states compete for business managers or equity holders, and whether either of these possibilities is a good or a bad thing. Suffice it to say, for our purposes, that the competition would be heightened in the same direction that currently exists. *See infra* Section I.A.

26. Lucian Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 91 (2020).

27. *See e.g.*, Ofer Eldar, *Designing Business Forms to Pursue Social Goals*, 106 VA. L. REV. 937, 937 (2020) (arguing for a legal intervention for the promotion of stakeholderism as a solution to costly private ordering guarantees of stakeholderism).

As a corollary, states would become able to promote corporate social responsibility (CSR) along with both honest and measurable environmental, social, and governance (ESG) metrics.

A multistate business entities regime can also produce multiple tax law benefits for the participating states, businesses, and other stakeholders.[28] The administrative and legislative tax benefits are compounded because participating states can coordinate across many tax regimes, including corporate income, personal income, payroll, sales and use, and specialized taxes. Importantly, states can choose to incorporate any level of tax cooperation into a multistate business entities regime. The tax law benefits augment the business entities law benefits, but states may forgo tax law cooperation if it is not politically viable.

Many of the administrative tax law advantages mirror the administrative business entities law benefits. These benefits include the ability to form multistate tax tribunals and centralized filing and compliance arrangements that will reduce administrative costs and enforcement burdens.

The legislative, or tax policy, benefits realizable by a multistate business entities system are extensive as well. Cooperation and uniformity can greatly increase efficiency in all aspects of lawmaking—legislative, administrative, and judicial. More impactful, however, is that participating states can adopt tax policy approaches that allow them to co-compete rather than compete individually against other states. Because migration is relatively easy at the state level, state tax policies often yield a race to the bottom that results in revenue losses for the states and laws that embody serious tax policy flaws. If states join together, they can jointly create tax laws that embody tax policy principles suited to the states' specific circumstances and prevent cross-border cannibalization. For example, states in the "rust belt"[29] could incorporate into their tax laws certain aspects that benefit their manufacturing and industrial constituents, such as single-sales factor apportionment and unified credits and incentives for job creation.[30] States that are close to each other geographically, such as those in the northeastern United States, could

28. Each business's employees stand to benefit significantly if states can cooperate in the context of sourcing wages for remote workers—an issue that is creating enormous controversy with the post-COVID shift toward remote work arrangements.

29. For a survey of the economic and tax landscape of the "rust belt," see Billy Hamilton, *Is the Rust Belt Revival Here Yet?*, 106 TAX NOTES ST. 231, 231 (2022).

30. In this example, a multistate regime would allow states such as Wisconsin, Michigan, and Ohio to co-compete, with several distinct advantages, against other states. In response, industrial states in the "sun belt" such as Mississippi, Georgia, and South Carolina could create a multistate regime to compete against the "rust belt" regime. This proliferation of regional multistate business entities and taxation regimes would rapidly advance the benefits discussed herein and prevent the current race to the bottom in the state tax corporate incentive context.

incorporate into their tax laws reciprocal or sharing agreements that solve remote workforce problems. Many more potential administrative and legislative benefits, discussed further below, buttress the idea of setting up a multistate business entities regime.

This Article proceeds in three Parts. Part I explains the constitutional foundation for effectuating a multistate business entities regime and the impact that such a regime would have on the market for business entities. In this Part, we also lay out and scrutinize what is commonly—yet, mistakenly—understood as a dichotomous choice between state separatism or federalization of business entities. Thereafter, Parts II and III describe, respectively, the business entities law and tax law benefits that a multistate business entities regime would provide. These Parts demonstrate that the multistate business entities regime holds the prospect for generating transformative business and tax benefits for the firms' managers, investors, and stakeholders at large. A brief Conclusion follows.

I. COMPETING FOR CHARTERS

Developing a multistate business entities regime will benefit participating states, will enhance the value of the firm, and will serve the interests of society as a whole. This Part answers the how and why questions. To explain how it is possible to create a multistate business entities regime, we first lay out the current practice of state separatism and federal ad hoc interventions, and then show the constitutional power of, and directive for, state-state cooperation. To explain why the multistate business entities regime will benefit the participating states, the relevant firms, and society at-large, we show that a state-state cooperative competition, or co-competition, will create an incentive structure that will benefit both the suppliers (the states) and the customers (the business entities) in the market for business entity formation.

Let us proceed in this order.

A. The False Dichotomy of State Separatism and Federalization

States compete to attract business entities.[31] They do so because it generates tax and fee revenues as well as intangible benefits for the state.[32] States compete for business entities by offering a menu of legal choices that they hope will attract firms.[33] These choices are bundles of business and tax

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31. *See supra* notes 4 and 6 and accompanying text.
32. *Id.*
33. *See* ROMANO*, supra* note 5.

laws that firms can choose to opt into or out of.[34] For example, if one state offers a business entity option that allows for both liability protection to owners (i.e., limited liability) and a single layer of income tax (i.e., pass-through taxation), but another state does not, we can expect that one state will attract a higher or lower number of firm formations compared to the other.

This state competition for firm formation has brought about two fundamental policy questions. The first question is whether state competition for firm formation is good or bad for the firm.[35] The second question is whether the state competition for firm formation is good or bad for society at-large.[36] The myriad of academic and legislative answers to these questions is proportional to their importance.[37] Shockingly, however, these answers all share one thing in common: all have only considered states competing alone, or the federal government intervening, but have not considered the possibility of state-state cooperation.

The most notorious example of the competition for firm formation is the competition for corporate charters. This example, provided in the following paragraphs, is a useful illustration for the false dichotomy of state separatism and federalization. This is why we use this example as the main guide of this Section. That said, it is important to emphasize that this false dichotomy exists for incorporated and unincorporated entities alike.

The internal affairs of a corporation are generally governed by the laws of the state in which it was incorporated.[38] This result is due to the aptly named "internal affairs doctrine."[39] The internal affairs doctrine allows states to adopt differing legislative and judicial menus of legal doctrines that regulate the governance, dealings, and liability of corporations.[40] The ability to attract corporations to one's state is extremely important and beneficial: it provides successful states with franchise taxes and other monetary and reputational

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34. *Id.*

35. *See e.g.*, Daines, *supra* note 3, at 33.

36. *See e.g.*, Donald Schwartz, *Towards New Corporate Goals: Co-Existence with Society*, 60 GEO. L.J. 57, 57 (1971).

37. For important works tackling these questions, see *supra* notes 3–6, 8 and accompanying text as well as KENT GREENFIELD, THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES (2006), and Lucian Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 553 (2002).

38. Sagarra Inversiones, S.L. v. Cementos Portland Valderrivas, S.A., 34 A.3d 1074, 1082 (Del. 2011) ("The term 'internal affairs' encompasses 'those matters that pertain to the relationships among or between the corporation and its officers, directors, and shareholders.' The doctrine requires that the law of the state (or, in this particular case, the sovereign nation) of incorporation must govern those relationships.").

39. *Id.*

40. *Id.*

benefits.[41] The market for corporations is currently dominated by the State of Delaware, which has successfully attracted over half of all publicly traded corporations (as well as a significant proportion of private corporations).[42] Other states that have recently experienced modest success are Nevada and Wyoming.[43]

There is an open debate as to whether this competition for corporate charters is good or bad for corporations.[44] That is, there is an open debate regarding the first fundamental policy question described above. The various answers to this question first address a preliminary question: When states attract corporations, do they do so because they attract the firm's owners (i.e., the shareholders), or is it because they attract the firm's managers (i.e., the directors)?[45] Those who believe that states compete for corporations by catering to the shareholders also generally believe that this competition is, therefore, a good thing for the value of the firm.[46] These types of theories are known in the literature as "race to the top" theories.[47] On the other end of the spectrum are those who believe that states compete for corporations by catering to directors, and that this phenomenon is a bad thing for the value of the firm.[48] Naturally, this set of theories is known in the literature as "race to the bottom" theories.[49] Other answers do not take the position that attracting shareholders or managers is inherently a good or a bad thing, respectively.[50]

The second fundamental policy question, whether the race for corporate charters is good or bad for society at-large, is equally open-ended.[51] In principle, one could believe in either type of race theory and also believe that it is either good or bad for society as a whole. While some legislatures and academics see a necessary and sufficient connection between benefiting the firm and benefiting society as a whole, many others are not as optimistic.[52]

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41. *See* Simmons, *supra* note 4, at 232.
42. *See* DELAWARE DIVISION OF CORPORATIONS, *supra* note 6.
43. *See supra* note 7 and accompanying text. For a discussion of Delaware's success in the international corporate charters arena *see Ido Baum & Dov Solomon, The Least Uncomfortable Choice: Why Delaware and England Win the Global Corporate Law* Race, 73 S. CAR. L. REV. 387 (2021).
44. *See* sources cited *supra* note 8.
45. *See* Tomer S. Stein, *Debt as Corporate Governance*, 74 HASTINGS L.J. 1281 (2023) (providing a comprehensive account of the debate and its many variations).
46. *Id.* at 33–34.
47. *Id.* at 34.
48. *Id.*
49. *Id.*
50. *Id.*
51. *See generally* Schwartz, *supra* note 36 and accompanying text.
52. *See, e.g.*, Bebchuk & Tallarita, *supra* note 26, at 99–102 nn.14–20 (presenting both views).

In summation, legislatures and academics have identified two focal points that may render the state separatist approach to business formation suboptimal: the impact on the firm and the impact on society at-large. Those who believe that the race for corporate charters brings about less than optimal results, whether due to the impact on the firm or due to the impact on society at large, generally offer two distinct solutions. The two solutions are sometimes offered separately, and other times offered in conjunction. The first solution calls for private organization and pressure on corporations to voluntarily change the way they conduct themselves. The second solution is a legal solution. This solution calls for the intervention of the federal government. Indeed, the federal government has already begun to intervene in corporate law and governance across several dimensions. For example, the Sarbanes-Oxley Act of 2002 requires the independence of audit committee members in public corporations.[53] Those who support the federalization of corporate law as a legal solution divide into those who call for narrow and particular interventions in specific manners and those who call for a complete taking-over of corporate law and firm formation. For example, many legislatures and academics have called for the federal chartering of all corporations.

