Fordham Law Review

Volume 28 | Issue 2 Article 8

1959

State Taxation of Imports: A New Test

STATE TAXATION OF IMPORTS: A NEW TEST

The Constitution prohibits the states from levying any taxes upon imports.[1] The pertinent section, absolute in its terms, is to be construed strictly, and can in no sense be interpreted as a prohibition of merely discriminatory taxes.[2] The authors of the Constitution in framing this clause did so in order to "protect the exclusive power of the national government to tax imports and to prevent what . . . would amount to the imposition of additional import duties by states in which the property might be found or stored before its sale or use."[3]

Thus, the states' acknowledged power to tax property within their jurisdiction[4] is qualified to the extent that so long as the articles retain their status as "imports" they remain immune from state taxation. Recent Supreme Court decisions[5] have discussed in detail this problem of determining when an imported article ceases to be an import.

IMPORTS FOR SALE

The landmark case with respect to goods imported for sale is *Brown v. Maryland*.[6] There the Court was confronted with the problem as to whether a state legislature could constitutionally subject an importer of foreign goods for sale to a state license tax as a prerequisite to selling the imported bale or package. The State of Maryland argued that the goods lost their immunity

201(7) defines injury and sickness as "accidental injury, disease, infection or illness," and § 201(8) defines disability during the employment as the "inability of an employee, as a result of injury or sickness not arising out of and in the course of an employment, to perform the regular duties of his employment or the duties of any other employment which his employer may offer him at his regular wages and which his injury or sickness does not prevent him from performing." Thus, in Shapiro v. Central Poultry Corp., 284 App. Div. 309, 131 N.Y.S.2d 716 (3d Dep't 1954), it was held that a typhoid fever carrier was entitled to disability benefits where he was unable to work without infecting others, though he was not physically disabled. In the light of this progressive approach and the need for employers to protect personnel in so many "fringe" situations, the legislature should respond to the present problem, and formulate a policy in agreement with the industrial needs of the times, for as has been pointed out by Horovitz "until every state adopts [a liberal] construction . . . or the legislatures carefully delete the words 'by accident' or 'accidental,' employees in a small minority of states will be faced with the alternative of trying to prove a slip, a twist, or fall, or excessive or unusual work or over-exertion or exposure, or other face-saving fortuitous cause, or be relegated to . . . charity. . . ." Horovitz, Reviews of Leading Current Cases, 19 NACCA L.J. 34, 43 (1957).

1. U.S. Const. art. I, § 10 provides: "No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws . . . ."

2. Richfield Oil Corp. v. State Bd. of Equalization, 329 U.S. 69, 76 (1946).

3. Hooven & Allison Co. v. Evatt, 324 U.S. 652, 664 (1945).

4. Brown v. Maryland, 25 U.S. (12 Wheat.) 419, 441 (1827).

5. Youngstown Sheet & Tube Co. v. Bowers, 358 U.S. 534 (1959); Hooven & Allison Co. v. Evatt, 324 U.S. 652 (1945).

6. 25 U.S. (12 Wheat.) 419 (1827).

upon entering the country.[7] Mr. Chief Justice Marshall, delivering the opinion of the Court, while admitting that there must be some time when the prohibition ceases and the states' power to tax commences,[8] stated that to hold this point of time is the instant the articles enter the country would defeat the prohibition.[9] It was the Chief Justice's opinion that the importer by paying duties to the United States purchased the privilege to incorporate, commingle or sell the goods, and only after the exercise of this right should the goods be exposed to state taxation.[10] While not attempting to lay down a universal rule,[11] he enunciated what was to be the prevailing principle in succeeding cases: "[W]hen the importer has so acted upon the thing imported, that it has become incorporated and mixed up with the mass of property in the country, it has, perhaps, lost its distinctive character as an import, and has become subject to the taxing power of the state . . . ."[12] The Chief Justice proceeded to hold that goods, although remaining the property of the importer, while stored in his warehouse in the original form or package in which they were imported were not "so acted upon" as to become "incorporated" with the property of this country so as to lose their constitutional immunity.[13] It was indicated that in addition to the breaking of the original package, the importer would also be separated from his exemption by the use[14] of the imported goods or the sale[15] thereof. Although not propounded by Marshall as necessarily exclusive, these three categories have for more than a century been the sole instances where the Court has found the property so "acted upon" as to render it subject to state taxation.[16]

In *Low v. Austin*[17] the state assessed for tax purposes imported wines which were stored in their original cases in a warehouse, awaiting sale. The Court,

7. Mr. Chief Justice Taney, counsel for Maryland in this case, later repudiated this earlier contention: "But further and more mature reflection has convinced me that the rule [Brown v. Maryland] laid down by the Supreme Court is a just and safe one, and perhaps the best that could have been adopted for preserving the right of the United States on the one hand, and of the States on the other, and preventing collision between them." The License Cases, 46 U.S. (5 How.) 573, 575 (1847) (opinion of Taney, C.J.).

