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COMMENTS

INTERSTATE COMMERCE AND STATE TAXING POWER

"The Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several States . . . ."[1] Thus, the commerce clause of the Constitution reserves to Congress, in its fullest extent, the regulation of interstate commerce. How much, if any, of this regulatory power—including therein the power to tax—over commerce was left within the legitimate sphere of the states, the Constitution does not say. The matter of the relation of the state taxing power to *foreign* commerce was largely disposed of in 1827 by the "original package" doctrine of *Brown v. Maryland*,[2] which has stood generally unchanged to this day, at least in so far as goods imported for sale are concerned.[3] As interstate commerce is far more complex than foreign commerce, so also is the law regarding the state taxing power in relation to interstate commerce that much more complex.[4] The Supreme Court has specifically refused to apply the "original package" doctrine to interstate commerce.[5] Instead, it has enunciated special rules for sales taxes, license taxes, various types of property taxes, and gross income and net income taxes. This comment will review the current state of the law in those specific fields.

SALES TAX

Where goods are brought into a state from another state and sold locally, the state of destination and sale may levy a tax on the sale of the goods.[6] Such a tax is sustainable on several bases: the goods are now part of the general mass of goods within the state and their origin has become immaterial;[7] the fact that they have come from outside the state should not give them an advantage over local goods and relieve them from bearing their fair share of the costs of local government;[8] and, the tax is not laid upon the goods, but upon the transfer of title to the goods,[9] the transfer being a local matter. The Court in *McGoldrick v. Berwind-White Coal Mining Co.*[10] also found additional weight

1. U.S. Const. art. I, § 8, cl. 3.

2. 25 U.S. (12 Wheat.) 419 (1827). The case held that goods in their original package were not subject to state taxation, and that a tax on the sale of such an article was a tax on the import itself; however, once the packages were broken up, they were no longer under the protection of the commerce clause or the constitutional prohibition against the taxing of imports.

3. See Comment, 28 Fordham L. Rev. 343, 344 (1959).

4. Mr. Justice Clark, in Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959), stated that the Supreme Court had handed down "some three hundred full-dressed opinions" on the problem.

5. Brown v. Houston, 114 U.S. 622 (1885); Woodruff v. Parham, 75 U.S. (8 Wall.) 123 (1869).

6. Eastern Air Transp., Inc. v. South Carolina Tax Comm'n, 285 U.S. 147 (1932).

7. Minnesota v. Blasius, 290 U.S. 1 (1933); New York ex rel. Burke v. Wells, 208 U.S. 14 (1908).

8. McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940).

9. Wiloil Corp. v. Pennsylvania, 294 U.S. 169 (1935).

10. 309 U.S. 33 (1940).

for upholding the New York City sales tax in the fact that the tax was passed on to the local buyer. A discriminatory sales tax, i.e., one taxing the sale only of goods manufactured *outside* the state would presumably be held unconstitutional.[11] It is reasoned that subjecting goods transported in interstate commerce to a local sales tax is no burden on interstate commerce since the obvious purpose of the commerce clause is to prevent discrimination against interstate commerce. To relieve such goods from the local sales tax would place local goods at a disadvantage, a situation which the commerce clause did not contemplate. Since the buyer's state may tax the sale, the state of origin may not tax the sale where the buyer is a foreign corporation and the goods are intended for transportation to another state, the theory being that the purchase there is part of interstate commerce.[12]

Property Taxes

In accord with the general rule that a state cannot tax interstate commerce, it was held in the *State Freight Tax Cases*[13] that a tax on goods moving in interstate commerce is unconstitutional. This case involved a Pennsylvania statute levying a per ton tax on *all* freight moving within the state. The tax was held to give offense to the commerce clause whether the property was transported through the state, or was picked up in the state to be carried out, or was carried into the state from without, the Court observing that the transportation of freight is a constituent part of the commerce itself.[14]