The currently understood landscape of regulatory choices, therefore, is bipolar: The options are either state separatism or federalization, or else firm action is left in the hands of private ordering. This regulatory landscape is of utmost importance because it impacts the value of the firm and society as a whole. It is by virtue of appeals to state competitions and federalizations that legislatures and academics have made recommendations and claims about the economical and societal impacts of corporate law specifically and business entities law generally. As this Article shows, however, state cooperation and a multistate business entities regime is also a possible solution.

B. The Compact Clause

The Compact Clause of the United States Constitution allows states the ability to cooperate in many contexts, both with and without the federal government's approval. Internally, the text of the Compact Clause operates as a limiting provision, stating in relevant part, "No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State . . . ."[54] The intent and scope of the Compact Clause, however, are

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53. *See, e.g.*, 17 C.F.R. § 240.13a-14 (2022) (compelling the principal executive and principal financial officer of reporting companies to certify annual and quarterly filings).

54. U.S. CONST. art. I, § 10, cl. 3.

narrowly tailored to prevent "the increase of political power in the states, which may encroach upon or interfere with the just supremacy of the United States."[55] If a multistate agreement does not have the potential to interfere with federal supremacy, then it does not require federal approval pursuant to the Compact Clause.[56] Externally, the Compact Clause is an enabling provision. It provides the states with the ability to rely on Congress's authority to create binding, mutual, and credible commitments amongst one another. The Compact Clause, therefore, effectuates the Framers' vision for multistate cooperation by both leaving certain non-binding state collaborations untouched and, in other cases, by providing an enforcement agent that could facilitate long-term and committed state–state collaborations. This Section illustrates the doctrine and history underlying both functions.

For the first 150 years after the nation's inception, interstate "compacts" consisted primarily of boundary and border settlements.[57] Beginning in the 1920s, the substantial proliferation of formal interstate arrangements to address governmental problems affecting multiple states was "one of the most significant developments in American federalism."[58] This trend toward multistate agreements gave rise to questions regarding the scope of the Compact Clause in the commercial context, which are discussed further below.

By way of background, scholars have divided "compacts" into two classifications: "Common Law Compacts" that do not require congressional consent, and "Constitutional Compacts" that do.[59] A compact falls within the latter classification if it has the potential to interfere with federal supremacy.[60] Precedent suggests that impermissible interference with federal supremacy—i.e., a Constitutional Compact—may occur only "through a legal requirement

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55. U.S. Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452, 468 (1978) (quoting Virginia v. Tennessee, 148 U.S. 503, 519 (1893)).

56. Although this federal supremacy principle is now well-established, at least one scholar argues that it is an improper interpretation of the Compact Clause. *See* Michael S. Greve, *Compacts, Cartels, and Congressional Consent*, 68 MO. L. REV. 285, 285 (2003).

57. *See* Frankfurter & Landis, *supra* note 1, at 695–96; James F. Blumstein & Thomas J. Cheeseman, *State Empowerment and the Compact Clause*, 27 WM. & MARY BILL RTS. J. 775, 780 (2019); David E. Engdahl, *Characterization of Interstate Arrangements: When Is a Compact Not a Compact?*, 64 MICH. L. REV. 63, 63 (1965); Davis & Branson, *supra* note 3, at 139–40. *See generally* JEFFREY B. LITWAK, INTERSTATE COMPACT LAW: CASES AND MATERIALS (4th ed. 2020).

58. Engdahl, *supra* note 57.

59. Blumstein & Cheeseman, *supra* note 57, at 787. Incorporating the term "common law" may be a misnomer because states will typically become a participant member of a compact by enacting legislation that codifies the compact terms.

60. *U.S. Steel*, 434 U.S. at 471 (discussing adherence to *Virginia v. Tennessee*'s precedent); *see also* Blumstein & Cheeseman, *supra* note 57, at 788.

from which the State may not extricate itself."[61] If a state is able to extricate itself, however, the agreement may not rise to the level of a "compact."[62] Several state supreme courts, discussed in detail below, have undermined the concept of a "Common Law Compact," instead concluding that because a multistate agreement was not a "Constitutional Compact" it was not a "compact" at all, but rather a non-binding agreement.[63] Thus, it is unclear, at least in the commercial context, whether there is an intermediate category between a non-binding agreement and a Constitutional Compact.

The boundaries of the Compact Clause have been considered several times in the state tax context. The United States Supreme Court and several state supreme courts have upheld the constitutionality of the Multistate Tax Compact under the Compact Clause.[64] In 1966, the states that would eventually comprise the Multistate Tax Commission created the Multistate Tax Compact as an advisory, model law.[65] States began incorporating the Compact into their statutory regimes in 1967, and it gained widespread adoption in the years that followed.[66] In 1972, when twenty-one states had adopted the Compact, a group of multistate corporate taxpayers filed a legal challenge asserting that the Compact was invalid under the Compact Clause.[67] The case, *United States Steel Corp. v. Multistate Tax Commission*, made its way to the United States Supreme Court.[68]

The Court began by examining its earlier Compact Clause decisions in *Virginia v. Tennessee*[69] and *New Hampshire v. Maine*.[70] In those cases, the Court declined to read the text of the Compact Clause literally because doing so "would require the States to obtain congressional approval before entering

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61. Duncan B. Hollis, *Unpacking the Compact Clause*, 88 TEX. L. REV. 741, 766 (2010); *see also* Sheldon H. Laskin, *The Nostalgia of Eternity: Interstate Compacts, Time, and Mortality*, 49 RUTGERS L. REV. 25, 25–26 (2021) (discussing the dispute arising from New Jersey's attempt to withdraw from the New York Waterfront Commission Compact).

62. *See, e.g.*, Davis & Branson, *supra* note 3, at 137 (describing the binding nature of compacts).

63. *See infra* notes 90–93 and accompanying text.

64. *See, e.g.*, *U.S. Steel*, 434 U.S. at 452; Gillette Co. v. Franchise Tax Bd., 363 P.3d 94, 96 (Cal. 2015); Int'l Bus. Machs. Corp. v. Dep't of Treasury, 852 N.W.2d 865, 868 (Mich. 2014); Kimberly-Clark Corp. v. Comm'r of Revenue, 880 N.W.2d 844, 848 (Minn. 2016); Graphic Packaging Corp. v. Hegar, 538 S.W.3d 89, 92 (Tex. 2017); Health Net, Inc. v. Dep't of Revenue, 415 P.3d 1034, 1035 (Or. 2018).

65. *Multistate Tax Compact*, MULTISTATE TAX COMM'N, https://www.mtc.gov/The-Commission/Multistate-Tax-Compact/ [https://perma.cc/M3U7-Q3WM].

66. *Id.*

67. *U.S. Steel*, 434 U.S. at 454–58.

68. *Id.* at 459.

69. Virginia v. Tennessee, 148 U.S. 503 (1893).

70. New Hampshire v. Maine, 426 U.S. 363 (1976).

into any agreement among themselves, irrespective of form, subject, duration, or interest to the United States."[71]

The *U.S. Steel* Court examined the history of the Compact Clause to reinforce the Court's earlier holdings that the Compact Clause applied more narrowly than its plain language might suggest.[72] The Court first considered Justice Story's theory that the terms "compact" and "agreement" "embrace 'mere private rights of sovereignty; such as questions of boundary; interests in land situate in the territory of each other; and other internal regulations for the mutual comfort and convenience of States bordering on each other.'"[73] The Court next reaffirmed earlier decisions where Justice Field adopted Justice Story's "functional view" of the Compact Clause.[74] The Court then reiterated that the Compact Clause applies only to agreements that "increase . . . political power in the States, which may encroach upon or interfere with the just supremacy of the United States."[75]

Even accepting the "federal supremacy" scope of the Compact Clause, the corporate taxpayers argued that because the Multistate Tax Compact was a multilateral agreement, and because it created an ongoing administrative body, that it did interfere with federal supremacy.[76] The Court rejected this argument.[77] At the outset, the Court expressly recognized that "the multilateral nature of the agreement and its establishment of an ongoing administrative body do not, standing alone, present significant potential for conflict with the principles underlying the Compact Clause."[78] The Court then undertook a qualitative analysis to determine if this particular compact interfered with federal supremacy.

Most importantly, the Court established that "the test is whether the Compact enhances state power *quoad* the National Government."[79] The Court determined that as to the Multistate Tax Compact, it did not "authorize the member States to exercise any powers they could not exercise in its absence" and that "each State is free to withdraw at any time."[80] Thus, the

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71. *U.S. Steel*, 434 U.S. at 459.
72. *Id.* at 460–63.
73. *Id.* at 464 (citing 2 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 1403, at 264 (T. Cooley ed. 1873)).
74. *Id.* at 468 (citing *Virginia v. Tennessee*, 148 U.S. at 519; Wharton v. Wise, 153 U.S. 155, 168–70 (1894)).
75. *Id.* at 471 (quoting *Virginia v. Tennessee*, 148 U.S. at 519).
76. *Id.* at 471–72.
77. *Id.* at 471–73.
78. *Id.* at 472.
79. *Id.* at 473.
80. *Id.*

Court determined that the Compact did not "threaten federal supremacy" and did not require congressional consent pursuant to the Compact Clause.[81]

More than thirty years after *U.S. Steel*, the Multistate Tax Compact again became the subject of significant controversy.[82] Instead of attempting to invalidate the Compact, however, corporate taxpayers were attempting to force states to honor the Compact's "election" provision. The Multistate Tax Compact provided corporate taxpayers the option to apportion their income using the respective state's apportionment method or the apportionment method provided in the Compact.[83] This election was largely irrelevant for many years following the adoption of the Compact because most states' statutory apportionment methods mirrored the apportionment method in the Compact—a formula that apportioned income using three equally weighted factors based on property, payroll, and sales.[84] In the 2000s, however, states rapidly shifted their apportionment methods toward a single sales factor method, which favored in-state corporations because their property and payroll were no longer used as a basis to apportion income to the state.[85] Corporate taxpayers—particularly out-of-state corporations that had smaller apportionment percentages using three factors instead of a single sales factor—filed legal challenges in several states seeking to bind the respective state under the Compact's election provision.[86]

The most prominent challenge occurred in California, where Gillette sought to use the Multistate Tax Compact's equally-weighted three-factor formula instead of California's statutory formula that gave double weight to the sales factor.[87] The California Court of Appeal held that Gillette was

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81. *Id.* The Court also held that the Compact did not violate the Commerce Clause, although the Commerce Clause challenge was extremely narrow. *Id.* at 478–79. It is unclear how the Court would view a robust Commerce Clause challenge to a multistate business or tax agreement.