8. Brown v. Maryland, 25 U.S. (12 Wheat.) 419, 441 (1827).

9. Ibid.

10. 25 U.S. (12 Wheat.) at 435-49.

11. Id. at 441. It was his opinion that it would be premature to state any rule as universal until the cases arose.

12. Id. at 441-42.

13. Id. at 442. The tax was held to be "too plainly a duty on imports, to escape the prohibition in the Constitution." Ibid.

14. Id. at 442-43. A tax upon imported fish was upheld in 1928, where they had "become, through processing, handling and sale, a part of the mass of property subject to taxation by the State." Gulf Fisheries Co. v. MacInerney, 276 U.S. 124, 126 (1928).

15. Brown v. Maryland, 25 U.S. (12 Wheat.) 419, 443 (1827). That a sale will destroy the import status of the goods has never been questioned.

16. The "original package" doctrine has perhaps most frequently been referred to and approved. See, e.g., Anglo-Chilean Corp. v. Alabama, 288 U.S. 218 (1933); May v. New Orleans, 178 U.S. 496 (1900); Cook v. Pennsylvania, 97 U.S. 566 (1878).

17. 80 U.S. (13 Wall.) 29 (1871).

espousing the rationale of *Brown v. Maryland*, held the tax unconstitutional: "[T]he authority given to import necessarily carried with it a right to sell the goods in the form and condition . . . in which they were imported . . . ."[18] The Court determined that the goods retained their distinctive import status, and were thus without the jurisdiction of the state's power to tax.[19]

May v. New Orleans[20] is significant only in that it is illustrative of the Court's meaning of "original package." There the packer placed the separate packages received from the manufacturer into large cases for shipment. The Court held that this large case in which the packages were shipped was the original package, each separate package losing its distinctive character as an import with the opening of the large case.[21]

The law, therefore, in regard to goods imported for sale is quite clear. It is not so clear, however, in regard to goods imported for manufacture.

Goods Imported for Manufacture

The Court was first confronted with the problem of whether goods imported for use in manufacture lose their immunity from state taxation upon storage in the importer's warehouse, pending use in the manufacturing operations, in *Hooven & Allison Co. v. Evatt*.[22] Bales of hemp and other fibers, brought from outside the United States,[23] were stored in their original packages in the petitioner's warehouse at his factory, preliminary to their use by petitioner in the manufacture of cordage. A three to six months supply was kept on hand. The ad valorem tax imposed on this property was sustained by the Supreme Court of Ohio, the court holding that *Brown v. Maryland* applied only to imports for sale, and that imports for use became upon storage, notwithstanding the fact that they were still in the original package, so commingled with the common mass as to be subject to state taxation.[24]

The Supreme Court reversed. Mr. Chief Justice Stone, speaking for the Court, ruled that there was no theoretical or practical reason for saying that goods imported for manufacture lose their distinctive "import" character any sooner or more readily than goods imported for sale.[25] The con-

18. Id. at 33.

19. Id. at 35.

20. 178 U.S. 496 (1900).

21. Id. at 508.

22. 324 U.S. 652 (1945).

23. It was contended that title did not vest in the petitioner until after the arrival of the goods in this country and that, therefore, he was not an importer. The Court rejected this contention, holding that it was "immaterial whether the title to the merchandise imported vested in him who caused it to be brought to this country at the time of shipment or only after its arrival here." Id. at 662.

The tax commissioner's contention that the goods from the Philippines were not imports because they were not from a foreign country was similarly rejected. The Court held that the goods need not be brought from a foreign country to be imports, but need only be brought from without the country. Id. at 671.