An important element of this exemption from state tax is that the property must actually be in interstate commerce, i.e., the prohibition applies only *while* the goods are in transit. It does not apply if the goods have not yet started in interstate commerce, or have completed the transit, or are at a *break* in the transit.[15] Thus coal, mined and prepared for shipment to another state, was legally subject to the tax of the state of mining, the incidence of the tax being before the shipment began;[16] this rule was followed even where all of the ore was immediately and continuously loaded on cars and shipped into other states.[17]

Although goods moving in interstate commerce are exempt from state tax, a state may tax all property *situated* within its borders, including property *used* in interstate commerce,[18] notwithstanding it is used exclusively in interstate commerce.[19] Several cases have been concerned with personal property moving interstate, such as railroad cars and trucks. It has been held that: "[V]ehicles of transportation, used constantly and continuously upon a single

11. See Welton v. Missouri, 91 U.S. 275 (1876). There the tax involved a license on persons selling goods manufactured outside the state.

12. Robbins v. Shelby County Taxing Dist., 120 U.S. 489 (1887).

13. Reading R.R. v. Pennsylvania, 82 U.S. (15 Wall.) 232 (1873).

14. Id. at 275.

15. Minnesota v. Blasius, 290 U.S. 1 (1933); Coe v. Errol, 116 U.S. 517 (1886).

16. Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922).

17. Oliver Iron Co. v. Lord, 262 U.S. 172 (1923).

18. United States Glue Co. v. Town of Oak Creek, 247 U.S. 321, 326 (1918).

19. Pullman's Palace Car Co. v. Twombly, 29 Fed. 658 (8th Cir. 1887).

run, acquire a *situs,* for purposes of taxation, independent and irrespective of the domicile of the owner; . . . where such vehicles are used upon a run extending through two states, there is a *situs* for taxation in each state to a fair proportion of the value of the property so used."[20] Generally, this "fair proportion" must have "relation to opportunities, benefits, or protection conferred or afforded by the taxing state."[21] There is, however, no one formula for making this fair apportionment.[22]

LICENSE TAXES

In 1869, the Supreme Court held that a corporation chartered by one state may enter other states only with their assent, which "may be granted upon such terms and conditions as those states may think proper to impose."[23] It was later held that the state has no power to restrict the right of a foreign corporation to transact *interstate* business within its borders.[24] Since a state cannot, without congressional consent, regulate interstate commerce,[25] obviously a state cannot demand a license as a prerequisite to doing interstate business, since engaging in such business is not a state "privilege,"[26] but a constitutional or congressional privilege.

Although the above rules are clear enough standing alone, they are not easily applied when a foreign corporation is transacting both interstate and intrastate commerce, and the license tax in question does not attempt to tax the activities separately but imposes a single-rate license tax. At one time such a statute would have been held unconstitutional as to companies transacting both types of business,[27] since part of the levy would be attributable to interstate commerce. In 1951, in *Spector Motor Service, Inc. v. O'Connor,*[28] the Supreme Court indicated that it was constitutional. The taxpayer in that case actually was engaged only in interstate commerce. The Court, therefore, held the state tax imposed upon the franchise of the foreign corporation for the "privilege" of doing business within the state unconstitutional. At the same time, the Court stated:

> Our conclusion is not in conflict with the principle that, where a taxpayer is engaged both in intrastate and interstate commerce, a state may tax the privilege of carrying on intrastate business and, within reasonable limits, may compute the amount of the charge by applying the tax rate to a fair proportion of the taxpayer's business done within the state, including both interstate and intrastate.[29]

20. Id. at 668-69.

21. Ott v. Mississippi Barge Lines, 336 U.S. 169, 174 (1949).

22. See p. 499 infra.

23. Paul v. Virginia, 75 U.S. (8 Wall.) 168, 181 (1869).

24. Leloup v. Port of Mobile, 127 U.S. 640 (1888).

25. See In re Rahrer, 140 U.S. 545 (1891); Leisy v. Hardin, 135 U.S. 100 (1890). The states can prohibit (and thereby regulate) the introduction of liquor into a state by the reservation contained in the twenty-first amendment.