82. *See Gillette Co.*, 363 P.3d at 96; *Int'l Bus. Machs. Corp.*, 852 N.W.2d at 868; *Kimberly-Clark Corp.*, 880 N.W.2d at 848; Graphic *Hegar*, 538 S.W.3d at 92; *Health Net, Inc.*, 415 P.3d at 1035.

83. The Multistate Tax Compact, Article III(1), provides:

> Any taxpayer . . . whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party State . . . may elect to apportion and allocate his income in the manner provided by the laws of such State[] . . . without reference to this compact, or may elect to apportion and allocate in accordance with Article IV.

Multistate Tax Compact, MULTISTATE TAX COMM'N, https://www.mtc.gov/The-Commission/Multistate-Tax-Compact [https://perma.cc/M3U7-Q3WM].

84. *See* JEROME R. HELLERSTEIN, WALTER HELLERSTEIN & ANDREW D. APPLEBY, STATE TAXATION ¶ 9.01[1] (Thomson Reuters rev. 3d. ed. 2022).

85. *See id.* ¶¶ 8.06[1], 9.02.

86. *See Gillette Co.*, 363 P.3d at 96; *Int'l Bus. Machs. Corp.*, 852 N.W.2d at 868; *Kimberly-Clark Corp.*, 880 N.W.2d at 848; Graphic *Hegar*, 538 S.W.3d at 92; *Health Net, Inc.*, 415 P.3d at 1035.

87. *Gillette*, 363 P.3d at 96.

permitted to use the Compact's formula as an alternative to the statutory formula because the Compact was "a binding agreement among sovereign signatory states," and, "having entered into it, California cannot, by subsequent legislation, unilaterally alter or amend its terms."[88] The Court of Appeal concluded that California was bound by the Compact's apportionment election provision "unless and until California withdraws from the Compact by enacting a statute that repeals [the provision adopting the Compact]."[89]

This victory for the taxpayer—and in many ways for the vitality of multistate "compacts" generally—would be short-lived. The California Supreme Court, and supreme courts in several other states, would question whether the Multistate Tax Compact was truly a "compact" that would bind the respective state to its agreed-upon terms.[90] In *Gillette*, the California Supreme Court relied heavily on *U.S. Steel* to conclude that the Multistate Tax Compact was not a "compact" and thus its terms were not binding on the state.[91] The court looked to several characteristics of a binding compact, based on the United States Supreme Court's decision in *Northeast Bancorp*, particularly: 1) whether the agreement created reciprocal state obligations, 2) whether unilateral state action was prohibited, and 3) the existence of a binding regulatory authority.[92] The court determined that the Multistate Tax Compact embodied none of these characteristics, thus it was a non-binding agreement instead of a binding compact.[93]

Taking existing precedent into account, states should consider carefully the extent to which participants—both states and businesses—are bound by the terms of the agreement. Regarding states, considering whether they have the option to withdraw from the compact at any time, or to deviate from any

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88. Gillette Co. v. Franchise Tax Bd., 144 Cal. Rptr. 3d 555, 567 (Cal. Dist. Ct. App. 2012) (emphasis omitted), *on rehearing*, 147 Cal. Rptr. 3d 603 (Cal. Dist. Ct. App. 2012), *rev'd*, 363 P.3d 94 (Cal. 2015).

89. *Id.* at 558. California and several other states did repeal their statutes adopting the Multistate Tax Compact in response to these apportionment election challenges. The subsequent question was whether the states could do so retroactively, which essentially every state court that heard the question answered in the affirmative.

90. *See* Int'l Bus. Machs. Corp. v. Dep't of Treasury, 852 N.W.2d 865, 868 (Mich. 2014); Kimberly-Clark Corp. v. Comm'r of Revenue, 880 N.W.2d 844, 848 (Minn. 2016); Graphic Packaging Corp. v. Hegar, 538 S.W.3d 89, 92 (Tex. 2017); Health Net, Inc. v. Dep't of Revenue, 415 P.3d 1034, 1035 (Or. 2018).

91. *Gillette*, 363 P.3d at 98–99.

92. *Id.* at 99–103; *see also* Ne. Bancorp., Inc. v. Bd. of Governors of Fed. Rsrv. Sys., 472 U.S. 159, 175–76 (1985) (holding that Massachusetts and Connecticut state banking deregulation statutes likely did not amount to a compact, and even if they did, the compact did not infringe federal sovereignty because the statutes complied with federal banking statutes.).

93. *Gillette,* 363 P.3d at 103; *see also* Seattle Master Builders Ass'n v. Pac. Nw. Elec. Power & Conservation Plan. Council, 786 F.2d 1359, 1363–64 (9th Cir. 1986).

of the compact's terms at any time. Regarding businesses, whether they may choose between the multistate business entities regime or the preexisting single state regime, or choose to accept or decline certain aspects of the regime. A non-binding agreement trades off certainty, uniformity, and administrative simplification for greater participant choice and less chance of a successful constitutional challenge. The Streamlined Sales Tax agreement illustrates the reduction in efficacy, however, when the agreement allows participants a significant degree of choice.[94]

If participating states choose to create a binding compact, there is a very strong argument under existing precedent that multistate business entity compacts would not threaten federal supremacy. The threat to federal supremacy is even less likely when the compact's scope is entity formation and general regulation, which currently falls within the sole purview of the states.[95] If the compact encompasses subject matter that is administered concurrently by the federal and state governments, such as securities regulation and taxation, a federal supremacy argument becomes more colorable but still very unlikely.[96] In fact, "it appears that no court has ever voided a state agreement for failure to obtain congressional consent."[97] With that said, even if a compact did not require congressional consent, congress could still enact legislation preempting the specific compact or a broad category of compacts.

Regardless of whether multistate agreements are binding or not, they have great potential to increase regulatory efficiency. Frankfurter and Landis recognized "regional problems call[] for regional solutions" and that "[c]ollective legislative action through the instrumentality of compact by States constituting a region furnishes the answer."[98] This Article effectuates

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94. For example, a state may be a Full Member State, Associate Member State, Contingent Member State, or Non-Member State. *State Information*, STREAMLINED SALES TAX GOVERNING BD., INC., https://www.streamlinedsalestax.org/Shared-Pages/State-Detail [https://perma.cc/A9N5-JVR8]. Businesses may register to use the Streamlined Sales Tax Registration System (SSTRS) in whichever Member states they select. *Id.*

95. *See* U.S. Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452, 472–73 (1978).

96. Opponents of a multistate business entities compact would likely have stronger arguments under the Commerce Clause than the Compact Clause.

97. Greve, *supra* note 56, at 289. Courts have either held that the agreement was not a "compact" or that it did not have the potential to interfere with federal supremacy. *See id.* at 289–90.

98. Frankfurter & Landis, *supra* note 1, at 708. Frankfurter and Landis also aptly noted:

> The imaginative adaptation of the compact idea should add considerably to resources available to statesmen in the solution of problems presented by the growing interdependence, social and economic, of groups of States forming distinct regions. It may well be that the New England States, the Middle

these ideas—examining and proposing efficient regional compacts focused on business entity formation and taxation.

C. Co-Competition

This Article suggests that a multistate business entity regime is not only possible, but also beneficial. The key insight of the multistate business entities regime is that it is preferable to both uncooperative competition (state separatism) and no competition (federalization). This insight draws on the institutional and jurisprudential advantages of state co-ops explained below in Parts II and III, but it could also be explained in abstraction by appeal to economics. This Section provides the economic backdrop to the constitutional and institutional argument of this Article.

Economists have a name for cooperative competition—"co-opetition."[99] The market for firm formation is a competitive market with many suppliers (states) offering competing goods (formation jurisdictions). In such a competitive a market, there are three general typecast scenarios where it will make for a good business judgment for rivals to cooperate.

The first scenario in which co-opetition occurs is when two or more business adversaries team up in order to reduce their individual efforts and costs and together enjoy economies of scale.[100] Professors Adam Brandenburger and Barry Nalebuff, who pioneered the modern economic analysis of co-opetition, point to the joint efforts by Apple and Google in creating a contact tracing technology for COVID-19 as a good example of such cooperation between rivals.[101]

This type of co-opetition makes for a good business judgment for many states as well. For example, imagine that New York, New Jersey, and Connecticut decided to pull their adjudication and filing resources together in order to create a tri-state business entities regime. We can expect, for instance, that together the states can significantly reduce their costs and increase their "bottom line" due to the ability to create joint tribunals and shared centralized compliance systems.

> Atlantic States, the Pacific Coast States, and similar groupings will each evolve, through compact, common industrial standards . . . .

Id. at 729.

99. Adam Brandenburger & Barry Nalebuff, *The Rules of Co-opetition*, HARV. BUS. REV. (Jan.–Feb. 2021), https://hbr.org/2021/01/the-rules-of-co-opetition [https://perma.cc/BQ9W-XU2Y].

100. *See id.*

101. *Id.*

The second scenario in which co-opetition occurs is when two or more competitors each have a unique capability, and together they are able to out-compete their common competitors.[102] A recent example of such co-opetition can be gleaned by the collaboration between Pfizer and BioNTech.[103] When companies competed to obtain government mandates for COVID-19 vaccines, Pfizer and BioNTech were able to outcompete almost all of their competitors because one of them contributed vaccine candidates and the other contributed research and development and manufacturing skills.[104]

There are states that would benefit from this type of co-opetition as well. Consider the unique abilities of Delaware and New York, for instance. Delaware's relative strength is in having developed the most influential and predictable form of corporate law.[105] New York's relative strength is that it homes most of the significant capital marketplaces in the United States.[106] As a result, while a majority of publicly traded corporations are incorporated in Delaware[107], they often enter into financing agreements that are governed by the laws of New York.[108] If the two worked together, however, they could design a multistate system that solves some of the issues that are traced to this formation-financing split. For illustration, one recurring issue that Delaware corporations face when tapping a New York based capital market is that they must provide the financing banks with legal opinions that cover both New York and Delaware law.[109] This sometimes means hiring one of the very few law firms that can opine on both bodies of law (and have expertise

102. *Id. See also* ADAM BRANDENBURGER & BARRY NALEBUFF, CO-OPETITION: A REVOLUTION MINDSET THAT COMBINES COMPETITION AND COOPERATION (1996).

