CHAPTER 4

Commerce Clause Restrictions on State Taxation

C. STATE TAXATION OF FOREIGN COMMERCE

D. THE EXERCISE OF CONGRESS'S AFFIRMATIVE POWER TO REGULATE STATE TAXATION UNDER THE COMMERCE CLAUSE

A. DELINEATION OF WHAT CONSTITUTES INTERSTATE OR FOREIGN COMMERCE

¶ 4.01 "COMMERCE" AND "INTERSTATE COMMERCE" DEFINED

Unless "commerce" is being carried on, no question can arise as to whether a tax imposes an undue burden on interstate or foreign commerce. The classic statement as to what constitutes "commerce" under the Commerce Clause was Chief Justice Marshall's declaration in *Gibbons v. Ogden*,[1] in which he rejected the view that "commerce" is limited to "traffic, to buying and selling, or to the interchange of commodities," because to do so "would restrict a general term applicable to many objects, to one of its significations."[2] Instead, the Chief Justice declared: "Commerce undoubtedly, is traffic, but it is something more—it is intercourse. It describes the commercial intercourse between nations, and parts of nations, in all its branches."[3]

Shortly after the Civil War, however, the Court went far toward adopting the narrower view of commerce rejected by Chief Justice Marshall. In *Paul v. Virginia*,[4] it held that insurance is not commerce, and it sustained a tax imposed on a foreign insurance company as a condition to doing business in the state, even though the state applied no comparable taxes to domestic insurers. The Court articulated the following rationale for holding that the levy did not violate the Commerce Clause:

> Issuing a policy of insurance is not a transaction of commerce. The policies are simple contracts of indemnity against loss by fire, entered into between the corporations and the assured, for a consideration paid by the latter. These contracts are not articles of commerce in any proper meaning of the word. They are not subjects of trade and barter offered in the market as something having an existence and value independent of the parties to them. They are not commodities to be shipped or forwarded from one State to another, and then put up for sale. They are like other personal

[1] Gibbons v. Ogden, 22 US (9 Wheat.) 1 (1824).

[2] *Gibbons*, 22 US (9 Wheat.) 1, 189 (1824).

[3] *Gibbons*, 22 US (9 Wheat.) 1, 189 (1824).

[4] Paul v. Virginia, 75 US (8 Wall.) 168 (1868).

> contracts between parties which are completed by their signature and the transfer of the consideration. Such contracts are not inter-state transactions, though the parties may be domiciled in different States. The policies do not take effect—are not executed contracts—until delivered by the agent in Virginia. They are, then, local transactions, and are governed by the local law. They do not constitute a part of the commerce between the States any more than a contract for the purchase and sale of goods in Virginia by a citizen of New York whilst in Virginia would constitute a portion of such commerce.[5]

In a later case, the Supreme Court reaffirmed this view, asserting that "[t]he business of insurance is not commerce."[6]

This narrow view of what constitutes commerce did not survive the growth of the national economy. In 1910, the Court took a more expansive view of the meaning of "commerce" in a case involving an out-of-state correspondence school.[7] In that case, the Court applied the principle that the Commerce Clause prohibits the states from barring a foreign corporation that is engaged solely in interstate commerce from conducting business in the state, declaring:

> If intercourse between persons in different States by means of telegraphic messages . . . is commerce among the States which no State may directly burden or unnecessarily encumber, we cannot doubt that intercourse or communication between persons in different States, by means of correspondence through the mails, is commerce among the States within the meaning of the Constitution especially where . . . such intercourse and communication really relate to matters of regular, continuous business.[8]

As Congress began to exercise its powers to regulate business under the Commerce Clause more extensively, the Court defined the scope of "commerce" and "interstate commerce" in the broadest terms.[9] As a result of these

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[5] *Paul*, 75 US (8 Wall.) 168, 183 (1868).

[6] New York Life Ins. Co. v. Deer Lodge County, 231 US 495, 509, 34 S. Ct. 167 (1913).

[7] International Textbook Co. v. Pigg, 217 US 91, 30 S. Ct. 481 (1910).

[8] *International Textbook Co.*, 217 US 91, 107, 30 S. Ct. 481 (1910).

[9] See Board of Trustees v. United States, 289 US 48, 56, 53 S. Ct. 509 (1933) (the language of the Commerce Clause "comprehend[s] every species of commercial intercourse between the United States and foreign nations"); Foster Fountain Packing Co. v. Haydel, 278 US 1, 10, 49 S. Ct. 1 (1928) ("Interstate commerce includes more than transportation; it embraces all the component parts of commercial intercourse among states"); Second Employers' Liability Cases, 223 US 1, 46, 32 S. Ct. 169 (1912) ("the term 'commerce' comprehends more than the mere exchange of goods"). For a review of the cases construing the term "commerce," see Stern, "The Commerce Clause and the National Economy: 1933–1946," 59 Harv. L. Rev. 883 (1946).

expansive decisions, the "roots of *Paul v. Virginia*" were destroyed,[10] and in 1944, the Court repudiated that decision in a case holding that the Sherman Anti-Trust Act applied to a group of fire insurance companies.[11] In part, the Court grounded the decision on the principle that "legal formulae devised to uphold state power cannot uncritically be accepted as trustworthy guides to determine congressional power under the Commerce Clause."[12] However, the Court went further and rejected the view expressed in *Paul v. Virginia* that, because insurance policies "are not commodities," or that "insurance policies are mere personal contracts subject to the laws of the state where executed," the insurance business does not constitute interstate commerce.[13] It declared that "a nationwide business is not deprived of its interstate character merely because it

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It is settled law that the power the Commerce Clause grants to Congress to regulate interstate commerce is not limited to such commerce. Congress has the power to regulate *intrastate* commerce that may affect its regulation of interstate commerce. Shreveport Rate Case, 234 US 342, 34 S. Ct. 833 (1914). In the New Deal legislation cases, the Court recognized Congress' power to regulate intrastate activities that have "a close and substantial relation to interstate commerce." NLRB v. Jones & Laughlin Steel Corp., 301 US 1, 37, 57 S. Ct. 615 (1937); see also Wickard v. Filburn, 317 US 111, 63 S. Ct. 82 (1942); United States v. Darby, 312 US 100, 61 S. Ct. 451 (1941). Moreover, as the Court declared in Hughes v. Oklahoma, 441 US 322, 326 n. 2, 99 S. Ct. 1727 (1979):

> *Philadelphia v. New Jersey*, 437 U.S. 617, 621–623 (1978), made clear that there is no "two tiered definition of commerce." The definition of "commerce" is the same when relied on to strike down or restrict state legislation as when relied on to support some exertion of federal control or regulation.

[10] See Stern, "The Commerce Clause and the National Economy: 1933-1946," 59 Harv. L. Rev. 883, 909 (1946).

[11] United States v. South-Eastern Underwriters Ass'n, 322 US 533, 64 S. Ct. 1162 (1944). See Murphy, "Insurance Under the Commerce Clause," 33 Iowa L. Rev. 91 (1947); Powell, "Insurance as Commerce—In Constitution and Statute," 57 Harv. L. Rev. 937 (1944). In 1945, Congress responded to the possible threat that the *South-Eastern Underwriters* case posed to the validity of state regulation of insurance by enacting the McCarran-Ferguson Act (59 Stat. 33 (1945), 15 USC § 1011), which set aside any Commerce Clause barrier to state regulation of insurance. Thereafter, the Court held that a state tax on a foreign insurance company as a condition of receiving a certificate of authority to conduct an insurance business in the state did not violate the Commerce Clause because Congress had removed the application of the "negative" Commerce Clause to state regulation or taxation of the insurance industry. Prudential Ins. Co. v. Benjamin, 328 US 408, 66 S. Ct. 1142 (1946). The states' freedom to tax insurance without regard to traditional Commerce Clause restraints extends to municipal taxes as well. Charleston v. Government Employees Ins. Co., 869 F. Supp. 378 (DSC 1994).

[12] See *South-Eastern Underwriters*, 322 US 533, 545, 64 S. Ct. 1162 (1944). But see supra note 9 (discussing Court's current position that the scope of congressional power to regulate commerce under the affirmative Commerce Clause is coextensive with the scope of judicial scrutiny over state regulations and taxes under the "dormant" Commerce Clause).

[13] *South-Eastern Underwriters*, 322 US 533, 546–547, 64 S. Ct. 1162 (1944).

is built upon sales contracts which are local in nature."[14] The Court traced the "commanding position" of the modern insurance business "in the trade and commerce of our nation" and said: "This business is not separated into 48 distinct territorial compartments which function in isolation from each other. Interrelationship, interdependence, and integration of activities in all the states in which they operate are practical aspects of the insurance companies' methods of doing business."[15] Accordingly, the Court held that the business of insurance constitutes interstate commerce.[16]

The Court has since gone on to hold that an enterprise conducting professional sports in more than one state,[17] a company producing, booking, and presenting theatrical productions in various states,[18] and a public utility holding company whose subsidiaries operate in various states[19] are each engaged in interstate commerce. In rejecting a challenge to the validity of the Public Utility Holding Company Act of 1935 on the ground that the ownership of securities in subsidiaries located in various states neither constituted nor was related to interstate commerce, the Court said:

> The mails and instrumentalities of interstate commerce are vital to the functioning of this system. . . . Without them, [petitioner] would be unable to . . . exercise and maintain the influence arising from its large stock holdings, receiving notices and reports, sending proxies to stockholders' meetings, collecting dividends and interest, and transmitting whatever instructions and advice may be necessary. . . . Such interstate commercial transactions involve the very essence of [petitioner's] business.[20]

Since the ownership of securities generated a constant flow of "reports, letters, equipment, securities, instructions, and money," the Court concluded that "the ownership of securities of operating companies has a real and intimate relation to the interstate activities of holding companies and cannot be effectively divorced therefrom."[21]

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[14] *South-Eastern Underwriters*, 322 US 533, 547, 64 S. Ct. 1162 (1944).

[15] *South-Eastern Underwriters*, 322 US 533, 541–542, 64 S. Ct. 1162 (1944).

[16] See also Group Life & Health Ins. v. Royal Drug Co., 440 US 205, 99 S. Ct. 1067 (1979).

[17] Radovitch v. National Football League, 352 US 445, 77 S. Ct. 390 (1957); United States v. International Boxing Club, 348 US 236, 75 S. Ct. 259 (1955); see Flood v. Kuhn, 407 US 258, 92 S. Ct. 2099 (1972).

[18] United States v. Schubert, 348 US 222, 75 S. Ct. 277 (1955).

[19] North Am. Co. v. SEC, 327 US 686, 66 S. Ct. 785 (1946).

[20] North Am. Co., 327 US 686, 694–695, 66 S. Ct. 785 (1946).

[21] *North Am. Co.*, 327 US 686, 702, 66 S. Ct. 785 (1946); see also American Power & Light Co. v. SEC, 329 US 90, 67 S. Ct. 133 (1946); Electric Bond & Share Co. v. SEC, 303 US 419, 58 S. Ct. 678 (1938).

The Court has also rejected the organized bar's contention that the "learned professions are not trade or commerce," stating: "The exchange of [legal services] for money is 'commerce' in the most common usage of that word. . . . In the modern world it cannot be denied that the activities of lawyers play an important part in commercial intercourse."[22]

¶ 4.02 WHEN INTERSTATE COMMERCE BEGINS: THE PROPERTY TAX CASES

[1] Introductory Caveat

Most of the cases considered in this section arose during the period when the Supreme Court embraced the view that direct taxes on interstate commerce violate the Commerce Clause. A corollary to that principle was that the states may not tax goods in transit in interstate commerce.[23] Consequently, a large number of cases dealt with the questions whether interstate commerce has begun, whether there has been an intermediate break in transit of a character that would take the property out of the stream of commerce, or whether the interstate journey had terminated at the point at which the state tax was imposed.

The Court's development of the multiple taxation doctrine during the 1930s undermined the view that the Commerce Clause prohibits direct taxes

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[22] Goldfarb v. Virginia State Bar, 421 US 773, 778, 95 S. Ct. 2004 (1975).

[23] As the Court declared in Coe v. Errol, 116 US 517, 525, 6 S. Ct. 475 (1886):

> [G]oods . . . already in the course of commercial transportation, . . . are clearly under the protection of the Constitution. And so, we think, would the goods in question be when actually started in the course of transportation to another State, or delivered to a carrier for such transportation. There must be a point of time when they cease to be governed exclusively by the domestic law and begin to be governed and protected by the national law of commercial regulation, and that moment seems to us to be a legitimate one for this purpose, in which they commence their final movement for transportation from the State of their origin to that of their destination.

In Champlain Realty Co. v. Town of Brattleboro, 260 US 366, 376, 43 S. Ct. 146 (1922), the Court similary observed:

> The interstate commerce clause of the Constitution does not give immunity to movable property from local taxation which is not discriminative, unless it is in actual continuous transit in interstate commerce. When it is shipped by a common carrier from one State to another, in the course of such an uninterrupted journey it is clearly immune.

In Minnesota v. Blasius, 290 US 1, 9, 54 S. Ct. 34 (1933), the Court likewise stated:

> Thus, the States cannot tax interstate commerce, either by laying the tax upon the business which constitutes such commerce or the privilege of engaging in it, or upon the receipts, as such, derived from it. Similarly, the States may not tax property in transit in interstate commerce.

on interstate commerce. Under the multiple taxation doctrine, the Commerce Clause prohibits only those state taxes that discriminate against interstate or foreign commerce, or that subject it to risks of multiple state taxation to which intrastate commerce is not exposed.[24] Moreover, in the 1970s, the Court explicitly repudiated the view that taxes imposed "directly" on interstate commerce violate the Commerce Clause.[25] As a consequence, earlier decisions that invalidated state taxes levied on goods in the stream of commerce, or on activities deemed to constitute the conduct of interstate commerce, on the theory that they were "direct" taxes on interstate commerce may no longer be good law and must be reevaluated in the light of the Court's current approach to the Commerce Clause.[26] In particular, one must now take account of the Court's decision in *DH Holmes Co. v. McNamara*,[27] which declared that it was "largely irrelevant," for Commerce Clause purposes whether goods were in the "stream of interstate commerce."[28]

Despite the "irrelevance" of the stream-of-commerce cases under the Court's existing Commerce Clause doctrine, they are briefly discussed below for several reasons. First, the question whether goods are in the stream of commerce may continue to be relevant under other constitutional provisions, specifically, the Import-Export Clause.[29] Second, the stream-of-commerce cases can be instructive with regard to the construction of the statutory exemptions for goods in "interstate commerce" that many states have adopted in their personal property and sales tax statutes.[30] Third, the cases retain their historical significance in the development of the Court's Commerce Clause jurisprudence.

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[24] See infra ¶ 4.08.

[25] See infra ¶¶ 4.10[2], ¶ 4.11.

[26] For a discussion of this point, see infra ¶ 4.12.

[27] DH Holmes Co. v. McNamara, 486 US 24, 108 S. Ct. 1619 (1988).

[28] *Holmes*, 486 US 24, 31, 108 S. Ct. 1619 (1988). The *Holmes* case is considered further infra ¶ 4.11[1] and in ¶ 16.03[3][a][ii]. Cf. Central Transp., Inc. v. Tracy, 72 Ohio St. 3d 296, 649 NE2d 1210 (1995) (sustaining use tax on goods moving in interstate commerce through Ohio transportation facility and observing that "since *Complete Auto Transit* was decided 'we have not needed to consider whether the property "came to rest" in Ohio.'").

[29] See Chapter 5.

[30] See, e.g., American Steamship Co. v. Limbach, 61 Ohio St. 3d 22, 572 NE2d 629 (1991) (relying on Coe v. Errol, 116 US 517, 6 S. Ct. 475 (1886) (discussed infra ¶ 4.02[2]), in concluding that lease payments for vessel used solely to ferry out-of-state goods from a transfer facility in Ohio to their final destination in Ohio were exempt from taxation under statute); cf. Mobile Marine Radio, Inc. v. City of Mobile, 699 So. 2d 1279 (Ala. Ct. Civ. App. 1997) (concluding that company operating ship-to-shore radio station, which relayed messages between ships in Gulf of Mexico and sites throughout the United States, was exempt from city license taxes insofar as its receipts were derived from "interstate commerce").

[2] Stream of Commerce

Coe v. Errol[31] was the seminal case delineating the contours of "the stream of commerce." In that case, the town of Errol, New Hampshire, assessed a property tax upon spruce logs lying in a stream along the town's banks on tax day, April 1. The logs were being held for transportation (by floating) down the Androscoggin River to Maine. Many of the logs had been cut in New Hampshire during the preceding winter, but one lot of logs had been cut in Maine and floated to Errol en route to another destination in Maine. All the logs assessed were being held in Errol by low water. The New Hampshire court abated the tax on the logs that had been cut in Maine, but sustained the tax on the logs that had been cut in New Hampshire, and the U.S. Supreme Court affirmed. The Court has summarized the holding in *Coe* as follows:

> Writing for the Court, Mr. Justice Bradley viewed "the precise question for solution" as follows:
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> > "Do the owner's state of mind in relation to the goods, that is, his intent to export them, and his partial preparation to do so, exempt them from taxation?"
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> > That question was answered in the negative. Recognizing that its task was to set a "point of time when state jurisdiction over the commodities of commerce begins and ends," the Court concluded that
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> > > " such goods do not cease to be part of the general mass of property in the State, subject, as such, to its jurisdiction, and to taxation in the usual way, ***until they have been shipped, or entered with a common carrier for transportation to another State, or have been started upon such transportation in a continuous route or journey.***" (emphasis added).
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> Since the logs in *Coe* had not begun a "final movement for transportation from the State of their origin to that of their destination," the Court held that the Constitution provided no immunity from local taxation.[32]

The Court has applied these principles to a wide variety of cases involving the validity of state taxes, not only under the Commerce Clause but also under the Import-Export Clause, since the Court has applied similar guidelines in determining whether goods are in the stream of commerce under the Commerce Clause and whether goods are in export transit under the Import-Export Clause.[33] For example, the Court considered whether property had entered the export stream in a case involving a California property tax imposed on the portions of a cement plant that had been partially dismantled and crated for ex-

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[31] Coe v. Errol, 116 US 517, 6 S. Ct. 475 (1886).

[32] Kosydar v. National Cash Register Co., 417 US 62, 66–67, 94 S. Ct. 2108 (1974) (quoting *Coe*, 116 US 517, 525–527, 6 S. Ct. 475 (1886)) (citations omitted).