26. States have sometimes used this term in describing the subject of a tax.

27. Crutcher v. Kentucky, 141 U.S. 47 (1891); Leloup v. Port of Mobile, 127 U.S. 640, 647 (1888).

28. 340 U.S. 602 (1951).

29. Id. at 609-10.

A vigorous dissent pointed out that if the taxpayer had been engaged in one iota of activity that could be characterized as intrastate, the majority, by its own rule, would have found the tax valid. It was further argued that "there is no apparent difference between an 'exclusively interstate' business and a 'mixed' business which would warrant different constitutional regard."[30] The majority's dictum augured the current trend toward allowing the widest possible latitude to the state in tax matters.

There is dicta in *United States Glue Co. v. Town of Oak Creek*,[31] that a state property tax on a foreign corporation doing interstate business may take the form of a tax for the privilege of exercising its franchises within the state. But, the Court added, the payment may not be made a condition precedent to the right to carry on the business. Were the tax a condition precedent it would in fact be a license tax. Regardless of its form, the tax must be essentially a property tax. Even as a property tax, its constitutionality may be challenged. "[T]he question whether a state may validly make interstate commerce pay its way depends first of all upon the constitutional channel through which it attempts to do so."[32] Opposed to this approach is another, used in the more recent case of *Railway Express Agency, Inc. v. Virginia*,[33] where the Court, faced with a franchise tax on a foreign corporation doing interstate business, looked not at the form of the tax, but at the fact that it was in lieu of other property taxes which the state could legally assess, and upheld it.

Gross Receipts and Net Income Tax

Gross receipts taxes and net income taxes are regarded in different constitutional lights by the Supreme Court. The difference was best stated in *United States Glue Co. v. Town of Oak Creek*:[34]

> The difference in effect . . . is manifest and substantial, and it affords a convenient and workable basis of distinction between a direct and immediate burden upon the business affected and a charge that is only indirect and incidental. A tax upon gross receipts affects each transaction in proportion to its magnitude and irrespective of whether it is profitable or otherwise. Conceivably it may be sufficient to make the difference between profit and loss, or to so diminish the profit as to impede or discourage the conduct of the commerce. A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and losses, and the tax cannot be heavy unless the profits are large.

The prohibition against a tax on gross receipts was recognized long before the *Oak Creek* case,[35] and has had recent affirmance.[36] A still more recent case, however, has cast some doubt on the future of gross receipts taxes. *Greyhound Lines v. Mealey*[37] ruled a New York tax on all gross receipts of a bus company

30. Id. at 612.

31. 247 U.S. 321, 326 (1918).

32. Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602, 608 (1951).

33. 358 U.S. 434 (1959).

34. 247 U.S. 321, 328-29 (1918). See also Peck & Co. v. Lowe, 247 U.S. 165 (1918).

35. See New York, L.E. & W.R.R. v. Pennsylvania, 158 U.S. 431 (1895); Philadelphia & S.S.S. Co. v. Pennsylvania, 122 U.S. 326 (1887).

36. Freeman v. Hewit, 329 U.S. 249 (1946).

37. 334 U.S. 653 (1948).

unconstitutional since the line passed through New Jersey and Pennsylvania and the latter state was taxing part of the gross receipts. The Court indicated that the tax would be constitutional as to that proportion of the mileage within New York State. While given as dictum, it may be taken as a sign of decisions yet to come. It accords with the Court's recently acquired respect for the states' taxing power.

The Supreme Court's statement in *Oak Creek* regarding a net income tax must be read in the light of another decision rendered the same year, *Peck & Co. v. Lowe*.[38] In the latter case the Court was faced with the federal income tax applied to profits from exports, as a possible violation of the constitutional provision that "no Tax or Duty shall be laid on Articles exported from any State."[39] The Court there held that the tax was not *on* the articles themselves, that it was only indirect and remote in relation to the exportation, and emphasized that it was not on the income *because* of its source but regardless of it. This approach would justify taxes on net income derived from interstate commerce.