103. Adam Hayes, *Coopetition Meaning, Benefits to Business, Example*, INVESTOPEDIA (Mar.25,2022),https://www.investopedia.com/terms/c/coopetition.asp#:~:text=Coopetition%20is%20the%20act%20of,producing%20complementary%20or%20related%20products [https://perma.cc/UT2Q-GYUH].

104. *Id.*

105. *See* LEWIS S. BLACK, JR., WHY CORPORATIONS CHOOSE DELAWARE, 1 (2007), https://corpfiles.delaware.gov/pdfs/whycorporations_english.pdf [https://perma.cc/6LNV-LZFV].

106. *See* Matthew Johnston, *How New York Became the Center of American Finance*, INVESTOPEDIA (Oct. 12, 2022), https://www.investopedia.com/articles/investing/022516/how-new-york-became-center-american-finance.asp [https://perma.cc/SD2C-24HV].

107. Jeffery W. Bullock, DELAWARE DIVISION OF CORPORATIONS: 2021 ANNUAL REPORT 1 (2021), https://corpfiles.delaware.gov/Annual-Reports/Division-of-Corporations-2021-Annual-Report.pdf [https://perma.cc/UX8Z-C9SQ].

108. Theodore Eisenberg & Geoffery P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-held Companies' Contracts*, 30 CARDOZO L. REV. 1475, 1478 (2009).

109. *See, e.g.*, TriBar Op. Comm., *Third-Party "Closing" Opinions*, 53 BUS. LAW. 592, 633–34 (1998) [hereinafter *Third-Party "Closing" Opinions*]; TriBar Op. Comm., *Special Report of the TriBar Opinion Committee—Opinions on Secondary Sales of Securities*, 66 BUS. LAW. 625, 634 n.53 (2011).

in fund raising) or hiring multiple law firms.[110] A New York-Delaware co-op could solve this problem by law and increase access to capital. Building on this example, it is at least equally as expensive (and likely more expensive) for a non-Delaware corporation, for instance a Nevada corporation, to find the right law firms for raising money in New York. Nevada, however, does offer some unique corporate law benefits that Delaware does not.[111] One could imagine, therefore, that a Nevada-New York cooperation could yield significant competitive powers.

The third scenario in which co-opetition occurs is when a market leader enjoying monopoly powers is able to maintain its leader status by offering benefits to its smaller competitors.[112] The smaller competitors in this example may have had some chances of working together to defeat the monopoly power of the leader, but the benefits offered by the leader place the smaller competitors in a collective action problem that maintains the status quo.[113] An illustration of this phenomena can be seen in the Amazon marketplace platform.[114] Amazon provides its competitors the ability to sell merchandise on its platform.[115] While this feature competes against Amazon's ability to sell their own goods, it allows Amazon to collect a fee and prevent smaller sellers from going to another platform or otherwise banding together.[116] The smaller sellers stay on the Amazon platform because the benefits of using the main centralized ecommerce hub outweigh the costs of the fees.[117]

This type of co-opetition could play a significant role in the market for business entities as well. Imagine that Delaware wanted to maintain its monopoly powers in the market for corporate formations. Delaware could, for example, enter into agreements with less successful states that would provide them with a certain percentage of any franchise taxes of corporations that stem from those states. Under certain conditions, this cooperation might allow Delaware to maintain the status quo by providing currently smaller competitors with sufficient benefits such that they will not band together against Delaware's monopoly.

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110. To note, many New York law firms are able to opine on basic terms of the Delaware General Corporation Law. That said, they are not able to opine on anything beyond very basic features. *See Third-Party Closing Opinions*, *supra* note 109, at 637.

111. *Compare, e.g.*, Guzman v. Johnson, 483 P.3d 531, 537 (Nev. 2021) (providing managers with enhanced business judgment rule deference as compared with Delaware), *with* Flood v. Synutra Int'l Inc., 195 A.3d 754, 761 (Del. 2018) (comparing the differences in the application of business judgement review in Nevada and Delaware).

112. *See* Brandenburger & Nalebuff*, supra* note 99.

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *See id.*

There are, therefore, a plurality of ways that co-opetition in the market for business entities could provide benefits to the competing states that do not exist in a non-cooperative competition or non-competitive environment. The benefits of this co-opetition also extend to the firm and society as a whole. Parts II and III show exactly that. Together with this Part, this Article shows that the private and public advantages of the multistate business regime, across both business and tax law, would generally outperform both state separatism and federalization.

II. THE BUSINESS ENTITIES LAW BENEFITS OF THE MULTISTATE REGIME

The multistate business entity regime can significantly improve the law of business entities. These improvements would provide gains in both equity and marketplace efficiency. Marketplace efficiency would be served by the administrative and legislative benefits that a multistate business entities regime would confer on the law of business entities. Equity would be served by the galvanized ability of a multistate regime to advocate for all stakeholders in honest and measurable environmental, social, and governance (ESG) metrics. This Part explains these administrative, legislative, and stakeholderism benefits—in this order.

A. Administrative Benefits

Administrative benefits include procedural and clerical benefits that streamline the formation and governance of business entities as well as organizational benefits that streamline the promulgation and enforcement of business entities law.

A multistate formation regime will streamline the formation and governance of business entities by alleviating the need to file for multiple annual reports, foreign qualifications, the formation of subsidiaries, and multiple DBAs (doing business as), as well as the need to order and pay for good standing certificates during firm-altering and time-sensitive transactions.[118] Many firms participate in interstate commerce. When firms conduct their business in non-native states, they are often faced with a choice of either applying for a foreign qualification in that state or forming a

118. *See* Andrew Appleby & Tomer Stein, *Why We Need Multistate Business Entities*, COLUM. L. SCH. BLUE SKY BLOG (Jan. 5, 2023), https://clsbluesky.law.columbia.edu/2023/01/05/why-we-need-multistate-business-entities/ [https://perma.cc/J8AF-23QU].

subsidiary entity in that state.[119] Whether a given interstate activity requires a foreign qualification or the formation of a subsidiary depends on the magnitude and type of activity in that state.[120] States largely follow the same doctrinal approach to foreign qualifications.[121] First, states must comply with the Commerce Clause when setting up their foreign qualification statute.[122] That is, the states cannot interfere with interstate commerce, or the federal regulation thereof, in their quest to regulate firms with operations in their states.[123] Secondly, the states outline when a firm must apply for a foreign qualification, or otherwise form and operate a subsidiary entity in the state.[124]

In the case of corporations, for example, states largely follow the Model Business Corporation Act's (MBCA) approach to foreign qualification.[125] The MBCA does not explicitly define what constitutes a need to apply for a foreign qualification, but it says that "[i]n general terms, any conduct more regular, systematic, or extensive than that described in subsection § 15.05(a) constitutes doing business and requires the foreign corporation to register to do business."[126] Section 15.05(a), in turn, provides a list of activities that do not, in and of themselves, constitute the need for a foreign qualification.[127]

The need to analyze and determine, on a state-by-state basis, whether to file for an annual report, a foreign qualification, and/or form a subsidiary, as well as the payment of the associated fees, therefore, imposes costs on firms and their personnel. These costs are also subsequently multiplied by the fact that many transactions require ordering and paying for good standing and foreign qualification certificates in order to proceed.[128] For example, if a company is seeking to tap either the equity or the debt capital markets, the company will generally have to tender good standing certificates or foreign qualification certificates for every significant subsidiary.[129] Not only that, but

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119. *See* Heather Huston, *Doing Business in Another State (Foreign Qualification)*, WOLTERS KLUWER (Feb. 25, 2021), https://www.wolterskluwer.com/en/expert-insights/doing-business-in-another-state-foreign-qualification [https://perma.cc/LRF6-TAK6].

120. Joyce Yeager, *Borders and Barriers, Definition of Authority To Do Business as a Foreign Corporation*, 102 COM. L.J. 398, 399–400 (1997).

121. *Id.*

122. *Id.* at 409–11.

123. *Id.* at 411.

124. *Id.*

125. *Id.* at 414–15.

126. MODEL BUS. CORP. ACT § 15.05(a), official cmt (AM. BAR ASS'N 2016).

127. *Id.* at § 15.05(a). The determination of whether a foreign qualification is required is not limited solely to publicly traded corporations. Even the smallest businesses may be required to comply with the foreign qualification requirements, particularly with the evolving digital economy and remote workforce.

128. *See Third-Party "Closing" Opinions*, *supra* note 109, at 646–47 (requiring closing opinion deliverables).

129. *Id.* at 641–42, 646–47.

the company will also generally have to do so about three times per transaction (e.g., upon the launch of the offering, the pricing of the offering, and the closing of the offering).[130] The payment for good standing and foreign qualification certificates is extremely expensive at scale.[131] Additionally, it is important to note that the existence of multiple subsidiaries per firm is a feature and not a bug.[132] As explained by Professor Gideon Parchomovsky and Professor Asaf Eckstein, as of December 2021, 100% of the largest 100 corporations on the S&P 500 had multiple subsidiaries.[133] This exponentially multiplies the administrative costs of foreign qualifications and good standing certificates.[134] Firms are thus in a constantly growing battle of keeping up with their foreign qualifications and subsidiaries, as well as the associated filings of annual reports and any DBAs.