[33] See cases cited supra ¶¶ 4.02[1] and in ¶ 5.01 et seq., in which the Court cites the cases arising under the two constitutional provisions interchangeably.

port. The former owner of the plant had sold it to a Colombian corporation for dismantling and shipment to Latin America, and 12 percent of the plant had already been shipped before tax day. The purchaser had obtained an export license for the plant, and the Court recognized that any diversion of the dismantled plant into the domestic market "would entail a breach of contract."[34] Nevertheless, the Court held that the dismantled, crated property had not yet "started on its journey on the tax date. . . . [T]he expectation on the tax date that exportation of the entire plant would eventuate . . . no matter how bright, does not start the process of exportation. On the tax date the movement to foreign shores had neither started nor been committed."[35]

If the term "committed," as used in the Court's opinion, means that the goods have been delivered to a carrier, this interpretation of the commencement of export, and similarly of interstate commerce, makes good sense. As stated by Justice Stewart:

> It may be said that insistence upon an actual movement into the stream of export in the case at hand represents an overly wooden or mechanistic application of the *Coe* doctrine. This is an instance, however, where we believe that simplicity has its virtues. The Court recognized long ago that even if it is not an easy matter to set down a rule determining the moment in time when articles obtain the protection of the Import-Export Clause, "it is highly important, both to the shipper and to the State, that it should be clearly defined so as to avoid all ambiguity or question." *Coe*, 116 U.S. at 526. . . .
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> . . . Our prior cases have determined that the protections of the Import-Export Clause are not available until the article at issue begins its physical entry into the stream of exportation. We find no reason to depart from that settled doctrine.[36]

¶ 4.03 INTERRUPTION OF INTERSTATE COMMERCE

Interruption of an interstate journey that has already begun will not take the goods out of the stream of commerce if (as was true with the logs held not to

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[34] Empresa Sidercurgica, SA v. County of Merced, 337 US 154, 157, 69 S. Ct. 995 (1949).

[35] *Empresa*, 337 US 154, 157, 69 S. Ct. 995 (1949). The Court articulated the governing rule as follows: "It is the entrance of the articles into the export stream that marks the start of the process of exportation. Then there is certainty that the goods are headed for their foreign destination and will not be diverted to domestic use. Nothing less will suffice." *Empresa*, 337 US 154, 157, 69 S. Ct. 995 (1949). See also Connell Rice & Sugar Co. v. County of Yolo, 569 F2d 514 (9th Cir. 1978).

[36] Kosydar v. National Cash Register Co., 417 US 62, 71, 94 S. Ct. 2108 (1974).

be taxable in *Coe*[37]) they are detained for a time in the state on account of such factors as low water.[38] The Court reached the same conclusion in a later New Hampshire case in which logs were cut in Vermont and placed in a stream there on their journey to the owner's mill in New Hampshire. A boom in the Connecticut River had held up the logs in Vermont for about a week until floodwaters subsided. The Court held that the Vermont town could not tax the logs, since the interstate journey had been interrupted not for the owner's benefit, but only to promote safe or convenient transit.[39]

The result is different if transit is interrupted to serve the nontransportation purposes of the owner. This principle is exemplified by a case in which a taxpayer purchased grain in transit from western states to the Northeast. In Chicago, the grain was unloaded from freight cars into the owner's elevator. While the grain was being inspected, weighed, and mixed before being reloaded onto the freight cars for continuing the journey, Illinois subjected it to property tax. The Supreme Court sustained the levy. The fact that the owner had shipped the grain at a through rate, under which it had a right to unload and reload at Chicago, did not alter the result, since the owner was holding the property in Chicago for his own purposes and with full power of disposition.[40]

The Court confronted a closer case involving a nonproperty tax on the storage of goods at an intermediate point in transportation in *Independent Warehouses, Inc. v. Scheele*.[41] The township of Saddle River, New Jersey, levied a license tax on the storage of goods for hire at the rate of three fourths of one cent per square foot of ground space utilized. The taxpayer operated a coal storage depot in the township as a public service facility for shippers of coal on the Erie Railroad. Shippers used the storage depot in connection with coal shipments from various points in Pennsylvania and elsewhere on the Erie line. Most of the coal was destined for the New York City market. As the coal came into Saddle River on railroad cars, it was unloaded and held in stockpiles until needed in the New York market. It was then loaded onto barges and transported across the Hudson River for delivery in New York. The Erie Rail-

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[37] Coe v. Errol, 116 US 517, 525, 6 S. Ct. 475 (1886).

[38] *Coe*, 116 US 517, 6 S. Ct. 475 (1886).

[39] Champlain Realty Co. v. Town of Brattleboro, 260 US 366, 43 S. Ct. 146 (1922).

[40] Bacon v. Illinois, 227 US 504, 516, 33 S. Ct. 299 (1913); see also Susquehanna Coal Co. v. South Amboy, 228 US 665, 33 S. Ct. 712 (1913); American Steel & Wire Co. v. Speed, 192 US 500, 24 S. Ct. 365 (1904). General Oil Co. v. Crain, 209 US 211, 28 S. Ct. 475 (1908), also falls into this category. There, the taxpayer shipped oil from Ohio and Pennsylvania in tank cars and transferred the oil in Tennessee into barrels or vessels of various sizes for delivery to the customers in other states. The Court found that the break in transit was not a "necessary delay or accommodation to the means of transportation, . . . but for the business purposes and profit of the company." *General Oil*, 209 US 211, 230–231, 28 S. Ct. 475 (1908). Accordingly, the Court held that the oil was taxable.

[41] Independent Warehouses, Inc. v. Scheele, 331 US 70, 67 S. Ct. 1062 (1947).

road provided the Saddle River storage facility to its customers without charge. The railroad also bore the consequent losses that Independent Warehouses suffered in its operations. Shippers of coal obtained the benefit of through railroad rates from the mines to the final destination of the coal in New York City, or elsewhere, as long as the coal did not remain at the storage depot more than two years.

The taxpayer assailed the tax under the Commerce Clause on the ground that the warehouse operated solely in interstate transportation. The Court held that the coal came to rest at the storage warehouse, subject to the control and direction of the shipper, and that the reshipment to out-of-state points constituted a new journey, despite the granting of through rates by the Interstate Commerce Commission. The warehouse was therefore conducting an intrastate activity subject to tax. Justice Jackson wrote a dissenting opinion, contending that the "whole operation is incidental to interstate transportation and not to any local business."[42] He declared:

> The unedifying story of Colonial rivalry in preying upon commerce, which more than any one thing made our Federal Constitution a necessity, is too often told by historians to justify repetition. This tax is reminiscent, however, of some phases of that commercial warfare. In 1787 New York was being supplied with firewood from Connecticut and much farm produce from New Jersey. It seized upon "local incidents" to lay a tax. Every sloop which came down through Hell Gate, every cart of firewood entering the city, and every market boat rowed across the Hudson River had to pay heavy entrance duties. Then came retaliatory measures. See Fiske, The Critical Period of American History, Chap. IV. These chronic quarrels were destroying the trade of all the rivals, and it was sought by the Constitution to free trade from local burdens and controls.
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> This New Jersey tax on transportation of New York's coal supply is more dangerous in the end than the old New York tax on its own firewood. In that case the consumers who ultimately would pay the tax also controlled the government which shortsightedly laid the tax. It was a tariff, and the tariff-ridden people could remove it.[43]

Because the New Jersey case, unlike the Illinois grain case, involved storage without processing, the tax is more difficult to justify. Nevertheless, the result appears warranted because Saddle River served the purpose normally served by the owner's warehouse in the area of its market, where it stored coal for as long as two years before delivery to customers. The entire arrangement was attributable to the fact that New York City is an island, where storage

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[42] *Independent Warehouses*, 331 US 70, 94, 67 S. Ct. 1062 (1947) (Jackson, J., dissenting).

[43] *Independent Warehouses*, 331 US 70, 94, 67 S. Ct. 1062 (1947) (Jackson, J., dissenting).

space is prohibitively expensive. Hence, the Court could fairly conclude that the interstate journey had ended at Saddle River, that New Jersey was entitled to tax the use of its territory as storage grounds, and that Justice Jackson's analogy of firewood shipped from Connecticut to New York was inapposite.

Determining whether the storage terminates the journey has proved particularly troublesome in cases in which taxpayers ship goods from internal points in the country to ports where they hold them without processing for foreign shipment. In a 1929 case,[44] the taxpayer purchased oil in the interior states and shipped it by rail in tank cars to a port in Louisiana. The taxpayer then pumped the oil into storage tanks owned by a subsidiary and, as required, loaded the oil from the storage tanks aboard tankers for shipment to foreign countries. Adopting the "liberal construction" that, according to the Court, it had been applying to continuity-of-journey cases in which "export trade has been actually intended and carried through,"[45] the Court enjoined the assessment of an ad valorem property tax on the oil in the storage tanks. In its more recent decisions, however, the Court has eschewed such a "liberal construction" of continuity of journey. The intention to export, followed by actual export of the goods stored, does not suffice. Rather the test is whether the goods have physically entered the stream of commerce or exportation.[46]

The guidelines as to what constitutes a break in an interstate or foreign journey that the courts have developed in the preceding cases indicate that the mere detention of goods for the normal period of delay, at an intermediate point in an intended interstate or foreign journey at a facility that is not owned or operated by the owner of the goods, will not break the stream of interstate or foreign commerce. If a shipper uses a port, rail, or airline terminal only to load goods from the incoming transport directly to the outgoing transport (e.g., when it pumps oil from railroad tank cars into a tanker vessel), one may fairly regard such use as an incident to the transportation. The normal delay of the tank cars while awaiting the arrival of the vessel should not be treated as an interruption of the journey that would warrant the imposition of an ad valorem property tax. Similarly, if a shipper unloads goods from the incoming transport vehicle into shipping containers and reloads the containers onto the vessel or airplane for shipment to another state or foreign country, such operations would appear to be part of the transportation and not a storage function. Consequently, the normal period of detention of the goods at the port or terminal for such purposes should not be regarded as a break in the stream of domestic

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[44] Carson Petroleum Co. v. Vial, 279 US 95, 49 S. Ct. 292 (1929).

[45] *Carson Petroleum*, 279 US 95, 105–106, 49 S. Ct. 292 (1929).

[46] See Kosydar v. National Cash Register Co., 417 US 62, 94 S. Ct. 2108 (1974); Empresa Sidercurgica, SA v. County of Merced, 337 US 154, 69 S. Ct. 995 (1949). See also Connell Rice & Sugar Co. v. County of Yolo, 569 F2d 514 (9th Cir. 1978).

or foreign commerce.[47] However, under any of the following conditions, one may reasonably conclude under the Court's decisions that the owner has interrupted the goods' journey and that they are therefore subject to state or local property taxes:

- The owner processes the goods at an intermediate point (e.g., mills or grades grain);
- The owner uses the goods for a nontransportation purpose; or
- The owner of oil in an incoming tank car or grain in an incoming freight car unloads the goods into storage tanks or grain elevators and holds them there until they can be loaded onto the incoming vessel.

These rules draw a reasonable and practicable line between interruptions that break a journey and those that do not. They appear to make an acceptable accommodation of (1) the interest of state and local governments in levying property taxes on the goods that benefit from their services and protection, (2) the interest of the shipper in being free of taxes of governments that provide no benefits or protection, and (3) the interest of the federal government in maintaining a national economy and facilitating international trade. These rules are supplemented by decisions, under the Commerce and Import-Export Clauses, prohibiting discriminatory taxation of interstate or foreign commerce and of imports.[48]

¶ 4.04 TAXES ON ACTS OR EVENTS PRECEDING COMMERCE OR OCCURRING AFTER IT HAS ENDED

[1] Taxes on Mining, Manufacturing, or Producing Goods in a State

Many Commerce Clause challenges to state taxes concern levies that the states successfully defended on the ground that the taxable event took place before interstate commerce commenced or after it terminated. Thus, there is a line of cases holding that taxes imposed on mining, manufacturing, publishing, and other activities fall on intrastate commerce, even though the product produced in the state is substantially or largely intended for sale outside the state and is,

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[47] Japan Line, Ltd. v. County of Los Angeles, 441 US 434, 99 S. Ct. 1813 (1979), is not inconsistent with this view. *Japan Line* concerned the taxation of shipping containers and not the goods being shipped, and it presented other issues, including the existence of an international customs convention that effectively assigned the taxable property to the owner's domicile. See infra ¶ 4.19 for a detailed discussion of *Japan Line*.

[48] See infra ¶ 4.13 and Chapter 5.

in fact, sold in other states. For example, in sustaining an occupation tax of 6 percent of the value of ore mined in the state, despite the fact that most of the ore was sold to customers in other states, the Court said:

> Mining is not interstate commerce, but, like manufacturing, is a local business subject to local regulation and taxation. . . .
>
> . . . The tax may indirectly and incidentally affect such commerce, just as any taxation of railroad and telegraph lines does, but this is not a forbidden burden or interference.[49]

The Court applied this principle in sustaining a St. Louis license tax on manufacturers, measured by the selling prices of the goods manufactured in the city, including goods sold in interstate commerce.[50] The Court declared that the "city might have measured such a tax by a percentage upon the value of all the goods manufactured," but in "order to mitigate the burden . . . it has postponed ascertainment and payment of the tax until the manufacturer can bring the goods into market."[51] The Court found that the levy imposed:

> no direct burden on commerce in the goods manufactured, whether domestic or interstate, and only the same kind of incidental and indirect effect as that which results from the payment of property taxes or any other and general contribution to the cost of government. Therefore, it does not amount to a regulation of interstate commerce.[52]

Similarly, the Court held that a tax on the production of a magazine in a state is a levy on intrastate commerce, even though the tax was measured by the receipts from advertising contracts made outside the state for advertisements designed to reach out-of-state readers.[53]

By contrast, the Court has historically treated the solicitation of orders in a state for the sale and shipment of goods there as interstate commerce.[54] It has also held that a state may not impose a gross receipts tax on the receipts from sales of goods for delivery to out-of-state customers, even if the goods were

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[49] Oliver Iron Mining Co. v. Lord, 262 US 172, 178–179, 43 S. Ct. 526 (1923). Accord, Hope Natural Gas Co. v. Hall, 274 US 284, 47 S. Ct. 639 (1927). In Commonwealth Edison Co. v. Montana, 453 US 609, 101 S. Ct. 2946 (1981), the Court repudiated the view that state severance taxes are insulated from Commerce Clause scrutiny on the theory that they were imposed on goods prior to their entry into the stream of commerce. See infra ¶ 4.17.

[50] American Mfg. Co. v. St. Louis, 250 US 459, 39 S. Ct. 522 (1919).

[51] *American Mfg.*, 250 US 459, 463–464, 39 S. Ct. 522 (1919).

[52] *American Mfg.*, 250 US 459, 464, 39 S. Ct. 522 (1919).

[53] Western Live Stock v. Bureau of Revenue, 303 US 250, 58 S. Ct. 546 (1938).

[54] Memphis Steam Laundry Cleaner, Inc. v. Stone, 342 US 389, 72 S. Ct. 424 (1952); Cheney Bros. v. Massachusetts, 246 US 147, 38 S. Ct. 295 (1918).

manufactured in the state.[55] Since the same amount of tax could have been imposed on the same local manufacturer if the statute had been drawn as a levy on the conduct of manufacturing in the state, the power of the state to tax came to depend on highly formalistic distinctions between the subject and measure of the taxes.[56]

One must now reconsider these rulings, however, in light of the Court's decisions in the 1970s and 1980s overruling earlier cases holding that the states may not tax the conduct of an exclusively interstate business and that direct taxes on interstate commerce violate the Commerce Clause. Under the Court's contemporary Commerce Clause doctrine, neither direct gross receipts taxes levied by the manufacturing or producing state nor franchise taxes on interstate selling levied by the market states are per se invalid under the Commerce Clause.[57]

If gross receipts taxes are fairly apportioned among the various states in which the receipts are generated, there can be no serious quarrel with the results of the new Commerce Clause approach. However, when the cases sustaining taxes measured by unapportioned gross receipts from sales outside the state of products mined, manufactured, or produced in the state are coupled with more recent holdings that the same receipts may be included in full in the tax base of the state in which they are marketed,[58] the risks of duplicative taxation are unmistakable. The avoidance of that risk, as well as the fostering of sound fiscal policy, would appear to require an equitable apportionment of the receipts in both the producing and market states. Nevertheless, it is less clear than it should be whether the Court's current interpretation of the Commerce Clause or the Due Process Clause would compel either state to provide for such apportionment.[59]

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[55] Gwin, White & Prince, Inc. v. Henneford, 305 US 434, 59 S. Ct. 325 (1939); JD Adams Mfg. Co. v. Storen, 304 US 307, 58 S. Ct. 913 (1938); see also Freeman v. Hewit, 329 US 249, 67 S. Ct. 274 (1946).

[56] See Hellerstein, "State Franchise Taxation of Interstate Businesses," 4 Tax L. Rev. 95 (1948).

[57] See infra ¶ 4.08.

[58] Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 US 232, 107 S. Ct. 2810 (1987); Standard Pressed Steel Co. v. Department of Revenue, 419 US 560, 95 S. Ct. 706 (1975).

[59] See generally Hellerstein, et al., "Commerce Clause Restraints on State Taxation After *Jefferson Lines*," 51 Tax L. Rev. 47 (1995). The development of the Court's approaches to the Commerce Clause limitations on the states' powers of taxation, including the avoidance of multiple tax burdens by apportionment and otherwise, is considered at length in infra part B.

¶ 4.05 THE SUPREME COURT'S CONTEMPORARY VIEW OF THE SCOPE OF THE DORMANT COMMERCE CLAUSE

[1] Taxes Substantially Affecting Interstate Commerce

In its contemporary decisions, the Court has come to recognize that any tax that affects interstate commerce must be evaluated under the Court's substantive Commerce Clause criteria regardless of what once may have been regarded as the limitations on the definition of "commerce." In *Commonwealth Edison Co. v. Montana*,[60] the Court considered the constitutionality of Montana's 30 percent severance tax on coal that allegedly discriminated against interstate commerce because virtually all of the coal severed in Montana was destined for out-of-state consumption. The state court had held that the tax was not subject to Commerce Clause scrutiny because severance was "an intrastate activity preceding the entry of the coal into interstate commerce."[61]

In rejecting this approach, the Court observed that it had "long . . . rejected any suggestion that a state tax or regulation affecting interstate commerce is immune from Commerce Clause scrutiny because it attaches only to a 'local' or 'intrastate' activity."[62] Rather, the Court's goal "[i]n reviewing Commerce Clause challenges to state taxes . . . has instead been to 'establish a consistent and rational method of inquiry' focusing on 'the practical effect of a challenged tax,'"[63]—namely, the *Complete Auto*[64] test. Consequently, even though taxes may be levied on local activities that may not be regarded as interstate commerce, such taxes "may substantially affect interstate commerce, and this effect is within the proper focus of Commerce Clause inquiry."[65]

Given the broad scope of the Court's view of what "affects" commerce, it will be the rare case in which any serious claim can be made that a tax is immune from scrutiny under substantive Commerce Clause standards, as long as the property, activity, or enterprise on which the tax is imposed has some connection with interstate commerce. For example, the Court has sustained as a legitimate exercise of Congress's power to regulate interstate commerce (1) the amount of wheat a farmer can grow for his own consumption;[66] (2) discrimina-

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[60] Commonwealth Edison Co. v. Montana, 453 US 609, 101 S. Ct. 2946 (1981).

[61] *Commonwealth Edison*, 453 US 609, 613–614, 101 S. Ct. 2946 (1981).

[62] *Commonwealth Edison*, 453 US 609, 615, 101 S. Ct. 2946 (1981).

[63] *Commonwealth Edison*, 453 US 609, 615, 101 S. Ct. 2946 (1981).

[64] Complete Auto Transit, Inc. v. Brady, 430 US 274, 97 S. Ct. 1076 (1977). See infra ¶¶ 4.10[2], 4.11.

[65] Commonwealth Edison, 453 US 609, 616, 101 S. Ct. 2946 (1981).