24. Hooven & Allison Co. v. Evatt, 142 Ohio St. 235, 51 N.E.2d 723 (1943).

25. 324 U.S. at 667-68.

stitutional necessity that the immunity survive the arrival of the goods "until a point is reached, capable of practical determination, when it can fairly be said that it has become a part of the mass of taxable property within a state . . ."[26] is equally applicable to both cases.[27] As in the case of goods imported for sale, the immunity subsists so long as the goods remain in their original package and have not been devoted to the purpose for which they were imported.[28] The Court held that the goods, not having been subjected to manufacture, i.e., not devoted to the use for which they had been imported, retained their immunity.[29]

The Court reserved decision on the question of whether "the presence of some fibers in the factory was so essential to current manufacturing requirements that they could be said to have entered the process of manufacture, and hence . . . put to the use for which they were imported . . . ."[30] Mr. Chief Justice Stone found any discussion of the virtue or applicability of this "current operational needs" test unnecessary as the state court had not rested its decision on that ground and, furthermore, the record afforded no evidence that the fibers in question were currently needed for manufacturing operations.[31]

The consolidated opinion of *Youngstown Sheet & Tube Co. v. Bowers* and *United States Plywood Corp. v. City of Algoma*[32] was predicated upon the very point which the *Hooven* Court declined to consider. The facts, although seemingly analogous to those of *Hooven,* warrant some detail.

The Youngstown Corporation, a manufacturer of iron and steel, imported ore from five countries for use in its manufacturing process. The ore was stored in an enclosed area adjacent to the factory with the ores segregated according to the country of origin. The company endeavored to maintain a supply to meet its manufacturing requirements for at least three months. The Supreme Court of Ohio sustained the proposed ad valorem tax based on the average value of the ore in the yards during the year.[33]

The Plywood Corporation imported both lumber and veneers for use in its manufacture of veneered wood products. The lumber was stored in the storage yard adjacent to the factory in such a way as to permit air to circulate through the stacks in order to "air dry" the wood. The veneers were stored separately in the bundles in which they were received. Both were stored for use as they were needed in the day to day operation of the plant. Petitioner paid the assessed tax based upon one half the value of the lumber and veneers, and

26. Id. at 667.

27. Ibid.

28. Id. at 668.

29. Id. at 667.

30. Ibid.

31. Id. at 667. However, Mr. Justice Black, dissenting, found that the imports were to be used in current production and kept as a "backlog" to assure constant operation. Id. at 688-89.

32. 358 U.S. 534 (1959).

33. Youngstown Sheet & Tube Co. v. Bowers, 166 Ohio St. 122, 140 N.E.2d 313 (1957), aff'd, 358 U.S. 534 (1959).

proceeded to sue for its recovery. The Supreme Court of Wisconsin sustained the tax.[34]

Speaking for the Court, Mr. Justice Whittaker, as did Mr. Chief Justice Marshall in *Brown v. Maryland,* found the principal question to be whether the importer had so acted upon the imported materials as to cause them to lose their distinctive character as "imports."[35] Finding the third category of *Brown v. Maryland* applicable to the facts at hand, Mr. Justice Whittaker ruled that when the goods imported for use are used for the purpose for which they are imported they cease to be imports.[36] The Court thereby espoused the prevailing principles of both *Brown v. Maryland* and *Hooven & Allison Co. v. Evatt.* The difficulty, however, arises with the Court's application of these principles to the case before it.[37]

The materials in both situations, the Court held, were irrevocably committed to use in manufacturing at the factory because they were required to meet the current operational needs, and were actually used to supply the daily needs. They had, therefore, entered the process of manufacture.[38] Thus, the Court, applying for the first time the "current operational needs" test, found that goods stored in their original package are being "used" within the meaning of *Brown v. Maryland* for the purpose for which they were imported.

It has been established that goods lose their import status when they are used for the purpose for which imported, not when they are "held for such use."[39] The imports here were not imported for the purpose of mere storage in the storage yard, but rather for use in the manufacture of a finished product. They are not so used until they have actually entered into the manufacturing process.[40] Therefore, it appears that the Court, while purporting to remain within the categories of *Brown v. Maryland,* is in reality establishing an independent criterion for stripping the import of its immunity. Congress is constitutionally authorized to consent to, and thereby regulate, state taxation of imports.[41] The absence of legislation affecting *Brown v. Maryland* for more

34. United States Plywood Corp. v. City of Algoma, 2 Wis. 2d 567, 87 N.W.2d 481 (1958), aff'd, 358 U.S. 534 (1959).

35. 358 U.S. at 536-37.