The multistate business entities regime would solve many of these problems. To be sure, the need to form subsidiaries will not disappear, but the ability to have one entity for multiple states would significantly eliminate the need for these enormous compliance costs.[135] This is because, under a multistate formation regime, a business entity would have to be formed only once (or, at least, just a few times, if there are multiple state coalitions that are relevant). Subsequently, the business entity would have just one annual report, only one DBA filing, and would only have to show one good standing certificate for all applicable states. Additionally, for many business entities, such a regime would eliminate the need for foreign qualifications. Imagine, for example, that a shuttle company operating in New York, Connecticut, and New Jersey specializes in driving people from their homes to the airports and back (as a great many do). In this case, the ability to be formed as a "tristate" entity would limit the shuttle company's registration, annual report, and good standing needs to just one administrative body. This is not merely a monetary cost savings measure. It also saves human resources and personnel efforts in navigating complex administrative puzzles, which is extremely important for small businesses.

The administrative benefits of the multistate formation regime also extend to the promulgation and enforcement of law. One of the unique advantages

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130. *Id.*

131. For example, in Delaware the ordering of good standing certificates varies between $10.00 and $50.00. *See Accessing Corporate Information*, DEL. DIV. OF CORPS., https://corp.delaware.gov/directweb/ [https://perma.cc/G4RP-RXJB].

132. GIDEON PARCHOMOVSKY & ASAF ECKSTEIN, CONGLOMERATE LAW 2 (July 13, 2022) (manuscript on file with authors).

133. *Id.* at 3. Please note that this figure includes subsidiaries outside the United States.

134. This is so as these fees are required of each entity that is formed. *See supra* note 131.

135. It is important to note that there many reasons to form subsidiaries that are not related to interstate activities. *See id.* at 32–37.

of the multistate regime is the ability of the states to pool resources together. This pooling would allow states to unify both their administrative and adjudicatory bodies. First, states that work as a coalition could create one website and one filing center that encapsulates all relevant entities. Second, state coalitions could form shared specialized court systems that deal with all business law matters in their unified jurisdiction. This means sharing both courthouses and legal personnel. Together, the benefits of scale that states who work together will receive will be a huge cost saving for the taxpayers and will promote uniformity of law.

The business law administrative benefits of the multistate business entities regime are thus extremely promising. These benefits will improve the efficiency of the market for the formation and governance of business entities, which would in turn benefit the states, the firms, and, most importantly, the occupants of the participating states.

B. Legislative Benefits

The legislative benefits of the multistate formation regime are equally promising. There are two principled ways that state co-ops could use their power of shared jurisdiction. First, states can aggregate their differing approaches to business entities in order to create a broad and rich menu of substantive options for their firms.[136] This approach is a heterogeneous legislative strategy.[137] Second, states can unify their differing approaches in order to offer a consistent and deterministic body of business law.[138] This approach is a homogeneous legislative strategy.[139] This Section shows how both of these approaches would benefit business entities law. There are times that these two approaches would be contradictory to one another. We purposely do not opine on the comparative strength of these two approaches because our aim is of a broader nature: we want to equip the states with the ability to weigh and use both strategies in their local adoption of the multistate business entities regime.

Prior to showing the arguments for, and practical benefits of, the heterogeneous and homogeneous legislative approaches, it is important to first clarify the general legislative function of the law of business entities.

The choice between various business entities, or the choice among bundles of default norms that govern the firm, is structured as a solution to two

136. *See supra* notes 20–21 and accompanying text.
137. *See supra* notes 20–21 and accompanying text.
138. *See supra* notes 20–21 and accompanying text.
139. *See supra* notes 20–21 and accompanying text.

problems. First, entities provide the Coasean solution of the firm.[140] Firms are, at times, a more efficient organizational solution than outside contracting.[141] That is, it is sometimes, and up to a point, more efficient to hire someone into a firm than it is to contract with that person for a discrete assignment.[142] This coordination solution is often referred to as vertical integration.[143] Within the framework of firms as a vertical integration solution, the various states offer a few substitute entity solutions.[144]

The choice among these various substitute entities (e.g., a corporation, a limited liability company, a limited partnership, etc.) is a choice that tackles the second of the problems that business entities law is designed to solve. It is the problem of how to best recruit, and subsequently manage, capital into a venture. The choice of entity type, for any given firm, will depend on how the entity type will limit the liability of the investor-owner, how the investments will be taxed, and what protections would be in place due to this separation between the investor-owner entity and the managing entity.[145] Other secondary norms that may impact this decision also include the ability to anonymously own part of the equity of the firm.[146]

The law of business entities has consequently developed along these two functions. First, the law of business entities creates and refines bundles of contracts so as to reduce the transaction costs of forming firms as compared with forming a multitude of discrete contractual relationships.[147] Second, the law of business entities attracts capital investments through imposing restrictions on how liability can be assigned to the investors, what restrictions apply to the managers of the entities, and how to balance the interests of the owners and the expertise of the managers.[148]

When we refer to state competition over the formation of entities, therefore, we are really referring to their legislative strategy around the bundling of default contractual norms in business entities law. Against this backdrop, the following words show the benefits of both a heterogeneous and homogeneous legislative strategy, in that order.

Consider the different corporate offerings by the states. Delaware offers corporations that are deferential towards managers, Massachusetts offers

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140. For the seminal work by Coase, see Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 386–87 (1937).

141. *See id.* at 388.

142 *Id.* at 395–96.

143. *Id.* at 397 n.5.

144. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 338 (5th ed. 1998).

145. *Id.* at 429.

146. *Id.*

147. *Id.* at 431.

148. *Id.* at 429

corporations that are saturated with shareholder protections, and Nevada offers corporations that that are even more deferential towards managers than Delaware.[149] Other examples of unique corporate offerings by states include the benefit corporation, which is a corporation partially formed for a public interest and partially for a profit (available in some but not all states),[150] as well as varying degrees of investor liability protection and anonymity capacity.[151]

A heterogeneous legislative strategy would simply aggregate the differing options in the state into one large menu of business entity choices. Imagine, for example, that within one jurisdiction entrepreneurs and their investors are able to choose between a "Delaware style" corporation and a "Massachusetts style" corporation. The advantage of such an approach would be the ability to provide the market with a broad and innovative array of business entity choices. This aggregative approach would allow state co-ops to swiftly adopt the laws and judicial precedent that make these business entities a possibility and offer them to their constituents. This strategy is beneficial because it allows market participants the autonomy to opt into whichever arrangements best fits their business needs, without the need to shop around and migrate to other jurisdictions.

This bundling of choices, however, is sometimes counterproductive. First, there is the rational and bounded-rationality problem of decisional stalemate.[152] That is, there is empirical evidence to suggest that too many choices might cause confusion, and that a certain limited number of menu options is the ideal approach.[153] To the extent this is true in the market of business entities, it would entail limiting the aggregation of the various state offerings.[154] Secondly, there are benefits in a unified and consistent body of

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149. *See, e.g.*, Ethan Z. Davis & Kurt S. Kusiak, *Gaining the Advantage in Close-Corporation Disputes: Examining Key Differences Between Massachusetts and Delaware Fiduciary Duty Law*, 97 MASS. L. REV. 23, 24 (2015) (comparing Delaware and Massachusetts corporate law); Barzuza, *supra* note 7, at 958 (comparing Delaware and Nevada corporate law).

150. *See generally* Ellen Berrey, *Social Enterprise Law in Action: Organizational Characteristics of U.S. Benefit Corporations*, 20 TRANSACTIONS: TENN. J. BUS. L. 21, 93–94 (2018) (describing the structure of benefit corporations). Some states, such as Florida, even offer multiple types of benefit corporations. *See* FLA. STAT. §§ 607.501, 607.601 (2023) (permitting Social Purposes Corporations and Benefit Corporations, respectively).

151. For a discussion on the anonymity feature, and its costs and benefits, see William Moon, *Anonymous Companies*, 71 DUKE L.J. 1425 (2022).

152. *See, e.g.*, Benjamin Scheibehenne et al., *Can There Ever be Too Many Options? A Meta-Analytic Review of Choice Overload*, 37 J. CONSUMER RSCH. 409 (2010) (analyzing investigations of this problem).

153. *Id.*

154. Whether this is the case is subject to debate. For an empirical examination of the topic see Yair Listokin, *What Do Corporate Default Rules and Menus Do? An Empirical Examination*, 6 J. EMPIRICAL LEGAL STUD. 279 (2009).

law that is always operative and deterministic in the market. For example, a state co-op's legislature may consider offering both the "Delaware style" and the "Massachusetts style" corporation, or they may decide that having both options would impose excessive research costs on potential investors. In other words, the legislature may determine that the lack of easily predictable law would provide a chilling effect on firm investments in their jurisdiction. Indeed, the ability to adopt a heterogeneous strategy has the unique positive advantage of providing predictability to business entities law. For example, while currently it is unclear to many Montana firms if they are governed by California's long-arm board diversity laws, a coalition between the two can momentously settle the matter.[155]

The legislative benefits of the multistate formation regime are, therefore, malleable to the unique needs of the relevant state cooperatives. State cooperation could internalize the legislative benefits of taking both an aggregative and heterogeneous approach and of taking a unifying and homogenous approach. Together with the administrative business entities law benefits, these improvements in market efficiency have the potential to boost economies and provide all with better and cheaper access to market. As importantly, the next Section shows that these benefits provide a greatly increased ability to equitably account for all stakeholders.

C. Stakeholderism and ESG

The multistate formation regime will boost stakeholderism and the advancement of honest and measurable Environmental, Social, and Governance (ESG) goals. Stakeholderism is the view that firms should pursue the interests of non-shareholder stakeholders.[156] Non-shareholder stakeholders (henceforth, Stakeholders) may include employees, local communities, the environment, suppliers, customers, and society as a whole.[157] There are two general types of stakeholderism.[158] The first type, which we call "Weak-Form Stakeholderism," is the view that firms should

155. The California laws were recently blocked as unconstitutional by a California court, but the battle for the viability of the law continues. *See* Cydney S. Posner, *California Appeals Court Reinstates Injunctions Against California Board Diversity Laws*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 19, 2022), https://corpgov.law.harvard.edu/2022/12/19/california-appeals-court-reinstates-injunctions-against-california-board-diversity-laws/ [https://perma.cc/NMT7-MAVC].