There have been many cases since *Oak Creek* was decided in 1918 that have upheld such taxes, but there were none until 1959 that had to face squarely the problem of whether income derived *exclusively* from interstate commerce was subject to state tax. Some had mentioned the problem obliquely. *Underwood Typewriter Co. v. Chamberlain*[40] had upheld the tax, "although these profits may have been derived *in part, or indeed mainly,* from interstate commerce."[41] The emphasized words left room for the inference that a tax on profits derived *entirely* from interstate commerce would be invalid and, in 1942, there was dictum in *Memphis Natural Gas Co. v. Beeler*[42] that a tax on the net income of a corporation doing wholly interstate commerce, but having a commercial domicile in the taxing state, was not prohibited by the commerce clause. In 1946, the Supreme Court's unanimous per curiam decision in *West Publishing Co. v. McColgan*[43] had upheld a California tax on income from exclusively interstate commerce.[44] Then, in 1959, the Supreme Court wrote a full opinion squarely on point in *Northwestern States Portland Cement Co. v. Minnesota*.[45] The decision involved cases from two states, Minnesota and Georgia, in which the highest courts had found as a fact that the taxpayer-corporations were engaged solely in interstate commerce, and the state statutes specifically levied income taxes on such corporations.[46] The Supreme Court,

38. 247 U.S. 165 (1918).

39. U.S. Const. art. I, § 9, cl. 5.

40. 254 U.S. 113 (1920). This case is significant for laying down the requirement that payment of the income tax must not be made a condition precedent to the right to engage in interstate commerce within the state, but that enforcement must be left to the ordinary means of collecting taxes.

41. Id. at 120. (Emphasis added.)

42. 315 U.S. 649 (1942).

43. 328 U.S. 823 (1946).

44. West Publishing Co. v. McColgan, 27 Cal. 2d 705, 166 P.2d 861 (1946).

45. 358 U.S. 450 (1959).

46. The Minnesota court upheld the tax. State v. Northwestern States Portland Cement

splitting 6-to-3, upheld the taxes. The majority pointed to several decisions, including *Oak Creek, Underwood Typewriter Co., Memphis Natural Gas* and *West Publishing Co.,* as precedents. The minority contended that all of the cited cases involved at least some intrastate commerce. The dissent of Mr. Justice Frankfurter also cited *Spector Motor Service, Inc. v. O'Connor*[47] as authority against the taxing of an exclusively interstate enterprise. In *Spector,* however, the tax fell because it was a tax on the franchise of the taxpayer for the privilege of doing interstate business, the net income being used only as a measure of the tax. But the split on the precedent value of the cases was secondary to the issue squarely presented; whether some small amount of intrastate activity must be present before income from interstate activity can be taxed. The majority aligned itself, at least insofar as income taxes are concerned, with Mr. Justice Clark's conclusion in *Spector* that "there is no apparent difference between an 'exclusively interstate' business and a 'mixed' business which would warrant different constitutional regard."[48]

The broad effect of the case that *all* net income from interstate commerce was subject to state taxation was short-lived. In September of 1959, Congress enacted the Interstate Commerce Tax Act.[49] The Act applies to corporations not incorporated in the taxing state, and to individuals not residents or domiciliaries of the taxing state. It exempts such individuals and corporations from a net income tax if their only business in the taxing state is the solicitation of orders for sales of tangible personal property if the orders are sent outside the state for approval, and are filled by shipment from outside the state. The exemption covers not only net income tax but any tax *measured* by net income. The net effect of the Act is to exempt businesses which have done no more than send "traveling salesmen" into the state.[50] It will be interesting to observe the outcome of the challenge, which is certain to be made, of the Act's constitutionality. We can expect the argument that Congress is now interfering with what has been held to be the proper dominion of the states.[51]

