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SUPREME COURT OF THE STATE OF WASHINGTON

SPACE AGE FUELS, INC,

Appellant,

v.

STATE OF WASHINGTON,

Respondent.

BRIEF OF RESPONDENT

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ORIGINAL

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I. INTRODUCTION

This case concerns Washington's jurisdiction to tax Space Age Fuels, Inc., an Oregon corporation that sells motor vehicle fuel and special fuel at wholesale to customers in Oregon and Washington. Space Age does substantial amounts of business in Washington. During the period at issue—January 2004 through June 2007—Space Age made at least 1,675 wholesale sales to Washington customers. Each sale was completed in Washington when a Space Age employee delivered the fuel to the Washington customer in a Space Age-owned delivery truck. Space Age received more than $48 million from its Washington sales during this period, an average of $13.7 million per year.

Despite its significant business activity in this state, Space Age claims that its contacts with Washington were insufficient to establish "substantial nexus" with the state under the dormant Commerce Clause. Therefore, according to Space Age, it is immune from liability for Washington's business and occupation (B&O) tax on its wholesale sales in Washington. Space Age is incorrect. It is not the purpose of the dormant Commerce Clause to shield out-of-state businesses from paying their fair share of taxes to those states in which the businesses choose to operate. Space Age's substantial in-state business activities and physical presence, coupled with its continuous economic exploitation of the Washington market, are more than sufficient under the Commerce Clause to give Washington the authority to impose a fairly apportioned tax on the sales.

Accordingly, the trial court correctly held that Space Age was not immune from paying B&O tax on its in-state sales. This Court should affirm.

II. COUNTERSTATEMENT OF THE ISSUE

Were regular in-state sales and deliveries of fuel by Space Age to its Washington customers sufficient under the dormant Commerce Clause to establish substantial nexus between Space Age and Washington?

III. STATEMENT OF THE CASE

A. Space Age Sold And Distributed Motor Fuel And Special Fuel To Washington Wholesale Customers, Earning Gross Income In Excess of $48 Million During The Period At Issue.

Space Age is a Washington licensed motor fuel and special fuel supplier. CP 351. The company is incorporated in Oregon and has its principal place of business in Clackamas, Oregon. CP 54. From January 1, 2004, through June 30, 2007, Space Age was engaged in the business of selling fuel at retail and wholesale in Oregon and Washington. During that period it supplied motor fuel and special fuel to roughly 40 wholesale customers in Washington. *Id.*[1] Space Age made at least 1,675 wholesale sales to Washington customers during the period at issue and received more than $48 million of gross income from its Washington wholesale

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[1] Space Age also made a few retail sales of fuel to Washington consumers during 2007. CP 85. However, Space Age is not seeking a refund of retailing B&O tax or retail sales tax it paid on its Washington retail sales. Consequently, this Statement of the Case will focus only on the Washington wholesale sales of fuel that Space Age made during January 1, 2004, through June 30, 2007.

sales. CP 81 (¶ 7); CP 171 (Space Age accounting report listing gross revenue from Washington wholesale sales made during the period at issue totaling $48,719,331.06).

All of the Washington wholesale sales at issue were made within Washington when Space Age employees transferred title and possession of the fuel to Washington customers using fuel delivery trucks owned by Space Age. CP 285; RCW 82.04.040(1) (defining when a sale occurs). On average, Space Age was physically present in Washington more than one each day during the three-and-one-half years at issue, making sales and distributing motor fuel and special fuel. CP 81 (¶ 7).[2]

In order to lawfully sell and distribute motor fuel and special fuel to its Washington customers, Space Age was required to obtain licenses from the Washington Department of Licensing. CP 351 (application filed by Space Age with Washington DOL for a motor fuel supplier license and a special fuel supplier license). Space Age charged its Washington customers the Washington motor fuel tax or special fuel tax owed on the fuel being supplied. CP 177 (representative Space Age invoice showing Washington motor fuel tax of $0.31 per gallon charged on the sale of gasoline to Washington customer); CP 178 (representative Space Age invoice showing Washington special fuel tax of $0.34 per gallon charged

[2] 1,675 deliveries ÷ 1,277 days during period at issue = average of 1.31 deliveries per day.

on sale of diesel to Washington customer).[3] Space Age did not, however, report these sales to the Department of Revenue and did not pay Washington B&O tax on its Washington wholesale sales until after it was assessed for unpaid taxes by the Department. CP 81-82 (¶¶ 4 and 14, Department assessed Space Age for unreported wholesaling B&O tax on 10/30/2008); CP 6 (¶¶ 7 and 11, Space Age paid the assessed wholesaling B&O tax on 11/9/2009).

The fuel trucks owned and operated by Space Age had the capacity to make multiple fuel deliveries during a single trip. CP 295-96. From mid 2005 through 2007, Space Age employees drove 186,877 miles in Washington delivering fuel. CP 330-49 (International Fuel Tax Agreement ("IFTA") tax returns filed by Space Age for the third quarter of 2005 through the fourth quarter of 2007, showing miles driven in Washington and other states).[4] The price Space Age charged its

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[3] The record does not reflect whether Space Age remitted any Washington motor fuel tax or special fuel tax to the Department of Licensing as required by RCW 82.36 (motor vehicle fuel tax chapter) and RCW 82.38 (special fuel tax chapter). However, there is no reason to believe Space Age was violating its obligation as a Washington motor fuel supplier and special fuel supplier to report and pay the Washington fuel taxes on fuel it imported into the state. *See* RCW 82.36.026(1) (licensed motor fuel supplier "shall be liable for and pay tax to the department [of Licensing] as provided in RCW 82.36.020"); RCW 82.38.035(1) (licensed special fuel supplier "shall be liable for and pay tax on special fuel to the department [of Licensing] as provided in RCW 82.38.070(7)(a)"). There is also no evidence suggesting that Space Age has asserted that it lacked nexus with Washington for purposes of its Washington motor fuel and special fuel tax payment obligations.

[4] IFTA tax returns for the first quarter of 2004 through the second quarter of 2005 were not made part of the record.

customers for motor fuel and special fuel was dependent to some extent on the distance Space Age had to travel to deliver the fuel. CP 292.

The Space Age employees that operated the Space Age trucks also provided important services to Washington purchasers. The manner in which fuel was transferred by Space Age to its Washington wholesale customers depended on whether the customer's fuel tank was below ground or above ground. For sales to customers with below-ground tanks, the Space Age employee delivering the fuel would "stick the tank" to determine whether the tank would hold the amount of fuel being delivered and then dispense a controlled amount of fuel from the Space Age truck into the customer's tank. CP 295. No pumping equipment was required for this type of delivery because the fuel moved from the Space Age truck to the customer's tank by force of gravity. CP 292-93. For sales to customers with above-ground tanks, the process was more complicated and required a truck capable of pumping fuel from the Space Age truck into the customer's tank. CP 292-93. Space Age had several trucks capable of pumping fuel in its fleet and used both types of trucks (gravity delivery and pump delivery) in its Washington business operations. CP 293.

During the period at issue Space Age did not send employees into Washington to solicit sales or to accept orders. Instead, Washington

customers ordered fuel from Space Age by telephone, email, or fax. CP 315-16. However, as previously noted, the actual sales were made in Washington when the Space Age employees transferred possession of the fuel to the Washington customers.

B. Department Of Revenue Assessed Space Age For Unpaid B&O Tax On Wholesale Sales Of Motor Fuel And Special Fuel To Washington Customers.

The Department audited Space Age's business records for the January 1, 2004 through June 30, 2007 period. The audit resulted in an assessment of retail sales tax, retailing B&O tax, wholesaling B&O tax, and hazardous substance tax in the total amount of $238,157. CP 257. Of this total amount, $235,834 was for unpaid wholesaling B&O tax pertaining to sales of motor fuel and special fuel Space Age sold and delivered to customers in Washington. CP 257; CP 82 (¶ 14). Penalties and interest were added to the unpaid taxes. CP 257.

Space Age paid the assessment and initiated a tax refund lawsuit under RCW 82.32.180. CP 5-8. In its complaint, Space Age sought a refund of the assessed wholesaling B&O tax it paid, plus associated penalties and interest. CP 6 (¶ 7). Space Age did not request a refund of the assessed retail sales tax, retailing B&O tax, or hazardous substance tax. *Id.*

C. The Trial Court Granted Summary Judgment To The Department.

After discovery was completed, both the Department and Space Age filed motions for summary judgment. CP 258-67 (Department's motion); CP 62-79 (Space Age's motion). The trial court, the Honorable Thomas McPhee, granted the Department's motion and denied Space Age's cross-motion. CP 443-46. The trial court concluded that Space Age had substantial nexus with Washington as a result of its regular in-state deliveries of fuel. VRP, vol. 2 at 5. Space Age timely appealed from the trial court's judgment. CP at 447.

IV. ARGUMENT

A. Standard Of Review.

This appeal stems from the grant of summary judgment in favor of the Department of Revenue and involves the application of undisputed facts to established principles of constitutional law. Accordingly, the Court's review is de novo. *Flight Options, LLC v. Dep't of Revenue*, 172 Wn.2d 487, 495, 259 P.3d 234 (2011).

B. The Business Activities Performed By Space Age In Washington Were More Than Sufficient To Meet The Nexus Requirement Of The Dormant Commerce Clause.

The Commerce Clause of the United States Constitution gives Congress the power to "regulate Commerce . . . among the several States." U.S. Const., art. I, § 8, cl. 3. The United States Supreme Court has

consistently interpreted this express grant of authority as also imposing certain limits on the power of the states to tax interstate commerce even in the absence of congressional action. These limits on state jurisdiction to tax interstate commerce under the "dormant" Commerce Clause have "evolved substantially over the years." *Quill Corp. v. North Dakota*, 504 U.S. 298, 309, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992). Under current dormant Commerce Clause jurisprudence, a state tax on interstate commerce is valid if it: (1) is applied to an activity with a substantial nexus with the taxing State; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services provided by the State. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977).

Space Age challenges the first prong of the four-part *Complete Auto* test as applied to its wholesale sales of motor fuel and special fuel to Washington customers.[5] That prong ("substantial nexus") has two important jurisdictional components. *See generally*, John A. Swain, *State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective*, 45 Wm. & Mary L. Rev. 319, 328-29 (2003-04) (explaining the two

[5] Washington courts have previously addressed the second and third prongs of the *Complete Auto* test with respect to the Washington B&O tax on retail or wholesale sales, upholding the tax as non-discriminatory and inherently apportioned. *E.g.*, *W.R. Grace & Co. v. Dep't of Revenue*, 137 Wn.2d 580, 596-97, 973 P.2d 1011, *cert. denied*, 528 U.S. 950 (1999).

meanings of the term "nexus" for purposes of state tax jurisdiction). First, it limits the jurisdictional reach of the states to tax transactions, activities, or property that are not sufficiently connected with the taxing state. *Id.* This component (often referred to as "transactional nexus") is not at issue in this case because all of the wholesale sales made by Space Age that are at issue in this case occurred within Washington. There is simply no dispute that Washington had sufficient "transactional nexus" to tax wholesale sales occurring within its borders.

The second important jurisdictional component of "substantial nexus" is the connection between the state and the taxpayer that owes the tax or is being asked to collect and remit the tax. *Id.* This component (often referred to as "entity nexus") is being disputed by Space Age and is the focus of the arguments that follow.

1. **Space Age had substantial nexus with Washington even under the *Quill* physical presence safe harbor.**

The concept of "substantial nexus" with the taxpayer under the dormant Commerce Clause is best understood as "a means for limiting state burdens on interstate commerce." *Quill Corp. v. North Dakota*, 504 U.S. 298, 313, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992). States are not permitted to unduly burden interstate commerce by taxing a person that lacks nexus with the taxing state. However, while the Commerce Clause

prevents states from unduly burdening interstate commerce, "[i]t is not the purpose of the Commerce Clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business." *General Motors Corp. v. City of Seattle*, 107 Wn. App. 42, 50, 25 P.3d 1022 (2001) (internal quotes and citations omitted), *review denied*, 145 Wn.2d 1014 (2001), *cert. denied*, 535 U.S. 1056 (2002). *See also Department of Revenue v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 748, 98 S. Ct. 1388, 55 L. Ed. 2d 682 (1978) ("The Commerce Clause balance tips against the [state] tax only when it unfairly burdens commerce by exacting more than a just share from the interstate activity.").

In the present case, Space Age did a substantial amount of interstate business with Washington customers from which it generates a significant amount of gross income each year. The question presented is whether Space Age has sufficient nexus under the dormant Commerce Clause to be subject to the Washington B&O tax on wholesale sales of motor fuel and special fuel to its Washington customers.

Since *Complete Auto Transit* was decided in 1977, the United States Supreme Court has not articulated any specific test or standard used to determine whether a taxpayer has substantial nexus with the taxing state. To the contrary, the Supreme Court recognizes that the concept of

nexus for state tax purposes is flexible and is determined not by rigid, bright-line rules, but based on the practical operation of the subject tax to the specific facts and circumstances involved. *E.g.*, *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 32-33, 108 S. Ct. 1619, 100 L. Ed. 2d 21 (1988) (facts pertaining to mail-order seller's activities directed towards taxing state, plus its significant in-state presence, held sufficient to establish nexus for purpose of imposing use tax on catalogs printed and mailed from outside the state to in-state customers); *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995) (in-state purchase of bus ticket, where transportation service originated, provided sufficient nexus for purpose of sales tax on transportation for hire services). As explained by Professor Swain:

> Before deciding *Complete Auto*, the Court had wrestled with various "free trade" interpretations of the Commerce Clause. *Complete Auto*, however, finally "abandoned the abstract notion that interstate commerce 'itself' cannot be taxed by the States." *Complete Auto* repudiated the wooden formalism of earlier Commerce Clause analysis because it bore "no relationship to economic realities." *Complete Auto* and subsequent Supreme Court decisions have consistently reiterated that modern Commerce Clause jurisprudence is grounded in "pragmatism" and "economic realties," and is disdainful of "formalism," "magic words," and "labels."

John A. Swain, *Cybertaxation and the Commerce Clause: Entity Isolation or Affiliate Nexus?*, 75 S. Cal. L. Rev. 419, 427 (2001-02) (footnotes omitted).

The Supreme Court has, however, maintained one bright-line rule as part of its post-*Complete Auto* dormant Commerce Clause analysis. In *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992), the Supreme Court upheld on *stare decisis* grounds the "safe harbor" rule established twenty-five years earlier in *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967).[6] Under that bright-line safe harbor rule, an out-of-state seller of goods can avoid the requirement to collect state sales or use taxes on in-bound sales if that seller has no physical presence in the taxing state and its "only connection with customers in the [taxing] State is by common carrier or the United States mail." *Quill*, 504 U.S. at 315 (quoting *Nat'l Bellas Hess*, 386 U.S. at 758).

Space Age had abundant physical presence in Washington during the periods at issue. It is undisputed that the fuel Space Age sold to its Washington wholesale customers during the period at issue was delivered

[6] The Court in *Quill* overruled the portion of *Nat'l Bellas Hess* involving due process limitations on the ability of states to tax out-of-state mail-order vendors, holding that "[t]he requirements of due process [can be] met irrespective of a corporation's lack of physical presence in the taxing State." *Quill*, 504 U.S. at 308. However, the Court upheld on *stare decisis* grounds the physical presence safe harbor under the dormant Commerce Clause. *Id.* at 317.

by Space Age employees using delivery vehicles owned by Space Age. CP 285. Space Age made, at a minimum, 1,675 in-state deliveries during the three-and-one-half years at issue, and drove at least 186,877 miles within Washington when travelling to and from the place of sale. CP 81 (¶ 7); CP 330-49 (IFTA tax returns for the third quarter of 2005 through fourth quarter of 2007, showing miles driven in Washington). For each load of fuel Space Age delivered, a Space Age employee not only drove the fuel to that customer's location, but also performed essential services at the point of delivery such as "sticking the tank" to measure whether there was room for the fuel being delivered, and dropping or pumping the fuel from the Space Age truck into the customer's tank. CP 292-93; CP 295.

It is generally understood that the "physical presence" safe harbor upheld in *Quill* does not apply outside the context of state sales and use taxes. *See General Motors*, 107 Wn. App. at 54-55 (physical presence in the state is not required to establish nexus for B&O tax purposes).[7] *But cf. Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 846-51, 246 P.3d 788,

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[7] In *General Motors*, the Court of Appeals quoted with approval from *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993), that "[a]ny corporation that regularly exploits the market of a state should be subject to its jurisdiction to impose an income tax even though not physically present." *General Motors*, 107 Wn. App. at 55. Applying that "regular exploitation" concept to the Seattle B&O tax at issue, the Court found that "[t]he automakers certainly exploit the market in the City, regardless of where they are physically located. We decline to extend *Quill's* physical presence requirement in this context." *Id.*

cert. denied, 132 S. Ct. 95 (2011) (this Court declined to address whether the physical presence safe harbor extends beyond sales and use taxes because taxpayer's regular visits to Washington to meet with customers were sufficient to established a physical presence). While this issue has not been squarely addressed by the United States Supreme Court, "the great weight of authority" supports the view of our Court of Appeals that the physical presence requirement does not extend beyond state sales and use taxes. *Lamtec*, 170 Wn.2d at 849. *See also KFC Corp. v. Iowa Dep't of Revenue*, 792 N.W.2d 308, 320-22 (Iowa 2010), *cert. denied*, 132 S. Ct. 97 (2011) (discussing numerous post-*Quill* cases addressing whether physical presence is constitutionally required for imposing state taxes other than sales or use taxes).