[66] Wickard v. Filburn, 317 US 111, 63 S. Ct. 82 (1942).

tory practices in local hotels and restaurants;[67] and (3) local criminal activity.[68] It has also observed that "the same interstate attributes that establish Congress's power to regulate commerce also support constitutional limitations on the powers of the States,"[69] and that "the definition of 'commerce' is the same when relied on to strike down or restrict state legislation as when relied on to support some exertion of federal control or regulation."[70] To be sure, there may be some instances in which a tax is imposed on an activity so attenuated from the common understanding of "commerce" that it will not be subjected to Commerce Clause review.[71] In recent years, however, the threshold question of the application of the Commerce Clause to a state tax alleged to burden commerce has been more theoretical than real.[72]

[2] The *Camps Newfound* Case

The Court's 1997 decision in *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine*[73] illustrates the breadth of the Court's view of interstate commerce that is subject to scrutiny under the dormant Commerce Clause. In *Camps Newfound*, the Court rejected the argument that the Commerce Clause did not apply to the claim that a statute discriminated against interstate commerce by denying a property tax exemption to charitable institutions that were

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[67] Katzenbach v. McClung, 379 US 294, 85 S. Ct. 377 (1964); Heart of Atlanta Hotel v. United States, 379 US 241, 85 S. Ct. 348 (1964).

[68] Perez v. United States, 402 US 146, 91 S. Ct. 1357 (1971).

[69] Lewis v. BT Inv. Managers, Inc., 447 US 27, 39, 100 S. Ct. 2009 (1980).

[70] Hughes v. Oklahoma, 441 US 322, 326 n. 2, 99 S. Ct. 1727 (1979).

[71] See United States v. Lopez, 514 US 549, 115 S. Ct. 1624 (1995) (Congress lacks the power under the Commerce Clause to prohibit possession of firearms in school zones because possession of a gun in a local school zone does not affect interstate commerce).

[72] But see Tamagni v. State Tax Tribunal, 91 NY2d 530, 695 NE2d 1125, 673 NYS2d 44 (1998) (New Jersey domiciliary'sclaim that New York's definition of "residence" exposes him to double taxation in violation of the Commerce Clause does not involve interstate commerce and therefore is not cognizable under the Commerce Clause). Cf. Department of Revenue v. Orange Beach Marina, 699 So. 2d 1279 (Ala. Ct. Civ. App. 1997) (exemption for sales of diesel fuel for vessels engaged in interstate commerce does not apply to charter fishing boats and pleasure craft that cruised in interstate waters because the exemption is limited to boats that travel between an Alabama port and the port of another state); La Crosse Queen, Inc. v. Department of Revenue, 208 Wis. 2d 439, 561 NW2d 686 (1997) (recreational excursion boat that cruised over Wisconsin and Minnesota waters was not engaged in "interstate commerce" within meaning of sales and use tax exemption because boat is not being used for purpose of transportation across state lines but for recreation and entertainment).

[73] Camps Newfound/Owatonna, Inc. v. Town of Harrison, Me., 520 US 564, 117 S. Ct. 1590 (1997).

operated principally for persons who were not in-state residents.[74] The taxing authority contended that the denial of the exemption to a summer camp that served mostly residents of other states was not cognizable under the Commerce Clause because (1) campers are not "articles of commerce"; (2) the camp's product was delivered and consumed entirely in Maine; and (3) the controversy involved a real estate tax.

The Court observed that even though the camp did not make a profit, it was "unquestionably engaged in commerce, not only as a purchaser, but also as a provider of goods and services."[75] The Court noted that the camp marketed its services across the country and that "[t]he attendance of these campers necessarily generates the transportation of persons across state lines that has long been recognized as a form of 'commerce.'"[76] The Court analogized the summer camps to hotels that offer their guests goods and services that are consumed locally. The Court thus relied on *Heart of Atlanta Motel, Inc. v. United States*,[77] where it had recognized that "commerce was substantially affected by private race discrimination that limited access to the hotel and thereby impeded interstate commerce in the form of travel."[78] The Court found that discrimination limiting access of nonresidents to summer camps created a similar impediment.

Even though *Heart of Atlanta* involved the scope of *congressional* power to regulate interstate commerce under the Commerce Clause whereas *Camps Newfound* involved the "negative" Commerce Clause, the Court reiterated that its contemporary Commerce Clause jurisprudence treats these two inquiries the same.[79] In light of the Court's broad view of the definition of "interstate commerce" under the congressional regulatory cases, the Court had little difficulty concluding in *Camps Newfound* that the services that the camp provided to out-of-state campers "clearly have a substantial effect on commerce, as do state restrictions on making those services available to nonresidents."[80]

Finally, the Court rejected the taxing authority's claims that the dormant Commerce Clause was inapplicable because a real estate tax was at issue. "A tax on real estate, like any other tax, may impermissibly burden interstate commerce."[81] Moreover, "[t]o allow a State to avoid the strictures of the dormant Commerce Clause by the simple device of labeling its discriminatory tax a levy on real estate would destroy the barrier against protectionism that the

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[74] The substantive discrimination claim is discussed infra ¶ 4.13[2][h].

[75] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1596 (1997).

[76] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1596 (1997).

[77] Heart of Atlanta Motel, Inc. v. United States, 379 US 241, 85 S. Ct. 348 (1964).

[78] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1597 (1997).

[79] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1597 (1997).

[80] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1597 (1997).

[81] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1597 (1997).

Constitution provides."[82] In short, "if 'it is interstate commerce that feels the pinch, it does not matter how local the operation which applies the squeeze.'"[83] Under such circumstances (as in *Camps Newfound*), the Commerce Clause applies, and a tax must satisfy the clause's substantive criteria in order to satisfy constitutional strictures.

B. HISTORICAL DEVELOPMENT OF SUPREME COURT'S CHANGING APPROACHES TO STATE TAXATION UNDER THE COMMERCE CLAUSE

¶ 4.06 THE DOCTRINAL BACKGROUND

Although it was not until late in the nineteenth century that the U.S. Supreme Court held that the Commerce Clause, by its own force, circumscribed the authority of the states to tax interstate commerce, the essential groundwork for much of the subsequent doctrinal development was laid earlier. The evolution of this early Commerce Clause doctrine is familiar reading to students of constitutional law. The Commerce Clause by its terms is no more than an affirmative grant of power to Congress "to regulate Commerce with foreign nations, and among the several states, and with the Indian Tribes."[84] Nevertheless, Chief Justice Marshall elaborated the view that "became central to our whole constitutional scheme: the doctrine that the commerce clause, by its own force and without national legislation, puts it into the power of the Court to place limits upon state authority."[85] A countervailing theme was articulated by Marshall's successor, Chief Justice Taney. Taney rejected the proposition that the grant of power to Congress to regulate commerce contained within it any implied restrictions on the states.[86] The clause simply provided authority to Congress to act, and the Court's function was limited to invalidating state legislation in plain contravention of congressional enactments.[87]

From these competing approaches to the scope of the commerce power, there emerged a compromise in the celebrated case of *Cooley v. Board of*

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[82] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1597 (1997).

[83] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1597 (1997) (citations omitted).

[84] U.S. Const. art I, § 8, cl. 3.

[85] F. Frankfurter, The Commerce Clause Under Marshall, Taney and Waite 18–19 (1964).

[86] F. Frankfurter, The Commerce Clause Under Marshall, Taney and Waite 50 (1964).

[87] F. Frankfurter, The Commerce Clause Under Marshall, Taney and Waite 50 (1964).

Wardens,[88] in which, as Professor Laurence Tribe has put it, the "Supreme Court attempted to reconcile all that had gone before in a formulation that laid the groundwork for all that has come since."[89] In *Cooley*, the Court announced the doctrine that the Commerce Clause forbade the states from regulating those aspects of interstate and foreign commerce that were inherently national in character, and thus demanded a single uniform rule that only Congress could provide, but permitted them to regulate those aspects of such commerce that were so local as to demand diverse treatment.[90]

During this era, judicial pronouncements directed specifically at state taxation of interstate commerce occasionally surfaced in the Court's decisions. In Justice Marshall's seminal opinion in *Gibbons v. Ogden*,[91] there is language that might have been read to suggest that the scope of state taxing power, as contrasted with state regulatory power, was undiminished by the Commerce Clause.[92] Marshall soon indicated, however, that a state tax measure might interfere with interstate commerce and, to the extent it did, would be subject to strictures similar to those proscribing state regulatory measures infringing upon the national commerce power:

> [T]he taxing power of the States must have some limits. . . . It cannot interfere with any regulation of commerce. If the states may tax all persons and property found on their territory, what shall restrain them from taxing goods in their transit through the State from one port to another . . . or from taxing the transportation of articles passing from the State itself to another State, for commercial purposes? These cases are all within the sovereign power of taxation, but would obviously derange the measures of Congress to regulate commerce, and affect materially the purpose for which it was given.[93]

The Court did not, however, have any occasion to apply this doctrine to a state tax on interstate commerce during Marshall's tenure, which ended in 1835.

For nearly the next three decades, Chief Justice Taney, whose views of the relation of the Commerce Clause to state taxing power were diametrically opposed to those of Marshall,[94] presided over the Court. It was during this period that the Court struggled with and, in the *Cooley* case, finally settled upon a shared approach to the limitations that the Commerce Clause imposed on state authority. Yet the precise impact of these doctrinal developments on the

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[88] Cooley v. Board of Wardens, 53 US (12 How.) 299 (1851).

[89] L. H. Tribe, American Constitutional Law 406 (2d ed. 1988).

[90] *Cooley*, 53 US (12 How.) 299, 319 (1851).

[91] Gibbons v. Ogden, 22 US (9 Wheat.) 1 (1824).

[92] *Gibbons*, 22 US (9 Wheat.) 1, 198–199 (1824).

[93] Brown v. Maryland, 25 US (12 Wheat.) 419, 448–449 (1827).

[94] See, e.g., The Passenger Cases, 48 US (7 How.) 282, 481 (1849) (Taney, C.J., dissenting).

taxing powers of the states could only be hypothesized, since few cases involving state taxation of interstate business reached the Court during this period, and in deciding them the Court said little, if anything, with regard to the effect of the Commerce Clause on the issues raised.

¶ 4.07 THE FREE TRADE APPROACH TO THE COMMERCE CLAUSE

Beginning in the late 1860s, the Court confronted an increasing number of cases involving state taxes on interstate business, and it began to delineate the restraints imposed by the Commerce Clause on such levies. In striking down a fee of $5 demanded by the wardens of the port of New Orleans from every vessel entering the port, whether or not the wardens were called upon to perform any service, the Court in 1867 concluded that the tax amounted to an unconstitutional regulation of commerce, although it also relied on the Duty of Tonnage prohibition in striking down the levy.[95] In that same year, the Court invalidated a tax of $1 "upon every person leaving the state by any railroad, stage-coach or other vehicle engaged or employed in the business of transporting passengers for hire."[96] The Court acknowledged that the *Cooley* doctrine limited state tax powers, even though it declined to rest the decision on Commerce Clause grounds. A year later, the Court, in passing on the validity of a nondiscriminatory local sales tax levied upon out-of-state goods, observed that a stamp tax upon bills of lading for interstate transportation of commodities was an unconstitutional regulation of commerce,[97] and that the Commerce Clause by its "own force" would prevent the states from exercising their tax power so as to interfere with interstate commerce;[98] but this was mere dictum, since the Court upheld the sales tax actually under consideration.

It was the *Case of the State Freight Tax*[99] that first unequivocally announced and squarely applied the doctrine that the Commerce Clause by its own force limits state tax power over interstate commerce. In that case, Pennsylvania levied a tax at a specified rate per ton on all freight transported in the state, including freight originating in or destined for other states. In holding that the Commerce Clause rendered the levy unconstitutional, the Court's reasoning was straightforward: transportation of freight constitutes commerce;[100] a

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[95] Steamship v. Portwardens, 73 US (6 Wall.) 31 (1867).

[96] Crandall v. Nevada, 73 US (6 Wall.) 35, 36 (1867).

[97] Woodruff v. Parham, 75 US (8 Wall.) 123, 137–138 (1868).

[98] *Woodruff*, 75 US (8 Wall.) 123, 140 (1868).

[99] Case of the State Freight Tax, 82 US (15 Wall.) 232 (1872).

[100] Case of the State Freight Tax, 82 US (15 Wall.) 232, 275 (1872).

tax upon freight transported from one state to another is in effect a regulation of interstate commerce;[101] "whenever the subjects over which a power to regulate commerce is asserted are in their nature national . . . they may justly be said to be of such a nature as to require exclusive legislation by Congress";[102] and "transportation of passengers or merchandise through a State, or from one State to another, is of this nature."[103] Therefore "no State can impose a tax upon freight transported from State to State."[104] While the Court's opinion may, in retrospect, appear to be an inevitable outgrowth of all that preceded it, it was the *Case of the State Freight Tax* that explicitly established the analytical framework for deciding cases involving state taxation of interstate business for many years to come. The decision has aptly been characterized as "one of the most important ever made under the Commerce Clause."[105]

During the 1880s, the Court delineated the area of interstate commerce that the Commerce Clause protected from state taxation in broad terms. In invalidating a license tax on an interstate transportation company, the Court declared:

> [N]o State has the right to lay a tax on interstate commerce in any form, whether by way of duties laid on the transportation of the subjects of the commerce, or on the receipts derived from that transportation, or on the occupation or business of carrying it on, 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.[106]

The Court likewise applied these principles to interstate selling. In *Robbins v. Shelby County Taxing District*,[107] the Court determined that the "negotiation of sales of goods which are in another State, for the purpose of introducing them into the State in which the negotiation is made is interstate commerce."[108] It accordingly struck down a state tax on drummers and all persons not having a regular licensed place of business in the taxing district, who offered goods for sale by sample. The Court regarded it as "obvious" that regulation of "the selling of goods by samples and the employment of drummers for that purpose . . . should be based on a uniform system applicable to the

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[101] Case of the State Freight Tax, 82 US (15 Wall.) 232, 275–276, 279 (1872).

[102] Case of the State Freight Tax, 82 US (15 Wall.) 232, 279–280 (1872) (citing *Cooley*, 53 US (12 How.) 299 (1851)).

[103] Case of the State Freight Tax, 82 US (15 Wall.) 232, 280 (1872).

[104] Case of the State Freight Tax, 82 US (15 Wall.) 232, 281–282 (1872).

[105] J. Sholley, "The Negative Implications of the Commerce Clause," 3 U. Chi. L. Rev. 556 (1936).

[106] Leloup v. Port of Mobile, 127 US 640, 648, 8 S. Ct. 1380 (1888).

[107] Robbins v. Shelby County Taxing Dist., 120 US 489, 7 S. Ct. 592 (1887).

[108] *Robbins*, 120 US 489, 497, 7 S. Ct. 592 (1887).

whole country, and not left to the varied, discordant, or retaliatory enactments of forty different states."[109] That there was no discrimination in the levy as between interstate and intrastate commerce did not justify the tax on interstate commerce: "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."[110]

[1] Property Taxes on Instrumentalities of Interstate Commerce

Although the Court's decisions created a zone of state tax immunity for interstate business, the Court recognized from the outset that the Commerce Clause did not protect interstate commerce from all state taxes. "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."[111]

T. R. Powell, "Indirect Encroachment on Federal Authority by the Taxing Powers of the States," 32 Harv. L. Rev. 234, 236 (1919). In accordance with this view, the Court upheld property taxes on railroad lines and cars and other tangible property employed directly in interstate transportation.[112] In sustaining a property tax on an express company, the Court declared:

> Although the transportation of the subjects of interstate commerce, or the receipts received therefrom, or the occupation or business of carrying it on, cannot be directly subjected to state taxation, yet property belonging to corporations or companies engaged in such commerce may be; and

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[109] *Robbins*, 120 US 489, 498, 7 S. Ct. 592 (1887). Chief Justice Waite, joined by Justices Field and Gray, disagreed with this "obvious" conclusion. In their dissent, they emphasized that the tax was limited to persons who offer goods for sale by sample, and that it was nondiscriminatory as between residents and nonresidents, adding: "It will be time enough to consider whether a non-resident can be taxed for merely soliciting orders without having samples when such a case arises. That is not this case." *Robbins*, 120 US 489, 502, 7 S. Ct. 592 (1887). For a consideration of the views of other justices who adopted the view that the Commerce Clause invalidates only discriminatory state taxes, see infra ¶ 4.11[2].

[110] *Robbins*, 120 US 489, 497, 7 S. Ct. 592 (1887).

[111] The Delaware RR Tax, 85 US (18 Wall.) 206, 232 (1873) (quoting State Tax on Railway Gross Receipts, 82 US (15 Wall.) 284, 293 (1872)). Referring to the *Delaware Railroad Tax* case, Professor Thomas Reed Powell wrote: "From that day forward it has never been seriously doubted that a tax on tangible property used as an instrument of interstate commerce is not a tax on that commerce." T. R. Powell, "Indirect Encroachment on Federal Authority by the Taxing Powers of the States," 32 Harv. L. Rev. 234, 236 (1919).

[112] Adams Express Co. v. Ohio, 165 US 194, 17 S. Ct. 305 (1897) .

> whatever the particular form of the exaction, if it is essentially only property taxation, it will not be considered as falling within the inhibition of the Constitution. Corporations and companies engaged in interstate commerce should bear their proper proportion of the burdens of the governments under whose protection they conduct their operations, and taxation on property, collectible by the ordinary means, does not affect interstate commerce otherwise than incidentally, as all business is affected by the necessity of contributing to the support of government.[113]

The Court sanctioned the states' power to tax not only the physical property of the instrumentalities of interstate commerce, but also the portion of the going concern value attributable to the states.[114] Moreover, because of serious practical difficulties involved in valuing the state's segment of the fixed, moving, and intangible property of an interstate transportation company, the Court sustained gross receipts taxes levied in lieu of property taxes on instrumentalities of interstate commerce.[115]

[2] The Direct-Indirect Tax Test of Validity of Taxes Affecting Interstate Commerce

The Court gradually extended its position that interstate transportation "cannot be directly subjected to state taxation," but that taxation that "does not affect interstate commerce otherwise than incidentally" falls outside "the inhibition of the Constitution,"[116] beyond the context of ad valorem taxes on the instrumentalities of interstate commerce to other taxes and to other interstate enterprises. The Court developed the general doctrine that while direct taxes unduly burden interstate commerce and were, therefore, repugnant to the Commerce Clause,

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[113] *Adams*, 165 US 194, 220, 17 S. Ct. 305 (1897); see also Pullman's Palace Car Co. v. Pennsylvania, 141 US 18, 11 S. Ct. 876 (1891).

[114] *Pullman's Palace Car*, 141 US 18, 11 S. Ct. 876 (1891); see Norfolk & W. Ry. v. Missouri State Tax Comm'n, 390 US 317, 88 S. Ct. 995 (1968).