Congressional desire to limit the state taxing power in this area was undoubtedly influenced by the dissenting opinion of Mr. Justice Frankfurter in *Northwestern States Portland Cement Co.,* in which he enumerated the impractical results of the holding. He pointed out that the taxpayers affected "will have to keep books, make returns, store records, and engage legal counsel, all to meet

Co., 250 Minn. 32, 84 N.W.2d 373 (1957), aff'd, 358 U.S. 450 (1959). The Georgia court found it violated the commerce clause. Williams v. Stockham Valves & Fittings, Inc., 213 Ga. 713, 101 S.E.2d 197 (1957), rev'd, 358 U.S. 450 (1959).

47. 340 U.S. 602 (1951).

48. Id. at 612.

49. 28 U.S.L. Week 18 (U.S. Sept. 8, 1959).

50. This exclusion of travelling salesmen, or "drummers," reflects the holding of Robbins v. Shelby County Taxing Dist., 120 U.S. 489 (1887), in which the Court struck down a license tax on the salesmen.

51. A full consideration of the constitutionality of the Interstate Commerce Tax Act is beyond the scope of this comment. Suffice it to say, however, that Congress has always been recognized to have the fullest control over interstate commerce. See McDermott v. Wisconsin, 228 U.S. 115 (1913); In re Rahrer, 140 U.S. 545 (1891); Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824).

the divers and variegated tax laws of [fifty] States,"[52] that the cost of complying with the requirements of all the states might exceed the taxes themselves, and concluded by calling for congressional action.

PRACTICAL CONSIDERATIONS

When a state levies a tax on net income within permissible limits, it may tax only that part of the income from interstate commerce attributable to the taxpayer's activities within the state. The same limitation applies to a tax on personal property used in interstate commerce, i.e., only a part can be taxed. As to how that "part" is determined, there is no one formula. The general "apportionment rule" was stated indirectly in *Pullman's Palace Car v. Pennsylvania.*[53] Pennsylvania levied a tax on the capital stock of the company in proportion to the number of miles over which it ran cars in the state as against the whole number of miles in all states. The Court found this "just and equitable" and one which, "if it were adopted by all the states through which these cars ran, the company would be assessed upon the whole value of its capital stock, and no more."[54] In a recent case, *Railway Express Agency, Inc. v. Virginia,*[55] the Court upheld a franchise tax which was "in lieu of other property taxes,"[56] and which was measured by gross receipts within the state.[57]

In income taxes, also, varying formulas have been approved. *Northwestern States Portland Cement Co. v. Minnesota*[58] involved cases from two states, each using slightly different apportionment formulas. The Court found both fair. Indeed, there is no reason to suppose that there is not an unending series of formulas, all of which are fair when taken by themselves. But it has been pointed out that there are thirty-five states which impose direct net income taxes on corporations.[59] There are probably more which impose property taxes. A given corporation, operating in many states, may find itself subject to a like number of formulas, all of them "fair." But it may also find that it is being taxed on more than one hundred per cent of its net income or property. Indeed, in one case,[60] the operations of the taxpayer in the taxing state were conducted at a loss, and still the Court found part of the overall net profit of the corporation reasonably attributable to the state.

It is difficult to see how the Court could control a combination of circumstances resulting in a tax imposition in excess of one hundred per cent, since it cannot choose arbitrarily from among the acceptable formulas. Congress has recognized this danger. It included in the Interstate Commerce Tax Act a provision for committee studies to propose uniform standards to be observed

52. 358 U.S. at 474.
53. 141 U.S. 18 (1891).
54. Id. at 26.
55. 358 U.S. 434 (1959).
56. Id. at 436.
57. See also Maine v. Grand Trunk Ry., 142 U.S. 217 (1891).
58. 358 U.S. 450 (1959).
59. Id. at 452.
60. Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924).