Moreover, even with respect to sales and use taxes where the physical presence safe harbor does apply, it is generally understood that any presence (property or activity) of the entity in the taxing state that is demonstrably more than a "slightest presence" will exceed that safe harbor. As explained by the New York Court of Appeals in *Orvis Co. Inc. v. Tax Appeals Tribunal*, 86 N.Y.2d 165, 654 N.E.2d 945, *cert. denied*, 516 U.S. 989 (1995), "[w]hile a physical presence of the vendor is required, it need not be substantial. Rather, it must be demonstrably more than a slightest presence . . . [and] may be manifested by the presence in

the taxing State of the vendor's property or the conduct of economic activities" performed by the vendor or on its behalf. 654 N.E.2d at 960-61 (internal quotations and citation omitted).

Whether physical presence is required under the dormant Commerce Clause to justify imposing Washington's gross receipts tax on an out-of-state seller is not at issue in this appeal because Space Age had an abundant physical presence in Washington during the period at issue. That presence was more than sufficient to justify subjecting Space Age to the Washington tax even under the *Quill* physical presence safe harbor.

2. Evidence of substantial nexus is not limited to in-state activities occurring during the "solicitation stage," and can include deliveries by an out-of-state vendor in its own trucks.

Space Age argues that the regular presence of its employees and delivery vehicles within Washington is immaterial as a matter of constitutional law because that in-state presence occurred after the customer had already ordered the fuel. Br. of App. at 11. According to Space Age, the substantial nexus requirement of the dormant Commerce Clause is concerned only with "activities that occur at the initial and ongoing solicitation stages of the customer relationship and are designed to generate [] original or subsequent sales." *Id.* at 21. From this initial premise, Space Age argues that all other contacts with the state, including

economic exploitation of the state's market and physical presence occurring after the customer has made the decision to purchase the seller's goods, are not material in determining substantial nexus. Space Age is incorrect.

a. Substantial nexus does not require in-state solicitation of orders.

It is well-established that in-state solicitation or acceptance of individual orders for goods is not required for an out-of-state seller to have substantial nexus with the taxing state. *E.g.*, *Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975); *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 246 P.3d 788, *cert. denied*, 132 S. Ct. 95 (2011); *General Motors Corp. v. City of Seattle*, 107 Wn. App. 42, 25 P.3d 1022, *review denied*, 145 Wn.2d 1014 (2001), *cert. denied*, 535 U.S. 1056 (2002). Courts instead look primarily to whether the taxpayer's connections with the state were purposeful. This can include economic exploitation of the in-state market and activities that occur after the "solicitation stage."

For instance, in *Standard Pressed Steel*, the Supreme Court held that Washington could constitutionally tax an out-of-state manufacturer on sales it made to a Washington customer where the manufacturer employed one person who resided and worked in Washington. 419 U.S. at 561, 564.

The single employee did not solicit sales nor receive orders. *Id.* at 561. Rather, his "primary duty was to consult with [the purchaser] regarding its anticipated needs and requirements for aerospace fasteners and to follow up any difficulties in the use of [the out-of-state manufacturer's] product after delivery." *Id.* Additional employees of the manufacturer visited Washington on occasion to assist in these tasks. *Id.* The Court held that the tax was constitutional despite the fact that these employees did not solicit sales nor receive orders in Washington. *Id.*

As a matter of constitutional law, a state's jurisdiction to tax an out-of-state business is not dependent on whether the nexus creating contacts occurred before or after a sale of goods was completed. *Standard Pressed Steel*, *supra*; *General Motors*, 107 Wn. App. at 52 ("Although the automakers place great emphasis on the fact that they engage in no direct selling activities in Seattle, substantial nexus has never turned on this distinction."). *See also Dell Catalog Sales L.P. v. N.M. Taxation & Revenue Dep't.*, 145 N.M. 419, 199 P.3d 863 (N.M. App.), *rev. denied*, 189 P.3d 1215 (N.M. 2008), *cert. denied*, 129 S. Ct. 1616 (2009) (post-sale warranty services performed on behalf of out-of-state vendor were sufficient to establish substantial nexus between the vendor and New Mexico). Moreover, in the present case Space Age did engage in nexus creating activity within Washington *before* the sale of fuel was complete.

While Space Age did not send employees into Washington to solicit sales or to accept orders, the actual sales were consummated in the state when Space Age employees transferred possession of the fuel to the Washington customers by dispensing the fuel into the customer's tank. *See* RCW 82.04.040(1) (defining "sale" to include "any transfer of the ownership of, title to, *or possession of* property for a valuable consideration") (emphasis added). Thus, the actual wholesale sales at issue in this appeal occurred in Washington when fuel was transferred from Space Age's trucks by Space Age employees into the holding tanks of Space Age's Washington customers.

Space Age is not constitutionally immune from Washington B&O tax on sales it made within the state using its own employees and its own transportation equipment simply because the orders were received and accepted outside Washington.

b. Deliveries of fuel by Space Age employees, using Space Age trucks, were significant and were associated with Space Age's ability to maintain its market within the state.

In *Tyler Pipe Indus., Inc. v. Dep't of Revenue*, 105 Wn.2d 318, 715 P.2d 123 (1986), *reversed on other grounds*, 483 U.S. 232, 250 (1987), this Court held that "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly

associated with the taxpayer's ability to establish and maintain a market in this state for the sales." *Id.* at 323. The standard used in *Tyler Pipe* should not be applied in a wooden or formulistic manner and is best suited for analyzing whether an out-of-state business that engages in in-state solicitation or similar sales supporting activities has sufficient connections with this state to meet the jurisdictional requirements of the dormant Commerce Clause. This case actually highlights the risk of using the standard applied in *Tyler Pipe,* and later in *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, as a one-size-fits-all "litmus test." Even though Space Age was almost continuously presence in Washington and carried on substantial business in this state, it claims it is immune from Washington B&O tax *as a result of Tyler Pipe* and *Lamtec*; two cases in which this Court *upheld* the state's jurisdiction to tax based on far less in-state contacts than are present here.

Space Age essentially argues that its copious physical presence in Washington during the period at issue was the wrong "type" of presence to satisfy *Tyler Pipe* and *Lamtec*. Br. of App. at 20. This Court should reject Space Age's crabbed notion of the jurisdictional limits imposed on states under the dormant Commerce Clause. If the language and holdings in *Tyler Pipe* and *Lamtec* are applied pragmatically, there can be serious

dispute that Space Age had sufficient nexus with Washington to satisfy the dormant Commerce Clause.

Space Age established a significant business presence in Washington by obtaining Washington motor fuel and special fuel supplier licenses and making regular visits into Washington to deliver fuel to its Washington customers. As part of its business operations, Space Age regularly used Washington roads and benefited from the market that Washington established for its goods. These connections with Washington were significant and enabled Space Age to compete for business with other motor fuel and special fuel suppliers. And because Space Age delivered fuel to its Washington wholesale customers and performed other licensed motor fuel and special fuel supplier activities in Washington, Space Age's customers did not have to engage in (or arrange for) the transportation or delivery of these hazardous substances themselves. This in-state presence helped Space Age maintain its sizable share of the Washington fuel supplier market. *Tyler Pipe* and *Lamtec* do not require more and do not require different types of in-state presence.

Space Age's assertion that *Tyler Pipe* and *Lamtec* limit the type of in-state presence that can be considered by courts and state taxing authorities is incorrect. The United States Supreme Court rejected this sort of "formalistic" approach in *Compete Auto Transit. See Complete*

Auto Transit, 430 U.S. at 288-89 (overruling *Spector Motor Service v. O'Connor*, 340 U.S. 602, 71 S. Ct. 508, 95 L. Ed. 573 (1951)). Space Age's efforts to turn back the clock more than thirty years should be rejected.[8]

c. Regular deliveries in the seller's own trucks are sufficient to establish substantial nexus.

Although no Washington appellate court has addressed whether regular delivery of goods by an out-of-state seller in its own trucks is sufficient to create substantial nexus under the dormant Commerce Clause, other jurisdictions that have addressed the issue have universally concluded that regular in-state delivery is sufficient. For instance, in *Brown's Furniture, Inc. v. Wagner*, 171 Ill.2d 410, 665 N.E.2d 795, *cert. denied*, 519 U.S. 866 (1996), the Supreme Court of Illinois held that regular deliveries by an out-of-state furniture retailer to customers within Illinois were sufficient to establish substantial nexus requiring the seller to

[8] To appreciate the sea-change brought about by *Complete Auto Transit*, it is useful to consider the Supreme Court's dormant Commerce Clause jurisprudence leading up to *Complete Auto*. Professor Hartman provides a thorough description of the Court's historical approaches to state tax jurisdiction under the dormant Commerce Clause prior to *Complete Auto*. *See* Paul J. Hartman, *Federal Limitations on State and Local Taxation* §§ 2:9-2:16 (1981). *See also Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 180-83, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995) (summarizing history of the Court's significant dormant Commerce Clause state tax cases). Simply stated, between 1829 and 1977, the Court "wound its way through a labyrinth of shifting, tortuous judicial interpretations and approaches concerning the *extent* to which the commerce clause limits state taxation of interstate and foreign commerce." Hartman, § 2:9 at 52-53. "After decades of distinctions based upon insubstantial and pointless formalism, in 1977 the Court cut the Gordian knot in *Complete Auto Transit, Inc. v. Brady*." *Id.*, § 2:17 at 88. Relevant portions of the Hartman treatise are attached as Appendix A.

collect and remit Illinois use tax on sales of merchandise delivered to its Illinois customers. As pointed out by the Illinois Supreme Court, "[t]hrough its deliveries, Brown's Furniture is physically present in Illinois on an almost continuous basis, directly competing with in-state retailers in establishing and maintaining a market for its furniture sales in Illinois. We conclude that Brown's Furniture has met the *Complete Auto* substantial nexus requirement." 171 Ill.2d at 425. While Brown's Furniture advertised extensively in Illinois and clearly directed its business activities towards the Illinois market, *id.* at 414, those facts were not relied on by the court in concluding that the company had substantial nexus with the state. Rather, the court's substantial nexus holding was predicated solely on the company's regular in-state deliveries. *Id.* at 425.[9]

In *Town Crier, Inc. v. Dep't of Revenue*, 315 Ill. App. 3d 286, 733 N.E.2d 780 (2000), the Illinois Court of Appeals held that a Wisconsin company had established substantial nexus in Illinois by delivering furniture to Illinois customers in its own vehicles. During the twenty-six month period at issue, the taxpayer made 30 deliveries in its own vehicles

[9] The Supreme Court of Illinois did address the taxpayer's advertising activities in the context of distinguishing the holding in *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 74 S. Ct. 535, 98 L. Ed. 744 (1954). *Brown's Furniture*, 171 Ill.2d at 427. *Miller Bros.* was a due process case decided before the Supreme Court in *Quill* held that the Due Process Clause no longer requires physical presence in the forum state as a jurisdictional prerequisite to taxing an out-of-state vendor. Consequently, "the continuing authority of *Miller Bros.* is in considerable doubt." 171 Ill.2d at 426. *Miller Bros.* is discussed in more detail below starting at page 32.

to Illinois customers, and installed window dressings in Illinois on five occasions. 315 Ill. App. 3d at 289. The court held these purposeful forays into Illinois were sufficient to take the seller outside the *Quill* physical presence safe harbor and to establish substantial nexus under the dormant Commerce Clause. *Id.* at 294. "By making deliveries into Illinois in its own vehicles, plaintiff has established a regular presence in Illinois that enhanced its ability to establish and maintain a market for its furniture sales." *Id.* Accordingly, the court had no trouble concluding that the seller's in-state delivery "satisf[ied] the first requirement of the *Complete Auto* test." *Id.*

Finally, in *Falcone v. Taxation Div. Director*, 12 N.J. Tax 75 (N.J. Tax Ct. 1991), the New Jersey Tax Court held that a Pennsylvania seller of garden and recreational equipment was required to collect New Jersey sales tax on sales of merchandise delivered to New Jersey residents by the taxpayer in its own trucks. While the Tax Court's opinion primarily addressed the seller's due process argument, it also rejected the seller's Commerce Clause argument by concluding that "the obligation [imposed on the seller] to collect sales tax for goods delivered to New Jersey customers does not rise to an impermissible burden on interstate commerce . . . ." *Id.* at 81 (citing *Complete Auto Transit*).

Other jurisdictions have reached the same conclusion, even though the companies at issue had additional contacts with the taxing jurisdiction. *See John Swenson Granite, Inc. v. State Tax Assessor*, 685 A.2d 425, 429 (Me. 1996) (180 deliveries per year in the taxpayer's own trucks helped create nexus); *Rowe-Genereux, Inc. v. Vermont Dep't of Taxes*, 138 Vt. 130, 139, 411 A.2d 1345 (1980) (delivery of goods by an out-of-state business in its company owned trucks helped create nexus). And at least two state courts have held that an out-of-state company's shipment of goods that were delivered into the taxing state via common carrier helped create substantial nexus under the dormant Commerce Clause. *See Koch Fuels, Inc. v. Clark*, 676 A.2d 330 (R.I.), *cert. denied*, 519 U.S. 930 (1996) (company's continuous contact and control over deliveries via common carrier helped create a substantial nexus within the state); *Saudi Ref. Inc. v. Dir. of Revenue*, 715 A.2d 89 (Del. 1998) (out-of-state company's complex arrangements for delivery and passage of title of goods into state supported finding that company had substantial nexus). *Cf. Aloha Freightways, Inc. v. Comm'n of Revenue*, 428 Mass. 418, 423, 701 N.E. 2d 961 (1998) (regular in-state pickup, transportation, and delivery of freight by an Illinois-based common carrier was sufficient to establish nexus with Massachusetts).

Space Age cites no persuasive authority suggesting that regular deliveries in its own vehicles were insufficient as a matter of constitutional law to establish substantial nexus.[10] Instead, Space Age argues that each of the cases cited by the Department is distinguishable from this case. Br. of App. at 27-29. But any distinguishing features of those cases from this case are not material. In fact, in key respects Space Age had even more nexus-creating contacts with Washington than the taxpayers at issue in *Brown's Furniture*, *Town Crier*, and *Falcone* had with the tax-imposing states in those cases.

Unlike the facts supporting nexus in those other cases, Space Age has obtained licenses from the Washington Department of Licensing allowing it to lawfully supply motor fuel and special fuel within the state and to compete with other motor fuel and special fuel suppliers. Moreover, Space Age made in-state sales and deliveries on average more than once per day, and received in excess of $48 million from this

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[10] In a different section of its brief, Space Age implies that federal legislation enacted by Congress under its affirmative Commerce Clause powers, and a Virginia case addressing that federal statute, are somehow pertinent in this case. Br. of App. at 25 n.14 (discussing "Public Law 86-272" and *Virginia Dep't of Taxation v. National Private Truck Council*, 480 S.E.2d 500 (Va. 1997)). That federal law, codified at 15 U.S.C. § 381, pertains to net income taxes and is not applicable to gross receipts taxes like the Washington B&O tax. Moreover, the Virginia case cited by Space Age held that an administrative regulation adopted by the state's Department of Taxation was inconsistent with the plain meaning of the federal statute and, therefore, invalid. *National Private Truck Council*, 480 S.E.2d at 502. Neither the federal statute nor the Virginia case have any bearing on what constitutes substantial nexus under the dormant Commerce Clause and do not support Space Age's claim that its regular deliveries of motor fuel and special fuel were insufficient to establish substantial nexus with Washington.

business activity during the three-and-one-half years at issue. While Space Age asserts that it did no advertising or solicitation in Washington, it apparently did not need to engage in those activities in order to take advantage of the Washington market. CP 54 (¶¶ 7 and 11, company president claimed that Space Age successfully obtained Washington business based solely on price it charges for fuel).[11] The regular presence of Space Age employees and delivery vehicles within the state was enough for Space Age to carve out a $13.7 million per year slice of the Washington motor fuel and special fuel wholesale market.

Space Age's regular presence in Washington through delivery in its own trucks helped it compete directly with other fuel suppliers. It used Washington's roads and regularly took advantage of the market that Washington created for its products. These deliveries were not occasional, but regular and systematic, numbering in the thousands. This in-state presence was substantial and was associated with Space Age's ability to establish and maintain its market within the state. Consequently, the trial court correctly granted summary judgment to the Department of Revenue.

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[11] The record on appeal establishes that Space Age did have a sales force that was responsible for "drum[ing] up new business" in both Oregon and Washington. CP 303-04, 307-10 (deposition testimony of David Maydew). However, the exact nature and extent of that sales activity was disputed and was not considered by the trial court in ruling on the Department's motion for summary judgment. VRP, vol. 2 at 3-4.

d. Once a taxpayer exceeds the physical presence safe harbor upheld in *Quill*, courts may consider all relevant facts and circumstances pertaining to the taxpayer's nexus with the taxing state, including the extent of the taxpayer's economic presence.