[115] Postal Tel. Cable Co. v. Adams, 155 US 688, 15 S. Ct. 268 (1895); Maine v. Grand Trunk Ry., 142 US 217, 12 S. Ct. 121 (1891). Where, however, the Court found that levies on interstate transportation or communication companies were imposed on "gross receipts" or on "the interstate business" and not in truth as "a just equivalent" for the "ordinary property tax," the Court struck them down. New Jersey Bell Tel. Co. v. State Bd. of Taxes & Assessments, 280 US 338, 50 S. Ct. 111 (1930); Galveston, H&SA Ry. v. Texas, 210 US 217, 28 S. Ct. 638 (1908) (tax imposed in addition to usual ad valorem property tax). The distinctions between the levies sustained and those invalidated were frequently based on formal language differences, with the Court according little consideration to the nature and effects of apportionment. Indeed, the Court declared that "we will not inquire into the exactitudes of the formula where appellant has not shown it to be so baseless as to violate due process." Railway Express Agency, Inc. v. Virginia, 358 US 434, 436, 79 S. Ct. 411 (1959).

[116] Adams Express Co. v. Ohio, 165 US 194, 220, 17 S. Ct. 305 (1897).

indirect taxes on commerce were valid. The direct-indirect tax distinction became an important criterion for determining the validity of a whole range of levies.

[a] Direct Taxes on Gross Receipts From Interstate Commerce

In 1872, during the same term in which it invalidated a tax on freight carried in interstate commerce,[117] the Court sustained the states' power to tax gross receipts from interstate transportation.[118] This nice distinction between a tax on goods transported between states and a tax on the gross receipts from such transportation was based on the rationale that the latter tax was not imposed on interstate commerce itself, but rather on the fruits of such commerce after it had ended. This highly refined reasoning did not survive long. The Court repudiated it fifteen years later in a case holding that the Commerce Clause barred a direct tax on gross receipts from interstate transportation.[119] In succeeding decades, the Court followed this decision in invalidating other gross receipts taxes on various aspects of interstate transportation and communication.[120]

In 1946, in *Freeman v. Hewit*,[121] the Court struck down a state tax on gross receipts derived from an interstate sale of securities. Justice Frankfurter, who wrote the majority opinion, was one of the most zealous of the Court's proponents of the view that the Commerce Clause "by its own force created an

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[117] See discussion of *Case of the State Freight Tax* supra ¶ 4.07.

[118] State Tax on Railway Gross Receipts, 82 US (15 Wall.) 284 (1872).

[119] Philadelphia & SMSS Co. v. Pennsylvania, 122 US 326, 7 S. Ct. 1118 (1887).

[120] See, e.g., Fisher's Blend Station, Inc. v. State Tax Comm'n, 297 US 650, 56 S. Ct. 608 (1936); Sonneborn Bros. v. Cureton, 262 US 506, 43 S. Ct. 643 (1923); Crew Levick Co. v. Pennsylvania, 245 US 292, 38 S. Ct. 126 (1917); Galveston, H&SA Ry. Co. v. Texas, 210 US 217, 28 S. Ct. 638 (1908); Western Union Tel. Co. v. Pennsylvania, 128 US 39, 9 S. Ct. 6 (1888); Fargo v. Michigan, 121 US 230, 7 S. Ct. 857 (1887). For an illuminating review of the cases, see W. Lockhart, "Gross Receipts Taxes on Interstate Transportation and Communication," 57 Harv. L. Rev. 40 (1943).

[121] Freeman v. Hewit, 329 US 249, 67 S. Ct. 274 (1946). The Court had invalidated gross receipts taxes on interstate sellers as early as 1887, see Robbins v. Shelby County Taxing Dist., 120 US 489, 7 S. Ct. 592 (1887), and, later, in a series of peddlers' or drummers' license tax cases. See J. Hellerstein & W. Hellerstein, State and Local Taxation: Cases and Materials 254–256 (6th ed. 1997); J. Hemphill, "The House to House Canvasser in Interstate Commerce," 60 Am. L. Rev. 641 (1928). As suggested in later opinions, the Court could have struck down the drummers' license taxes without relying on the principle that direct taxes on gross receipts from interstate commerce violate the Commerce Clause, because the drummers' license taxes discriminated against interstate commerce. See infra ¶ 4.13. Many of the taxes the Court invalidated were license or privilege taxes on doing business and, hence, were also vulnerable under the then-prevailing doctrine that no state may tax the privilege of conducting an exclusively interstate business. See infra ¶ 4.07[3].

area of trade free from interference by the State."[122] In his opinion in *Freeman* Justice Frankfurter declared that "a tax on gross receipts" is repugnant to the Commerce Clause because it is a "direct imposition on that very freedom of commercial flow which for more than a hundred and fifty years has been the ward of the Commerce Clause."[123] Such taxes, he stated, could not be sustained by a showing that they are applied without discrimination between interstate and intrastate commerce.

> So to argue is to disregard the life of the Commerce Clause. Of course a State is not required to give active advantage to interstate trade. But it cannot aim to control that trade even though it desires to control its own. It cannot justify what amounts to a levy upon the very process of commerce across States' lines by pointing to a similar hobble on its local trade. It is true that the existence of a tax on its local commerce detracts from the deterrent effect of a tax on interstate commerce to the extent that it removes the temptation to sell the goods locally. But the fact of such a tax, in any event, puts impediments upon the currents of commerce across the State line, while the aim of the Commerce Clause was precisely to prevent States from exacting toll from those engaged in national commerce.[124]

[b] Taxes on Intrastate Subjects Measured by Gross Receipts From Interstate Commerce

In applying the direct-indirect tax distinction, the Court adopted the view that levies on locally taxable activities, although measured by gross receipts from interstate commerce, constitute only indirect taxes on interstate commerce and therefore lie within the states' taxing power. In the leading case of *American Manufacturing Co. v. St. Louis*,[125] the Court considered a tax imposed on manufacturers as a condition to obtaining a license to carry on manufacturing within the city. The tax was measured by the entire gross receipts from sales of goods manufactured in the city, regardless of whether they were sold within or without the state. The taxpayer had sued to recover the tax paid on the receipts from sales of goods that the taxpayer manufactured in the city, moved

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[122] *Freeman*, 329 US 249, 252, 67 S. Ct. 274 (1946).

[123] *Freeman*, 329 US 249, 254, 67 S. Ct. 274 (1946). The majority of the Court had already largely rejected the Commerce Clause thinking reflected in Justice Frankfurter's opinion in *Freeman* by the time he delivered it, since the Court had by then embraced the multiple taxation doctrine. See Justice Rutledge's concurring opinion in the *Freeman* case, 329 US 249, 259–260, 67 S. Ct. 274 (1946).

[124] *Freeman*, 329 US 249, 254, 67 S. Ct. 274 (1946).

[125] American Mfg. Co. v. St. Louis, 250 US 459, 39 S. Ct. 522 (1919).

to warehouses outside the state, and then sold and delivered from the out-of-state warehouses to customers in states other than Missouri.

The Court began its analysis by stating, as the taxpayer had conceded, that there "is no doubt of the power of the State, or of the city acting under its authority, to impose a license tax in the nature of an excise upon the conduct of a manufacturing business in the city."[126] That power was not undercut by the city's postponement of the ascertainment and payment of the tax until the goods were sold, an action that the Court regarded as designed to mitigate the burden of the tax.[127] Nor did the use of the gross receipts measure run afoul of the Commerce Clause:

> In our opinion, the operation and effect of the taxing ordinance are to impose a legitimate burden upon the business of carrying on the manufacture of goods in the city; it produces no direct burden on commerce in the goods manufactured, whether domestic or interstate, and only the same kind of incidental and indirect effect as that which results from the payment of property taxes or any other and general contribution to the cost of government. Therefore, it does not amount to a regulation of interstate commerce.[128]

The Court relied on the same distinction between the subject and the measure of a tax—viewing a tax on a taxable subject as only "indirectly" affecting its measure—in upholding state severance taxes on the production or extraction of natural resources in the state, even though the taxes were measured by the value of the resources sold in interstate commerce.[129] It also relied on this distinction in sustaining a corporate franchise tax apportionment formula: The

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[126] *American Mfg.*, 250 US 459, 463, 39 S. Ct. 522 (1919).

[127] The opinion adverted to the possible difference in the value of the goods in St. Louis, after manufacturing but before storage and shipment elsewhere, and their value after storage and shipment. If the taxpayer had pressed the constitutional significance of this difference (i.e., the point that Missouri was taxing out-of-state value by including the out-of-state storage and shipping charges of the tax measure), it might have affected the outcome. See Hope Natural Gas Co. v. Hall, 274 US 284, 47 S. Ct. 639 (1927) (emphasizing importance of the fact that the tax measure was limited to in-state values).

[128] *American Mfg.*, 250 US 459, 464, 39 S. Ct. 522 (1919).

[129] Hope Natural Gas Co. v. Hall, 274 US 284, 47 S. Ct. 639 (1927); Oliver Iron Mining Co. v. Lord, 262 US 172, 43 S. Ct. 526 (1923); Heisler v. Thomas Colliery Co., 260 US 245, 43 S. Ct. 83 (1922). In *Hope*, the Court upheld a West Virginia business and occupation tax on the business of producing natural gas in the state, measured by the gross proceeds of the sale of the gas, including sales delivered to customers outside the state. Most of the gas was, in fact, sold in interstate commerce. To thwart challenges to the levy's constitutionality, the state court had limited the measure of the tax to the value of the natural gas at the wellhead before it had entered the stream of commerce. Hope Natural Gas Co. v. Hall, 102 W. Va. 272, 135 SE 582 (1926). For the Court's contemporary Commerce Clause doctrine as applied to severance taxes imposed on resources destined for out-of-state consumption, see infra ¶ 4.17.

Court found no constitutional bar to the inclusion in the state's sales factor numerator of receipts from interstate sales.[130] Even if the state could not tax those sales "directly," here the sales were merely employed to determine the measure of a tax imposed upon a local subject—the privilege of doing business in the state.

The competing principles the Court thus articulated—that a direct tax on gross receipts from interstate commerce is repugnant to the Commerce Clause, but that a tax on intrastate activities measured by gross receipts is valid—inevitably resulted in the drawing of close lines as to the nature of various levies, particularly those applied to activities involving the solicitation for, or sales of, goods in interstate commerce.[131]

[3] Taxes on Conduct of Exclusively Interstate Business

In the early stages of the development of its Commerce Clause doctrine, the Court struck down taxes on the privilege of conducting an exclusively interstate business in cases involving transportation and communication companies and other instrumentalities of the interstate commerce.[132] In *Gloucester Ferry Co. v. Pennsylvania*,[133] the Court invalidated a Pennsylvania capital stock tax on all domestic or foreign corporations "doing business . . . or having capital employed in this Commonwealth."[134] The ferry company, a New Jersey corporation, whose boats were registered in that state, was engaged in carrying passengers and freight across the Delaware River between New Jersey and Pennsylvania. The company conducted no other business in Pennsylvania, and

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[130] International Harvester Co. v. Evatt, 329 US 416, 67 S. Ct. 444 (1947).

[131] For the divergent results in the cases over the years as to the validity of taxes measured by gross receipts that were imposed on locally based commission agents who solicited orders for interstate sales of the goods of their principals, compare Ficklen v. Shelby County Taxing Dist., 145 US 1, 12 S. Ct. 810 (1892) with Gwin, White & Prince, Inc. v. Henneford, 305 US 434, 59 S. Ct. 325 (1939). As Professor Powell put the matter in 1918: "There is no dispute that gross receipts from interstate commerce are not taxable directly as such. . . . Our task is to discover what coating is necessary to make it palatable." T.R. Powell, "Indirect Encroachment on Federal Authority by the Taxing Powers of the States," 32 Harv. L. Rev. 374, 377 (1918).

[132] Western Union Tel. Co. v. Kansas, 216 US 1, 30 S. Ct. 190 (1910); Leloup v. Port of Mobile, 127 US 640, 8 S. Ct. 1380 (1888); Pickard v. Pullman S. Car Co., 117 US 34, 6 S. Ct. 635 (1886); Gloucester Ferry Co. v. Pennsylvania, 114 US 196, 5 S. Ct. 826 (1885). A number of the taxes the Court invalidated were imposed as a condition to doing business in the state, and the Court relied in part on that feature of the levies in striking them down. See *Western Union*, 216 US 1, 30 S. Ct. 190 (1910); *Leloup*, 127 US 640, 8 S. Ct. 1380 (1888). However, the Court discarded this constitutional crutch in other cases where the payment of the tax was not made a condition precedent to the operations.

[133] Gloucester Ferry Co. v. Pennsylvania, 114 US 196, 5 S. Ct. 820 (1885).

[134] *Gloucester*, 114 US 196, 198, 5 S. Ct. 820 (1885).

it maintained no property in that state other than a slip in Philadelphia that it held under lease. Here, as in other cases decided during the last quarter of the nineteenth century, the Court regarded it as self-evident that regulation, including taxation, of "transportation of persons and property" between the states "is a subject of national character" requiring uniformity and accordingly, under *Cooley v. Board of Wardens*, was beyond the pale of state taxation.[135]

In some of its opinions, the Court justified the view that a state tax on the privilege of conducting an exclusively interstate business violates the Commerce Clause by reference to the postulate that a state may not keep a foreign corporation engaged solely in interstate commerce out of its territory.[136] To do so would impede the free movement of goods between the states, which the Commerce Clause was designed to safeguard. From this premise, it was an easy, although not a necessary, step to conclude that a state may not exact a tax as a condition precedent to a foreign corporation's entry into a state to do business.[137] When the issue arose as to whether a state, without exacting a tax or license fee as a condition to commencing business, could impose a general franchise tax—applicable to foreign and domestic corporations and to interstate and intrastate business alike—upon a foreign corporation doing an exclusively interstate business, the Court held that such a levy also violated the Commerce Clause.[138]

The Court extended the doctrine that state taxation of the privilege of conducting an exclusively interstate business violated the Commerce Clause beyond taxes imposed on the instrumentalities of interstate commerce to non-

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[135] The Court said:

> And it needs no argument to show that the commerce with foreign nations and between the States, which consists in the transportation of persons and property between them, is a subject of national character, and requires uniformity of regulation. Congress alone, therefore, can deal with such transportation; its non-action is a declaration that it shall remain free from burdens imposed by State legislation. Otherwise, there would be no protection against conflicting regulations of different States, each legislating in favor of its own citizens and products, and against those of other States. It was from apprehension of such conflicting and discriminating State legislation and to secure uniformity of regulation, that the power to regulate commerce with foreign nations and among the States was vested in Congress.

Gloucester, 114 US 196, 204, 5 S. Ct. 820 (1885).

[136] International Textbook Co. v. Pigg, 217 US 91, 30 S. Ct. 481 (1910); Crutcher v. Kentucky, 141 US 47, 11 S. Ct. 851 (1891).

[137] See, e.g., Western Union Tel. Co. v. Kansas, 216 US 1, 30 S. Ct. 190 (1910); Leloup v. Port of Mobile, 127 US 640, 8 S. Ct. 1380 (1888). For a treatment of the development of this doctrine, see A. Harding, Double Taxation of Property and Income 252 et seq. (1933); T.R. Powell, "Indirect Encroachment on Federal Authority by the Taxing Powers of the States," 31 Harv. L. Rev. 572, 721 (1918); T.R. Powell, "Contemporary Commerce Clause Controversies Over State Taxation," 76 U. Pa. L. Rev. 773, 958 (1928).

[138] Alpha Portland Cement Co. v. Massachusetts, 268 US 203, 45 S. Ct. 477 (1925); Cheney Bros. v. Massachusetts, 246 US 147, 38 S. Ct. 295 (1918).

discriminatory franchise taxes imposed on merchants and manufacturers selling goods across state lines.[139] Thus the Court held that a state could not subject a foreign corporation to a franchise tax measured by capital stock, where the corporation manufactured goods in one state from which it shipped the goods to customers in another state. The Court so held, even though the taxpayer maintained an in-state office with a display of samples and employed in-state solicitors who obtained orders for out-of-state acceptance and shipment.[140] As late as 1951, the Court reaffirmed the traditional doctrine, saying, "[t]here is not only reason but long established precedent for keeping the federal privilege of carrying on exclusively interstate commerce free from state taxation. To do so gives lateral support to one of the corner stones of our constitutional law—*McCulloch v. Maryland*."[141]

¶ 4.08 THE REPUDIATION OF TRADITIONAL RESTRICTIVE COMMERCE CLAUSE DOCTRINE BY THE ADOPTION OF THE MULTIPLE TAXATION DOCTRINE

The free trade philosophy that created a tax-free zone of immunity for interstate commerce dominated the Court's Commerce Clause jurisprudence from roughly the post–Civil War period to the eve of World War II. It spanned the era of the development of the infrastructure of the twentieth century U.S. economy, with the building of the canals and railroads and the opening of the Midwest and Far West to settlement and trade, the creation of the vast American breadbasket for the burgeoning domestic population and world markets, and the industrialization of the United States. This approach remained the essential

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[139] Cudahy Packing Co. v. Hinkle, 278 US 460, 49 S. Ct. 204 (1929); *Alpha Portland Cement*, 268 US 203, 45 S. Ct. 477 (1925); *Cheney Bros.*, 246 US 147, 38 S. Ct. 295 (1918); Looney v. Crane Co., 245 US 178, 38 S. Ct. 85 (1917); Robbins v. Shelby County Taxing Dist., 120 US 489, 7 S. Ct. 592 (1887).

[140] *Alpha Portland Cement*, 268 US 203, 45 S. Ct. 477 (1925); *Cheney Bros.*, 246 US 147, 38 S. Ct. 295 (1918).

[141] Spector Motor Serv., Inc. v. O'Connor, 340 US 602, 610, 71 S. Ct. 508 (1951). Justices Clark, Black, and Douglas dissented. Another quarter of a century was to elapse before a unanimous Court adopted the views of the dissent and overruled the *Spector* doctrine. See Complete Auto Transit, Inc. v. Brady, 430 US 274, 97 S. Ct. 1076 (1977). The trenchant pen of Thomas Reed Powell provides the most comprehensive critical analysis of the first fifty years of the Supreme Court's Commerce Clause tax decisions in his series of articles entitled "Indirect Encroachment on Federal Authority by the Taxing Powers of the State," 31 Harv. L. Rev. 572, 721, 932 (1918); 32 Harv. L. Rev. 234, 374, 634, 902 (1919). For other major studies of the history of the Commerce Clause tax decisions, see P. Hartman, Federal Limitations on State and Local Taxation (1981); J. Nowak et al., Treatise on Constitutional Law ch. 11 (1995).

Commerce Clause doctrine during World War I and the postwar period, in which the United States emerged as a leading economic, military, and political world power.

The Supreme Court's state taxation decisions under the Commerce Clause were consistent with the dominant economic and political ideology of the era. Its decisions that removed state tax "burdens" on interstate commerce were in line with the high priority that Americans accorded to business growth and its expansion across the land. The waves of trust busting and populist thinking that at times took hold in some parts of the country did not significantly alter these attitudes. To be sure, there were some interstitial deviations from the Court's fundamental approach to the Commerce Clause, and shadings crept into the decisions as Justices and times changed, so that not all the cases fit neatly into the general pattern. Withal, however, there was no basic departure during this period from the conventional wisdom as to Commerce Clause limitations on state taxing powers.