156. Bebchuk & Tallarita, *supra* note 26, at 94.

157. *Id.*

158. See *id.* at 108–14 for further explanation of these two general approaches, termed in the article as instrumental stakeholderism and pluralistic stakeholderism.

pursue the interests of stakeholders because to do so would benefit the shareholders.[159]

The second type, which we call "Strong-Form Stakeholderism," is the view that firms should pursue the interests of stakeholders even when doing so conflicts with the interests of the shareholders.[160] Both weak and strong form stakeholderism can be further divided on the question of process and procedures. While some stakeholderists believe that stakeholderism (either weak or strong form) should be ensured through legal design (henceforth, Legal Stakeholderism), others believe that stakeholderism is purely a moral position that should be left to private ordering (henceforth, Moral Stakeholderism).[161] Our aim is not to settle the debate within the various types of stakeholderist views. Rather, we show that the multistate formation regime would significantly benefit all forms of stakeholderism. This is so because the multistate regime can simultaneously tackle the biggest respective obstacles of Legal Stakeholderism and Moral Stakeholderism.

Legal stakeholderists promote legal changes to address stakeholderist concerns through both state law and federal law.[162] State law examples of stakeholderist initiatives include the California law for board gender and racial diversity.[163] Federal law examples of stakeholderist initiatives include the incoming regulation of ESG disclosure[164] and the federal approval of stock exchange board diversity rules (which is a private-public action).[165] The biggest obstacle that legal stakeholderists face is that business entities law is currently a matter of state law, and going state by state is at best a slow strategy and at worst a losing strategy. To make things worse, since states must compete for the formation of business entities, they are often unable to promote stakeholderist initiatives because it repels in-state formation.[166] It therefore may seem that the federalization of business entities law is the appropriate solution.[167] Federalization, however, has the obvious problem of taking away one of the longest lasting and traditional state powers. Additionally, federalization removes the element of competition from the

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159. *Id.* at 108–13.

160. *See id.* at 114–15.

161. *See id.* at 108–14.

162. *See id.* at 94.

163. *See supra* note 155 and accompanying text.

164. *See* David A. Katz & Laura A. McIntosh, *SEC Regulation of ESG Disclosures*, HARV. CORP. GOVERNANCE BLOG (May 28, 2021), https://corpgov.law.harvard.edu/2021/05/28/sec-regulation-of-esg-disclosures/ [perma.cc/557W-6S5B].

165. Order Approving Proposed Rule Changes, Release No. 34-92590, 86 FR 44424 (Aug. 6, 2021).

166. *See supra* notes 4–6 and accompanying text.

167. *See supra* Section I.B.

design of business entities law, which curtails the incentive for innovation. Most fundamentally, stakeholderism requires different solutions in different regions of the country in order to truly serve the interests of constituents on the ground.

The multistate regime solves this problem. Multistate formation provides the ability to coordinate among the states without federalization, thereby maximizing the benefits of broad legislative initiatives while minimizing the costs of concentrated jurisdictional power. This is so because state-state cooperation allows for geographically sensitive initiatives that are backed with sufficient legislative leverage, but without eliminating state power or curtailing competition.

Imagine, for example, that a "rust belt"[168] co-op is able to adopt stakeholderist initiatives that prioritize manufacturing employees and clean air, while a "tri-state" co-op prioritizes reducing the opportunity gap between the privately and publicly educated. In such a world, the states are able to maintain power over entity formation, but stakeholderist initiatives are adopted more broadly and effectively. Further yet, this allows for stakeholderist initiatives to be sensitive to the specific needs of the relevant communities. Economically, the state co-ops are able to leverage the administrative and legislative benefits that they provide the firms in order to promote ESG goals without losing the rate of formation. Lastly, this type of broad stakeholderist impact would not overly curtail competition, as the state cooperatives would still have to compete with one another.

As explained above, when the framers sliced the jurisprudential powers between the union and the states, they also envisioned state-state cooperation.[169] When it comes to the ability to galvanize Legal Stakeholderism, this slicing method allows us to have our cake and eat it too.

The multistate entity regime will also help promote Moral Stakeholderism. For stakeholderism to occur in private ordering, private actors must be motivated to promote such initiatives. The motivation does not have to be pure. Moral Stakeholderism could occur if, for example, corporations have the honest and earnest motivation to promote such initiatives. On the other hand, Moral Stakeholderism might also occur if, for example, self-interested corporations felt pressured to do so by the markets. There is an open question regarding whether Moral Stakeholderism has been effective. Some say yes and point to statements by private actions, such as the Business Roundtable's Statement on the Purpose of Corporation.[170] This statement, and others like

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168. *See supra* notes 20 and 29.

169. *See supra* Section I.B.

170. *See One Year Later: Purpose of a Corporation*, BUS. ROUNDTABLE, https://purpose.businessroundtable.org/ [https://perma.cc/6KR5-VBBX].

it, vouch to integrate stakeholderism into the firm.[171] Beyond rhetoric, there is also some empirical evidence that hints at the private incorporation of stakeholderism.[172] One particularly strong line of such empirical evidence is the sharp increase in green and sustainability-linked loans.[173] On the other end of the spectrum are those that argue that stakeholderism has not been meaningfully advanced by private actions.[174] Commentators who ascribe to this view argue either that private action lacks the proper motivation to honestly promote ESG goals,[175] or that even if such motivation exists, it has not been meaningfully pursued.[176] Colloquially, these commentators describe statements, such as the one by the Business Roundtable, as mere "x washing" (e.g., green washing, pink washing, etc.).[177] Others yet prefer to focus on the narrower question of whether certain kinds of investors (for example, institutional investors) are more or less likely to pursue Moral Stakeholderism.

Regardless of one's view on the current success and future potential of Moral Stakeholderism, the multistate formation regime can be incorporated to advance stakeholderist goals. The reason for that is simple. The multistate entity regime allows firms to save money that they otherwise would have paid to the various states. This puts firms in a unique strategic position vis-à-vis the relevant authority: either the firms devote some of these cost savings to increase value for the various stakeholders, or they risk the permanent claws of Legal Stakeholderism. This will incentivize, in equilibrium, even ill-motivated firms to increase their stakeholderists commitments. A fortiori, this

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171. *See id.*

172. *See* Shelly Anderson, *Why Stakeholder Management Is Essential to Sustainable Business*, ISYSTAIN (May 19, 2020), https://www.isystain.com/blog/2020/5/18/stakeholder [https://perma.cc/4T5D-UR7K].

173. *See, e.g.*, *Chart: Sustainable Loans Set To Rise Up to 80% to USD 400 Billion This Year*, NN INV. PARTNERS (Oct. 28, 2021), https://www.nnip.com/en-INT/professional/insights/articles/chart-sustainable-loans-set-to-rise-up-to-80-to-usd-400-billion-this-year [https://perma.cc/5ZMR-LZD4].

174. *See, e.g.*, Okechukwu Enyinna, *Is Stakeholder Theory Really Ethical?,* 7 AFRICAN J. BUS. ETHICS 79, 79 (2013).

175. *See, e.g.*, Charles M. Elson, *Three Problems with the Stakeholder Theory*, BIDEN INST., https://www.bidenschool.udel.edu/bideninstitute/bcblog/Pages/Three-Problems-With-the-Stakeholder-Theory.aspx [https://perma.cc/89GJ-WJ7Z].

176. *See, e.g.*, Steve Denning, *Why Stakeholder Capitalism Will Fail*, FORBES (Jan. 5, 2020), https://www.forbes.com/sites/stevedenning/2020/01/05/why-stakeholder-capitalism-will-fail/?sh=67e96b7a785a [https://perma.cc/C3ND-XTTF].

177. *See* Stephen Bainbridge, *More Evidence That the Business Roundtable Statement on Corporate Purpose Was Just Green Washing*, PROFESSORBAINBRIDGE.COM (Oct 14, 2020), https://www.professorbainbridge.com/professorbainbridgecom/2020/10/more-evidence-that-the-business-roundtable-statement-on-corporate-purpose-was-just-green-washing.html [https://perma.cc/DT6C-KR5Y].

will incentivize well intentioned firms to honestly and measurably pursue ESG goals. Together with the ability of the states to pursue Legal Stakeholderism, the multistate business entity regime is a promising avenue for true advocacy and ESG realization.

The business entity law benefits of the multistate regime are thus both effective and just. This regime is able to provide administrative and legislative benefits that are not present in state separatism or federalist structures, which in turn allows for an honest promotion of stakeholderism and ESG goals. The following Part shows that these benefits are reflected just as well in the realm of tax law.

III. THE TAX LAW BENEFITS OF THE MULTISTATE REGIME

A multistate business entities regime can also produce many tax law benefits for the participating states, businesses, and other stakeholders. Multistate tax coordination increases efficiency, uniformity, and certainty. Improving certainty, in particular, is tremendously important for large business taxpayers that are required to set aside financial statement reserves for uncertain tax positions. The administrative and legislative tax benefits are compounded because participating states can coordinate across many tax regimes, discussed in detail below.[178] States can choose to incorporate any level of tax cooperation into a multistate business entities regime, although the benefits increase exponentially as the scope of cooperation broadens.

A. Administrative Benefits

Many of the administrative tax law advantages mirror the administrative business entities law advantages. These benefits fall into two general categories: compliance and enforcement. Compliance consists of activities undertaken by taxing authorities and taxpayers related to taxpayers reporting their tax liabilities. The taxing authorities must create tax return forms and instructions, issue technical guidance, and process voluminous tax return forms.[179] Taxpayers must analyze each jurisdiction's laws and guidance, prepare lengthy and detailed tax returns for each entity, and undertake the

178. *See infra* Section III.B.