Citing *Quill*, Space Age also argues that the "magnitude" of its activities directed towards the Washington market are unimportant. Br. of App. at 24 n.13. Space Age is incorrect. While the extent of an out-of-state seller's economic exploitation of the taxing state's market is not important in determining whether the seller exceeds the physical presence safe harbor in *Quill*, courts often consider the magnitude of the seller's "economic presence" when physical presence has been satisfied or is not applicable. For instance, in *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 108 S. Ct. 1619, 100 L. Ed. 2d 21 (1988), the Supreme Court relied in part on the taxpayer's significant economic presence in the state to support its holding of substantial nexus. 486 U.S. at 33. Likewise, in *General Motors*, the Court of Appeals held that, although the taxpayers had little physical presence within the City of Seattle, "the collective activities of each automaker [were] strategically designed to maximize their sales within the city and that the absence of these activities would significantly affect their ability to maintain a share of the Seattle market." 107 Wn. App. at 53. Accordingly, the automakers' exploitation of the Seattle

market was sufficient to establish substantial nexus "regardless of where they are physically located." *Id.* at 55.

The undisputed facts and circumstances in the record, including Space Age's physical presence in this state and its economic exploitation of the Washington fuel supplier's market, establish that Space Age had more than sufficient connection with Washington to meet the dormant Commerce Clause nexus requirement. It is hard to imagine how an out-of-state seller could have any more presence or connection with Washington than Space Age had here. As in *D.H. Holmes*, there is nexus "aplenty" here. 486 U.S. at 33. Space Age's claim that Washington is prohibited by the dormant Commerce Clause from imposing B&O on its wholesaling business activities is nonsense and borders on the frivolous.

3. The example in WAC 458-20-193(11) does not support Space Age's claim that regular deliveries are insufficient to satisfy the substantial nexus requirement of the dormant Commerce Clause.

Space Age also argues that an example in WAC 458-20-193(11) supports its claim that regular deliveries alone cannot establish substantial nexus. Br. of App. at 17-19. The example Space Age relies on provides:

> (11) **Examples - Inbound sales**. The following examples show how the provisions of this section relating to interstate sales of tangible personal property will apply when the goods originate outside Washington (inbound sales). The examples presume the seller has retained the proper proof documents.

> (a) Company A is located in California. It sells machine parts at retail and wholesale. Company B is located in Washington and it purchases machine parts for its own use from Company A. Company A uses its own vehicles to deliver the machine parts to its customers in Washington for receipt in this state. The sale is subject to the retail sales and B&O tax if the seller has nexus, or use tax if nexus is not present.

WAC 458-20-193(11).[12]

Space Age reads too much into this example. The example does not state that *regular* deliveries of goods by a taxpayer in its own vehicles are insufficient to establish substantial nexus with the taxpayer under the dormant Commerce Clause. In fact, the Department in WAC 458-20-193(9)(d) expressly states that an out-of-state seller that "[r]egularly engages in the delivery of property in this state other than by for-hire carrier or U.S. mail" has an obligation to collect Washington's use tax on sales that are delivered to the purchaser in Washington. That is a correct interpretation of constitutional law.

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[12] Space Age implies that Rule 193 is a significant legislative rule that "carries the force of law." Br. of App. at 17 n.11. That is incorrect. RCW 34.05.328(5)(c)(iii) defines a "significant legislative rule" as a rule that either (1) adopts substantive provisions of law pursuant to delegated legislative authority, the violation of which may result in a penalty or sanction; (2) pertains to the issuance, suspension, or revocation of a license or permit; or (3) pertains to a "policy or regulatory program." Rule 193 meets none of these criteria. Instead, Rule 193 is an interpretive rule "that sets forth the agency's interpretation of statutory provisions it administers." RCW 34.05.328(5)(c)(ii). In any event, both legislative rules and interpretive rules must be "consistent with the statutory scheme" to be valid. *Association of Wash. Bus. v. Dep't. of Revenue*, 155 Wn.2d 430, 441, 120 P.3d 46, 51 (2005).

Moreover, the dormant Commerce Clause nexus threshold is no higher for imposing an obligation on a seller to pay business activity taxes such as the wholesaling B&O tax than it is for imposing an obligation on a seller to collect retail sales or use taxes.[13] Regular in-state deliveries by an out-of-state business establishes nexus between the state and the business under the dormant Commerce Clause. Once that nexus threshold is met, the business has an obligation to comply with all of Washington's tax laws that apply to it, not just Washington's use tax laws.

WAC 458-20-193 is not without its faults. The problem with the example in WAC 458-20-193(11)(a) is that it seems to imply there may be a different constitutional nexus requirement for use taxes than for other types of state taxes. "Company A" in the example clearly has nexus with Washington if it regularly "uses its own vehicles to deliver . . . machine parts to its customers in Washington." Company A therefore has an obligation to comply with Washington's sales and use tax laws and with Washington's B&O tax laws. The example does not make that point clear.

The example in Rule 193(11)(a) could have been better drafted. However, Space Age is incorrect when it argues that the example "acknowledges that mere delivery of the product by the out-of-state seller

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[13] If anything, the dormant Commerce Clause nexus threshold is lower for business activity taxes such as the wholesaling B&O tax because the *Quill* physical presence safe harbor likely does not apply to business activity taxes.

does not create nexus." Br. of App. at 18. First, Rule 193(11)(a) does not make such a blanket statement of constitutional law. More importantly, under Space Age's interpretation of Rule 193, the rule would exceed the Department's express or implied rule-making authority.

As this Court made clear in *Coast Pac. Trading, Inc. v. Dep't. of Revenue*, 105 Wn.2d 912, 719 P.2d 541 (1986) "when the Legislature enacted the business and occupation tax the Legislature intended 'to tax all business activities not expressly excluded." *Id.* at 917 (quoting *Rena-Ware Distribs., Inc. v. State,* 77 Wn.2d 514, 517, 463 P.2d 622 (1970)). The Legislature, recognizing that the federal Constitution imposes certain limits on Washington's authority to tax, has provided a B&O tax deduction for amounts "which the state is prohibited from taxing under the Constitution . . . of the United States." RCW 82.04.4286. The Department is authorized to administer that tax deduction statute and, in doing so, to adopt rules setting out the Department's interpretation of the statute. *Association of Wash. Bus. v. Dep't. of Revenue*, 155 Wn.2d 430, 440, 120 P.3d 46 (2005). However, the Department has no authority to establish jurisdictional limits on Washington's ability to tax interstate commerce, and cannot "expand the tax immunity . . . beyond the exemptions provided by statute or required by the constitution." *Coast Pac.*, 105 Wn.2d at 917. Reading Rule 193 to restrict Washington's

ability to tax out-of-state sellers operating within the state like Space Age is here would improperly "expand the tax immunity" of those sellers beyond what the Constitution provides. *Id.*

Space Age is not immune from Washington B&O tax on its in-state sales and deliveries of motor fuel and special fuel, and nothing in Rule 193 could compel this Court to conclude otherwise.

4. The Supreme Court has limited *Miller Bros v. Maryland* to its facts, and that case has never been applied to limit the jurisdiction of a state to tax a seller that regularly delivers goods in its own vehicles.

Space Age challenges the imposition of Washington B&O tax on its in-state sales of fuel on only dormant Commerce Clause grounds. However, Space Age implies that *Miller Bros. v. Maryland*, 347 U.S. 340, 74 S. Ct. 535, 98 L. Ed. 744 (1954), is informative and should be considered in deciding this case. Br. of App. at 20 n.12. Consequently, even though *Miller Bros.* is a pre-*Quill* due process case, a discussion of that case is necessary.

Miller Bros. involved a Delaware retailer that sold household furniture from its store in Wilmington, Delaware. 347 U.S. at 341. The retailer did some advertising that reached the neighboring state of Maryland, and Maryland residents would occasionally come to the retailer's store to purchase goods. *Id.* at 341-42. For the convenience of

the customers, the retailer would occasionally deliver goods purchased at its Wilmington store to its Maryland customers. *Id.* at 342.

Maryland attempted to impose a use tax collection requirement on the Delaware business with respect to all sales to Maryland residents. The Supreme Court, on due process grounds, struck down Maryland's efforts to force the retailer to collect the Maryland tax. The Court reasoned that imposition of a Maryland use tax collection obligation on the retailer was improper based on "the occasional delivery of goods" sold to Maryland residents and "the incidental effects of general advertising" that reached into Maryland. *Id.* at 347. The Court also noted that state use taxes of the type imposed by Maryland were "a relatively new and experimental form of taxation" and that its prior cases were "not always clear" or "consistent" in expressing the jurisdictional limits on state taxation of "extraterritorial transactions or nonresidents with tax liabilities." *Id.* at 343, 344.

The jurisdictional requirements imposed by the Due Process Clause have changed considerably since *Miller Bros.* was decided, and state use taxes are no longer viewed as "experimental." In *Quill*, the Supreme Court held that a physical presence in the taxing state is not necessary to establish nexus under the Due Process Clause and that North Dakota could impose a use tax collection requirement on Quill Corporation consistent with due process. *Quill*, 504 U.S. at 307-08. As a

result of *Quill* and the other significant changes in the Court's due process analysis, the continuing validity of *Miller Bros.* has been called into question. *See Brown's Furniture, Inc. v. Wagner*, 171 Ill.2d 410, 426, 665 N.E.2d 795 (1996), *cert. denied*, 519 U.S. 866 (1996) (as a result of *Quill*, "the continuing authority of *Miller Brothers* is in considerable doubt").

But even before *Quill* was decided, the Supreme Court had limited *Miller Bros.* to its facts. Specifically, in *Scripto, Inc. v. Carson*, 362 U.S. 207, 80 S. Ct. 619, 4 L. Ed. 2d 660 (1960), the Court rejected the taxpayer's claim that the holding in *Miller Bros.* should be extended to prohibit Florida from imposing a use tax collection obligation on an out-of-state seller of specialized writing instruments. As explained in *Scripto*:

> Appellant earnestly contends that *Miller Bros. Co. v. Maryland*, *supra*, is to the contrary. We think not. Miller had no solicitors in Maryland; there was no "exploitation of the consumer market"; no regular, systematic displaying of its products by catalogs, samples or the like. But, on the contrary, the goods on which Maryland sought to force Miller to collect its tax were sold to residents of Maryland when personally present at Miller's store in Delaware. True, there was an "occasional" delivery of such purchases by Miller into Maryland, and it did occasionally mail notices of special sales to former customers; but Marylanders went to Delaware to make purchases—Miller did not go to Maryland for sales. Moreover, it was impossible for Miller to determine that goods sold for cash to a customer over the counter at its store in Delaware were to be used and enjoyed in Maryland. This led the Court to conclude that Miller would be made "more vulnerable to liability for another's tax than to a tax on itself." 347 U.S., at 346. In

> view of these considerations, we conclude that the "minimum connections" not present in *Miller* are more than sufficient here.

362 U.S. at 212-13.[14]

Since *Miller Bros.* was decided, no court has held that *Miller Bros.* limits the jurisdiction of a state to tax an out-of-state seller that regularly delivers merchandise into the taxing state in its own vehicle. *See, e.g.*, *Town Crier, Inc. v. Dep't of Revenue*, 315 Ill. App. 3d 286, 207, 733 N.E.2d 780 (2000) (distinguishing *Miller Bros.* involving a use tax on out-of-state purchases, citing *Scripto*); *Good's Furniture House, Inc. v. Iowa State Bd. of Tax Review*, 382 N.W.2d 145, 149-50 (Iowa 1986) (distinguishing *Miller Bros.* and holding that due process nexus was satisfied by exploitation of the in-state market and regular delivery of merchandise by the taxpayer in its own trucks with its own employees); *Cooey-Bentz Co. v. Lindley,* 66 Ohio St. 2d 54, 56, 419 N.E.2d 1087 (1981) ("Making deliveries, installations, and repairs in Ohio with company-owned vehicles, appellant regularly took advantages of this state's police protection, as well as the roads provided by the state for the use of its residents."); *In re Sales or Use Tax Liability of Webber Furniture*, 290 N.W.2d 865, 869 (S.D. 1980) ("As long as appellant

[14] The Court in *Scripto* also confirmed that nexus for due process purposes involved a facts and circumstances inquiry and "[t]he test is simply the nature and extent of the activities of the appellant in Florida." *Id.* at 211-12.

chooses to do business in this state, as evidenced by the regular presence of its merchandise haulers and employees delivering purchases to South Dakota residents, there is a sufficient nexus between the state and appellant to constitutionally support the imposition of use tax collection responsibility upon appellant.").

Even if *Miller Bros.* were still good law after *Quill*, that case stands only for the proposition that occasional in-state deliveries might not establish a sufficient connection with the taxing state to require an out-of-state seller to collect use tax on sales taking place outside the taxing state. That holding is of no help to Space Age. Space Age delivered fuel to its Washington customers on a regular basis, entering this state more than once per day on average. In addition, the tax at issue here is not a use tax on sales occurring outside Washington, but a B&O tax on the privilege of doing business in this state and measured by Space Age's wholesale sales of fuel to Washington customers. *Miller Bros.* does not prohibit Washington from imposing wholesaling B&O tax on Space Age's Washington sales.

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V. CONCLUSION

For all the foregoing reasons, the Court should affirm the trial court's order granting summary judgment to the Department.

RESPECTFULLY SUBMITTED this 24th day of July, 2012.

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APPENDIX A

Federal Limitations on State and Local Taxation

Paul J. Hartman
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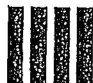
1981



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privileges of benefit and protection by the owner of out-of-state bulldozers or works of art a sufficient basis for measuring the value of those privileges by the bulldozers and works of art for taxation of the owner?[59]

Without going into the question of the desirability or undesirability of multiple taxation of either tangibles or intangibles, it is a bit difficult to see how the due process clause permits the owner to be taxed on his out-of-state intangibles as the measure of the benefit the owner receives from the taxing State, but at the same time forbids the State where he lives to tax out-of-state tangible property.[60]

B. Approach to Commerce Clause Question

§ 2:9. Generally.

Since its first decision striking down a state tax on commerce

59. Dissatisfaction has been expressed with the doctrine that the due process clause forbids taxation of out-of-state tangible property by the State of domicile of the owner. For a provocative discussion of the position that the due process clause affords no valid basis for denying the domiciliary State the power to tax out-of-state tangibles, see Bittker, *Taxation of Out-of-State Tangible Property,* 56 Yale L J 640 (1947). The basic reason for this dissatisfaction is well expressed by Justice Holmes in a dissenting opinion concerning the taxation of intangibles. He said: "Taxes generally are imposed upon persons, for the general advantage of living within the jurisdiction, not upon property. . . . The notion that property must be within the jurisdiction puts the emphasis on the wrong thing." Safe Deposit & Trust Co. v Virginia, 280 US 83 at 97, 74 L Ed 180, 50 S Ct 59, 67 ALR 386 (1929) (Holmes, J., dissenting).

60. Justice Holmes once delivered a one-sentence dissenting opinion on this matter in which he said: "It seems to me that the result reached by the court (not to permit the taxation by the State of domicile of out-of-state tangibles) probably is a desirable one, but I hardly understand how it can be deduced from the Fourteenth Amendment." Union Refrigerator Transit Co. v Kentucky, 199 US 194 at 211, 50 L Ed 150, 26 S Ct 36 (1905) (Holmes, J., dissenting). And on another occasion he said: "I have not yet adequately expressed the more than anxiety that I feel at the ever increasing scope given to the Fourteenth Amendment in cutting down what I believe to be the constitutional rights of the States. As the decisions now stand, I see hardly any limit but the sky to the invalidating of those rights if they happen to strike a majority of this Court as for any reason undesirable. I cannot believe that the Amendment was intended to give us *carte blanche* to embody our economic or moral beliefs in its prohibitions." Baldwin v Missouri, 281 US 586 at 595, 74 L Ed 1056, 50 S Ct 436, 72 ALR 1303 (1930) (Holmes, J., dissenting). Justice Holmes was later vindicated on the precise holding of this case, when the Court permitted taxation by the domiciliary State of out-of-state intangibles. State Tax Com. v Aldrich, 316 US 174, 86 L Ed 1358, 62 S Ct 1008, 139 ALR 1436 (1942).

clause grounds in 1829,[61] the Court has wound its way through a labrinth of shifting, tortuous judicial interpretations and approaches concerning the *extent* to which the commerce clause limits state taxation of interstate and foreign commerce. The Court has expressly recognized that it has handed down decisions that are not clear, consistent or reconcilable.[62] Likewise, the Court has characterized its commerce clause decisions, spread over hundreds of volumes of Supreme Court Reports, as a "quagmire."[63] Consequently, in a good many of the cases, there has been but little in the way of trustworthy guidance for tax purposes when state taxes have been queried on commerce clause grounds. Of such uncertainty has been the approach taken by the Court toward state taxation that the Court has thought it necessary to comment on the unreliable and confused state of the law, in this manner:

> The resulting judicial application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation.[64]

Moreover, the Court has concluded that to "attempt to harmonize all that has been said in the past would neither clarify what has gone before nor guide the future."[65] Nevertheless, defining the limitations of the commerce clause as it relates to state power has been a continuing task for the Supreme Court.[66]

A number of the reported cases express the view that a basic purpose of the commerce clause was to assure free trade within the national economy.[67] Likewise, there is some evidence that

61. Brown v Maryland, 23 US 419, 6 L Ed 678 (1827).

62. See Miller Bros. Co. v Maryland, 347 US 340, 344, 98 L Ed 744, 74 S Ct 535 (1954), reh den 347 US 964, 98 L Ed 1106, 74 S Ct 708.