The wave of political liberalism that swept the United States from the first Roosevelt administration to the outbreak of World War II had a powerful impact on the Supreme Court. The period was marked by the Court's sympathetic reading of the Norris LaGuardia Act and the National Labor Relations Act, the emergence of a constitutional right of picketing and an increased respect for the civil rights of dissident groups, the sustaining of the constitutionality of the Public Utility Holding Company Act and the Wage-Hour Law, a growing deference to the determination of administrative agencies, and the development of the great milestones in a realistic interpretation of the federal income tax laws—the *Gregory*, *Clifford*, *Court Holding Company*, *Tower*, and *Lusthaus* cases.[142] In the field of state taxation, it was inevitable that the new realpolitik, the revaluation of the roles of big and small business in the U.S. economy, and the increasing reluctance of the Court to thwart the states in meeting economic conditions should result in broadening the states' power to tax business carried on across state lines. As a consequence, a new era opened in the tortuous history of state taxing power under the Commerce Clause.

[1] The Multiple Taxation Doctrine

In 1938, Justice Stone, the chief architect of the multiple taxation doctrine, handed down an opinion for the Court that deviated sharply from the traditional free trade approach to the Commerce Clause. In *Western Live Stock v.*

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[142] Gregory v. Helvering, 293 US 465, 55 S. Ct. 266 (1935); Helvering v. Clifford, 309 US 331, 60 S. Ct. 554 (1940); Comm'r v. Court Holding Co., 323 US 702, 65 S. Ct. 190 (1944); Comm'r v. Tower, 327 US 280, 66 S. Ct. 532 (1946); Lusthaus v. Comm'r, 327 US 293, 66 S. Ct. 539 (1946).

Bureau of Revenue,[143] New Mexico applied its tax on the privilege of engaging in specified business activities measured by the gross receipts from the business to a taxpayer's receipts from advertising in a magazine published in the state. The taxpayer published a monthly livestock journal that it prepared, edited, and printed in New Mexico, where its only place of business was located. The taxpayer distributed the journal in several other states by mail and other modes of transportation. The magazine carried advertising, some of which the taxpayer obtained from advertisers in other states through the taxpayer's solicitation in those states. The advertisers remitted payment for the advertising to the taxpayer's New Mexico office, and the taxpayer shipped advertising cuts, mats, information, and copy to its out-of-state advertisers.

The major issue in the case was whether the tax violated the Commerce Clause, in view of the fact that performance of the contracts with the publishers required distribution of the journal in a number of states. The Court rejected this challenge in part by relying on earlier cases in which it had held that the Commerce Clause does not bar state taxation of an in-state activity, such as manufacturing, if the tax is measured by the gross receipts from sales of the goods manufactured in the state, including those sold in other states.[144] The Court declared in *Western Live Stock* that the sales price of the goods in such cases is "no more than the measure of the value of the goods manufactured, and so an appropriate measure of the value of the privilege."[145] Such holdings, said the Court, "would seem decisive" of the validity of a tax on the receipts from advertising in the taxpayer's journal.[146]

The larger importance of the case, however, lay in the Court's enunciation of a broader ground on which its decision rested:

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[143] Western Live Stock v. Bureau of Revenue, 303 US 250, 58 S. Ct. 546 (1938).

[144] See American Mfg. Co. v. St. Louis, 250 US 459, 39 S. Ct. 522 (1919) (discussed in *Western Live Stock*, 303 US 250, 256–257, 58 S. Ct. 546 (1938)); *American Manufacturing* is discussed supra ¶ 4.07[2][b]. The taxpayer also contended that the advertising receipts were immune from tax under the Commerce Clause because the advertising contracts were formed by transactions across state lines and resulted in the transmission of advertising materials across state lines. The Court rejected this contention:

> That the mere formation of a contract between persons of different states is not within the protection of the commerce clause, at least, in the absence of Congressional action, unless the performance is within its protection, is a proposition no longer open to question. Hence it is unnecessary to consider the impact of the tax upon the advertising contracts except as it affects their performance, presently to be discussed. Nor is taxation of a local business or occupation which is separate and distinct from the transportation and intercourse which is interstate commerce forbidden merely because in the ordinary course such transportation or intercourse is induced or occasioned by the business.

Western Live Stock, 303 US 250, 253, 58 S. Ct. 546 (1938) (citations omitted).

[145] *Western Live Stock*, 303 US 240, 258, 58 S. Ct. 546 (1938).

[146] *Western Live Stock*, 303 US 250, 258, 58 S. Ct. 546 (1938).

> But we think that the tax assailed here finds support in reason, and in the practical needs of a taxing system which, under constitutional limitations, must accommodate itself to the double demand that interstate business shall pay its way, and that at the same time it shall not be burdened with cumulative exactions which are not similarly laid on local business.[147]

Justice Stone cited the decisions upholding the validity of various types of state taxes levied on interstate businesses—property, net income, and franchise taxes—and pointed out that they all "add to the expense of carrying on interstate commerce, and in that sense burden it; but they are not for that reason prohibited."[148] He then proceeded to reinterpret the rationale behind the decisions that had struck down state taxes measured by gross receipts:

> On the other hand, local taxes, measured by gross receipts from interstate commerce, have often been pronounced unconstitutional. The vice characteristic of those 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 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.[149]

The Court concluded that the New Mexico tax at issue did not put the publisher at risk of multiple taxation in view of the subject of the levy. Since the tax was imposed on the preparation and publication of the journal, which "occur in New Mexico and not elsewhere . . . ," no other state could tax them, even "without the Commerce Clause" (presumably because the Due Process Clause would prevent such a tax).[150]

During the same term, the Court struck down an unapportioned gross receipts tax imposed on a taxpayer conducting its manufacturing operations in the state, as applied to sales to out-of-state and foreign customers.[151] The tax was not framed as an "excise upon the privilege of producing or manufacturing within the state, measured by volume of production or the amount of sales,"[152] which the Court recognized would have been within the state's constitutional power. Instead it was "a privilege tax upon the receipt of gross in-

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[147] *Western Live Stock*, 303 US 250, 258, 58 S. Ct. 546 (1938).

[148] *Western Live Stock*, 303 US 250, 255, 58 S. Ct. 546 (1938).

[149] *Western Live Stock*, 303 US 250, 255–256, 58 S. Ct. 546 (1938) (citations omitted).

[150] *Western Live Stock*, 303 US 250, 260, 58 S. Ct. 546 (1938). Justices McReynolds and Butler dissented.

[151] JD Adams Mfg. Co. v. Storen, 304 US 307, 58 S. Ct. 913 (1938).

[152] *JD Adams*, 304 US 307, 310, 58 S. Ct. 913 (1938).

come," "a tax on gross receipts from commerce."[153] Speaking for the Court, Justice Roberts wrote:

> 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 those 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, and which the commerce clause forbids.[154]

Justice Rutledge, whose opinions refined and elaborated upon the multiple taxation doctrine, explicated this approach in his concurring opinion in a later case:

> The long history of this problem boils down in general statement to the formula that the states, by virtue of the force of the commerce clause, may not unduly burden interstate commerce. This resolves itself into various corollary formulations. One is that a state may not single out interstate commerce for special tax burden. Nor may it discriminate against interstate commerce and in favor of its local trade. Again, the state may not impose cumulative burdens upon interstate trade or commerce. Thus, the state may not impose certain taxes on interstate commerce, its incidents or instrumentalities, which are no more in amount or burden than it places on its local business, not because this of itself is discriminatory, cumulative or special or would violate due process, but because other states also may have the right constitutionally, apart from the commerce clause, to tax the same thing and either the actuality or the risk of their doing so makes the total burden cumulative, discriminatory or special.[155]

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[153] *JD Adams*, 304 US 307, 310–311, 58 S. Ct. 913 (1938).

[154] *JD Adams*, 304 US 307, 311, 58 S. Ct. 913 (1938).

[155] This quotation is from Justice Rutledge's opinion concurring in part and dissenting in part in the three companion cases of McLeod v. JE Dilworth Co., 322 US 327, 64 S. Ct. 1023 (1944), General Trading Co. v. State Tax Comm'n, 322 US 335, 64 S. Ct. 1028 (1944), and International Harvester Co. v. Department of Treasury, 322 US 340, 349, 358, 64 S. Ct. 1019 (1944). This opinion is one of the outstanding analyses of and contributions to the Supreme Court's Commerce and Due Process Clause jurisprudence bearing on state taxation. Justice Rutledge interpreted the holdings in the Court's cases as reflecting the judgment that interstate sales could be made taxable in consonance with the multiple taxation doctrine by restricting such taxes to the buyer's state. *International Harvester*, 322 US 340, 361, 64 S. Ct. 1019 (1944). The Court recently placed considerable reliance on Justice Rutledge's analysis in sustaining a state sales tax on the sale of a bus ticket for interstate transportation. See Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 US 175, 115 S. Ct. 1331 (1995). For analyses of the multiple taxation doctrine and its development, see E. Barrett, Jr., "State Taxation of Interstate Commerce, 'Direct Burdens,' 'Mul-

[a] Risk or Actuality of Multiple Taxation

In several cases,[156] the Court used language that some state courts had read to mean that the multiple taxation prohibition applies only if there is proof of *actual* duplicative taxation by more than one state.[157] Other opinions, however, used language indicating that the Commerce Clause bars taxes that create the *risk* of multiple taxation. Thus, in *Gwin, White & Prince, Inc. v. Henneford,* the Court stated:

> Here the tax, measured by the entire volume of the interstate commerce in which appellant participates, is not apportioned to its activities within the state. If Washington is free to exact such a tax, other states to which the commerce extends may, with equal right, lay a tax similarly measured for the privilege of conducting within their respective territorial limits the activities there which contribute to the service. The present tax, though nominally local, thus in its practical operation discriminates against interstate commerce, since it imposes upon it, merely because interstate commerce is being done, "*the risk of a multiple burden to which local commerce is not exposed.*"[158]

More recent decisions have put the matter to rest by reaffirming that the risk, and not just the actuality, of multiple taxation suffices to establish a constitutional violation. In *Mobil Oil Corp. v. Commissioner of Taxes,*[159] Mobil challenged Vermont's inclusion of foreign source dividends in its apportionable tax base under the Commerce Clause. Mobil contended, among other things, that there was a risk of multiple taxation on the ground that New York, the state of its commercial domicile, had the power to tax 100 percent of its dividends, and that Vermont's assertion of the right to tax an apportioned share of such dividends therefore exposed it to multiple taxation. Vermont

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tiple Burdens' or What Have You," 4 Vand. L. Rev. 496 (1951); A. Dunham, "Gross Receipts Taxes on Interstate Transactions," 47 Colum. L. Rev. 211 (1947).

[156] See Moorman Mfg. Co. v. Bair, 437 US 267, 276–277, 98 S. Ct. 2340 (1978); Standard Pressed Steel Co. v. Department of Revenue, 419 US 560, 563, 95 S. Ct. 706 (1975); General Motors Corp. v. Washington, 377 US 436, 449, 84 S. Ct. 1564 (1964); Northwestern States Portland Cement Co. v. Minnesota, 358 US 450, 462–463, 79 S. Ct. 357 (1959).

[157] For state court opinions adopting the test of actual, rather than potential, multiple taxation, see Great Lakes Pipe Line Co. v. Commissioner of Tax'n, 272 Minn. 403, 138 NW2d 612 (1965), appeal dismissed, 348 US 718, 86 S. Ct. 1886 (1966); New Mexico Newspapers, Inc. v. Bureau of Revenue, 82 NM 436, 483 P2d 317 (1971); Mobil Oil Corp. v. Commissioner of Taxes, 136 Vt. 545, 394 A2d 1147 (1978), aff'd on other grounds, 445 US 425, 100 S. Ct. 1223 (1980).

[158] Gwin, White & Price, Inv. v. Henneford, 305 US 434, 439, 59 S. Ct. 325 (1939) (emphasis supplied) (citation omitted).

[159] Mobil Oil Corp. v. Commissioner of Taxes, 445 US 425, 100 S. Ct. 1223 (1980). The case is treated in ¶ 8.08[2][a].

countered that there was no violation of the multiple taxation principle because the New York statute did not in fact tax such dividends. In rejecting Vermont's position and holding squarely that the Commerce Clause protects taxpayers against the risk, and not merely the actuality, of multiple taxation, the Court declared:

> Inasmuch as New York does not presently tax the dividends in question, actual multiple taxation is not demonstrated on this record. The Vermont courts placed some reliance on this fact, and much of the debate in this Court has aired the question whether an actual burden need be shown. We agree with Mobil that the constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy. But the absence of any existing duplicative tax does alter the nature of appellant's claim. Instead of seeking relief from a present tax burden, appellant seeks to establish a theoretical constitutional preference for one method of taxation over another.[160]

Cases applying the "internal consistency" doctrine have likewise articulated the view that a tax that exposes a multistate taxpayer to the risk of multiple taxation is invalid under the Commerce Clause.[161]

In holding that the Commerce Clause forbids the risk—not just the fact—of multiple taxation, the Court accorded the multiple taxation doctrine its proper scope. As Justice Frankfurter observed in an opinion addressed to the constitutionality of Indiana's gross receipts tax:

> It is suggested, however, that the validity of a gross sales tax should depend on whether another State has also sought to impose its burden on the transactions. If another State has taxed the same interstate transaction, the burdensome consequences to interstate trade are undeniable. But that, for the time being, only one State has taxed is irrelevant to the kind of freedom of trade which the Commerce Clause generated. The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment.[162]

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[160] *Mobil Oil*, 445 US 425, 444, 100 S. Ct. 1223 (1980) (citations omitted). See also Exxon Corp. v. Wisconsin Dep't of Revenue, 447 US 207, 100 S. Ct. 2109 (1980).

[161] American Trucking Ass'ns, Inc. v. Scheiner, 483 US 266, 107 S. Ct. 2829 (1987); Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 US 232, 107 S. Ct. 2810 (1987); Armco, Inc. v. Hardesty, 467 US 638, 104 S. Ct. 2620 (1984). The "internal consistency" doctrine is discussed infra ¶ 4.15[1].

[162] Freeman v. Hewit, 329 US 249, 256, 67 S. Ct. 274 (1946).

Justice Goldberg expressed a similar view: "Presumably, if there is to be a limitation on the taxing power of each of these states, that limitation surely cannot be on a first-come-first-tax basis."[163]

In resolving a controversy that arose under the Privileges and Immunities Clause, the Supreme Court also took the position that the scope of one state's taxing powers depends not on whether other states have in fact exercised their taxing powers, but rather on their power to do so. In *Austin v. New Hampshire*,[164] the Court held that a New Hampshire income tax that effectively fell only on nonresident commuters violated the Privileges and Immunities Clause. New Hampshire sought to defend the tax on the ground that it was tied to the credit that Maine and other neighboring states granted to their own residents for income taxes paid to other states. New Hampshire argued that "the only practical effect of the tax is to divert to New Hampshire tax revenues that would otherwise be paid to Maine, an effect entirely within Maine's power to terminate by repeal of its credit provision for income taxes paid to another state."[165] The Supreme Court, however, rejected the argument, declaring: "Nor . . . can the constitutionality of one State's statutes affecting nonresidents depend upon the present configuration of the statutes of another State."[166]

¶ 4.09 THE TEMPORARY REVERSION TO EARLIER DOCTRINE

Within eight years after the Court's enunciation of the multiple taxation doctrine in *Western Live Stock*,[167] a new majority led by Justice Frankfurter repudiated the doctrine.[168] In *Freeman v. Hewit*,[169] the Court held that Indiana's gross income tax could not be applied to the proceeds of a sale of securities made by a resident of Indiana through a local broker on the New York Stock Exchange. In so holding, the Court went out of its way to repudiate the multiple taxation doctrine and to reassert the direct-indirect test of taxation of interstate commerce. Justice Frankfurter declared that the Commerce Clause by its

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[163] General Motors Corp. v. Washington, 377 US 436, 458, 84 S. Ct. 1564 (1964) (Goldberg, J., dissenting).

[164] Austin v. New Hampshire, 420 US 656, 95 S. Ct. 1191 (1975).

[165] *Austin*, 420 US 656, 666, 95 S. Ct. 1191 (1975).

[166] *Austin*, 420 US 656, 668, 95 S. Ct. 1191 (1975).

[167] See discussion supra ¶ 4.08[1].

[168] Justice Frankfurter had never fully embraced the doctrine. As noted above, however, Justice Frankfurter was enamored of certain aspects of the doctrine that were consistent with his own "free trade" approach to the Commerce Clause. See supra ¶ 4.08[1][a] (supporting the "risk" rule of multiple taxation).

[169] Freeman v. Hewit, 329 US 249, 67 S. Ct. 274 (1946).

own force created an area of trade free from interference by the states; that a state cannot "justify what amounts to a levy on the very process of commerce across state lines by pointing to a similar hobble on its local trade"; and that "a tax on gross receipts" is a "direct imposition on that very freedom of commercial flow which for more than a hundred and fifty years has been the ward of the Commerce Clause."[170]

The partial restoration of the ancien régime reached its high-water mark in *Spector Motor Service, Inc. v. O'Connor*.[171] There, Connecticut had levied a tax on the privilege of doing business measured by net income allocated to the state. The taxpayer, a foreign corporation, operated an interstate trucking business with terminals and trucks in Connecticut. A strong opinion by the U.S. Court of Appeals for the Second Circuit had taken the position that the states have the power to impose a tax on the privilege of doing business measured by net income, where the measure of the tax is properly apportioned.[172] The Supreme Court held otherwise, concluding that the states are precluded from taxing the privilege of doing an exclusively interstate business, even by means of a nondiscriminatory, fairly apportioned net income tax.

¶ 4.10 THE NEW ASCENDANCY OF STATE TAXING POWERS: THE REPUDIATION OF TRADITIONAL RESTRICTIVE COMMERCE CLAUSE DOCTRINE

[1] The Validation of Direct Net Income Taxes on Exclusively Interstate Business: The *Northwestern* Decision

The reversion to the philosophy of Commerce Clause limitations on state taxing powers that created a tax-free haven for interstate commerce was short-lived. In 1959 in *Northwestern States Portland Cement Co. v. Minnesota*,[173] the Court undertook to clear up the "tangled underbrush of past cases" spawned by the 300-plus full-dress opinions it had handed down in state tax controversies arising under the Commerce Clause.[174] In *Northwestern*, the Court for the first time explicitly held that there is no Commerce Clause barrier to the imposition of a nondiscriminatory, fairly apportioned direct net income tax on a foreign corporation carrying on an exclusively interstate business within the taxing

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[170] *Freeman*, 329 US 249, 254, 256, 67 S. Ct. 274 (1946).

[171] Spector Motor Serv., Inc. v. O'Connor, 340 US 602, 71 S. Ct. 508 (1951).

[172] Spector Motor Serv., Inc. v. O'Connor, 181 F2d 150 (2d Cir. 1950).

[173] Northwestern States Portland Cement Co. v. Minnesota, 358 US 450, 79 S. Ct. 357 (1959).

[174] *Northwestern States*, 358 US 450, 457, 79 S. Ct. 357 (1959).

state. In upholding the net income tax on interstate commerce, the Court emphasized those factors that defined its modern Commerce Clause doctrine—namely, the requirement that there be a connection between the taxpayer and the taxing state, the absence of any discrimination in the state's taxing scheme, and the lack of "multiple taxation," which was assured if the tax was fairly apportioned.