179. *See* Tax Pol'y Ctr., *What Does the IRS Do and How Can It Be Improved?*, BRIEFING BOOK, https://www.taxpolicycenter.org/briefing-book/what-does-irs-do-and-how-can-it-be-improved [https://perma.cc/6A56-9QNC].

often grueling process of quantifying and disclosing various tax positions for financial accounting purposes.[180]

Large multistate businesses commonly have compliance obligations with all fifty states, and for multiple tax types—some of which require monthly reporting.[181] These reports may be required for each entity within a corporate group, resulting in each corporate group filing hundreds to thousands of tax reports annually across jurisdictions with substantial variance in their tax laws.[182] As one can imagine, the compliance costs are extraordinary. But this means a centralized filing and compliance arrangement could produce extraordinary reductions in administrative costs for both taxpayers and taxing authorities.[183]

One important point is that a centralized filing regime is practical only with significant uniformity in the tax base.[184] Administratively, a centralized filing regime would be unworkable with multiple inconsistent tax bases. The participating states can collectively agree, however, upon the details of that tax base, explored further below, and each state can choose the rate at which they will impose tax.[185]

Enforcement begins with taxing authorities performing a preliminary audit of tax filings to determine what they believe is each taxpayer's proper tax

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180. *See Tax Administration: Compliance, Complexity, and Capacity*, BIPARTISAN POL'Y CTR. 6 (Apr. 2019), https://bipartisanpolicy.org/download/?file=/wp-content/uploads/2019/04/Tax-Administration-Compliance-Complexity-Capacity.pdf [https://perma.cc/4FGF-RVU3]. Most medium-to-large businesses, including all publicly traded companies, work with an independent financial statement auditor to provide accurate financial statements to investors annually. *See generally What Is a Private Company Audit?*, ASS'N INT'L CERTIFIED PUB. ACCTS., https://www.aicpa.org/news/article/what-is-a-private-company-audit [https://perma.cc/DQ4H-LU23].

181. DOUGLAS L. LINDHOLM ET AL., COUNCIL ON STATE TAXATION, THE BEST AND WORST OF TAX ADMINISTRATION 9 (2016).

182. In addition to the fifty U.S. states, there are thousands of subnational taxing jurisdictions in the U.S. Many local taxes are administered by the state taxing authority so they would likely fall within the scope of the multistate regime automatically—a benefit to the localities and taxpayers. *See* Jared Walczak, *Sales Tax Rates in Major Cities, Midyear 2021*, TAX FOUND. (Aug. 18, 2021), https://taxfoundation.org/publications/sales-tax-rates-in-major-cities/#:~:text=There%20are%20over%2011%2C000%20sales,States%2C%20with%20widely%20varying%20rate [https://perma.cc/FG8K-U6D5] (recognizing more than eleven thousand taxing jurisdictions in the United States for sales tax alone—just one of many tax types).

183. *See, e.g.*, Michael J. Bologna, *Single Portal for State Sales Tax Returns Still Years Away*, BLOOMBERG (Oct. 6, 2022, 2:58 PM), https://news.bloomberglaw.com/cannabis/single-portal-for-state-sales-tax-returns-still-years-away (recognizing that a "centralized portal for e-commerce sellers to look up sales tax rates and file returns" is "a worthy goal that will slash burdens on taxpayers and boost compliance").

184. Specifically, the states uniformly agreeing as to which specific items of income or transactions are subject to taxation, and which are exempt or excluded from taxation.

185. There are benefits to uniform tax rates as well, but uniform tax rates are not as crucial as uniform tax bases to provide a workable centralized administrative function.

liability. If the taxing authority and taxpayer disagree as to the proper tax liability, the enforcement process continues along the tax controversy path, through the audit process, to administrative protests, to formal hearings or trials, and potentially ending with appellate litigation. The enforcement process often takes many years and can involve tax periods that closed over a decade prior. Streamlining the enforcement process can produce enormous economies of scale.

The current limited MTC audit program has not been well-received by corporate taxpayers[186], but a multistate regime could incorporate the lessons from that audit program to craft a unified audit program that is welcomed by all parties—a task that would be much easier with a truly uniform tax base. The unified enforcement process could achieve taxpayer buy-in if it incorporated one centralized—and preferably impartial—office to conduct administrative protests with the ability to settle disputes on a multistate basis.[187]

For disputes in which settlement is not possible, creating an impartial multistate tax tribunal to adjudicate tax disputes would be a revolutionary improvement in the state tax controversy process.[188] A multistate forum would streamline enforcement burdens and promote uniformity of law—no longer would neighboring states have contradictory precedent on identical issues. In addition, a forum that adjudicates the tax disputes of multiple jurisdictions would be much less likely to be influenced by one state's executive branch or other political pressures.[189] The multistate tax tribunal could, and should, exist as an administrative rather than judicial body. Creating an administrative forum is practical from a political and constitutional perspective, and also allows for a much more efficient

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186. *See* W. Bartley Hildreth et al., *Cooperation or Competition: The Multistate Tax Commission and State Corporate Tax Uniformity*, 38 ST. TAX NOTES 827, 829–30 (2005).

187. The lack of such a centralized administrative function is a primary—and substantial—criticism of the current MTC audit program, through which a taxpayer must protest the MTC auditor's determination to each individual state's administrative protest body. *See generally* Jeffrey Friedman, Todd A. Lard & Charles C. Kearns, *Demystifying the MTC Joint Audit Program*, 68 ST. TAX NOTES 599–600 (2013).

188. The current state tax controversy process has many deficiencies, most notably the lack of independent adjudicatory bodies. *See* W. Scott Wright, Jonathan A. Feldman & Andrew Appleby, *Courting Independence: The Rise of Effective State Tax Courts and Tribunals*, 63 ST. TAX NOTES 475, 475 (2012).

189. State courts are less likely than federal courts to strike down their own state's tax regime, colloquially deemed the "home cooking" doctrine. *See* Walter Hellerstein & Andrew Appleby, *Substantive and Enforcement Jurisdiction in a Post-*Wayfair *World*, 90 ST. TAX NOTES 283, 292 (2018).

adjudicatory process.[190] Multijurisdictional adjudicatory bodies are not a novel concept; one can look to the European Court of Justice for a functional example that adjudicates tax disputes.[191] Although not required of a multistate business entities regime, a centralized administrative and adjudicatory function would add enormous value.

B. Legislative Benefits

The legislative, or tax policy, benefits realizable by a multistate business entities system are extensive as well. Cooperation and uniformity can greatly increase efficiency in all aspects of lawmaking—notably the perpetual legislative and administrative processes that are required in the realm of taxation. There is also much less uniformity in state taxation than in state business regulation. As discussed above, states tend to follow, somewhat closely, a model act for each business entity type and deviations are largely at the margins. In addition, with a movement toward a contractarian approach, at least for unincorporated entity types, the state statute often merely establishes the guardrails and allows investors options as to how to structure and operate their businesses. Such is not the case with state tax regimes. For example, many states do not impose even the same *type* of tax on corporations.[192] Therefore, there is even more to gain with uniformity in state tax regimes.[193]

Uniformity in the tax base is mutually beneficial in the areas of administration and compliance, as discussed immediately above, but uniformity also unlocks myriad possible legislative and tax policy benefits as well. Uniformity has long been a chimera in state taxation, largely because state legislatures have fractured their tax bases for political purposes, often to create tax incentives to attract and retain businesses.[194] Although model tax laws exist for corporate income tax and sales and use tax, even the states that

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190. The majority of existing state tax tribunals are administrative bodies that facilitate streamlined hearings through limited discovery and lax rules of evidence. The primary criticism, however, is that these administrative bodies often appear to lack impartiality because they co-exist in the executive branch with the state's department of revenue. *See supra* notes 188–189.

191. *See, e.g.*, Ranier Bräutigam et al., *Decline of Controlled Foreign Company Rules and Rise of Intellectual Property Boxes: How the European Court of Justice Affects Tax Competition and Economic Distortions in Europe*, 38 FISCAL STUD. 719, 720 (2017).

192. In lieu of a traditional corporate net income tax, Texas imposes a "margin tax," Washington imposes a "business & occupation tax," Ohio imposes a "commercial activity tax," and the list continues. *See* RSCH. DIV., TEX. LEGIS. COUNCIL, 79TH LEG., SUMMARY OF ENACTMENTS 9–11 (2006); WASH. REV. CODE § 82.04.220(1) (2022); OHIO REV. CODE ANN. § 5751.02(A) (West 2019).

193. *See* Hildreth, *supra* note 186, at 827.

194. *Id.* at 837.

initially adopted the model laws wholesale eventually drifted away in many aspects.[195] A multistate regime can alleviate a primary cause of this fragmentation by allowing states with shared regional interests to co-compete against other regions instead of against each other. A multistate regime can further ensure lasting uniformity by incorporating a binding approach whereby states may not unilaterally alter their tax laws to deviate from the agreed upon uniform laws. States would have the option to either gain consensus among the other participating states to change the laws on a multilateral basis or to prospectively withdraw from the multistate regime.

Participating states can adopt tax policy approaches that allow them to co-compete rather than compete individually against other states, and to remedy inherent multijurisdictional taxation problems. If states collaborate, they can create tax laws jointly that embody tax policy principles suited to the states' collective needs and prevent cross-border cannibalization.[196] This Article proceeds to address ways in which states can cooperate in the context of corporate income tax, personal income tax, and sales and use tax.

A primary tax policy motivation in the corporate income tax context is to incentivize as much economic growth as possible within the state, which typically equates to businesses creating jobs and developing property in the state.[197] There are several mechanisms states may use to effectuate this policy goal, discussed further below, but they all tend to produce a race to the bottom that results in revenue losses for the states and laws that embody serious tax policy flaws.[198]

If groups of states with regional or industry-specific shared interests co-compete, however, they stand a better chance of winning the competition against non-participating states, and they can benefit collectively. For example, states in the "rust belt" could incorporate into their tax laws certain aspects that benefit their manufacturing and industrial constituents, such as

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195. *Id.* at 830–31.

196. *See, e.g.*, Ryan Pulver, *Interstate Transfer Pricing and the Provocation of the Compact Clause*, 46 CUMB. L. REV. 103, 103 (2015) (discussing interstate transfer pricing issues in the context of the Compact Clause).

197. *See generally* Kirk J. Stark & Daniel J. Wilson, *What Do We Know About the Interstate Economic Effects of State Tax Incentives?*, 4 GEO. J. L. & PUB. POL'Y 133, 158–59 (2006).