63. Northwestern States Portland Cement Co. v Minnesota, 358 US 450, 457, 3 L Ed 2d 421, 79 S Ct 357, 67 ALR2d 1292 (1959).

64. Id. This judicially characterized loblolly of confusion in this area has been reaffirmed much more recently, in Boston Stock Exchange v State Tax Com., 429 US 318, 329, 50 L Ed 2d 514, 97 S Ct 599 (1977).

65. Freeman v Hewit, 329 US 249, 252, 91 L Ed 265, 67 S Ct 274 (1946), reh den 329 US 832, 91 L Ed 705, 67 S Ct 497.

66. See Boston Stock Exchange v State Tax Com., 429 US 318, 329, 50 L Ed 2d 514, 97 S Ct 599 (1977).

67. See *Id.* at 328–29; Memphis Steam Laundry Cleaner, Inc. v Stone, 342 US 389, 395, 96 L Ed 436, 72 S Ct 424 (1952); Freeman v Hewit, 329 US 249, 263–64, 91 L Ed 265, 67 S Ct 274 (1946), reh den 329 US 832, 91 L Ed 705, 67 S Ct 497.

the framers of the Constitution intended the commerce clause to create an area of trade free from state taxation.[68] Free trade was regarded as a means of achieving an optimum allocation of resources.[69] The Court has never implemented fully a free trade policy; instead, it has drawn back from full-scale enforcement of that policy, in face of the insistent revenue needs of the States. So far as this writer has found, never has the Court taken the position that the commerce clause eclipses the states' reserved power to tax for the support of their own government.[70] In the late epochal case of *Complete Auto Transit, Inc. v Brady,*[71] the Court described the "free trade" view found in some of the opinions favoring free trade as "a sort of 'free trade' immunity from state taxation."[72]

Within the next several pages, we will see the judicial origin of the rudiments of "free trade", as well as the judicial peregrinations through the various approaches to taxation of multistate operations, when the taxes have been called into judgment on commerce clause grounds.

§ 2:10. Marshall and exclusive nature of congressional power over commerce.

The doctrine that the commerce clause places a limitation on the taxing power of the States had its judicial origin in *Brown v Maryland,*[73] upsetting a state tax on foreign commerce under the commerce clause. A little earlier, however, Marshall had been afforded a cherished opportunity to give a broad delineation of the power of the Federal Government over interstate commerce and its impact on state power, in *Gibbons v Ogden.*[74] There Marshall established the supremacy of the federal commerce power over state power in what has been characterized as one of

68. See *Federal Limitations on State Taxation of Interstate Business,* 75 Harv L Rev 953, 956 (1962), and authorities cited.

69. *Id.* at 957, which describes how each geographic region should operate under a free trade economy.

70. See Boston Stock Exchange v State Tax Com., 429 US 318, 328-29, 50 L Ed 2d 514, 97 S Ct 599 (1977).

71. 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076 (1977), reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669.

72. *Id.* at 278.

73. 25 US 419, 6 L Ed 678 (1827). The tax also was held to violate the Import-Export Clause of the Constitution.

74. 22 US 1, 6 L Ed 23 (1824).

Marshall's greatest and most decisive opinions.[75] Thus, the stage was set for Marshall to extend that federal supremacy over state taxing power, when *Brown v Maryland* appeared on the scene. In *Brown v Maryland,* Marshall all but committed the Court to the view that the commerce clause impliedly prohibits all state taxation of interstate commerce, just as there was a "total failure" of power in the States to tax the operations of a federal instrumentality, as declared in *M'Culloch v Maryland.*[76] In *Brown v Maryland,* the *M'Culloch* doctrine was brought over and declared to be "entirely applicable" to state taxation of commerce.[77]

Although Marshall was a staunch disciple of the view that the commerce clause conferred upon the national government the exclusive power to *regulate* interstate commerce, the possession by Congress of that power was not thought by Marshall to cut off the States from all legislative relation to interstate commerce. At another time, Chief Justice Marshall recognized that it did not cut off the power of the States to tax for the support of their own government.[78] He also recognized that there are matters primarily of local concern, the valid regulation of which by the States would unavoidably *affect* interstate commerce.[79] Not-

75. See Haines, THE ROLE OF THE SUPREME COURT IN AMERICAN GOVERNMENT AND POLITICS, 1789-1935, at page 488 (1944).

76. 17 US 316, 430, 4 L Ed 579 (1819). For a somewhat extensive discussion of this case, see Chapter 6, "Federal Immunity from State and Local Taxation".

77. *Id.* at 449.

78. Gibbons v Ogden, 22 US 1, 10, 6 L Ed 23 (1824).

79. Willson v Black Bird Creek Marsh Co., 27 US 245, 7 L Ed 412 (1829) is, of course, the historic example. There the State of Delaware had authorized plaintiff to build a dam which obstructed commerce on a navigable river. The owners of a craft, which was regularly licensed and enrolled under the navigation laws of the United States, broke the dam, and a suit was brought by plaintiff to recover damages. The defense was that the plaintiff's dam wrongfully obstructed navigation. The Court, speaking through Marshall, held for the plaintiff, reasoning that the State act authorizing the construction of the dam was not, under the circumstances of the case, "repugnant to the power to regulate commerce in its dormant state" nor was it in conflict with any law of Congress. *Id.* at 252. Observing that the state's purpose was the improvement of health and the enhancement of property values, Marshall concluded that the state regulation was within the power reserved to the States, and was not in conflict with the Constitution or the laws of the United States. *Id.* at 251. At a later date, the Court came to refer to this residuum of state power as the "police power". Case of State Freight Tax, 82 US 232, 279, 21 L Ed 146 (1873).

withstanding the commerce clause, Marshall would leave the regulation of such matters to the States. The reserved power of the States to provide for such local matters as the safety, health and morals of their own people was thought by Marshall to coexist with the commerce power of Congress. In the effort to accomplish those proper purposes, Marshall would permit the States to enact statutes which necessarily would impinge on the conduct of interstate commerce; but, under his understanding of the term "to regulate," this did not involve state regulation of interstate commerce.[80] In a factual sense, of course, any rule or regulation which includes within its scope the conduct of persons while engaged in commerce is a regulation of that commerce, and the States constantly make and enforce such regulations even though they do retard or constrict the flow of commerce. In like fashion, no "doubt every tax upon personal property, or upon occupations, business, or franchises, affects more or less the subjects, and the operations of commerce. Yet it is not everything that affects commerce that amounts to a regulation of it, within the meaning of the Constitution."[81]

§ 2:11. *Cooley* case doctrine of concurrent power over commerce.

After *Brown v Maryland,* perhaps the next case of any considerable consequences that shaped commerce clause doctrine with respect to the power of the States was *Cooley v Board of Wardens.*[82] Although the *Cooley* case did not involve a state taxing statute, it enunciated constitutional doctrine that later came to have a tremedous effect on the regulatory powers of the State, and to a lesser degree, the taxing power. Not in conformity with the view taken by Justice Marshall concerning interstate commerce, there emerged in the *Cooley* case a compromise to the effect that the commerce clause prohibited *some* but not *all* state regulation of interstate commerce. The principle enunciated in *Cooley* seemed to divide the possible subjects of regulation into two classes: (a) those *national in character* and requiring uniform rules of regulation, as to which the power of Congress was said to be exclusive; and (b) those *local in charac-*

80. Willson v Black Bird Creek Marsh Co., 27 US 245, at 252, 7 L Ed 412 (1829).

81. State Tax on Railway Gross Receipts, 82 US 284, 293, 21 L Ed 164 (1873).

82. 53 US 299, 13 L Ed 996 (1852).

ter permitting or adapted to diversity of regulation, as to which the power of the States was said to be *concurrent* with that of Congress.

In 1867, some fifteen years after the *Cooley* case, this division of power was recognized in the field of taxation, where a majority of the Court classified a tax, required to be paid by the railroads and stage coach companies for passengers carried, as falling within that branch of commerce which is local in character.[83] In 1872, the doctrine of the *Cooley* case was again applied in the taxation field in the *Case of State Freight Tax,*[84] this time to upset a tax. There Pennsylvania attempted to lay a tax at a specified rate per ton on freight transported by rail or water within the State in interstate commerce. The tax was condemned on the formal ground that it was a "regulation" of commerce among the States, with the subjects *exclusively* within the jurisdiction of Congress because the "transportation of passengers or merchandise through a State, or from one State to another" is in its "nature national" and admits only "of one uniform system or plan of regulation."[85] However, the doctrine that there were local aspects of interstate commerce where the State could act, even from the start, did not find uniform lodgment within the Court.[86]

The *Cooley* approach suggested, in resolving the commerce clause controversy involving state taxation, the necessity for weighing of the advancement of local interests as against interference with national interests. This balancing process was a job for the courts to do.[87] Also, under the *Cooley* doctrine, the Court

83. Crandall v Nevada, 73 US 35, 18 L Ed 745 (1868). The *Crandall* tax actually was upset as a violation of the privileges and immunities clause, however, and the commerce clause doctrine of this case was later criticized and limited. See Helson & Randolph v Kentucky, 279 US 245, 251, 73 L Ed 683, 49 S Ct 279 (1929).

84. 82 US 232, 21 L Ed 146 (1873).

85. *Id.* at 279–80.

86. See, *e.g.,* Henderson v Mayor of New York, 92 US 259, 272, 23 L Ed 543 (1876). The Cooley doctrine continued to be used for awhile, however, to strike down taxes. See Robbins v Shelby County Taxing Dist., 120 US 489, 30 L Ed 694, 7 S Ct 592 (1887); Gloucester Ferry Co. v Pennsylvania, 114 US 196, 29 L Ed 158, 5 S Ct 826 (1885).

87. The *Cooley* doctrine, as applied to taxation of foreign commerce, where the tax was challenged on commerce clause grounds, recently was used by the Court in holding that the tax could not withstand constitutional scrutiny. Japan Line, Ltd. v County of Los Angeles, 441 US 434, 457, 60 L Ed 2d 336, 99 S Ct 1813 (1979).

no longer looked to Marshall's conception of the exclusive nature of the power granted to Congress to regulate interstate commerce. Instead, the Court focused its attention on the "subjects of the power". In resolving the dispositive commerce clause question, the judicial search shifted from the nature of the power to the target at which the legislative arrow was shot. It is hardly necessary to add that the *Cooley* concurrent power theory has been much easier to describe than to apply to any particular state action.

§ 2:12. Concurrent power and "will" of congress.

Soon after the emergence of the *Cooley* doctrine, the Court's opinions began to add some reference to the inaction of Congress as a fact having a significant bearing upon the question whether the subject of commerce was "national" (as to which the power of Congress was exclusive) or "local" in character (concurrent control by Congress and the States).[88] Under this view, no prohibition to state action was found to inhere in the commerce clause itself, but an impediment to state action might arise from the implied "will" of Congress.[89] The silence of Congress thus became the test for determining whether a state tax was constitutionally permissible.[90] The state action called into question met its Waterloo, however, not from the application of any prohibition of the commerce clause itself; but, in the absence of affirmative consent by Congress, from a presumed congressional negative. The failure of Congress, however, to regulate interstate commerce was taken by the Court to signify a congressional purpose to leave undisturbed the authority of the States to take action affecting the commerce in matters of peculiarly local concern.[91] Conversely, state action affecting an aspect of interstate commerce that the Court regarded as national in character and requiring uniform control would be banned, even if Congress had not acted with respect to it.[92] Thus while the *Cooley*

88. See Welton v Missouri, 91 US 275, 282, 23 L Ed 347 (1876).

89. See Robbins v Shelby County Taxing Dist., 120 US 489, 492–93, 30 L Ed 694, 7 S Ct 592 (1887).

90. Brennan v Titusville, 153 US 289, 38 L Ed 719, 14 S Ct 829 (1894); Lyng v Michigan, 135 US 161, 34 L Ed 150, 10 S Ct 725 (1890); Philadelphia & Southern Mail S.S. Co. v Pennsylvania, 122 US 326, 30 L Ed 1200, 7 S Ct 1118 (1887).

91. See Robbins v Shelby County Taxing Dist., 120 US 489, 493, 30 L Ed 694, 7 S Ct 592 (1887).

92. See Philadelphia & Southern Mail S.S. Co. v Pennsylvania, 122 US

doctrine of the division of interstate commerce into subjects local and subjects national in character was maintained, there was a transition to the "will" of Congress as the criterion for determining the matter. The ascertainment of that congressional "will" was a task for the Court.

Under this doctrine, Congress had power to control both aspects of interstate commerce. It could supersede state action affecting a local aspect of the commerce, or it could permit state action in areas regarded as national in character.[93] The "will" of Congress doctrine, which found acceptance in both the regulatory and taxing fields, was not of lasting vitality. Its heyday was in the last quarter of the preceding century.

§ 2:13. Mechanical "direct-indirect burdens" approach to tax validity.

While no distinct theories as to the approach the Court would take in determining permissible and nonpermissible taxes, other than those considered, appear to have been adopted by the Court prior to 1938, beginning around the 1880's new terminology crept into the Court's opinions. Increasingly, the Court talked of "direct" and "indirect" affects or burdens on interstate commerce—the former connoting invalidity and the latter connoting validity of a tax, when challenged on commerce clause grounds.[94]

When the Court spoke of "direct-indirect" burdens as the test of constitutionality of state action under the commerce clause, in most instances it seems to be echoing the recurrence of Marshall's view that Congress has exclusive power to regulate interstate commerce and that the States have no power to tax that commerce.[95] The opinions of the Court during this era make

326, 336, 30 L Ed 1200, 7 S Ct 1118 (1887); Welton v Missouri, 91 US 275, 282, 23 L Ed 347 (1876).

93. See Dowling, *Interstate Commerce and State Power,* 27 Va L Rev 1, 6 (1940).

94. See *e.g.,* Ozark Pipe Line Corp. v Monier, 266 US 555, 563, 568–70, 69 L Ed 439, 45 S Ct 184 (1925); Crew Levick Co. v Pennsylvania, 245 US 292, 297–98, 62 L Ed 295, 38 S Ct 126 (1917).

95. See Ozark Pipe Line Corp. v Monier, 266 US 555, 563, 69 L Ed 439, 45 S Ct 184 (1925) ("If the business taxed is in fact separate local business, not so connected with interstate commerce as to render the tax a burden upon such commerce, the tax is good."). The following cases also are supportive of this position: Minnesota v Blasius, 290 US 1, 8, 78 L Ed 131, 54 S Ct 34 (1933); Kansas City, Ft.S. & M. R. Co. v Botkin, 240 US 227, 231, 60 L Ed 617, 36 S Ct 261 (1916); Helson & Randolph v Kentucky, 279 US 245, 252, 73 L Ed 683, 49 S Ct 279

that position fairly clear. Thus the Court declared that "no State has the right to lay a tax on interstate commerce in any form . . . and the reason is that such taxation is a burden on that commerce, and amounts to a regulation of it, which belongs solely to Congress."[96] The cases continued to retain the same doctrinal texture.[97] Conversely, the conclusion by the Court that the tax "indirectly" affected or burdened the commerce ordinarily appears to be another fashion in judicial speech tantamount to the conclusion that the tax was on a "local" activity, considered by the Court as separate and apart from interstate commerce.[98]

In some of its cases, the Court apparently did not regard the *Cooley* "concurrent power" theory as sharply separable from the Marshall theory that the power of Congress over interstate commerce was "exclusive." At the same time that the Court was speaking of the exclusive power of Congress over interstate commerce, it also often spoke in terms of the "concurrent power" in the States to regulate interstate commerce.[99] Although at a time when the Court was allegedly committed to the *Cooley* doctrine which treated the division of commerce power into subjects national and local, it was not uncommon for the Court to assign as its reason for nullifying a tax the idea that interstate commerce could not be taxed at all, and that such taxation is a burden on that commerce and amounts to a regulation, which belongs to Congress.[1] Yet these cases were decided during

(1929); Stockard v Morgan, 185 US 23, 37, 46 L Ed 785, 22 S Ct 576 (1902); Brennan v Titusville, 153 US 289, 308, 38 L Ed 719, 14 S Ct 829 (1894); Crutcher v Kentucky, 141 US 47, 58–59, 35 L Ed 649, 11 S Ct 851 (1891); Lyng v Michigan, 135 US 161, 166, 34 L Ed 150, 10 S Ct 725 (1890); Leloup v Port of Mobile, 127 US 640, 648, 32 L Ed 311, 8 S Ct 1380 (1888); Robbins v Shelby County Taxing Dist., 120 US 489, 497, 30 L Ed 694, 7 S Ct 592 (1887).

96. Leloup v Port of Mobile, 127 US 640, 648, 32 L Ed 311, 8 S Ct 1380 (1888).

97. See Helson & Randolph v Kentucky, 279 US 245, 252, 73 L Ed 683, 49 S Ct 279 (1929); Lyng v Michigan, 135 US 161, 166, 34 L Ed 150, 10 S Ct 725 (1890).

98. See Wiloil Corp. v Pennsylvania, 294 US 169, 79 L Ed 838, 55 S Ct 358, 1 Ohio Ops 542 (1935), reh den 294 US 733, 79 L Ed 1262, 55 S Ct 543; Ozark Pipe Line Corp. v Monier, 266 US 555, 563, 69 L Ed 439, 45 S Ct 184 (1925); Postal Telegraph-Cable Co. v Richmond, 249 US 252, 257–58, 63 L Ed 590, 39 S Ct 265 (1919).