The Court did not, however, explicitly repudiate its earlier doctrine. Rather it distinguished the *Spector* case as involving a tax on the privilege of doing business, albeit measured by net income, and cited that decision without disapproval. And it reaffirmed the principle that the Commerce Clause bars "privilege taxes based on the right to carry on business in the taxing State."[175]

The practical consequences of the Court's decision in *Northwestern* were far reaching. The corporation net income tax, whether imposed as the measure of a franchise tax (as in *Spector*) or as a direct corporate income tax (as in *Northwestern*), is the most widely used state corporation business tax in the country. A number of states promptly took steps to avoid the barrier of the *Spector* doctrine by replacing their franchise taxes on the privilege of doing business by direct net income taxes, or by adding to their franchise taxes a supplementary so-called second tier direct net income tax applicable only to corporations not subject to the franchise tax. The states used the same rates, methods of apportionment, and essentially the same tax base under both the franchise tax and the direct net income tax.[176]

[2] The Overruling of *Spector Motor Service, Inc. v. O'Connor*

Even prior to its decision in *Northwestern*, a series of Supreme Court opinions narrowly construing the scope of an exclusively interstate business had undermined the force of the doctrine that the Commerce Clause condemns taxes lev-

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[175] *Northwestern States*, 358 US 450, 458, 79 S. Ct. 357 (1959). Similarly, although the Court did not explicitly disavow the contrary views expressed in the *Freeman* opinion, it appeared to accept Justice Rutledge's view that the infirmity with the tax in that case was its unapportioned character.

[176] There is one important difference between the permissible measures of the two levies, and it derives from the intergovernmental immunity doctrine. Under that doctrine, the states are prohibited, in the absence of congressional consent, from imposing "direct" net income taxes on interest from U.S. government obligations. See 31 USC § 3124 (codifying the constitutional principle). There is no prohibition, however, on the inclusion of such interest in the measure of an "indirect" franchise tax. 31 USC § 3124; see generally Chapter 22. This difference in the allowable tax base has been a major reason for some states' retention of both a franchise tax and a direct net income tax, because retention of a franchise tax enables the states to reach income from U.S. obligations. On the other hand, there is no longer any significance to the distinction between a "direct" net income tax and an "indirect" franchise tax for Commerce Clause purposes, as the ensuing discussion reveals.

ied on the privilege of conducting an exclusively interstate business. Thus in *Memphis Natural Gas Co. v. Stone*,[177] a case involving a tax on an interstate pipeline, the Court accepted the "construction" given by the Mississippi Supreme Court to a tax imposed on "doing business" as a tax on the "local activities" of keeping in repair and otherwise maintaining the pipeline. On the basis of that dubious construction, the Court sustained the tax on the theory that it was not levied on the conduct of an interstate business, but was a tax on local activities not barred by the Commerce Clause.

In two cases, the Railway Express Agency challenged Virginia tax assessments measured by gross receipts from operations within the state. In the first case, the Supreme Court struck down the levy, which was an annual license tax "for the privilege of doing business in this State," as a prohibited franchise tax on the conduct of an exclusively interstate business.[178] Virginia thereupon revised the wording of its statute so as to impose a "franchise tax" on "intangible property," in the form of "going concern" value as measured by gross receipts. The Court sustained the levy in an opinion that recognized that "the use of magic words or labels" can be decisive as to the constitutionality of a tax.[179]

Moreover, following its decision in *Northwestern*, the Court continued to broaden the states' taxing powers by narrowly circumscribing the area of exclusively interstate selling. In several cases arising under the state of Washington's excise tax, the Court seized on activities traditionally treated as an integral part of interstate sales solicitation to hold that the taxpayer was engaged in intrastate commerce subject to privilege taxes.[180] Surprisingly, in the light of the then apparent continued vitality under the Commerce Clause of the direct-indirect tax distinction, the Court upheld the Washington privilege taxes even though they were measured by the unapportioned gross receipts from sales of goods delivered across state lines to in-state customers.

The Court's Commerce Clause jurisprudence reached a new peak in judicial casuistry in 1975 when the Court sustained a fairly apportioned Louisiana capital stock tax on an exclusively interstate pipeline in *Colonial Pipeline Co. v. Traigle*.[181] There, as in the Virginia cases, the state courts had invalidated the original statute, which imposed a tax on the privilege of carrying on or doing business in the state.[182] Thereupon, the legislature rephrased the statute as a levy on "the qualification to carry on or do business in this state or the actual

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[177] Memphis Natural Gas Co. v. Stone, 335 US 80, 68 S. Ct. 1475 (1948).

[178] Railway Express Agency v. Virginia, 347 US 359, 74 S. Ct. 558 (1954).

[179] Railway Express Agency v. Virginia, 358 US 434, 441, 79 S. Ct. 411 (1959).

[180] See Standard Pressed Steel Co. v. Department of Revenue, 419 US 560, 95 S. Ct. 706 (1975) and General Motors Corp. v. Washington, 377 US 436, 84 S. Ct. 1564 (1964).

[181] Colonial Pipeline Co. v. Traigle, 421 US 100, 95 S. Ct. 1538 (1975).

[182] Colonial Pipeline Co. v. Mouton, 228 So. 2d 718 (La. App. 1969), aff'd, 255 La. 474, 231 So. 2d 393 (1970).

doing of business within this state in a *corporate* form."[183] This time, both the state court and the U.S. Supreme Court upheld the tax on an interstate pipeline. The Supreme Court's opinion confined the *Spector* doctrine to the *reductio ad absurdum* that a tax on foreign corporations for the privilege of doing an exclusively interstate business in the state is repugnant to the Commerce Clause, whereas a tax on foreign corporations for the privilege of doing such a business in the state *in corporate form*—the only form in which corporations can do business—is permissible.

Two years after its decision in *Colonial Pipeline*, the Court took the final step in its retreat from the position that the privilege of doing interstate business is immune from state taxation: It repudiated the doctrine altogether, along with the philosophy underlying it. In *Complete Auto Transit, Inc. v. Brady*,[184] the Court confronted a tax imposed on the privilege of doing business as applied to a corporation engaged in interstate transportation services in the taxing state. The tax was measured by the corporation's gross receipts from such services. In upholding the levy, the Court took the direct and wholesome step of explicitly overruling the by-then impaired *Spector* doctrine. The Court concluded:

> Simply put, the *Spector* rule does not address the problems with which the Commerce Clause is concerned. Accordingly, we now reject the rule of *Spector Motor Service, Inc. v. O'Connor*, that a state tax on the "privilege of doing business" is *per se* unconstitutional when it is applied to interstate commerce, and that case is overruled.[185]

Instead, the Court noted that its recent decisions had relied on four criteria—which have since become known as the *Complete Auto* doctrine—as the guiding principles for determining the validity of a state tax affecting interstate commerce:

> These decisions . . . have sustained a tax against Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.[186]

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[183] La. Rev. Stat. Ann. § 47:601.A(1) (West 1990) (emphasis supplied).

[184] Complete Auto Transit, Inc. v. Brady, 430 US 274, 97 S. Ct. 1076 (1977).

[185] *Complete Auto*, 430 US 274, 288–289, 97 S. Ct. 1076 (1977).

[186] *Complete Auto*, 430 US 274, 279, 97 S. Ct. 1076 (1977).

¶ 4.11 THE SUPREME COURT'S CURRENT APPROACH TO STATE TAXES AFFECTING INTERSTATE COMMERCE

[1] Court's Articulation of and Continued Adherence to the *Complete Auto* Commerce Clause Test

As suggested above, the Court in *Complete Auto* did not merely overrule *Spector*, it also explicitly rejected the formalistic Commerce Clause doctrine that provided the foundation for the *Spector* rule. Thus, the Court repudiated the "underlying philosophy [of the *Spector* rule] that interstate commerce should enjoy a sort of 'free trade' immunity from state taxation."[187] The Court likewise disapproved *Freeman v. Hewit*'s "blanket prohibition against any state taxation imposed directly on an interstate transaction."[188] In so doing, the Court stressed those factors that were germane to the validity of a state tax under the Commerce Clause in light of the Court's contemporary Commerce Clause jurisprudence. At three separate points in its unanimous opinion, the Court referred to the following four criteria it regarded as controlling the determination of whether a state tax affecting interstate commerce is valid under the Commerce Clause:

1. The tax must be applied to an activity that has a substantial nexus with the state;
2. The tax must be fairly apportioned to activities carried on by the taxpayer in the state;
3. The tax must not discriminate against interstate commerce; and
4. The tax must be fairly related to services provided by the state.[189]

A year after it decided *Complete Auto*, the Court reiterated that case's four-part test in overruling two other long-standing decisions that had invalidated taxes on the privilege of doing business measured by the gross receipts from local stevedoring of ships that were engaged exclusively in interstate and foreign commerce.[190] The Court reaffirmed its position that the Commerce Clause does not bar state taxes merely because they are levied on the privilege of conducting an exclusively interstate business or because they constitute direct taxes on interstate commerce.

In 1988, in an opinion that again invoked *Complete Auto*'s four-part test, the Court, in sustaining a use tax on catalogs shipped directly from outside the

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[187] *Complete Auto*, 430 US 274, 278, 97 S. Ct. 1076 (1977).

[188] *Complete Auto*, 430 US 274, 280–281, 97 S. Ct. 1076 (1977).

[189] *Complete Auto*, 430 US 274, 277–279, 287, 97 S. Ct. 1076 (1977).

[190] Department of Revenue v. Association of Wash. Stevedoring Cos., 435 US 734, 98 S. Ct. 1388 (1978).

state to the taxpayer's customers in the state, repeated its view that goods or activities in interstate commerce may be subject to taxation:

> *Complete Auto* abandoned the abstract notion that interstate commerce "itself" cannot be taxed by the States. . . . Accordingly, in the present case, it really makes little difference for Commerce Clause purposes whether appellant's catalogs "came to rest" in the mailboxes of its Louisiana customers or whether they were still considered in the stream of interstate commerce. This distinction may be of some importance for other purposes . . . , but for Commerce Clause analysis it is largely irrelevant.[191]

Indeed, in virtually every Commerce Clause opinion it has rendered subsequent to *Complete Auto*, the Court has faithfully reiterated and adhered to the four-part test articulated in that opinion, a test the Court has characterized as a "consistent and rational method of inquiry" that looks to "the practical effect of a challenged tax" on interstate commerce.[192] In the Court's view, its contemporary Commerce Clause state tax jurisprudence is grounded in "economic realities,"[193] wedded to "pragmatism,"[194] disdainful of "formalism,"[195] and contemptuous of "magic words and labels."[196]

In this chapter, we consider in more detail two of the four prongs of the Court's contemporary Commerce Clause jurisprudence—the requirements that a tax not discriminate against interstate commerce and that it be fairly related to services provided by the state.[197] Because they warrant extended separate

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[191] DH Holmes Co. v. McNamara, 486 US 24, 30–31, 108 S. Ct. 1619, 1623 (1988). See also ¶ 16.03[3][a][ii] for further consideration of the *Holmes* case.

[192] Mobil Oil Corp. v. Commissioner of Taxes, 445 US 425, 443, 100 S. Ct. 1223 (1980). See, e.g., Fulton Corp. v. Faulkner, 516 US 325, 331, 116 S. Ct. 848 (1996); Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 US 175, 183, 115 S. Ct. 1331 (1995); Barclays Bank PLC v. Franchise Tax Bd., 512 US 298, 310–311, 114 S. Ct. 2268 (1994); Quill Corp. v. North Dakota, 504 US 298, 310, 112 S. Ct. 1904 (1992); Trinova Corp. v. Michigan Dep't of Treasury, 498 US 358, 372, 111 S. Ct. 818 (1991); Amerada Hess Corp. v. Director, Div. of Tax'n, 490 US 66, 72, 109 S. Ct. 1617 (1989); Goldberg v. Sweet, 488 US 252, 259–260, 109 S. Ct. 582 (1989); DH Holmes Co. v. McNamara, 486 US 24, 30, 108 S. Ct. 1619 (1988); American Trucking Ass'ns, Inc. v. Scheiner, 483 US 266, 291, 107 S. Ct. 2829 (1987); Wardair Can., Inc. v. Florida Dep't of Revenue, 477 US 1, 8, 106 S. Ct. 2369 (1986); Commonwealth Edison Co. v. Montana, 453 US 609, 617, 101 S. Ct. 2496 (1981); Maryland v. Louisiana, 451 US 725, 754, 101 S. Ct. 2114 (1981); *Mobil*, 445 US 425, 443, 100 S. Ct. 1223 (1980); Department of Revenue v. Association of Wash. Stevedoring Cos., 435 US 734, 745, 98 S. Ct. 1388 (1978).

[193] *Complete Auto*, 430 US 274, 279, 97 S. Ct. 1076 (1977).

[194] *Quill*, 504 US 298, 310, 112 S. Ct. 1904 (1992).

[195] *Trinova*, 498 US 358, 373, 111 S. Ct. 818 (1991).

[196] *Quill*, 504 US 298, 310, 112 S. Ct. 1904 (1992) (quoting Railway Express Agency v. Virginia, 358 US 434, 441, 79 S. Ct. 411 (1959)).

[197] See infra ¶¶ 4.13, 4.17[2][c].

treatment, we address the other two Commerce Clause requirements—substantial nexus and fair apportionment—in other chapters of the treatise.[198]

[2] Justice Scalia's Challenge to Court's Negative Commerce Clause Doctrine

Justice Scalia espouses the view—which is apparently not shared by any member of the present Court except, perhaps, Justice Thomas—that, in the silence of Congress, the Commerce Clause forbids only facially discriminatory state taxation of interstate commerce. In a series of vigorous, provocative dissents and concurrences, Justice Scalia has forcefully articulated his position.

In *Tyler Pipe Industries, Inc. v. Washington Department of Revenue*,[199] Justice Scalia first challenged the long-standing, deeply embedded doctrine that the Commerce Clause, by its own force and without implementing congressional legislation, imposes limitations on state taxing powers. Justice Scalia declared that there is a "lack of any clear theoretical underpinning for judicial 'enforcement' of the Commerce Clause."[200] He examined each of the justifications that has been offered to support the invalidation of taxes under the unexercised power of Congress to regulate interstate commerce and found them all wanting. The text of the Commerce Clause "is a charter for Congress, not the courts, to insure an area of trade free from interference by the States."[201] Nor does the language of the Commerce Clause, unlike some other clauses of the Constitution, support a concept of exclusivity of the powers of Congress over interstate commerce. On the contrary, Justice Scalia pointed out that many of the powers of Congress over commerce have historically been exercised concurrently with the states (citing, inter alia, the patent and bankruptcy powers and congressional power over a wide range of economic activities).

Justice Scalia also rejected the theoretical justification offered in support of "judicial enforcement of the Commerce Clause" on the ground that "whatever subjects of [interstate commerce] are in their nature national, or admit only of one uniform system, or plan of regulations, may justly be said to be of such a nature as to require exclusive legislation by Congress."[202] That

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[198] See Chapters 6 and 19 for discussion of nexus issues; see Chapters 8 and 9 for discussion of apportionment.

[199] Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 US 232, 107 S. Ct. 2810 (1987).

[200] *Tyler Pipe*, 483 US 232, 260, 107 S. Ct. 2810 (1987) (Scalia, J., concurring in part and dissenting in part).

[201] *Tyler Pipe*, 483 US 232, 260, 107 S. Ct. 2810 (1987) (Scalia, J., concurring in part and dissenting in part).

[202] *Tyler Pipe*, 483 US 232, 261–262, 107 S. Ct. 2810 (1987) (Scalia, J., concurring in part and dissenting in part).

view "has the misfortune of finding no conceivable basis in the text of the Commerce Clause, which treats 'Commerce . . . among the several States' as a unitary subject."[203]

In Justice Scalia's opinion:

> The least plausible theoretical justification of all is the idea that in enforcing the negative Commerce Clause the Court is not applying a constitutional command at all, but is merely interpreting the will of Congress, whose silence in certain fields of interstate commerce (but not in others) is to be taken as a prohibition of regulation. There is no conceivable reason why congressional inaction under the Commerce Clause should be deemed to have the same preemptive effect elsewhere accorded only to congressional action. There, as elsewhere, "Congress' silence is just that—silence."[204]

Finally, Justice Scalia found that the "historical record provides no grounds for reading the Commerce Clause to be anything other than what it says: an authorization for Congress to regulate commerce."[205]

Justice Scalia's criticisms of the textual and historical bases for the broad doctrine of the negative implications of the Commerce Clause are supported by some leading students of the area.[206] Over the Court's history, several individual Justices have espoused the view that the mere grant by the Constitution to Congress of the power to regulate interstate commerce does not serve to invalidate state taxes, unless they discriminate against commerce.[207] In the early

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[203] *Tyler Pipe*, 483 US 232, 262, 107 S. Ct. 2810 (1987) (Scalia, J., concurring in part and dissenting in part).

[204] *Tyler Pipe*, 483 US 232, 262, 107 S. Ct. 2810 (1987) (citation omitted) (Scalia, J., concurring in part and dissenting in part).

[205] *Tyler Pipe*, 483 US 232, 263, 107 S. Ct. 2810 (1987) (Scalia, J., concurring in part and dissenting in part).

[206] See D. Currie, The Constitution in the Supreme Court: The First Hundred Years 1789–1888, at 168–181, 222–236, 330–342, 403–416 (1985); F. Frankfurter, The Commerce Clause under Marshall, Taney & Waite, at 12 (1937). Justice Scalia cites both of these authorities.

[207] See supra ¶¶ 4.06, 4.07. The justices who have expressed the view that state taxes may not be invalidated under the Commerce Clause in the silence of Congress, unless they discriminate against interstate commerce, are Justices Wayne and Davis (1872), Black (1938), and Douglas (1945). See infra ¶ 4.13 note 301.

In many respects, Justice Scalia's views echo those of Justice Black who, in a series of dissenting opinions issued soon after his appointment to the Court in 1937, made clear his opposition to judicial limitation on state action in the tax area. In the absence of actual discrimination against interstate commerce, Justice Black believed that the Commerce Clause (unassisted by congressional action) did not warrant the invalidation of state taxes. In his 1937 dissent in Adams Mfg. Co. v. Storen, 304 US 307, 316, 58 S. Ct. 913 (1938), he voiced the opinion that the "interests of interstate commerce will best be fostered, preserved and protected—in the absence of direct regulation by Congress—by leaving those

twentieth century, Professor Thomas Reed Powell, the then-authoritative analyst of the Commerce Clause, adopted this position.[208] He regarded discriminatory taxes as "regulations" of commerce that violate the Commerce Clause.[209]

In accord with these views, Justice Scalia (sometimes with the concurrence of Justice Thomas) has taken the position that unless a tax facially discriminates against interstate commerce, he will vote to sustain it.[210] His

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engaged in it in the various states subject to the ordinary and non-discriminating taxes of the states from which they receive governmental protection." To him, a "century and a half of constitutional history and government admonishes this Court to leave the choice to the elected legislative representatives of the people themselves." Southern Pac. Co. v. Arizona ex rel. Sullivan, 325 US 761, 789, 65 S. Ct. 1515 (1945). He was also of the opinion that overall policies, comprehensive and fair to the state and nation alike, cannot be devised within the framework of the judicial process. In a dissent in McCarroll v. Dixie Greyhound Lines, Inc., 309 US 176, 188, 60 S. Ct. 504 (1939), he articulated the view that

> Judicial control of national commerce—unlike legislative regulations—must from inherent limitations of the judicial process treat the subject by the hit-and-miss method of deciding single local controversies upon evidence and information limited by the narrow rules of litigation. Spasmodic and unrelated instances of litigation cannot afford an adequate basis for the creation of integrated national rules which alone can afford that full protection for interstate commerce intended by the Constitution.