36. Id. at 542-43.

37. It is submitted that perhaps the Court is not applying these principles, but establishing its own independent test. See p. — infra.

38. 358 U.S. at 545-48.

39. Mr. Justice Black, dissenting in Hooven & Allison Co. v. Evatt, 324 U.S. 652 (1945), interpreted Brown v. Maryland, supra note 8, to mean "goods held for use" are taxable. Id. at 687-91. This proposition was refuted in Powell, State Taxation of Imports —When Does an Import Cease to be an Import?, 58 Harv. L. Rev. 858, 862 (1945).

40. The majority, having found all the goods in question in the Youngstown case, supra note 32, to be taxable, did not have occasion to consider the specific lumber which had been stored in such a way as to permit "air drying." As to this portion of the "imports" in question, Mr. Justice Frankfurter conceded that they had entered into the process of manufacture and were, thus, subject to state taxation. 358 U.S. at 564-66.

41. U.S. Const. art. I, § 10. "[T]he Constitution gives Congress authority to consent to state taxation of imports and hence to lay down its own test for determining when the immunity ends . . . ." Hooven & Allison Co. v. Evatt, 324 U.S. 652, 668 (1945).

than a century would certainly imply congressional approval of the categories therein delineated. Any supplement thereto would seem properly within the realm of the legislature, rather than the judiciary.

CONCLUSION

The "current operational needs" test as applied in the instant case is in effect discriminating against the manufacturer in favor of the seller. The merchant in *Low v. Austin* required his wines for current selling operations, just as the importers here needed the goods in question for manufacturing operations. Yet the goods imported for sale remained immune from state taxation. There does not appear to be any sustainable reason to hold goods currently needed for manufacture vulnerable to state taxation, and at the same time hold goods needed for selling operations exempt therefrom. Furthermore, it has reasonably been submitted that goods awaiting processing have an even stronger claim to immunity than goods imported for sale.[42] The latter if sold out of state will escape taxation by the state in which it was stored awaiting sale, whereas the goods for manufacture will become taxable upon entering the manufacturing process, which will invariably be in the same state.

The "current operational needs" test will undoubtedly result in considerable confusion in its application. What property will be deemed necessary for current operational needs? In the *Hooven* case, wherein a "minimum working inventory" of from three to six months supply was the property in question, the Court said there was no basis for saying that the fibers were required for current needs. Now, however, in the *Youngstown* case, where sufficient ore was kept on hand to meet estimated requirements for at least three months, the Court has found the test satisfied.

It was urged by the majority in *Youngstown* that to hold the goods in question "imports" would result in a discrimination in favor of foreign goods not intended by the Constitution. This proposition is without merit. The framers of the Constitution in permitting state taxation of property, while at the same time prohibiting state taxation of imports, could not have but recognized, and thereby acquiesced in, the resulting discrimination with regard to state taxation in favor of foreign goods.

Mr. Justice Frankfurter, in his dissenting opinion, concluded that the result of the majority's decision was that "if imported goods are needed, they are taxable. If useless, they retain their constitutional immunity."[43] While this is admittedly rather strong language, nevertheless, the decision greatly encroaches upon and limits the constitutional prohibition, at least insofar as goods imported for manufacture are concerned. It seems that there are very few instances when property imported for manufacture will not comply with the literal language of the "current operational needs" test. Very rarely will a well managed business tie up its capital in inventories, other than that amount necessary to meet its short term requirements. Consequently, practically all

42. Powell, supra note 39, at 871.

43. Youngstown Sheet & Tube Co. v. Bowers, 358 U.S. 534, 570 (1959).

imports will be imported to meet the current operational needs of the business. What then *will* be "imports" within the meaning of the Constitution?

It will be interesting to note whether the Court, given the appropriate facts, will follow suit and apply this new formula to the heretofore settled area of imports for sale. In view of the strong language of *Hooven* refusing to distinguish the two purposes of import, it is conceivable that the Court will, upon a finding that the goods are currently needed for the selling operations of the retailer or wholesaler, hold the merchandise to be without the constitutional prohibition, and thereby subject to state taxation, notwithstanding that it is still in its original package. This of course, would practically destroy any application or significance of the prohibition.