99. See, *e.g.*, East Ohio Gas Co. v Tax Com. of Ohio, 283 US 465, 470, 75 L Ed 1171, 51 S Ct 499 (1931).

1. See Lyng v Michigan, 135 US 161, 166, 34 L Ed 150, 10 S Ct 725 (1890); Robbins v Shelby County Taxing Dist., 120 US 489, 497, 30 L Ed 694, 7 S Ct 592 (1887).

a period when the *Cooley* doctrine applied.[2] The commingling of constitutional doctrines appear even in the same cases.[3] From a constitutional doctrinal standpoint, of course, the Court is speaking in two completely different tongues. As might be expected, this "miscegenation" of diverse constitutional theories produced some strange and queer offspring by the way of opinions. Thus, in upsetting a license tax in *Robbins v Shelby County Taxing Dist.*,[4] the Court regarded the *Cooley* doctrine of division of power over interstate commerce as "principles" which had "been already established by the decisions." In the same opinion, the Court regarded it as an "established principle" that "no regulation" made by the States "directly affecting interstate commerce" could be valid, and that "interstate commerce cannot be taxed at all even though the same amount of tax should be laid on domestic commerce."[5]

Until the late part of the 1930's, when a tax was questioned on commerce clause grounds, the predominate judicial declaration adopted the view of Chief Justice Marshall that the States are forbidden to tax interstate commerce for the reason that the power of Congress over interstate commerce is exclusive.[6] The doctrinal foundation of Marshall may perhaps be accounted for, in part, because in the early days of the Republic it was "in the nature of the power"—possibly it was necessary—to set absolute judicial boundaries in the distribution of power between the States, on the one hand, and the Federal Government on the other. National sentiment at that time was weak; Congress did

2. See Leisy v Hardin, 135 US 100, 108–09, 34 L Ed 128, 10 S Ct 681 (1890).

3. See Missouri ex rel. Barrett v Kansas Natural Gas Co., 265 US 298, 309, 68 L Ed 1027, 44 S Ct 544 (1924) (rate-fixing statute); Anderson v Pacific Coast S.S. Co., 225 US 187, 195, 56 L Ed 1047, 32 S Ct 626 (1912) (compulsory pilotage laws); Robbins v Shelby County Taxing Dist., 120 US 489, 492-94, 497, 30 L Ed 694, 7 S Ct 592 (1887) (taxation). In Seaboard A. L. Railway v Blackwell, 244 US 310, 61 L Ed 1160, 37 S Ct 640 (1917) (blow post law), the majority invalidated the law as a "direct burden upon interstate commerce". Three members applied the *Cooley* doctrine and dissented on the ground that the regulation was in the class which the States were entitled to enact.

4. 120 US 489, 492, 30 L Ed 694, 7 S Ct 592 (1887).

5. *Id.* at 492, 497.

6. See Minnesota v Blasius, 290 US 1, 9, 78 L Ed 131, 54 S Ct 34 (1933); Ozark Pipe Line Corp. v Monier, 266 US 555, 562, 69 L Ed 439, 45 S Ct 184 (1925); Kansas City, Ft.S. & M. R. Co. v Botkin, 240 US 227, 231, 60 L Ed 617, 36 S Ct 261 (1916); Lyng v Michigan, 135 US 161, 166, 34 L Ed 150, 10 S Ct 725 (1890).

not seem disposed to a strong assertion of federal powers. Moreover, it was a period when natural law was in the ascendancy; and it, no doubt, gave an appearance of greater authority to a conclusion to deduce its syllogistically from allegedly conceded premises, than to confess that it involved some pragmatic "appraisal and accommodation of the competing demands of the State and national interest involved."[7] However such thinking was no longer an acceptable nor satisfactory basis for giving interstate commerce an immunity bath from state and local taxation, as the Republic grew stronger, and Congress was no longer afraid vigorously to assert federal power.

In the field of taxation, there are, of course, many forms of valid taxes imposed upon judicially designated "local" aspects of multistate operations whose burdens, when distributed through the play of economic forces, conceivably could affect or curtail interstate commerce to an extent equal to a judically forbidden exaction imposed directly upon what the Court regards as interstate commerce itself. These taxes have, however, been upheld under even the view that Congress possesses "exclusive" power over interstate commerce, although interstate operations were induced or occasioned by the taxed activity or event, and however drastic the consequences on interstate commerce, with the Court taking the position that such state action falls short of the regulation of interstate commerce which the Constitution leaves to Congress. The exactions were sustained on the ground that they were levied on a "local" incident or event, or that the burden of the tax on the interstate commerce was "indirect" or "incidental." Although the particular activities or events, upon which the tax was imposed, was essential to the interstate commerce operation, they were taxable.[8] The approach to the test of constitutionality of the tax was thus conceptual and mechanical.[9] Generally, the economic consequences of a tax were

7. Southern Pacific Co. v Arizona, 325 US 761, 768–69, 89 L Ed 1915, 65 S Ct 1515 (1945). For a perspective of the judicial thinking of Marshall in the context of its times, see Justice Learned Hand's appraisal in Spector Motor Service, Inc. v Walsh (CA2 Conn) 139 F2d 809 822–23 (1943) (dissenting opinion), vacated 323 US 101, 89 L Ed 101, 65 S Ct 152 (involving taxation of interstate commerce).

8. Wiloil Corp. v Pennsylvania, 294 US 169, 79 L Ed 838, 55 S CT 358, 1 Ohio Ops 542 (1935) reh den 294 US 733, 79 L Ed 1262, 55 S Ct 543; Postal Telegraph-Cable Co. v Richmond, 249 US 252, 63 L Ed 590, 39 S Ct 265 (1919).

9. See Parker v Brown, 317 US 341, 87 L Ed 315, 63 S Ct 307 (1943), for a

not thought by the Court to be of any significance in determining whether the tax was forfended by the commerce clause.[10] At infrequent intervals the economic burden of the exaction was part of the equation in deciding the commerce clause question.[11] Economic similarity as an exclusive test of tax validity, when questioned on commerce clause grounds, would make pertinent precedents out of many cases in conflict with each other.[12] With regard to the tests of constitutionality for commerce clause purposes, during this time, it was realistically declared that "names were made to matter more than mathematics or economics."[13]

The touchstone for a judicial condemnation of a tax was not any actual or probable hampering affect of the taxation on the commerce; the judicially declared vice of an invalid tax was simply its "direct" bearing or affect on interstate commerce. That brand of doctrinal declaration, of course, assumed a trustworthiness in the test of constitutionality which did not exist, and afforded but little guidance to the legislator, the lower courts, or the taxpaying businessman in predicting whether a particular tax would run afoul of the commerce clause. This test of constitutionality simply implied the impotence of state power; it described a result reached, not the reasons for that result. The Court was more concerned with captions than with consequences.

Decisions of the magnitude of the constitutionality of a tax should not be made by resort to labels or virtually meaningless formulas. Such judgments need much more than selecting a

judicial recognition that such was true.

10. Alpha Portland Cement Co. v Massachusetts, 268 US 203, 217, 69 L Ed 916, 45 S Ct 477, 44 ALR 1219 (1925); Robbins v Shelby County Taxing Dist., 120 US 489, 497, 30 L Ed 694, 7 S Ct 592 (1887).

11. See United States Glue Co. v Oak Creek, 247 US 321, 329, 62 L Ed 1135, 38 S Ct 499 (1918).

12. Sales and use tax cases furnish striking examples supporting this proposition. In Helson & Randolph v Kentucky, 279 US 245, 73 L Ed 683, 49 S Ct 279 (1929), the Court upset as a direct burden on interstate commerce an attempt by a State to impose a use tax on the consumption of gasoline by an instrumentality engaged in interstate commerce. On the other side of the coin, a sales tax imposed on gasoline used by airplanes that operated only in interstate commerce was sustained as innocuously incidental to the commerce clause. The economic consequences of both taxes would seem the same.

13. Powell, *More Ado about Gross Receipts Taxes,* 60 Harv L Rev 501, 503 (1947).

particular shibboleth. As Justice Cardozo once put it, "a great principle of constitutional law is not susceptible of comprehensive statement in an adjective."[14] Justice Stone was one of the first members of the Court expressly to deprecate the "direct-indirect" affects and burdens test. He did so by making a frontal assault in his *Di Santo* dissent in 1927.[15] This test is "too mechanical, too uncertain in its application, and too remote from actualities to be of value," said Justice Stone, and to employ it was "little more than using labels to describe a result rather than any trustworthy formula by which it is reached."[16]

An occasional case during this period using the "direct-indirect" burdens test indicated a conscious regard for the practical tax needs of the States, and the essential fairness that multistate business should bear its fair share of the tax load.[17] Generally the Court steadfastly adhered to the view that "interstate commerce cannot be taxed at all, even though the same amount of tax should be laid on domestic commerce, or that which is carried on solely within the state."[18] Under this approach, in many instances, local business was handicapped when it competed with interstate business, and there have been times in later years when there was judicial recognition that the denial of state taxing power "would be to make local industry suffer a competitive disadvantage."[19] Under the earlier prevailing view, not only was local business required to pay a disproportionately large amount toward the support of the local government whose protection and benefits interstate business received, but at the same time local business was required to

14. Dissenting in Carter v Carter Coal Co., 298 US 238, 327, 80 L Ed 1160, 56 S Ct 855 (1936).

15. Di Santo v Pennsylvania, 273 US 34, 44, 71 L Ed 524, 47 S Ct 267 (1927) (ovrld on other grounds California v Thompson 313 US 109, 85 L Ed 1219, 61 S Ct 930).

16. *Id.* at 44. For useful commentary on the Di Santo dissent and Justice Stone's views generally, see Nowak, Rotunda and Young, CONSTITUTIONAL LAW 250–52 (1978); Dowling, *Interstate Commerce and State Power*, 27 Va L Rev 1 (1940).

17. See Superior Oil Co. v Mississippi, 280 US 390, 395, 74 L Ed 504, 50 S Ct 169 (1930). There Justice Holmes declared that it "is important to prevent that clause (commerce) being used to deprive the States of their lifeblood". *Id.* at 395.

18. Robbins v Shelby County Taxing Dist., 120 US 489, 497, 30 L Ed 694, 7 S Ct 592 (1887).

19. International Harvester Co. v Department of Treasury, 322 US 340, 349, 88 L Ed 1313, 64 S Ct 1019 (1944), reh den 322 US 772, 88 L Ed 1597, 64 S Ct 1281.

compete against interstate business, which received a large and unmerited immunity as compared with the tax burden on local business. Bringing his guns to bear on such tax inequities, Justice Holmes uttered his succinct, pithy and now famous dissent: "Even interstate commerce must pay its way."[20] That, of course, only sets forth a challenging problem or necessary objective. It does not, obviously, purport to reveal any taxing techniques nor constitutional doctrines by which interstate commerce should be required to pay its way.

§ 2:14. Pragmatic "multiple burdens" approach to tax validity.

Justice Stone's *Di Santo* dissent in 1927 revealed his intense dissatisfaction with the "direct-indirect" burdens test of constitutionality when state action was called into judgment on commerce clause grounds. In 1938, Justice Stone began to chart a course which would carry the Court beyond the rocks and shoals of the untrustworthy legalisms and outmoded doctrines into smoother water, where the polestar by which the Court would steer in determining tax validity under the commerce clause would give more consideration to the possible practical effect of the particular tax on interstate commerce. Implicit, too, in his approach is the essential fairness that interstate commerce should bear its fair share of the cost of local governments whose protection and benefits it enjoys. In short, a questioned tax should not be considered in a vacuum of conceptual words, dissociated from the economic impact of the tax. To Justice Stone's way of thinking, the paramount concern of the Court would be a balancing of the conflicting concerns involved, in order to determine whether the consequence of the tax placed interstate trade at a practical disadvantage, as compared with local business.

The development of this practical approach began in *Western Live Stock v Bureau of Revenue.*[21] There the Court sustained a New Mexico occupation tax on the business of publishing a

20. New Jersey Bell Tel. Co. v State Board of Taxes & Assessments, 280 US 338, 351, 74 L Ed 463, 50 S Ct 111 (1930). A similar idea had been expressed in the earlier case of Postal Telegraph-Cable Co. v Richmond, 249 US 252, 259, 63 L Ed 590, 39 S Ct 265 (1919).

21. 303 US 250, 82 L Ed 823, 58 S Ct 546, 115 ALR 944 (1938).

magazine having an interstate circulation, measured by the gross receipts from the sale of advertising in the magazine. One ground for upholding the tax was the application of the traditional, mechanical formula of calling it a tax imposed on the "local activity" of preparing, printing and publishing magazine advertising, and the gross receipts from the advertising fairly measured the value of the local enterprise. But in his *Western Live Stock* opinion, Justice Stone introduced his "cumulative burdens" test for determining whether a tax transgressed commerce clause limitations. This test was used as an "added reason" for sustaining the tax, but it marks the case as an epochal decision. The pith and substance of Justice Stone's "added reason" is two-fold: (1) Interstate commerce should bear its just share of state tax burdens; and (2) State taxes on interstate commerce should be sustained when not involving the *risk* of "cumulative burdens not imposed on local commerce."[22] In *Western Live Stock*, Justice Stone laid the predicate for his view in this oft-quoted and familiar declaration: "It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business."[23]

The background for sustaining the tax, because it did not threaten a "cumulative burden" on interstate commerce, is laid early in the Court's *Western Live Stock* opinion where Justice Stone devoted approximately two full pages to developing the thesis summarized in this oft-quoted passage:

> The vice characteristic of those (taxes) which have been held invalid is that they have placed on the commerce burdens of such a nature as to be capable, in point of substance of being imposed . . . or added to . . . with equal right by every state which the commerce touches, merely because interstate commerce is being done, so that without the protection of the commerce clause it would bear cumulative burdens not imposed on local commerce.[24]

To demonstrate that the "vice characteristic of those taxes which have been held invalid" had no application to the *Western Live Stock* tax under consideration, Justice Stone continued:

> The tax is not one which in form or substance can be repeated by

22. *Id.* at 255–56.

23. *Id.* at 254.

24. *Id.* at 255–56.

> other states in such manner as to lay an added burden on the interstate distribution of the magazine . . . . All the events upon which the tax is conditioned—the preparation, printing and publication of the advertising matter, and the receipts of the sums paid for it—occur in New Mexico (taxing State) and not elsewhere. All are beyond any control and taxing power which, without the commerce clause, those states could exert through its dominion over the distribution of the magazine or its subscribers. The dangers which may ensue from the imposition of a tax measured by gross receipts derived directly from interstate commerce are absent.[25]

So, not being able to perceive any risk that other States could, in form or substance, levy the same or a similar tax upon the same segment of the interstate transaction taxed by New Mexico (taxing State), the Court sustained the tax.

In the *Western Live Stock* opinion, Justice Stone marshalled cases of gross receipts taxes on interstate transportation, originally sustained on very different grounds, to buttress the "cumulative burdens" doctrine. The potential risk of a multiple or cumulative tax burden on interstate commerce as compared with local business was made, by Justice Stone's interpretation, the controlling factor in separating those gross receipts taxes on transportation which had been condemned from those which had been sustained. Justice Stone explained that such taxes had "been sustained when fairly apportioned to the commerce carried on within the taxing state."[26]

In classifying the gross receipts tax cases used to support the *Western Live Stock* decision, into those sustained where apportioned, Justice Stone makes a neat, but not then a doctrinally accurate, classification of the cases. The Court that decided those gross receipts cases at no place in the opinions mentioned any sort of doctrine, such as apportionment to avoid a cumulative tax burden. An examination of the cases reveals that, in those instances where the Court sustained the tax, used to support the *Western Live Stock* holding, it did so on one of two theories. The tax was upheld either on the traditional theory that the "subject" of the tax was some "local" activity or event (privilege or franchise), separate and distinct from the interstate commerce,

25. *Id.* at 260.

26. *Id.* at 256.

with the value of the subject determined by gross receipts,[27] or that the gross receipts tax was levied "in lieu" of, and as a fair substitute for, all other valid taxes on taxpayer's property.[28] The cases cited in the *Western Live Stock* opinion, where the gross receipts tax had been condemned, had been held by the Court deciding them to transcend commerce clause limitations upon the traditional doctrine that the tax amounted to a regulation of interstate commerce by the States, a power thought vested exclusively in Congress.[29] No mention was made by the Courts that decided the cases used by Justice Stone to support his "cumulative burden" doctrine of a lack of apportionment as the fatal flaw in the tax.

In fact, Justice Stone's *Western Live Stock* opinion misinterpreted the facts of the *Fargo*[30] case, when he stated that the gross receipts tax was there invalidated because it extended to "commerce carried on without the state boundaries and, if valid, could be similarly laid in every other state in which the business is conducted."[31] The taxed *Fargo* earnings were confined to those earnings received from the use of the taxed cars within the State. It is difficult to see how an apportionment could have been much fairer or how it more clearly could have avoided the risk of "cumulative burdens," which Justice Stone reasoned in *Western Live Stock* was the "vice characteristic of those taxes (taxes from transportation measured by gross receipts) which have been held invalid."[32] Ostensibly, "unapportionment" causing cumulative tax burdens when interstate commerce was taxed was a tax "vice" of which the Court was not cognizant when it decided the *Fargo* case.