In some respects, Justice Black's views, like Justice Scalia's, are a reversion to Chief Justice Taney's. However, Taney apparently would not, with Justices Black and Scalia, have made an exception for discriminatory state legislation. License Cases, 46 US (5 How.) 504, 578–586 (1847).

[208] T. R. Powell, "Indirect Encroachment on Federal Authority by the Taxing Power of the States," 31 Harv. L. Rev. 572, 573–574 (1918); see also N. Dowling, "Interstate Commerce and State Power," 27 Va. L. Rev. 1, 14–16 & n.22 (1940).

[209] See T.R. Powell, "Indirect Encroachment on Federal Authority by the Taxing Power of the States," 31 Harv. L. Rev. 572, 573–574 (1918).

[210] Justice Scalia indicated in *Tyler Pipe* and other cases that he embraces the view that the Commerce Clause forbids "rank" or "facial" discrimination against interstate commerce. See, e.g., Amerada Hess, Inc. v. Director, Div. of Tax'n, 490 US 66, 72, 109 S. Ct. 1617 (1989) (Scalia, J., concurring); Goldberg v. Sweet, 488 US 252, 271, 109 S. Ct. 582 (1989) (Scalia, J., concurring); American Trucking Ass'ns, Inc. v. Scheiner, 483 US 266, 304, 107 S. Ct. 2829 (1987) (Scalia, J., dissenting); Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 US 232, 265, 107 S. Ct. 2810 (1987) (Scalia, J., concurring in part and dissenting in part). Moreover, he wrote the Court's opinion in New Energy Co. v. Limbach, 486 US 269, 108 S. Ct. 1803 (1988), which invalidated Ohio's discriminatory fuel tax credit on Commerce Clause grounds. Nevertheless, more recently, Justice Scalia has declared that he would "not apply 'negative' Commerce Clause decisional theories to new matters coming before us." American Trucking Ass'ns, Inc. v. Smith, 596 US 167, 204, 110 S. Ct. 2323 (1990) (Scalia, J., concurring in the judgment). See generally W. Hellerstein, "Justice Scalia and the Commerce Clause: Reflections of a State Tax Lawyer," 12 Cardozo L. Rev. 1763 (1991), in a symposium on the jurisprudence of Justice Scalia; see also Richard B. Collins, "Justice Scalia and the Elusive Idea of Discrimination Against Interstate Commerce," 20 N. Mex. L. Rev. 555 (1990).

concurrence in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*,[211] which Justice Thomas joined, is illustrative:

> I agree with the Court's conclusion that Oklahoma's sales tax does not facially discriminate against interstate commerce.... That seems to me the most we can demand to certify compliance with the "negative Commerce Clause"—which is "negative" not only because it negates state regulation of commerce, but also because it does not appear in the Constitution.
>
> I would not apply the remainder of the eminently unhelpful, so-called "four-part test" of *Complete Auto Transit, Inc. v. Brady*,... Under the real Commerce Clause ("The Congress shall have Power... To regulate Commerce... among the several States," U.S. Const., Art. I, § 8), it is for Congress to make the judgment that interstate commerce must be immunized from certain sorts of nondiscriminatory state action—a judgment that may embrace (as ours ought not) such imponderables as how much "value [is] fairly attributable to economic activity within the taxing State," and what constitutes "fair relation between a tax and the benefits conferred upon the taxpayer by the State."... I look forward to the day when *Complete Auto* will take its rightful place in Part II of the Court's opinion, among the other useless and discarded tools of our negative-Commerce-Clause jurisprudence.

¶ 4.12 EFFECTS ON ITS EARLIER DECISIONS OF COURT'S CURRENT APPROACH TO COMMERCE CLAUSE

[1] Introduction

The Court's current views of Commerce Clause limitations on state taxation require a reevaluation of some of its decisions that were handed down during a period when more restricted views of state taxing power prevailed. Some of the results of the doctrinal changes are clear. Interstate commerce may be taxed; "direct" as well as "indirect" taxes may be imposed on such commerce; the Commerce Clause no longer prohibits the states from taxing the privilege of conducting an exclusively interstate business within the state; and a state tax affecting interstate commerce will be sustained as long as it is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to ser-

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[211] Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 US 175, 200, 115 S. Ct. 1331 (1995) (Scalia, J., concurring) (citations omitted).

vices provided by the state.[212] This much is clear, and is reflected in such decisions as *Complete Auto*[213] and *Washington Stevedoring*,[214] overruling some of the Court's earlier precedents. But the impact of the new Commerce Clause philosophy on other cases decided in earlier eras is less clear.

[2] Taxation of Instrumentalities of Interstate Commerce

[a] Surface Transportation

The states' power to impose property taxes on property used by railroads and other overland transportation businesses in interstate commerce has never been questioned, despite the Supreme Court's changing approaches to state taxation of interstate commerce.[215] The Court upheld such taxes on the theory that taxes on railroad track, rolling stock, and other property employed by instrumentalities of interstate transportation are not levies on the commerce itself and, hence, affect the commerce only indirectly.[216] The Court applied the same principle to apportioned capital stock taxes on interstate railroads, which it regarded in substance as taxes on the property of the railroad within the state.[217] Nor did the Commerce Clause prevent the states from taxing intangible property, including the going-concern value of an interstate transportation business, as long as the property values were fairly apportioned to the state.[218]

Until recently, the Court construed the Commerce Clause as prohibiting gross receipts taxes on interstate commerce,[219] although it upheld such levies when the states imposed them in lieu of property taxes.[220] This was a pragmatic yielding of constitutional theory to the serious practical difficulties of using traditional property tax assessment methods for valuing the state's share of property—including lands and structures, rolling stock, and the going-concern value of railroads and other instrumentalities of interstate commerce conducting an integrated or unitary business carried on in more than one state.

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[212] See supra ¶¶ 4.10, 4.11.

[213] See supra ¶¶ 4.10[2], 4.11.

[214] See supra ¶ 4.11.

[215] See supra ¶ 4.07[1].

[216] See supra ¶ 4.07[1].

[217] The Delaware RR Tax, 85 US (18 Wall.) 206 (1873).

[218] See ¶ 8.05.

[219] See supra ¶ 4.07[2][a].

[220] See W. Lockhart, "Gross Receipts Taxes on Interstate Transportation and Communication," 57 Harv. L. Rev. 40 (1943); Comment, "State Taxation of Interstate Commerce: *Roadway Express*, the Diminishing Privilege Tax Immunity, and the Movement Toward Uniformity in Apportionment," 36 U. Chi. L. Rev. 186 (1968).

Now that the Court has repudiated its earlier view that direct state taxes on interstate commerce are barred by the Commerce Clause, nondiscriminatory, fairly apportioned taxes on the gross receipts of railroads, truck lines, and others conducting interstate overland transportation businesses ought to be sustained.[221]

[b] Interstate Telecommunications and Broadcasting

In *Cooney v. Mountain States Telephone & Telegraph Co.*,[222] the Court invalidated a tax on a telephone company that conducted a combined intrastate and interstate business, on the ground that the two aspects of the business were so "inextricably intermingled" that, as a practical matter, the intrastate business could not be given up without also abandoning the interstate business. The rationale of *Cooney* clearly does not survive *Complete Auto*, since it was based on the view that the taxpayer was engaged in interstate commerce, and "a State cannot tax interstate commerce; it cannot lay a tax upon the business which constitutes such commerce or the privilege of engaging in it."[223] However, the tax would probably be sustained under current law. It was a license

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[221] See Western Md. Ry. v. Goodwin, 167 W. Va. 804, 282 SE2d 240 (1981), appeal dismissed, 456 US 952, 102 S. Ct. 2025 (1982) (sustaining nondiscriminatory carrier income tax on railroad, trucking, and barge line companies engaged in interstate commerce). Professor William B. Lockhart accurately forecast this development in 1943, in the light of the multiple taxation doctrine, when he wrote:

> Forecasting judicial decisions on constitutional issues is precarious business. Nevertheless, it seems safe to predict that formal dogma will not influence the Court to condemn a nondiscriminatory state gross receipts tax on interstate transportation or communication. On the contrary, the Court will probably sustain such a tax if it does not threaten interstate commerce with a heavier burden than local commerce, or in some other manner threaten an unfair or unreasonable burden on interstate commerce. The present Chief Justice was doubtless aware of the Biblical warning when he poured his new wine into the old wineskins in 1938, and probably has no intention of interfering with the laws of nature.

W. Lockhart, "Gross Receipts Taxes on Interstate Transportation and Communication," 57 Harv. L. Rev. 40, 95 (1943). See generally G. Brabson, "Multistate Taxation of the Transportation Industry," 18 Ohio St. LJ 22 (1957); W. Hellerstein & M. Kaufman, "Sales and Use Taxation of Movable Property in Interstate Commerce," 1981 Procs. of the Nat'l Tax Ass'n—Tax Inst. of Am. 69 (1982); G. Kronenberg, "State Taxation of Moving Equipment Engaged in Interstate Commerce," 15 Ala. L. Rev. 186 (1962).

[222] Cooney v. Mountain States Tel. & Tel. Co., 294 US 384, 55 S. Ct. 477 (1935).

[223] *Cooney*, 294 US 384, 392, 55 S. Ct. 477 (1935). See AT&T Communications of the Mountain States, Inc. v. State Dep't of Revenue, 778 P2d 677, 681 (Colo. 1989) (characterizing *Cooney* as "factually outdated and legally superseded by *Complete Auto*"); cf. Goldberg v. Sweet, 488 US 252, 265 n.16, 109 S. Ct. 582 (1989) (*Cooney* considered a telecommunications technology "only distantly related to modern telecommunications technology" and was "decided in a pre–*Complete Auto* era when this Court held the view that interstate commerce itself could not be taxed").

tax on every person engaged in the business of operating or maintaining telephone lines in Montana measured by a fixed amount per telephone instrument "owned, controlled, and operated by it" during the year. The only conceivable objection to the tax is that a flat rate on telephone instruments owned, controlled, and operated is not a fair measure of the business conducted in the state, due to the variable use of particular instruments.[224] But this objection seems weak because, unlike a flat tax on a vehicle that can be used in more than one state (as in *American Trucking Ass'ns*[225]), a flat tax on a telephone that can be used only in one state is a reasonable measure of in-state use. Of course, if one includes mobile telephones in the calculus, the issue may be less clear.

In *Fisher's Blend Station, Inc. v. State Tax Commission*,[226] Washington imposed its business and occupation tax on a radio broadcasting station whose programs were heard in other states. The Court struck down the levy under the Commerce Clause because the state was taxing the conduct of an interstate business. The rationale of *Fisher's Blend* does not survive *Complete Auto* for the same reasons set forth in the preceding paragraph with respect to *Cooney*. The case would be decided differently today, because it satisfies *Complete Auto*'s four-prong test. Indeed, there is no evidence that the taxpayer engaged in any out-of-state activity, and the Court has generally sustained Washington's business and occupation tax over objections that it is not fairly apportioned.[227]

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[224] Cf. *American Trucking Ass'ns*, 483 US 266, 107 S. Ct. 2829 (1983) discussed infra ¶ 4.13[2][g].

[225] *American Trucking Ass'ns*, 483 US 266, 107 S. Ct. 2829 (1983).

[226] Fisher's Blend Station, Inc. v. State Tax Comm'n, 297 US 650, 56 S. Ct. 608 (1936).

[227] In Rhoden v. Goodling Enters., Inc., 295 So. 2d 433 (Miss. 1974), a cable television operator received television signals emanating from both within and without the state and retransmitted these signals to local subscribers to the cable system. The individual housing units of the subscribers were connected to the system, and they paid a monthly charge of $4.75 for the service, which permitted them to receive television signals that would otherwise be inaccessible owing to the distance between the residences of the subscribers and the broadcasting stations. The State Tax Commission had assessed a doing business tax measured by gross income upon the cable operator but the lower court had held this improper under *Fisher's Blend* on the ground that part of the signals emanated from out-of-state broadcasting stations. The Mississippi Supreme Court reversed, noting that "all of the income upon which the tax could be imposed is derived within this state. The character of appellee's business is such that it is not subject to the danger of burdensome cumulative taxation by other states." *Rhoden*, 295 So. 2d 433, 436 (Miss. 1974). See also Albuquerque Broadcasting Co. v. Bureau of Revenue, 51 NM 332, 184 P2d 416 (1947) (sustaining tax upon receipts from "local advertising broadcasts" while invalidating tax upon receipts from "interstate" "network broadcasts" carrying "national spot advertising"). See generally R. Katz, "State and Local Taxation of Radio and Television Broadcasting," 12 Fed. Communications Bar J. 49 (1952); E.P. Ruehlmann, "State Taxation of

[c] Maritime Instrumentalities and the "Home Port" Doctrine

In 1854, the Supreme Court struck down a California property tax on steamships that were engaged in carrying passengers and freight from New York, their port of registry, by way of the isthmus of Panama, to California and Oregon.[228] The ships were owned by a New York corporation, whose principal office was located in New York. The owner maintained an agency in San Francisco and a naval dock and shipyard in the port of Benicia, California. The ships remained in San Francisco for no longer than the time required to land passengers and freight, usually one day, and then proceeded to Benicia, where they remained for refitting and repairs until the commencement of the next voyage, usually ten or twelve days later. The State of New York had taxed the steamship company on all its capital represented by the vessels. In invalidating the California tax, the Court said:

> We are satisfied that the State of California had no jurisdiction over these vessels for the purpose of taxation; they were not, properly, abiding within its limits, so as to become incorporated with the other personal property of the state; they were there but temporarily, engaged in lawful trade and commerce, with their *situs* at the home port, where the vessels belonged, and where the owners were liable to be taxed for the capital invested, and where the taxes had been paid.[229]

The Court did not refer to the Commerce Clause in its opinion. Indeed, it was not until 1867 that the Court handed down its first decision invalidating a state tax as conflicting with the Commerce Clause.[230] Nor, of course, could the Court have relied on the Due Process Clause of the Fourteenth Amendment, since that amendment was not adopted until 1868. The decision was, instead, grounded in the fundamental notion, perhaps a natural law concept, that a government cannot, or at least should not, tax property "not properly abiding within its limits."[231]

Radio and Television," 20 U. Cin. L. Rev. 19 (1951); Note, "Gross Receipts Tax on Radio Stations," 1 Stan. L. Rev. 740 (1949).

[228] Hays v. Pacific Mail SS Co., 58 US (17 How.) 596 (1854).

[229] *Hays*, 58 US (17 How.) 596, 598–599 (1854).

[230] Steamship Co. v. Port Wardens, 73 US (6 Wall.) 31 (1867).

[231] *Hays*, 58 US (17 How.) 596, 599 (1854). It is also noteworthy that even though the Court did not rely on the Commerce Clause, the Court referred to the danger of multiple taxation that would ensue if the tax were sustained, thus foreshadowing the doctrine that the Court subsequently embraced in interpreting the Commerce Clause.

> 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 also impose a like tax.

Hays, 58 US (17 How.) 596, 599 (1854).

In 1891, the Court considered a challenge by the Pullman Company to a Pennsylvania tax on its capital stock, apportioned by the ratio of the number of rail miles the Pullman cars' routes traversed in Pennsylvania to the company's total rail mileage.[232] The company was organized in Illinois, where it maintained its principal place of business. In rejecting Pullman's contention that "its cars could be taxed only in the State of Illinois," the Court observed that the "old rule expressed in the maxim *mobilia sequuntur personam*," which "grew up in the Middle Ages . . . has yielded more and more to the *lex situs*, the law of the place where the property is kept and used."[233] The Court distinguished cases involving ships or vessels engaged in interstate and foreign commerce, which were taxable at their home port:

> Ships or vessels . . . engaged in interstate or foreign commerce upon the high seas, or other waters which are a common highway, and having their home port, at which they are registered under the laws of the United States, at the domicil of their owners in one State, are not subject to taxation in another State at whose ports they incidentally and temporarily touch for the purpose of delivering or receiving passengers or freight. But that is because they are not, in any proper sense, abiding within its limits, and have no continuous presence or actual situs within its jurisdiction, and, therefore, can be taxed only at their legal situs, their home port and the domicil of their owners.[234]

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[232] Pullman's Palace Car Co. v. Pennsylvania, 141 US 18, 11 S. Ct. 876 (1891).

[233] *Pullman's Palace Car*, 141 US 18, 22, 11 S. Ct. 876 (1891).

[234] *Pullman's Palace Car*, 141 US 18, 23–24, 11 S. Ct. 876 (1891). The Court was also conscious of the special importance of marine transportation to the Commerce Clause, for it went on to say:

> Between ships and vessels, having their situs fixed by act of Congress, and their course over navigable waters, and touching land only incidentally and temporarily; and cars or vehicles of any kind, having no situs so fixed, and traversing the land only, the distinction is obvious. As has been said by this Court:
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> "Commerce on land between the different States is so strikingly dissimilar, in many respects, from commerce on water, that it is often difficult to regard them in the same aspect in reference to the respective constitutional powers and duties of the State and Federal governments. No doubt commerce by water was principally in the minds of those who framed and adopted the constitution, although both its language and spirit embrace commerce by land as well. Maritime transportation requires no artificial roadway. Nature has prepared to hand that portion of the instrumentality employed. The navigable waters of the earth are recognized public highways of trade and intercourse. No franchise is needed to enable the navigator to use them. Again, the vehicles of commerce by water being instruments of intercommunication with other nations, the regulation of them is assumed by the National legislature. So that state interference with transportation by water, and especially by sea, is at once clearly marked and distinctly discernible. But it is different with transportation by land. Railroad Co. v. Maryland, 21 Wall. 456, 470."
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> *Pullman's Palace Car*, 141 US 18, 23–24, 11 S. Ct. 876 (1891).

Subsequent decisions eroded and, ultimately, repudiated the home port doctrine, at least in the context of interstate as distinguished from foreign commerce. In *Ott v. Mississippi Valley Barge Line Co.*,[235] a group of barge lines relied on the home port doctrine in challenging Louisiana and New Orleans property taxes on tugboats and barges used up and down the Mississippi and Ohio Rivers. The taxpayers were foreign corporations, and the vessels had out-of-state ports of registry. The vessels of one taxpayer spent 10 percent to 17 percent of their time in Louisiana during the tax years at issue, with smaller percentages for the other barge lines. The Supreme Court upheld the tax, which had been apportioned to activities in Louisiana, determining that the principle of *Pullman's Palace Car*[236] should apply to the case. It said, "[w]e can see no reason which should put water transportation on a different constitutional footing than other interstate enterprises."[237]

Standard Oil Co. v. Peck,[238] established an important corollary of the rationale of the *Ott* decision, one that has implications well beyond property taxation of instrumentalities of interstate commerce. The Court held that Ohio, the state in which Standard Oil had its domicile, was precluded from taxing the whole value of its boats and barges used in interstate river transportation, since they were subject to taxation on an apportioned basis in several other states where they operated. The taxation of all of Standard Oil's boats and barges by the state of domicile, coupled with other states' taxes on an apportioned share of those boats and barges, would have created multiple taxation. Although the decision rested on the Due Process Clause, the Court has reiterated the same principle under the Commerce Clause.[239]

In *Japan Line, Ltd. v. County of Los Angeles*,[240] the Court discarded the home port doctrine as a tool of constitutional analysis. The case presented the question whether Los Angeles could impose an apportioned property tax on foreign-owned and foreign-based shipping containers used exclusively in inter-

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[235] Ott v. Mississippi Valley Barge Line Co., 336 US 169, 69 S. Ct. 432 (1949).