198. *See, e.g.*, Gabrielle Coppola, *Ford Jobs Cost $414,000 Apiece as Factory Fight Takes Off*, BLOOMBERG (Oct. 13, 2022, 1:06 PM), https://news.bloombergtax.com/daily-tax-report-state/ford-jobs-cost-414-000-apiece-as-fight-for-factories-takes-off (describing a multi-billion dollar tax credit bidding war to lure electric vehicle manufacturers involving Georgia, Kentucky, Michigan, and Tennessee); Michael J. Bologna, *Panasonic Nabs $207,000 Per Job in Mega Tax Credit Deal*, BLOOMBERG (July 15, 2022, 8:09 AM), https://news.bloombergtax.com/daily-tax-report-state/panasonic-nabs-207-000-per-job-in-mega-tax-credit-deal [https://perma.cc/ECJ3-K2ZN] (describing a bidding war in which Kansas prevailed over neighboring Oklahoma by offering $829.2 million in tax credits).

single-sales factor apportionment and unified credits and incentives for job creation.[199] Instead of Wisconsin competing against Michigan and Ohio to lure a new manufacturing facility, they could cooperatively present a superior business regulatory and tax environment to incentivize the manufacturing business to choose their region.[200] The business would have more flexibility to locate its facilities throughout the region and the participating states could share the resultant tax revenue and economic appreciation.

The participating states may find shared economic interests even if they do not share a geographic region. For example, states that accommodate the financial services industry could form a multistate regime that allows those businesses to thrive. Although it would be foreseeable for states such as New York, Connecticut, New Jersey, Massachusetts, and Illinois to form a compact based on their traditional concentration of financial firms, states that are currently engaged in vociferous competition could also put aside their differences for mutual benefit. New York and Florida could co-compete to provide an unparalleled environment for private equity and hedge funds, while California and Texas could do so for the technology industry.

In the personal income tax context, states face several challenges brought on by the proliferation of remote work and by the federal cap on state and local tax deductions as part of the Tax Cuts and Jobs Act of 2017 (TCJA).[201] States that are close to each other geographically, such as those in the northeastern United States, are grappling with their personal income tax bases migrating just over the border into a neighboring state.[202] This migration has resulted in states suing each other—notably *New Hampshire v. Massachusetts*—and creating legislation that is openly hostile to interstate cooperation.[203] Some state statutes also contain inconsistent definitions of the

199. *See generally* Dan R. Bucks et al., *Would a Multistate Incentives Compact Work?*, 96 TAX NOTES ST. 487 (2020); Billy Hamilton, *Whatever Became of the Multistate Compact on Tax Incentives?*, 100 TAX NOTES ST. 1125 (2021); Aaron Davis, *States Push for Cooperation over Competition*, 95 TAX NOTES ST. 993 (2020).

200. At no point do the authors suggest that these states stop competing on the football field.

201. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (codified as amended in scattered sections of 26 U.S.C.).

202. *See, e.g.*, Young Ran (Christine) Kim, *Taxing Teleworkers*, 55 U.C. DAVIS L. REV. 1149, 1151–54 (2021); Richard D. Pomp, New Hampshire v. Massachusetts*: Taxation Without Representation?*, 36 J. STATE TAX'N 19, 19–20 (2021); Darien Shanske, *Remote Workforce Doctrine and Policy: Short-Term and Long-Term Considerations*, COLUM. J. TAX L. (Oct. 21, 2020), https://journals.library.columbia.edu/index.php/taxlaw/announcement/view/350 [https://perma.cc/6NGA-ZTLK]; Edward A. Zelinsky, *Taxing Interstate Remote Workers After* New Hampshire v. Massachusetts*: The Current Status of the Debate*, 25 FLA. TAX REV. 767 (2023).

203. New Hampshire v. Massachusetts, 141 S. Ct. 2848, 2848 (2021) (mem.) (denying motion for leave to file a bill of complaint); N.H. REV. STAT. ANN. §78-F:1 (declaring that based

term "resident," which results in unconstitutional double taxation and likely forces individuals away from both states.[204] A multistate tax regime could easily remedy all these problems. The participating states could incorporate into their tax laws consistent definitions and sourcing methods, and create reciprocal or sharing agreements to solve remote workforce problems. This approach would attract businesses and employees to the region.

States are also navigating novel challenges related to their efforts to work around the federal cap on state and local tax deductions.[205] States created new laws, known as passthrough entity workarounds, that actually created entirely new tax regimes that impose entity level taxation on passthrough entities.[206] The individual owners of the entities are later allowed a state-level credit for the taxes paid at the entity level.[207] Because the entity and not the individual paid the state tax, the deduction is not limited by the federal cap on state and local tax deductions. The difficulty, however, arises when the unincorporated entity is doing business in multiple states, and thus pays passthrough entity tax in multiple states, but the owner resides in only one state.[208] Whether the state of residence will give a credit to the individuals for passthrough taxes paid to another jurisdiction is certain to be the source of lasting disputes.[209] If states entered into a compact and agreed to incorporate uniform statutory workaround provisions, and reciprocal credits, those disputes could be eliminated.

In the sales tax context, there are two primary areas in which states could cooperate to solve resource-consuming disputes. First, most states have now enacted statutes that impose a sales tax collection and remittance obligation on "platforms" or "marketplaces" that facilitate sales instead of the actual vendor.[210] These provisions have become essential with evolving business

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on the "sovereign interest of the state of New Hampshire" no other state can impose personal income tax on New Hampshire residents in certain circumstances).

204. *See* HELLERSTEIN, HELLERSTEIN & APPLEBY, *supra* note 84, ¶ 20.03[1]; Andrew Appleby, *No Migration Without Taxation: State Exit Taxes*, 60 HARV. J. LEGIS. 55 (2023); Edelman v. N.Y. State Dep't of Tax'n & Fin., 162 A.D.3d 574, 574–75 (N.Y. App. Div. 2018); Chamberlain v. N.Y. State Dep't of Tax'n & Fin., 166 A.D.3d 1112, 1113–14 (N.Y. App. Div. 2018).

205. *See* Walter Hellerstein & Andrew Appleby, *State Tax Credit Issues Raised by SALT Cap Workaround Legislation*, 99 TAX NOTES ST. 211, 211–12 (2021); Steven N.J. Wlodychak, *IRS Just Raised State Taxes for Multistate Passthrough Entity Owners*, 98 TAX NOTES ST. 1159, 1159–60 (2020).

206. Hellerstein & Appleby, *supra* note 205, at 211–13.

207. *Id.* at 211.

208. *Id.* at 212.

209. *Id.* at 212–15.

210. *See* Walter Hellerstein & Andrew Appleby, *Platforms: The Postscript*, 100 TAX NOTES ST. 1365, 1368–1414 (2021) (summarizing the details of each state's platform provisions, which deviate substantially).

models in almost all areas of commerce that now utilize platform providers—such as Amazon, Uber, and Airbnb—to facilitate sales.[211] The problem, though, is that states have enacted platform provisions that are both overinclusive and underinclusive, and are inconsistent across states.[212] If states cooperated to adopt uniform platform provisions, the taxing authorities, platform providers, vendors, and customers would all benefit greatly.

Second, and more importantly, is the digital economy.[213] State legislatures and tax administrators face the difficult task of keeping tax laws on pace with rapid technological advancements. Trying to contort antiquated tax laws to address novel digital business models is a frustrating endeavor for taxing authorities and taxpayers alike. State legislatures need to enact laws that adequately and uniformly address the digital economy and its unique contours. Most notable is sourcing, *i.e.*, how to determine the jurisdiction that has the prevailing claim to tax a transaction.[214] For example, if someone pays a monthly subscription fee to stream video content, but does so from their phone across three states each day during their commute, which state should have the ability to impose tax on that monthly subscription fee? There are many options, but all are problematic and imprecise.[215] If states agreed on a uniform sourcing method, or simply aggregated all receipts and allocated the revenue between the states based on an agreed upon metric, countless hours and resources would be conserved.

The situations discussed above are not exhaustive, but rather provide a survey of areas in which a multistate tax regime could benefit states and taxpayers. A multistate business entities regime need not incorporate any tax aspects, but doing so would add exponential value to an already transformative concept.

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211. Sangeet Paul Choudary, Geoffrey Parker & Marshall Van Alstyne, *What Twitter Knows That Blackberry Didn't*, MARKETWATCH (Oct. 10, 2013), https://www.marketwatch.com/story/what-twitter-knows-that-blackberry-didnt-2013-10-10 [https://perma.cc/8CKW-QQPJ].

212. *See* Hellerstein & Appleby *supra* note 210.

213. *See, e.g.,* Andrew Appleby, *Subnational Digital Services Taxation*, 81 MD. L. REV. 1, 2–4 (2021); Orly Mazur & Adam Thimmesch, *Closing the Digital Divide in State Taxation: A Consumption Tax Agenda*, 98 TAX NOTES ST. 961, 961–62 (2020); Gladriel Shobe et al., *Why States Should Consider Expanding Sales Taxes to Services, Part 1*, 98 TAX NOTES ST. 1349, 1351–53 (2020); Grace Stephenson Nielsen et al., *How States Should Now Consider Expanding Sales Taxes to Services, Part 2*, 99 TAX NOTES ST. 45, 48 (2021).

214. *See* Appleby, *supra* note 213, at 41–44; *see, e.g.*, Roxane Bland, *Multistate Tax Commission Digital Products Project: The Practitioners Speak*, 106 TAX NOTES ST. 381, 381–82 (2022); Sanjay Talwani, *Inconsistent State Rules Muddy Apportionment, Panelists Say*, LAW360 (Oct. 20, 2022).

215. *See* Hellerstein & Appleby, *supra* note 210.

CONCLUSION

The multistate business entity regime is an alternative to single-state formation that does not require federalization. This regime is novel in the realm of business and tax law but is firmly rooted in the constitutional principles of interstate cooperation.

This Article provides the constitutional and economical backdrop to the multistate formation regime and draws out the robust and practical business entities and tax law advantages that such a regime would bring. Understanding that business entities were not destined to lie outside the constitutional imperative for interstate cooperation would enable lawmakers to set up a multistate entity formation regime that will offer firms unique business and tax law benefits that simultaneously promote market efficiency and equitable stakeholderism. The multistate entity formation regime will thus fulfill the dual purpose of remedying corporate shortcomings and realizing the business vision of the Compact Clause.