Justice Stone was, of course, on solid ground when he con-

27. Wisconsin & M. R. Co. v Powers, 191 US 379, 48 L Ed 229, 24 S Ct 107 (1903); Maine v Grand Trunk R. Co., 142 US 217, 35 L Ed 994, 12 S Ct 121 (1891).

28. Cudahy Packing Co. v Minnesota, 246 US 450, 62 L Ed 827, 38 S Ct 373 (1918); United States Express Co. v Minnesota, 223 US 335, 56 L Ed 459, 32 S Ct 211 (1912).

29. Meyer v Wells, Fargo & Co., 223 US 298, 56 L Ed 445, 32 S Ct 218 (1912); Galveston, H. & S. A. R. Co. v Texas, 210 US 217, 52 L Ed 1031, 28 S Ct 638 (1908); Fargo v Michigan, 121 US 230, 30 L Ed 888, 7 S Ct 857 (1887).

30. Fargo v Michigan, 121 US 230, 30 L Ed 888, 7 S Ct 857 (1887).

31. This reference and quotation regarding Fargo by Justice Stone is in Western Live Stock v Bureau of Revenue, 303 US 250, 257, 82 L Ed 823, 58 S Ct 546, 115 ALR 944 (1938).

32. *Id.* at 255–56.

cluded that taxation of a single event or activity by more than one state, where interstate commerce is involved, works to the competitive advantage of the local business, which cannot be exposed to such duplicative taxation. Even if there are no local competitors, multiple taxation is disruptive of an open, expanding economy, for the reason that it rewards, financially, business operations that transact business in the fewest States, and thus discourages the expansion of business operations into additional States. To prevent parochialism among the States was one of the chief ends sought to be achieved by the adoption of the commerce clause.

Justice Stone's position that interstate commerce should be taxable by the States is consistent with his position in regulatory measures. The *Cooley* doctrine with its division of subjects of interstate commerce into those demanding national and those admitting of state regulation was much in evidence under Justice Stone.[33]

Western Live Stock is not, however, the fountainhead of the "cumulative burdens" approach. In a case almost a century older there can be found what are perhaps the rudiments of the "cumulative burdens" test. In upsetting a California tax on ships that sailed the high seas on the ground that a port of call had no jurisdiction to tax, the Court gave utterance to this language in *Hays v Pacific Mail S.S. Co.*[34]

> Now, it is quite apparent that if the State of California possessed the authority to impose the tax in question, any other state in the Union, into the ports of which the vessels entered in the prosecution of their trade and business, might impose a like tax.[35]

The same danger of multiple burdens, which Justice Stone made more articulate in *Western Live Stock,* had also been recognized in *Case of State Freight Tax,*[36] in 1872. In striking down a Pennsylvania tax on freight transported through the State, the

33. Southern Pacific Co. v Arizona, 325 US 761, 89 L Ed 1915, 65 S Ct 1515 (1945); Parker v Brown, 317 US 341, 87 L Ed 315, 63 S Ct 307 (1943); California v Thompson, 313 US 109, 85 L Ed 1219, 61 S Ct 930 (1941); Milk Control Board v Eisenberg Farm Products, 306 US 346, 83 L Ed 752, 59 S Ct 528 (1939), reh den 306 US 669, 83 L Ed 1063, 59 S Ct 773; South Carolina State Highway Dept. v Barnwell Bros., Inc., 303 US 177, 82 L Ed 734, 58 S Ct 510 (1938), reh den 303 US 667, 82 L Ed 1124.

34. 58 US 596, 15 L Ed 254 (1855).

35. *Id.* at 598.

36. 82 US 232, 21 L Ed 146 (1873).

Court, with a vision of an expanding national economy, noted that

> if one State can directly tax persons or property passing through it, or tax them indirectly by levying a tax upon their transportation, every other may, and thus commercial intercourse between States remote from each other may be destroyed. The produce of Western States may thus be effectually excluded from Eastern markets, for though it might bear the imposition of a single tax, it would be crushed under the load of many.[37]

The "cumulative burdens" approach, which became established in *Western Live Stock,* wound its way through a maze of subsequent cases with varying degrees of acceptance and rejection. Although the "cumulative burdens" approach appeared as an "added reason" for sustaining the tax in *Western Live Stock,* it soon became the controlling reason in *Adams Mfg. Co. v Storen.*[38] A few weeks after *Western Live Stock,* the Court relied on the multiple burdens ("cumulative burdens") approach in the *Adams* case to invalidate an Indiana gross receipts tax imposed directly on an Indiana manufacturer's unapportioned gross receipts from manufactured products shipped on orders taken from purchasers in other States. The Court, speaking through Justice Roberts, found unconstitutional this gross receipts tax imposed by the State of the seller as a

> tax upon gross receipts from commerce. . . . The vice of the statute as applied to receipts from interstate sales is that the tax includes in its measure, without apportionment, receipts derived from activities in interstate commerce; and that the exaction is of such a character that if lawful it may in substance be laid to the fullest extent by States in which the goods are sold as well as those in which they are manufactured. Interstate commerce would thus be subjected to the risk of a double tax burden to which intrastate commerce is not exposed.[39]

It really is not clear from Justice Roberts' *Adams* opinion exactly what he means by the phrase "without apportionment." It is not clear whether he meant only "without apportionment between local and interstate receipts", or whether he meant "without splitting the interstate receipts between the participating States."[40]

37. *Id.* at 280.

38. J. D. Adams Mfg. Co. v Storen, 304 US 307, 82 L Ed 1365, 58 S Ct 913, 117 ALR 429 (1938).

39. *Id.* at 311.

40. Compare Justice Roberts' statement in the Adams case at page 311

The *Adams* Court rejected the reliance by the taxing authority on *American Mfg. Co. v St. Louis,*[41] where the Court had upheld an excise tax on manufacturing, measured by the total gross proceeds of interstate sales of the manufactured goods. The *Adams* Court differentiated the *American Manufacturing* case on the ground that *American Manufacturing* was not a sales tax, such as was *Adams,* but an excise on manufacturing, measured by the proceeds of the sales of the goods produced and sold.[42] The *Adams* opinion points out that the tax involved in *American Manufacturing* was "upon the privilege of manufacturing" and "it was permissible to measure the tax by the sales price of the goods produced rather than their value at the date of manufacture." But, said the *Adams* Court, *American Manufacturing* did not authorize the *Adams* tax which "reaches indiscriminately and without apportionment, the gross compensation for both interstate commerce and intrastate activities."[43] Of course, the "sales price" of the *American Manufacturing* interstate sales presumably would include not only selling expenses, but also any profits. From a dollars-and-cents standpoint, that has a rather striking resemblance to the *Adams* transaction. It seems fairly clear, too, that both types of tax (excise and sales) would have yielded the same amount of revenue in the *American Manufacturing* situation, and would have the same economic affect on interstate commerce.[44]

Shortly after the *Adams* case, the Court, in *Gwin, White*[45] struck down a State of Washington tax for the privilege of engaging in business, measured by the total gross receipts from sales made by taxpayers who were a marketing agency for fruit growers in the taxing State. Taxpayers engaged in marketing, in other States, fruit grown in the taxing State. The Court, speaking through Justice Stone, rejected the claim of the taxing authority that the tax was imposed on the "local business" of

with his statement at page 314 of the same case. See Powell, *More Ado About Gross Receipts Taxes,* 60 Harv L Rev 501, 521–22 (1947).

41. 250 US 459, 63 L Ed 1084, 39 S Ct 522 (1919).

42. J. D. Adams Mfg. Co. v Storen, 304 US 307, 312–13, 82 L Ed 1365, 58 S Ct 913, 117 ALR 429 (1938).

43. *Id.* at 312–14.

44. The Adams case will be examined more fully later. See Chapter 5, "Gross Receipts Taxes".

45. Gwin, White & Prince, Inc. v Henneford, 305 US 434, 83 L Ed 272, 59 S Ct 325 (1939).

taxpayer's activities in the taxing State promoting interstate marketing. The Court concluded that the taxed proceeds included not only that part of the proceeds of sales attributable to the taxpayers within the taxing State, but also included receipts attributable to activities of sales agencies without the States. The Court concluded that if the *Gwin, White* tax were valid, other States to which the commerce extends may, with equal right, impose a tax similarly measured for the privilege of conducting within their respective borders the activities there which contributed to the marketing service. Since the *Gwin, White* tax was not apportioned, the multiple tax burden would thus place interstate commerce at a competitive disadvantage with local commerce, which would be exposed only to a single tax.

It is important to point out that the condemned tax in *Gwin, White* had as its "subject" the taxpayer's occupation of marketing, which is clearly a local event, and the gross receipts were used as the "measure" of the tax. When *Gwin, White* was decided, it had been familiar commerce clause doctrine that the "validity of the tax can in no way be dependent upon the mode which the State may deem fit to adopt in fixing the amount."[46] And as if to emphasize the point, the Court went on to declare that no "constitutional objection lies in the way of a legislative body prescribing any mode or measurement to determine the amount it will charge for the privilege it bestows."[47] The method of measuring the tax has been said by the Court not to be open to attack even though the measure is found in property or receipts from property not in themselves taxable.[48]

Nevertheless, *Gwin, White* held that the observance of this traditional statutory "subject-measure" ritual did not absolve the tax of commerce clause complaints and infirmities. Justice

46. Home Ins. Co. v New York State, 134 US 594, 600, 33 L Ed 1025, 10 S Ct 593 (1890).

47. *Id.* at 600.

48. See Baltic Mining Co. v Massachusetts, 231 US 68, 87, 58 L Ed 127, 34 S Ct 15 (1913) (ovrld on other grounds Alpha Portland Cement Co. v Massachusetts 268 US 203, 69 L Ed 916, 45 S Ct 477, 44 ALR 1219). Compare Northwestern States Portland Cement Co. v Minnesota, 358 US 450, 3 L Ed 2d 421, 79 S Ct 357, 67 ALR2d 1292 (1959) *with* Spector Motor Service, Inc. v O'Connor, 340 US 602, 95 L Ed 573, 71 S Ct 508 (1951) (ovrld Complete Auto Transit, Inc. v Brady 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076, reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669).

Stone observed "that the tax, though nominally imposed upon appellant's (taxpayer's) activities in Washington (taxing State), by the very method of its measurement reaches the entire interstate commerce service rendered both within and without the state and burdens the commerce in direct proportion to its volume."[49] Seemingly Justice Stone repudiated the formalistic "subject-measure" test of tax validity. Of course, viewing the matter realistically, if the State is given completely free rein in selecting a *measure* of the tax, its tax could be as harmful to interstate commerce as if it were permitted unlimited use of the commerce itself as the subject.

Both the *Adams* and *Gwin, White* taxes were on gross proceeds from sales, where the tax was imposed on the seller's end of the interstate operation. Soon thereafter, under the caption of a local "taxable event", the Court upheld a sales tax imposed at the buyer's end of the journey. That was *McGoldrick v Berwind-White,*[50] which imposed a tax upon purchases for consumption of tangible personal property, with the amount of the tax being a percentage of the amount of the receipts from every sale in the taxing city of New York. "Sale" was defined as "any transfer of title or possession." The questioned tax was imposed on sales in the taxing city of coal mined in Pennsylvania, shipped through interstate channels and delivered in the taxing city, where the contract of sale had been executed. A sharply divided Court upheld this sales tax imposed on the "transfer of possession" of goods at the situs of the goods, although the sales transaction was consummated by delivery to the consumer at the conclusion of an interstate trip.

A forceful *Berwind-White* dissent[51] opposed the tax on the ground that it threatened a multiple tax burden on interstate commerce, which local business did not bear. To the dissent's way of thinking, the taxed event of the delivery of coal within the State was an integral part of the interstate transaction.[52] The dissenting justices in *Berwind-White* urged that the decision would permit other States to reach what is essentially the same transaction. It pointed out that delivery (the taxable event),

49. Gwin, White & Prince v Henneford, 305 US at 438.

50. McGoldrick v Berwind-White Coal Mining Co., 309 US 33, 84 L Ed 565, 60 S Ct 388, 22 Ohio Ops 84, 128 ALR 876 (1940).

51. *Id.* at 59.

52. *Id.* at 64.

unlike subsequent use or sale, is an integral part of the interstate transaction; that if New York (the taxing city) could lay a tax on the local act of delivery, it seems just as logical to argue that Pennsylvania, where the coal was mined, could impose a tax on the local act of shipment, and New Jersey on the local act of transshipment, likewise integral parts of the interstate transaction.[53] Hence, commerce between the states would be exposed to the danger of a "multiple tax" burden much like the taxes condemned in *Adams* and *Gwin, White.*[54]

Realistically, to avoid multiple taxation of receipts from sales made through interstate commerce, to which local business is not exposed, two alternatives are open. One method of avoiding tax duplication would be to apportion the tax on the full proceeds of the sale; the other would be to deny either the State of the market or the State of origin the power to tax at all the proceeds of the sales transaction, and permitting the other State to tax the full proceeds, whether it be a gross receipts tax, such as found in *Adams* and *Gwin, White,* or a regular retail sales tax, such as that imposed in *Berwind-White.* Apportionment of the proceeds might be somewhat awkward, at times, in trying to determine the amount fairly attributable to each State. Permitting only one State to tax the full proceeds might be a much easier solution. Whether the State of origin or the State of the market should be permitted to impose the tax presents a very controversial question, on which well-intentioned, intelligent people may sharply differ. Ultimately, of course, the choice between the two States involves a pure policy decision. Justice Rutledge did considerable, careful thinking along these lines, and he concluded that the solution most nearly in accord with the purpose of the commerce clause, and the one that would produce less practical difficulties in administration, would be to vest the power to tax in the State of the market.[55] Justice

53. *Id.* at 68–69.

54. Sales taxes will be examined in much more detail later in Chapter 10, "Sales and Use Taxes".

55. See his lengthy concurring opinion in International Harvester Co. v Department of Treasury, 322 US 340, 349, at 360–61, 88 L Ed 1313, 64 S Ct 1019 (1944), reh den 322 US 772, 88 L Ed 1597, 64 S Ct 1281, in which he also concurs in General Trading Co. v State Tax Com., 322 US 335, 88 L Ed 1309, 64 S Ct 1028 (1944), but in which he dissents in McLeod v J. E. Dilworth Co., 322 US 327, 88 L Ed 1304, 64 S Ct 1023 (1944). See also his concurring opinion in Freeman v Hewit, 329 US 249, 279–80, 91 L Ed 265, 67 S Ct 274 (1946), reh den 329 US 832, 91 L Ed 705, 67 S Ct 497.

Rutledge favored the State of the market for the reason that it is the place where the goods enter into competition with goods sold on the local market and which would be subject to the same sales taxation. Hence, the tax burden would necessarily fall with equal force on both interstate and local trade. The competitive situation would remain the same as if no sales tax were imposed.

The *risk* or *potentiality* alone of multiple tax burdens was sufficient to call for invalidating a tax on commerce clause grounds, as Justice Stone[56] and Justice Rutledge viewed the matter.[57] They did not think it was necessary to show the *actual* presence of multiple taxation, in order to conclude that the tax would run afoul of the commerce clause. Justice Rutledge gave his reasons why the *risk* of multiple taxation is sufficient to condemn a tax. He said: "To require factual determination of forbidding effects in each case would be to invite costly litigation, make decision turn in some cases, perhaps many, on doubtful facts or conclusions, and encourage the enactment of legislation involving those consequences."[58] In essence, the difficulties of judicial administration were considered by Justice Rutledge to call for the same policy with respect to both potential and actual tax multiplication.

Under the "multiple burdens" doctrine, as principally developed by Justices Stone and Rutledge, the Court increasingly emphasized the consequences and effects, either actual or threatened, of the questioned tax to block or clog interstate operations. The Court repeatedly stressed that it was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just and fair share of state tax burdens, even though it increased the cost of doing interstate business. A paramount concern of the Court was whether the questioned tax would place interstate commerce at a competitive disadvantage with local business. Likewise, the Court employed a test of substance, rather than form, in resolving the commerce clause issue. Consistent with the Court's approach of substance, rather

56. See Western Live Stock v Bureau of Revenue, 303 US 250, 255–56, 82 L Ed 823, 58 S Ct 546, 115 ALR 944 (1938).

57. See Freeman v Hewit, 329 US 249, 279, 91 L Ed 265, 67 S Ct 274 (1946), reh den 329 US 832, 91 L Ed 705, 67 S Ct 497.

58. Freeman v Hewit, 329 US 249, 279, 91 L Ed 265, 67 S Ct 274 (1946), reh den 329 US 832, 91 L Ed 705, 67 S Ct 497 (concurring opinion).

than formalism, in determining the commerce clause issue, the Court virtually abandoned the "subject-measure" formula for determining whether the tax curtailed or impeded interstate commerce. A pragmatic approach to the commerce clause question had been adopted, and for awhile interstate commerce did pay its way.

§ 2:15. —"Multiple burdens" doctrine abandoned.

The practical considerations that were making headway in influencing commerce clause decisions under the "multiple burdens" doctrine were jettisoned soon after Justice Stone left the Court. *Freeman v Hewit*[59] temporarily marked an end of that cycle, and formalism and labels again became the bench mark for determining taxability under the commerce clause.[60] The *Freeman* Court, in a high-water mark free trade case, created an unneeded tax refuge for interstate commerce in that battered litigation, when a sharply divided Court, speaking through Justice Frankfurter, condemned an Indiana gross income tax. The tax was applied to gross receipts from the sale of stock by an Indiana stockholder (trustee), where the stock was sold through brokers on the New York Stock Exchange and the proceeds, after deducting expenses and commissions, were transmitted to the trustee-taxpayer in the taxing State. *Freeman* established a *per se* violation of the commerce clause on this interstate sale.

In announcing the *Freeman* blanket prohibition against any state taxation imposed *directly* on this interstate transaction, Justice Frankfurter explicitly regarded as unnecessary to the decision any showing of discrimination against interstate commerce; nor was he concerned with the competitive handicap which the *Freeman* decision foisted off upon local business, shouldered with the cost of government. Also, the economic affect of the tax was regarded by the Court as totally irrelevant in determining whether the tax was offensive to the commerce

59. 329 US 249, 91 L Ed 265, 67 S Ct 274 (1946), reh den 329 US 832, 91 L Ed 705, 67 S Ct 497.

60. "The failure of the Court to adhere to the philosophy of our recent cases corroborates the impression which some of us had that *Freeman v Hewit*, 329 US 249, marked the end of one cycle under the Commerce Clause and the beginning of another." Justice Douglas dissenting in Joseph v Carter & Weekes Stevedoring Co., 330 US 422, 91 L Ed 993, 67 S Ct 815 (1947) (ovrld Department of Revenue v Association of Washington Stevedoring Cos. 435 US 734, 55 L Ed 2d 682, 98 S Ct 1388).

clause. Justice Frankfurter pontificated that "the aim of the Commerce Clause was precisely to prevent States from exacting toll from those engaged in national commerce."[61] During the course of the opinion the *Freeman* Court made it clear that it would brook no interference with interstate commerce by way of taxation no matter how light the economic burden:

> Nor is there any warrant in the constitutional principles heretofore applied by this Court to support the notion that a State may be allowed one single-tax-worth of direct interference with the free flow of commerce. An exaction by a State from interstate commerce falls not because of a proven increase in the cost of the product. What makes the tax invalid is the fact that there is interference by a State with the freedom of interstate commerce.[62]

The *Freeman* decision marked a recrudescence of what was tantamount to the old, imprecise and unreliable "direct-indirect" burdens test for determining the constitutionality of a tax when questioned on commerce clause grounds. The *Freeman* criterion of tax validity under the commerce clause pretty much dredged up the discredited and discarded pre-Stone Age "direct-indirect" burdens test, used when the Court was declaring that interstate commerce could not be taxed at all.

The *Freeman* opinion used a variety of appellations to describe the infirmity of the tax to which it had given the commerce clause quietus. The tax was said to be "a direct tax" on interstate commerce,[63] levied on "the very sale",[64] and a "direct imposition on that very freedom of commercial flow",[65] as well as "a levy upon the very process of commerce across State lines",[66] a "direct imposition on interstate commerce",[67] and a forbidden imposition on the "very process of interstate commerce."[68] Justice Frankfurter's *Freeman* opinion summarily dismissed the practical "multiple burdens" test as "a fashion in judicial writing."[69] What condemned the tax in *Freeman* was neither the comparative disadvantage of interstate commerce with local business, nor any actual or probable clogging effect of the tax on

61. Freeman v Hewit, 329 US at 254.

62. *Id.* at 256–57.

63. *Id.* at 253.

64. *Id.* at 255.

65. *Id.* at 256.

66. *Id.* at 254.

67. *Id.* at 257.

68. *Id.* at 253.

69. *Id.* at 254.

the interstate commerce, which had been the commerce clause criterion for taxability under the "multiple burdens" test. The infirmity of the tax, according to *Freeman,* was simply the "direct" bearing and "incidence" of the tax on interstate commerce alone. In the place of the "multiple burdens" test, designed to require interstate commerce to pay its way, *Freeman* resurrected the judicially declared doctrine that the commerce clause "created an area of trade free from interference by the States," and that it "is immaterial that local commerce is subjected to a similar encumbrance."[70]

It can readily be understood why the present-day Court in *Auto Transit* has noted that the modern origin of the rule that interstate commerce cannot be taxed dates from *Freeman.*[71] Also in *Auto Transit,* the Court observed that the rule announced in *Freeman* has been characterized as a "triumph of formalism over substance, providing little guidance even as to formal requirements."[72]

In a lengthy separate opinion, Justice Rutledge took the position that the *Freeman* tax should be judged by its economic consequences rather than by its formal phrasing.[73] Justice Rutledge vigorously criticized the *Freeman* majority for discarding the multiple burdens doctrine and returning to the formalism of another day. After reviewing prior decisions, Justice Rutledge concluded: "The fact is that 'direct incidence' of a state tax or regulation . . . has long since been discarded as being in itself sufficient to outlaw state legislation."[74] In the judgment of Justice Rutledge, a state tax is unconstitutional only where the taxed activity lacks the necessary nexus or connection with taxing state to "comply with due process requirements";[75] or if the questioned tax discriminates against the interstate commerce; or if the activity is subject to "multiple state taxation."[76] Justice Rutledge concurred in the *Freeman* result because there

70. *Id.* at 252.

71. See Complete Auto Transit, Inc. v Brady, 430 US 274, 279, 51 L Ed 2d 326, 97 S Ct 1076 (1977), reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669.

72. *Id.* at 281. At an earlier date the writer was critical of *Freeman.* See Hartman, STATE TAXATION OF INTERSTATE COMMERCE 200 (1953).

73. Freeman v Hewit, 329 US 249, 91 L Ed 265, 67 S Ct 274 (1946), reh den 329 US 832, 91 L Ed 705, 67 S Ct 497. (concurring opinion at 259).

74. *Id.* at 265–66.

75. *Id.* at 271.

76. *Id.* at 271, 276–77.

was no apportionment of the gross proceeds from this interstate sale. He concluded that the proceeds would thus be subject to the risk of multiple tax burdens not borne by local business. Justice Rutledge took the position, however, that the multiple burdens problem would best be solved by denying the State of origin (here the taxing State) the power to tax the proceeds and permitting only the State of market to impose unapportioned gross receipts taxes on sales.[77]

Had the *Freeman* doctrine been fully utilized by the Court in later cases, it would have carved out an area of complete freedom of interstate commerce from state taxation. While *Freeman* was not carried that far, for several years it did have a very substantial impact on commerce clause doctrines, as applied to state taxation. A number of decisions by the Court after *Freeman* did adhere to the *Freeman* view that interstate commerce is virtually free from state taxation. *Joseph v Carter & Weekes Stevedoring Co.,*[78] decided a year after *Freeman,* perpetuated the *Freeman* doctrine that interstate commerce is immune from taxation, although the Court professed to apply the multiple burdens doctrine in so doing. *Weekes* invalidated New York's gross receipts tax as applied to stevedoring connected with both interstate and foreign commerce. While the Court paid lip service to the multiple burdens doctrine, it gave that test of taxability a meaning vastly different from that used in earlier cases, especially by Justices Stone and Rutledge. The Court held invalid the *Weekes* tax on proceeds from loading and unloading cargo, because it feared the risk of a "multiple tax burden"; but in so doing the Court declared that the risk of a "multiple tax burden" could not be avoided since stevedoring was not a "local incident" that was "distinct enough" from the commerce to permit the tax.[79] *Weekes* emasculated the "multiple burdens" doctrine. In the *Weekes* case the same taxed incident, loading and unloading, clearly could not be reached by any other State. That activity was confined exclusively to the jurisdiction that imposed the tax. No other State could tax the *same* activity. A tax upon gross receipts from loading or unloading in another

77. *Id.* at 279-80. See § 2:14, *supra,* where the views of Justice Rutledge in this respect are expanded somewhat.

78. 330 US 422, 91 L Ed 993, 67 S Ct 815 (1947) (ovrld Department of Revenue v Association of Washington Stevedoring Cos. 435 US 734, 55 L Ed 2d 682, 98 S Ct 1388).

79. *Id.* at 429.

State would be taxation of receipts from an entirely separate activity. Local business in the taxing jurisdiction, including stevedoring, presumably had to pay the tax involved in the *Weekes* case on both loading and unloading operation. Thus, the grant of immunity to the *Weekes* taxpayer was a grant of a preference to interstate commerce. *Weekes* later was overruled on the ground that the commerce clause does not *per se* invalidate a tax on interstate commerce, and that a tax on stevedoring could not be repeated in another state.[80]

A beggared definition of the "multiple burdens" doctrine, like the tortured one found in *Weekes,* was used as an *additional* hurdle for the tax to cross, instead of as a test for sanctioning taxes levied on interstate commerce, in *Michigan-Wisconsin Pipe Line Co. v Calvert.*[81] Not being able to find that there was "a genuine separation of the taxed local activity from the interstate process",[82] the *Calvert* Court concluded that the tax was violative of the "multiple burdens" test; the Court thought the tax could be repeated in other States. It was struck down, with the Court adhering to the position that interstate commerce cannot be taxed. The *Calvert* Court left no doubt that it is "now well settled that a tax imposed on local activity related to interstate commerce is valid if, and only if, the local activity is not such an integral part of the interstate process, the flow of commerce, that it cannot realistically be separated from it."[83]

The post-*Freeman* case of *Spector Motor Service, Inc. v O'Connor,*[84] decided in 1951, is one of the best-known and most severely criticized cases reaffirming *Freeman,* and giving interstate commerce unneeded shelter from state taxation. There a fairly apportioned, nondiscriminatory net income tax was nullified by the Court on commerce clause grounds, for the reason

80. Department of Revenue v Association of Washington Stevedoring Cos., 435 US 734, 55 L Ed 2d 682, 98 S Ct 1388 (1978). A few years after the *Weekes* case was handed down, the writer criticized that case. See Hartman, STATE TAXATION OF INTERSTATE COMMERCE 204 (1953).

81. 347 US 157, 98 L Ed 583, 74 S Ct 396 (1954) reh den 347 US 931, 98 L Ed 1083, 74 S Ct 528.

82. *Id.* at 166.

83. *Id.* at 166. For an analysis of the cases during the period, with special emphasis upon the economic characteristics of the problem, see Barrett, *"Substance" vs. "Form" in the Application of the Commerce Clause to State Taxation,* 101 U Pa L Rev 740 (1953).

84. 340 US 602, 95 L Ed 573, 71 S Ct 508 (1951).

that the statute was so drafted that the Court concluded that the subject of the tax was the nontaxable privilege of engaging in interstate commerce, although all the taxed income was generated in the taxing State from trucking operations. Nor could the *Spector* tax be repeated in another State, so as to constitute a multiple tax burden on the same segment of interstate commerce, not borne by local business.[85]

The shadow of *Freeman* stretched longer. In 1952, *Memphis Steam Lanudry Cleaner, Inc. v Stone*[86] gave short shrift to a tax on the ground that it was levied on the taxwise untouchable privilege of engaging in interstate commerce. *Spector* was followed, since that was before the demise of *Spector*. The *Freeman* prohibition against the state taxation of the privilege of engaging in interstate commerce was also reaffirmed in 1954 in *Railway Express Agency Inc. v Virginia.*[87]

§ 2:16. —Revised version of "multiple burdens" doctrine

Not long after *Freeman* virtually parched the field of state taxation of interstate commerce, the Court started to permit the States to mow a considerably wider tax swath. As will appear presently, a number of later cases permitted expanded state taxing power. But the most noteworthy case, using a revised version of the "multiple burdens" doctrine, in this area of growing judicial liberality in the taxing field, is *Northwestern States Portland Cement Co. v Minnesota.*[88] There the Court sustained a state net income tax imposed directly on that portion of a foreign corporation's net income earned from, and fairly apportioned to, business activities within the taxing State, when those activities were exclusively in furtherance of inter-

85. Spector, too, was overruled in Complete Auto Transit, Inc. v Brady, 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076 (1977) reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669.

86. 342 US 389, 96 L Ed 436, 72 S Ct 424 (1952).

87. 347 US 359, 98 L Ed 757, 74 S Ct 558 (1954).

88. 358 US 450, 3 L Ed 2d 421, 79 S Ct 357, 67 ALR2d 1292 (1959). In fact, just two years after *Freeman*, the Court indicated by way of dictum that a tax imposed directly on gross receipts from interstate transportation would be valid, if properly apportioned to business done within the state. Central Greyhound Lines, Inc. v Mealey, 334 US 653, 92 L Ed 1633, 68 S Ct 1260 (1948). The tax as applied was interdicted by the commerce clause because it was an unapportioned gross receipts tax derived from interstate transportation of passengers by bus.

state commerce.[89] The *Northwestern States* opinion realistically and commendably emphasized that while "it is true that a State may not erect a wall around its borders preventing commerce an entry, it is axiomatic that the founders did not intend to immunize such commerce (interstate) from carrying its fair share of the costs of the state government in return for the benefits it derives from within the State."[90]

While the *Northwestern States* decision found no multiple burdens infirmity in the tax, the multiple burdens test of taxation, as announced there, required a showing of *actual* tax multiplication, in order to invalidate a tax on that ground. Thus, the Court came out with a revised, and a considerably narrowed version of that doctrine. To Justices Stone and Rutledge, a showing of a *possibility* or *risk* of multiple taxation of interstate commerce, not borne by local business, was enough to invalidate a tax on commerce clause grounds. In *Northwestern States,* the Court disposed of the multiple burdens doctrine argument by pointing out that there was "nothing to show that multiple taxation is present."[91] The requirement of showing an *actual* multiple tax burden gives the States a bigger tax bite in many instances, because of the difficulty of showing such actual tax duplication. In later cases, the Court has adhered to this same concept of requiring a showing of *actual* multiple tax burdens, before the tax would fall on that ground.[92]

89. Northwestern States Portland Cement Co. v Minnesota, 358 US 450, 3 L Ed 2d 421, 79 S Ct 357, 67 ALR2d 1292 (1959).

90. *Id.* at 461–62.

91. *Id.* at 463.

92. *E.g.,* Exxon Corp. v Department of Revenue (US) 65 L Ed 2d 66, 100 S Ct 2109 (1980); Moorman Mfg. Co. v Bair, 437 US 267, 57 L Ed 2d 197, 98 S Ct 2340 (1978), reh den 439 US 885, 58 L Ed 2d 201, 99 S Ct 233; Department of Revenue v Association of Washington Stevedoring Cos., 435 US 734, 55 L Ed 2d 682, 98 S Ct 1388 (1978) (foreign commerce); Complete Auto Transit, Inc. v Brady, 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076 (1977), reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669; General Motors Corp. v Washington, 377 US 436, 12 L Ed 2d 430, 84 S Ct 1564 (1964), reh den 379 US 875, 13 L Ed 2d 79, 85 S Ct 14. However, at times the "risk" of multiple taxation doctrine has reappeared. In Evco v Jones, 409 US 91, 34 L Ed 2d 325, 93 S Ct 349 (1972), the Court quoted with approval language from the *Adams* opinion, which says that the "risk" of multiple taxation is sufficient to render the tax inimical to the commerce clause. The "risk" of multiple taxation doctrine also reappeared where a property tax imposed upon the instrumentalities of interstate commerce was questioned. See Central R. Co. v Pennsylvania, 370 US 607, 8 L Ed 2d 720, 82 S Ct 1297 (1962) reh den 371 US 856, 9 L Ed 2d 93, 83 S Ct 15. The "risk"

The showing of *actual* multiple tax burdens as required by *Northwestern States* and subsequent cases, in order to disable a tax on commerce clause grounds, leaves some questions unanswered as yet. If the Court makes it a requirement that the taxpayer must show, for example, that the *same* net income or gross receipts from interstate commerce have been taxed elsewhere before upsetting a tax as a multiple burden on interstate commerce, some unresolved issues would be presented. Could not a particular tax then be valid with respect to one State and invalid elsewhere, depending upon whether some other State actually had imposed a tax on that same net income or gross receipts derived from interstate commerce? Moreover, under this approach, has the State first applying its tax to the particular aspect of the interstate business preempted the tax field from the standpoint of the commerce clause, and must other States then hold their taxes in abeyance? It hardly seems plausible to suggest that, under the *actual* multiple burdens commerce clause strictures on the taxing power of each of the States, the limitation would apply on a first-come-first-tax basis.[93]

Hopefully, the Court would make some sort of fair attribution of values among the concerned States for tax purposes. The due process clause might be included in the judicial arsenal for such purposes. The Court has recently said that the basis for its approval of apportioned property taxation, when vehicles of interstate commerce are involved, has been the Court's ability to enforce full apportionment by all potential taxing entities.[94] Conceivably, the Court has the ability to enforce full apportionment by all potential taxing entities, with respect to other types of taxes. However, when the Court was urged in *Moorman v Bair*[95] to require uniform rules for the division of net income

language also appeared in Japan Line Ltd. v County of Los Angeles, 441 US 434, 60 L Ed 2d 336, 99 S Ct 1813 (1978), with respect to the commerce clause and *foreign* commerce. The Japan exaction was a property tax on foreign-owned and based vehicles of interstate commerce.

93. See Justice Goldberg's dissenting opinion in General Motors Corp. v Washington, 377 US 436, 451 at 458, 12 L Ed 2d 430, 84 S Ct 1564 (1964) reh den 379 US 875, 13 L Ed 2d 79, 85 S Ct 14. The writer earlier raised those questions shortly after the *Northwestern States* decision, in Hartman, *State Taxation of Corporate Income From a Multistate Business*, 13 Vand L Rev 21, 40–41 (1959).

94. See Japan Line, Ltd. v County of Los Angeles, 441 US 434, 447, 60 L Ed 2d 336, 99 S Ct 1813 (1979).

95. Moorman Mfg. Co. v Bair, 437 US 267, 57 L Ed 2d 197, 98 S Ct 2340

from multistate operations, in order to avoid duplicative taxation, it declined to do so. The Court made it plain that such policy decisions should be left to Congress.[96] Or, as where gross receipts from an interstate sales transaction are taxed, the Court might make a policy decision to deny taxing power to one State, permitting that power to be exercised by another.[97]

Despite *Northwestern States'* holding, rich with the promise of a revenue harvest for the taxing States, unfortunately the Court remained glued to the view that, from the "quagmire" of " 'not always clear, consistent . . . or reconcilable' " cases, one of the unquestioned "firm peaks" that emerges is that "it is beyond dispute that a State may not lay a tax on the 'privilege' of engaging in interstate commerce," citing as authority the much citicized and later overruled *Spector* spectre.[98]

The unnecessary freedom from taxation accorded interstate commerce by *Freeman,* and continued in *Spector,* began to be curtailed by astute legislative draftsmanship of the taxing statutes, plus a more sympathetic understanding by later majorities of the Court of the revenue needs of the States and the essential fairness that interstate commerce should pay its fair share of the cost of government. Although accompanied by some vacillation on the part of the Court, there began a judicial erosion of the full-blown *Freeman* doctrine that interstate commerce could not be taxed at all. Valid taxable local events began to flourish. Various privileges and activities were found by the Court to be constitutionally proper subjects for taxation, when challenged on commerce clause grounds, although the taxed events were integral and essential parts of a purely interstate operation. Implicit in such holdings is a concern for local revenue needs. Thus while the Court was saying that interstate commerce could not be

(1978) reh den 439 US 885, 58 L Ed 2d 201, 99 S Ct 233.

96. *Id.* at 279–80.

97. Justice Rutledge suggested such a solution. See § 2:14, *supra.*

98. Northwestern States Portland Cement Co. v Minnesota, 358 US 450, 3 L Ed 2d 421, 79 S Ct 357, 67 ALR2d 1292 (1959). Spector Motor Service, Inc. v O'Connor, 340 US 602, 95 L Ed 573, 71 S Ct 508 (1951) (ovrld Complete Auto Transit, Inc. v Brady 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076, reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669), pulled the props from under a fairly apportioned, nondiscriminatory net income tax for the reason that the infelicitously drafted taxing statute permitted the Court to find that the subject of the tax was the tax immune "privilege of engaging in interstate commerce". This case is discussed in § 2:17, *infra.*

taxed, at times it permitted the States to single out for tax purposes "local" activities or events that were essential to interstate commerce.

The narrowing of the *Freeman* tax immunity rule to one of statutory draftsmanship and phraseology soon found conspicuous lodgment in *Memphis Natural Gas Co. v Stone.*[99] There the Court, while professing to stand by the *Freeman* view that interstate commerce was untouchable, taxwise, sustained a privilege tax imposed upon the activities of "maintaining, keeping in repair and otherwise in manning" the pipeline facilities used in transporting gas through the taxing State, although the taxpayer was engaged exclusively in transporting gas in interstate commerce. While agreeing that the interstate commerce could not be conducted "without these local activities," the Court concluded that these "are events apart from the flow of commerce"; hence the tax was not an unreasonable burden on the interstate business.[1] The Court thus cut to the bone what it regarded as interstate commerce for tax purposes.

Also, the *Freeman* freeze on state taxation of interstate commerce was considerably thawed by the Court through distinctions in cases that appear devoid of meaningful significance, as the Court continued to indicate that interstate commerce must pay its way. Semantic differences in the taxing statues served as the basis on which the Court attached constitutional significance. Economically meaningless and purely mechanical was the test employed by the Court in *Northwestern States Portland Cement Co. v Minnesota,*[2] to determine whether the challenged tax could pass muster under the commerce clause. There the Court held that neither the commerce clause nor the due process clause denies to a State the power to impose fairly apportioned, nondiscriminatory excise taxes directly "on" the net income of a foreign corporation whose activities were exclusively in furtherance of interstate commerce. The economic emptiness of the Court's test of tax validity regarding net income taxes is dramatically manifested in its efforts to distinguish *Spector,*[3] which had

99. 335 US 80, 92 L Ed 1832, 68 S Ct 1475 (1948).

1. *Id.* at 96.

2. 358 US 450, 3 L Ed 2d 421, 79 S Ct 357, 67 ALR2d 1292 (1959).

3. Spector Motor Service, Inc. v O'Connor, 340 US 602, 95 L Ed 573, 71 S Ct 508 (1951) (ovrld Complete Auto Transit, Inc. v Brady 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076, reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669).

upset a tax imposed upon a foreign corporation for the privilege of engaging in business, where taxpayer engaged solely in interstate commerce, with the net income attributable only to business done within the taxing State being used as the "measure" of the tax. *Spector* reflected the underlying *Freeman* philosophy that interstate commerce should enjoy a free trade tax immunity. While clinging to the *Spector* doctrine that the privilege of engaging in interstate commerce was not taxable, the *Northwestern States* case distinguished *Spector* on the ground that the forbidden *Spector* tax was levied "on" the privilege of engaging in exclusively interstate commerce, with the net income being used as the "measure" of the tax; while the valid *Northwestern States* taxes were imposed directly "on" the net income as the subject of the tax. Under this test, the constitutionality of net income taxes from business that is exclusively interstate, when challenged on commerce clause grounds, depended entirely upon the purely formal statutory ritual in which the taxing statute was cast. A constitutionally permissible tax was achieved by the flourish of the magic wand of a statutory draftsman's pen. By way of dissent in the *Spector* case, members of the Court aptly questioned whether there was any "reasonable warrant for cloaking a purely verbal standard with constitutional dignity."[4] A nondiscriminatory privilege tax "measured by" apportioned net income from interstate commerce would seem to present, in practical consequence, no more danger of suppressing or hampering that commerce than a tax imposed *directly* upon that *same* income. Both taxes would yield the *same* amount of revenue. Thus a great principle of constitutional law hinged on a judicially hatched distinction that has about as much economic substance as soup made from the shadow of an emaciated sparrow on a cloudy day.

The *Northwestern States* case thus preserved the *Spector* doctrine that taxes levied for the privilege of doing business, when applied to interstate commerce, are *per se* unconstitutional. The present Court has explicitly recognized that the *Spector* rule stood "only as a trap for the unwary draftsman."[5]

4. Spector Motor Service, Inc. v O'Connor, 340 US 602, 95 L Ed 573, 71 S Ct 508 (1951) (ovrld Complete Auto Transit, Inc. v Brady 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076, reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669).

5. Complete Auto Transit, Inc. v Brady, 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076 (1977) reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669.

Thus, there still was very considerable substance in the observation made over a half century ago that the "states can tax interstate commerce if they go about it in the right way."[6]

The last Supreme Court exercise in commerce clause taxation doctrine, based on pure linguistics, in order to require the taxpayer to pay its just share of the cost of state government upon which taxpayer necessarily relies, and by which it was furnished protection and benefits, was *Colonial Pipeline Co. v Traigle.*[7] *Colonial Pipeline* represents the quintessence of unrealistic distinctions, to get around the *Spector* rule that a nondiscriminatory, fairly apportioned tax imposed upon the privilege of engaging in interstate commerce is nevertheless *per se* a violation of the commerce clause.[8] Presently it will be seen that the Court ceased jousting with linguistic windmills. *Colonial Pipeline* sustained a fairly apportioned, nondiscriminatory franchise tax levied upon a foreign corporation for the privilege of doing business in the taxing State *in corporate form,* although the taxpayer was engaged exclusively as an interstate carrier of liquified petroleum products; it did no local business within the taxing State. Taxpayer did have within the State inspection and maintenance crews, as well as pumping stations; and taxpayer had qualified to do business within the taxing State. It is not clear from the opinion how much, if any, the Court's decision was affected by the fact that taxpayer had voluntarily qualified to do business in the taxing State.[9]

The *Colonial Pipeline* Court stresses that taxpayer gained benefits and protection from the taxing State of value and importance to its business; hence the State's fairly apportioned and nondiscriminatory levy on taxpayer did not offend the commerce clause.[10]

If doing business "in corporate form" is enough to distinguish *Colonial Pipeline* from *Spector,*[11] then the rule, that the commerce clause condemns a tax imposed upon the privilege of engaging in interstate commerce, went down the drain, for all practical purposes, in *Colonial Pipeline.*[12]

6. Powell, *Contemporary Commerce Clause Controversies over State Taxation,* 76 U Pa L Rev 773, 774 (1928).

7. 421 US 100, 44 L Ed 2d 1, 95 S Ct 1538 (1975).

8. *Id.* at 112.

9. *Id.* at 101.

10. *Id.* at 114.

11. *Id.* at 109, 113–14.

12. Professor W. Hellerstein ana-

§ 2:17. Contemporary approach.

Under the *Colonial Pipeline* rationale, presumably tax validity could be achieved under the commerce clause by a stroke of the draftsman's pen, by simply providing in the statute that the tax is imposed for the privilege of "doing business *in corporate form.*" That, of course, would permit the States to reach, taxwise, virtually all business engaged in interstate commerce. At the same time it would sap the vitality of *Spector*, which held that the States are powerless to impose a tax, the incidence of which the Court finds is the privilege of engaging in interstate commerce. Such empty and formalistic distinctions should be entirely too shadowy a basis for resolving the crucial issue of whether a sovereign State possesses constitutional power to generate essential revenue needs.

After decades of distinctions based upon insubstantial and pointless formalism, in 1977 the Court cut the Gordian knot in *Complete Auto Transit, Inc. v Brady.*[13] In that case the Court sustained a nondiscriminatory tax imposed directly on the privilege of engaging in interstate commerce, thus rejecting the long-entrenched view, familiarly known as the *Spector* rule, that a tax imposed for the privilege of engaging in interstate commerce is *per se* a violation of the commerce clause. In *Auto Transit*, the taxing State (Mississippi) applied a tax for the privilege of doing business to a foreign corporation (taxpayer) that transported to dealers in the taxing State vehicles manufactured outside the State. The tax was measured by the gross proceeds of taxpayer's transportation charges. All the taxed receipts were for transportation services from a railhead within the taxing State to dealers within the State. For purposes of the decision, the Court assumed that the taxpayer's transportation services were interstate commerce,[14] and that the challenged tax was imposed upon the privilege of engaging in interstate commerce.

lyzed this case and made a prediction that came true. See W. Hellerstein, *State Taxation of Interstate Business and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline*, 6 Va L Rev 149, 176, 188 (1976). For the fulfillment of the prediction, see Complete Auto Transit, Inc. v Brady, 430 US 274, 287, 51 L Ed 2d 326, 97 S Ct 1076 (1977) reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669. For additional analysis and commentary on *Complete Auto Transit*, see *The Supreme Court, 1976 Term*, 91 Harv L Rev 70 (1977).

13. 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076 (1977) reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669.

14. *Id.* at 276, n. 4.

Taxpayer resisted the *Auto Transit* tax solely on decisions holding that a tax on the "privilege" of engaging in an activity in the taxing State may not be applied to an activity that is part of interstate commerce. Taxpayer thus based its case squarely on the *Spector* and *Freeman* doctrine.[15] In upholding the tax, the *Auto Transit* Court expressly overruled *Spector*, as well as the *Freeman* series of cases that had held that any tax levied on the privilege of engaging in interstate commerce was a *per se* violation of the commerce clause. The economically empty formalism represented by *Spector* and *Freeman*, as well as their prototypes, for determining tax validity, was belatedly relegated to the limbo of useless commerce clause doctrine by *Auto Transit*. The rule of those cases, said the *Auto Transit* Court, looked only to the fact that the incidence of the tax was the privilege of doing business; and it deemed irrelevant any consideration of the practical effect of the tax.[16] In arriving at its decision, *Auto Transit* did not focus its attention on the linguistics or ritual of the taxing statute; instead, the Court directed its attention to the real effects of the tax on interstate commerce. "Simply put," said the Court, "the *Spector* rule does not address the problems with which the Commerce Clause is concerned."[17] In repudiating the *Spector* rule, *Auto Transit* also rejected the underlying philosophy that the privilege of engaging in interstate commerce should be automatically immunized from taxation. The entire *Spector* concept, said the Court, had no relationship to economic realities;[18] rather the *Spector* rule "stands only as a trap for the unwary draftsman."[19] *Spector* made constitutionality turn upon a semantic distinction with no relationship to the economic consequences of the tax. To focus on such formalism merely obscures the question whether the tax produces a forbidden burden, concluded the *Auto Transit* Court.[20] "The *Spector* rule had come to operate only as a rule of draftsmanship," thought the *Auto Transit* Court, "and served only to distract the courts and parties from their inquiry into whether the challenged tax produced results forbidden by the Commerce Clause."[21] *Spector*

15. *Id.* at 278.
16. *Id.* at 278.
17. *Id.* at 288.
18. *Id.* at 279.
19. *Id.* at 279.
20. *Id.* at 288.
21. *Id.* at 284–85.

and cases of that vintage truly represented a triumph of formalism over substance.[22]

Auto Transit borrowed from Justice Rutledge who had insisted more than thirty years earlier, in protesting the rationale of the controversial *Freeman* decision,[23] that a tax should be judged by its economic effects rather than its formal phrasing.[24] The modern origin of the *Spector* rule was thought by *Auto Transit* to be found in *Freeman.*[25] The *Auto Transit* Court pointed out that not only had the philosophy underlying the *Spector* rule been rejected by cases since *Spector,* but the rule itself had been stripped of any practical significance.[26] In discrediting *Spector* and upholding the tax in *Auto Transit,* the Court applied the commerce clause doctrine announced by Justice Stone almost forty years earlier in the landmark case of *Western Live Stock v Bureau of Revenue:*[27] "It was not the purpose of the commerce clause" said Justice Stone, "to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business."[28] *Auto Transit* thus recognized that the taxing State has a significant interest in exacting its just share of the cost of the state government.[29]

The *Auto Transit* opinion notes that some modern decisions by the Court, sustaining taxes over commerce clause objections, had considered not the formal language of the statute, but rather the practical effects of the tax. In those cases, the tax had passed constitutional muster, although interstate commerce seemingly was taxed. Those cases, the Court points out, had sustained taxes where questioned on commerce clause grounds, and when the taxes were applied to activities with a substantial nexus with the taxing State, were fairly apportioned, did not discriminate against interstate commerce, and were fairly related to the

22. *Id.* at 281.

23. Discussed in § 2:15, *supra.*

24. See Complete Auto Transit, Inc. v Brady, 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076 (1977), reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669.

25. *Id.* at 279.

26. *Id.* at 288.

27. 303 US 250, 82 L Ed 823, 58 S Ct 546, 115 ALR 944 (1938).

28. Quoted in Complete Auto Transit, Inc. v Brady, 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076 (1977) reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669.

29. See Department of Revenue v Association of Washington Stevedoring Cos., 435 US 734, 55 L Ed 2d 682, 98 S Ct 1388 (1978).

services provided by the State.[30] Even though the activity producing the taxed gross proceeds in *Auto Transit* was a part of interstate commerce, there was no danger of duplicate taxation of the proceeds, since the entire operation generating the proceeds took place within the borders of the taxing State.

The Court generally takes the position that "a taxpayer claiming immunity from a tax has the burden of establishing his exemption."[31] The *Auto Transit* Court concluded that the objecting taxpayer had not claimed: (1) that the taxed activity was not sufficiently connected with the taxing State to justify the tax; (2) nor had it been claimed that the tax was not fairly rolated to benefits provided the taxpayer; (3) neither had it been claimed that the tax discriminated against interstate commerce; (4) nor was there a claim that the tax was not fairly apportioned.[32] So the Court held that the *Auto Transit* tax imposed on the privilege of doing business in the State did not violate the commerce clause.

The *Auto Transit* Court thus focuses its attention on the analysis of the practical economic consequences of the challenged tax and disregards the formalistic statutory distinctions, where a purely verbal standard had been cloaked with constitutional dignity.[33]

In just over one year after *Auto Transit,* the Court passed judgment on another tax imposed upon gross proceeds; this time the proceeds were derived from foreign commerce, as distinguished from the interstate commerce in *Auto Transit.* That litigation was *Washington Revenue Dep't v Stevedoring Ass'n.,*[34] challenging a Washington occupation tax imposed upon the privilege of engaging in the business of stevedoring, which is loading and unloading cargo from ships. The commerce in question was exclusively foreign. The tax was measured by the gross

30. See Complete Auto Transit, Inc. v Brady, 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076 (1977), reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669

31. Norton Co. v Department of Revenue, 340 US 534, 95 L Ed 517, 71 S Ct 377 (1951). For a discussion of the burden which the protesting taxpayer must carry, see § 2:5, supra.

32. Complete Auto Transit, Inc. v Brady, 430 US at 279, 287.

33. See Spector Motor Service, Inc. v O'Connor, 340 US 602, 95 L Ed 573, 71 S Ct 508 (1951) (ovrld Complete Auto Transit, Inc. v Brady 430 US 274, 51 L Ed 2d 326, 97 S Ct 1076, reh den 430 US 976, 52 L Ed 2d 371, 97 S Ct 1669) (dissenting opinion).

34. 435 US 734, 55 L Ed 2d 682, 98 S Ct 1388 (1978).