[236] See pages 4-50–4-51.

[237] *Ott*, 336 US 169, 175, 69 S. Ct. 432 (1949).

[238] Standard Oil Co. v. Peck, 342 US 382, 72 S. Ct. 309 (1952).

[239] See, e.g., Japan Line, Ltd. v. County of Los Angeles, 441 US 434, 445–447, 99 S. Ct. 1813 (1979); Central RR of Pa. v. Pennsylvania, 370 US 607, 612, 82 S. Ct. 1297 (1962); see also East-West Express, Inc. v. Collins, 264 Ga. 774, 449 SE2d 599 (1994) (recognizing right of taxpayer to require domiciliary state to apportion property tax on trucks domiciled in state when such trucks are taxable in other states); Ryder Truck Rental, Inc. v. County of Chesterfield, 248 Va. 575, 449 SE2d 813, 816 n.4 (1994) (same); Montana Dakota Utils. v. South Dakota Dep't of Revenue, 337 NW2d 818 (SD 1983) (Department barred from assessing full value of trains where freight cars were habitually employed on fixed routes outside the state). See also ¶ 8.02[1].

[240] Japan Line, Ltd. v. County of Los Angeles, 441 US 434, 99 S. Ct. 1813 (1979).

national commerce. The first issue the Court addressed was whether the home port doctrine retained any viability as a criterion of Commerce Clause analysis.

The Court recognized that the home port doctrine had been sapped of much of its vitality over the years. It observed that the doctrine of *mobilia sequuntur personam* (movables follow the person) in which the home port doctrine is rooted "has fallen into desuetude" and that the doctrine had "yielded to a rule of fair apportionment among the States."[241] The Court noted that it had "held that various instrumentalities of commerce may be taxed on a properly apportioned basis by the nondomiciliary States through which they travel."[242] Nevertheless, even in "discarding the 'home port' theory of apportionment, . . . the Court has consistently distinguished the case of ocean-going vessels."[243] Faced with the question whether to rehabilitate the home port doctrine for purposes of the Commerce Clause or to reject it completely, the Court chose the latter course.

Although conceding that the home port doctrine "has an inner logic" as applied to the taxation of oceangoing vessels, the Court pointed out that the doctrine was rooted in neither the Commerce Clause nor the Due Process Clause, but in common-law concepts of jurisdiction to tax. Unable to identify any constitutional source for the doctrine, the Court characterized it as "anachronistic" and declared that its underpinnings had been "abandoned."[244] The Court therefore proceeded to analyze the question before it under the substantive criteria for determining the validity of a tax on foreign commerce that it articulated in the *Japan Line* case.[245]

The home port doctrine thus appears to be another relic of Commerce Clause doctrine of an earlier era that the Court has abandoned. Interestingly, in its decision in *Japan Line*, the Court reached the same result as it would have reached had it applied the home port doctrine to oceangoing shipping, namely, that the shipping containers used in international transportation were not taxable in California, because the containers' home port was not in that state. Nevertheless, because the Court based its decision on its interpretation of the Commerce Clause as imposing stricter limitations on state taxation of foreign

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[241] *Japan Line*, 441 US 434, 442, 99 S. Ct. 1813 (1979).

[242] *Japan Line*, 441 US 434, 442, 99 S. Ct. 1813 (1979).

[243] *Japan Line*, 441 US 434, 442, 99 S. Ct. 1813 (1979).

[244] *Japan Line*, 441 US 434, 443, 99 S. Ct. 1813 (1979).

[245] The *Japan Line* case, which established that state taxation of foreign commerce is subject to more rigorous dormant Commerce Clause requirements than state taxation of interstate commerce, is considered infra ¶ 4.19. For a comprehensive treatment of the development of the home port doctrine prior to the Court's decision in *Japan Line*, see Note, "Limitations on State Taxation of Foreign Commerce: The Contemporary Vitality of the Home Port Doctrine," 127 U. Pa. L. Rev. 817 (1979); see also J. Clark, "Property Taxation of Foreign Goods and Enterprises—A Study in Inconsistency," 4 Pepperdine L. Rev. 39 (1976).

commerce than upon state taxation of interstate commerce, the direction the Court will take in cases involving state taxation of ships, shipping containers, and other instrumentalities of foreign commerce owned by U.S. corporations and registered in this country remains unclear.[246] It is, however, worth noting that the Court reaffirmed its prior holdings that, in the case of interstate transportation by land or waterway, each state through which the instrumentalities travel may levy property taxes on a properly apportioned basis, and that, as a consequence, the home port of the vessel and the domicile of the owner of railroad cars, vessels, and the like may not impose an unapportioned property tax.[247]

[d] Airplanes Flying in Interstate Commerce

In *Northwest Airlines, Inc. v. Minnesota*,[248] the Court refused to extend the principles developed in the land transportation cases to air transport equipment. Writing for a sharply divided Court, Justice Frankfurter, who was not sympathetic to the apportionment principle as a device for dealing with interstate commerce taxation problems, declined to apply "the rule of apportionment . . . beset with friction, waste and difficulties . . . and established . . . in regard to, land commerce" to air commerce. Instead, the decision permitted Minnesota, the state of Northwest's incorporation, the locus of its principal place of business and its major repair and overhaul base, to tax the entire value of the planes, without apportionment. Justice Frankfurter strongly implied that no other state in which Northwest operated its planes and maintained terminals and repair bases could tax any part of the value of the planes on an apportioned basis.[249]

The authority of the *Northwest Airlines* case was short-lived. Ten years later, the Court held that Nebraska could impose an apportioned property tax

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[246] *Japan Line*, 441 US 434, 442–444, 99 S. Ct. 1813 (1979).

[247] *Japan Line*, 441 US 434, 443, 99 S. Ct. 1813 (1979).

[248] Northwest Airlines, Inc. v. Minnesota, 322 US 292, 64 S. Ct. 950 (1944). During the years at issue, Northwest's lines were confined to the United States.

[249] Justice Jackson, who was critical of the apportionment method as "a mongrel one," (*Northwest Airlines*, 322 US 292, 306, 64 S. Ct. 950 (1944)) (Jackson, J., concurring), reached a similar conclusion, but grounded his holding on the analogy to vessels moving in interstate commerce, which, under the then-prevailing doctine, were subject to property tax only at the home port. See ¶ 4.12[2][c]. He analogized the point of registration of the planes with the Civilian Aeronautics Authority (there, St. Paul) to the home port of a vessel. Justice Black, in concurring, made it clear that he would not foreclose states other than Minnesota from taxing on an apportioned basis. Chief Justice Stone dissented in an opinion joined by Justices Roberts, Reed, and Rutledge, taking the position that the traditional railroad apportionment cases should be applied to property taxation of airlines.

on the planes of Braniff Airways,[250] whose aircraft, operating in interstate air routes, regularly flew over, landed at, and departed from airports in the state. The airline was not incorporated in Nebraska and did not maintain its principal office or major overhaul and repair stations in that state. The Court considered the airline's contention that its aircraft never "attained a taxable situs within Nebraska."[251] First, it rejected the argument that the home port doctrine should be applied to airlines. Just as it had relied on the railroad cases to sustain apportioned taxes on inland waterway vessels,[252] the Court "perceive[d] no logical basis for distinguishing the constitutional power to impose a tax on such aircraft from the power to impose taxes on river boats."[253] The Court then considered whether "eighteen stops per day by appellant's aircraft is sufficient contact with Nebraska to sustain that State's power to levy an apportioned ad valorem tax on such aircraft . . . even though the same aircraft do not land every day and . . . none . . . is continuously within the state."[254] The Court said:

> The basis of the jurisdiction is the habitual employment of the property within the state. Appellant rents its ground facilities and pays for fuel it purchases in Nebraska. This leaves it in the position of other carriers such as rails, boats and motors that pay for the use of local facilities so as to have the opportunity to exploit the commerce, traffic, and trade that originates in or reaches Nebraska. Approximately one-tenth of appellant's revenue is produced by the pickup and discharge of Nebraska freight and passengers. Nebraska certainly affords protection during such stops and these regular landings are clearly a benefit to appellant.[255]

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[250] Braniff Airways, Inc. v. Nebraska State Bd. of Equalization, 347 US 590, 74 S. Ct. 757 (1954).

[251] *Braniff*, 347 US 590, 598, 74 S. Ct. 757 (1954). The Court noted that the airline had erroneously made this argument as a Commerce Clause contention, observing:

> While the question of whether a commodity en route to market is sufficiently settled in a state for purpose of subjection to a property tax has been determined by this Court as a Commerce Clause question, the bare question whether an instrumentality of commerce has tax situs in a state for the purpose of subjection to a property tax is one of due process.

Braniff, 347 US 590, 598–599, 74 S. Ct. 757 (1954).

[252] Ott v. Mississippi Valley Barge Line Co., 336 US 169, 69 S. Ct. 432 (1949), discussed supra ¶ 4.12[2][c].

[253] *Braniff*, 347 US 590, 600, 74 S. Ct. 757 (1954).

[254] *Braniff*, 347 US 590, 600–601, 74 S. Ct. 757 (1954).

[255] *Braniff*, 347 US 590, 601, 74 S. Ct. 757 (1954). Justice Reed, who had dissented in *Northwest Airlines*, wrote the majority opinion in *Braniff Airways*. Justices Frankfurter and Jackson dissented, the latter having expressed the opinion in *Northwest Airlines* that "the act of landing [airplanes] within a state, even regularly and on schedule" does not "confer jurisdiction to tax." Northwest Airlines, Inc. v. Minnesota, 322 US 292, 304, 64 S. Ct. 950 (1944) (Jackson, J., concurring). See also *Northwest Airlines*, 322 US 292, 312 n.1, 64 S. Ct. 950 (1944) (Stone, C.J., dissenting) ("We need not consider here

Although the Court did not explicitly face the issue as to whether the state of Braniff's commercial domicile or the state in which the planes are registered by the Civil Aeronautics Authority could tax the full value of the planes, the logic of the *Braniff* opinion suggests that such taxation would be prohibited, that *Northwest Airlines* has been overruled, and that an unapportioned property tax imposed by such states would not be sustained. State courts have so read the opinion in the *Braniff* case.[256]

Notwithstanding the erosion of the home port doctrine, it remains the law that the domiciliary state retains the power to tax the full value of instrumentalities of interstate commerce that have not acquired a tax situs in other states. As the Court declared in *Central Railroad Co. v. Pennsylvania*,[257] "[i]t is only 'multiple taxation of interstate operations' that offends the Commerce Clause. And obviously multiple taxation is possible only if there exists some other jurisdiction, in addition to the domicile of the taxpayer, which may constitutionally impose an ad valorem tax."[258]

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whether the jurisdiction of a state over air above it . . . affords a basis for taxation of planes which regularly fly over the state but do not regularly land within its borders," since Northwest's planes made regular scheduled landings in the states over which it flew).

[256] See Flying Tiger Line v. County of Los Angeles, 51 Cal. 2d 314, 333 P2d 323 (1958), cert. denied, 359 US 1001, 79 S. Ct. 1140 (1959); Zantop Air Transp. v. County of San Bernardino, 246 Cal. App. 2d 433, 54 Cal. Rptr. 813 (1966); S. Snell, "*Northwest Airlines* Revisited," 33 Taxes 659 (1955); Note, "Application of 'Home Port Doctrine' and Due Process Clause to State Taxation of Aircraft," 35 S. Cal. L. Rev. 316 (1962); Note, "State Taxation of International Air Carriers," 57 Nw. UL Rev. 92 (1962).

[257] Central RR v. Pennsylvania, 370 US 607, 82 S. Ct. 1297 (1962).

[258] *Central RR*, 370 US 607, 612, 82 S. Ct. 1297 (1962) (citation omitted). The Court also pointed out that the Due Process Clause does not "confine the domiciliary State's taxing power to the proportion of the value of the property being taxed as is equal to the fraction of the tax year which the property spends within the State's borders." *Central RR*, 370 US 607, 612, 82 S. Ct. 1297 (1962). It reaffirmed its commitment to "the principle established by earlier cases that tangible personal property for which *no* tax situs has been established elsewhere may be taxed to its full value by the owner's domicile." *Central RR*, 370 US 607, 612, 82 S. Ct. 1297 (1962) (emphasis in original). The Court observed that:

> [i]f such property has had insufficient contact with States other than the owner's domicile to render any one of these jurisdictions a "tax situs," it is surely appropriate to presume that the domicile is the only State affording the "opportunities, benefits, or protection" which due process demands as a prerequisite for taxation.

Central RR, 370 US 607, 612, 82 S. Ct. 1297 (1962). See also Peabody Coal Co. v. State Tax Comm'n, 731 SW2d 837 (Mo. 1987), appeal dismissed and cert. denied, 484 US 960, 108 S. Ct. 446 (1987) (two aircraft that spent approximately 75 percent of ground time in Missouri, even though they made 19 and 32 percent of their respective landings in Indiana, had not acquired taxable situs outside Missouri, and were therefore taxable on unapportioned basis by Missouri); Arkansas County Appraisal Review Bd. v. Texas Gulf Shrimp Co., 707 SW2d 186 (Tex. Ct. App. 1986) (shrimp trawlers that operated outside

In a questionable decision, the Missouri Supreme Court sustained an unapportioned ad valorem property tax on an aircraft, despite the fact that it was owned by a nondomiciliary corporation and was operated in other states.[259] The majority found that St. Louis County was entitled to impose the unapportioned tax because the aircraft was regularly kept in the state and that the thirteen stops and three overnight stays the aircraft made in New Hampshire were insufficient to establish a taxable situs there. The dissent observed that no previous case has held that a nondomiciliary state may levy an unapportioned ad valorem tax on an instrumentality of interstate commerce not located permanently and continuously within its borders. The majority appears to have erroneously equated the power of domiciliary and nondomiciliary states to tax. New Hampshire, as the domiciliary state, plainly had power to tax the aircraft, except to the extent that it was taxable on an apportioned basis elsewhere.[260] The fact that the property was usually maintained in another state did not deprive the domiciliary state of its power to tax at least a portion of the property's value.

[i] Overflights. Some states have sought to determine the portion of an airline's property or income that is properly attributable to the state by including the flight mileage over the state of aircraft whose flights do not originate or terminate in the state. Thus, Oregon apportioned the property of airlines for property tax purposes by a single-factor time basis formula consisting of three elements: ground time, flight time for aircraft landings and departures in the state, and fly-over time for aircraft that do not touch down in the state. The

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of state waters for 70 percent of year were taxable in full by the state because they had not acquired a taxable situs or been exposed to taxation in another state or nation); Ryder Truck Rental, Inc. v. County of Chesterfield, 248 Va. 575, 449 SE2d 813 (1994) (leased trucks taxable in full by county in which they were registered because lessor was unable to show that the trucks either traveled on regular, scheduled routes or were habitually employed outside the county); Winchester & W. RR v. State Corp. Comm'n, 236 Va. 473, 374 SE2d 66 (1988), cert. denied, 490 US 1099, 109 S. Ct. 2450 (1989) (railroad rolling stock taxable in full by domiciliary state because taxpayer failed to prove average number of cars irregularly used outside of state); compare Montana-Dakota Utils. Co. v. South Dakota Dep't of Revenue, 337 NW2d 818 (SD 1983) (department barred from assessing full value of trains where freight cars were habitually employed on fixed routes outside the state). Post-assessment changes in situs require no change in the tax or apportionment for the corresponding assessment year. Kenai Peninsula Borough v. Arndt, 958 P2d 1101 (Alaska 1998) (boat owner not entitled to proportional rebate of property taxes assessed on January 1, even though boat was sold and moved out of state on May 1, because tax reflected benefits conferred during preceding year; Seegmiller v. County of Nevada, 53 Cal. App. 4th 1397, 62 Cal. Rptr. 2d 238 (1997) (similar holding).

[259] Bi Go Mkts., Inc. v. Morton, 843 SW2d 916 (Mo. 1992).

[260] *Central RR*, 370 US 607, 612, 82 S. Ct. 1927 (1962).

Oregon Supreme Court sustained the formula.[261] However, the Oregon Department of Revenue subsequently modified it by removing fly-over time for aircraft that do not touch down in the state[262] after Congress enacted legislation that prohibits states from levying "any tax on or with respect to any flight of a commercial aircraft or any activity or service on board such aircraft unless such aircraft takes off or lands in such State or political subdivision as part of such flight."[263]

In sustaining an Illinois excise tax on the unapportioned charges for interstate telecommunications that originate or terminate in the state and are charged to a service address in the state, the Supreme Court sought to allay the concern of taxpayers that its decision would result in multiple taxation. It did so by stating that "only two States have a nexus substantial enough to tax a consumer's interstate telephone call," the state of origination and the state of termination of the call.[264] It supported that conclusion by stating that a "State has no nexus to tax an airplane based solely on its flight over the State."[265] The Oregon Supreme Court responded to the contention that it was taxing property over which it had no jurisdiction in the airline property tax apportionment case, declaring that the aircraft was "in the state," and that the taxpayers could not explain "where an overflight was if not 'in' this state while travelling within the borders of this state."[266]

The Court might have advanced a more fundamental answer to such a contention, namely, that Oregon was simply using the overflight mileage to determine the portion of the airline's property that was properly attributable to the state, and overflight mileage is one of a number of factors that it might reasonably employ for such a purpose. The congressional legislation barring any state taxation relating to aircraft overflights would not appear to preempt a

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[261] Alaska Airlines, Inc. v. Department of Revenue, 307 Or. 406, 769 P2d 193 (1989).

[262] See Or. Admin. R. 150-308.550(2)-(A) (Sept. 1, 1990).

[263] Pub. L. No. 101-508, § 9125, 104 Stat. 1388, codified at 49 USC § 40116(c). The codified version of the statute reads as follows:

> A State or political subdivision of a State may levy or collect a tax on or related to a flight of commercial aircraft or an activity or service on the aircraft only if the aircraft takes off or lands in the State or political subdivision as part of the flight.

See ¶ 10.02[6] for a treatment of apportionment of the income of airlines and ¶ 18.03 for a consideration of sales and use taxes on transactions on planes flying over a state.

[264] Goldberg v. Sweet, 488 US 252, 263, 109 S. Ct. 582 (1989).

[265] *Goldberg*, 488 US 252, 263, 109 S. Ct. 582 (1989).

[266] *Alaska Airlines*, 769 P2d 193, 198 (1989). But see Northwest Airlines, Inc. v. Department of Revenue, 295 Ill. App. 3d 889, 692 NE2d 1264 (1998) (fly-over miles not includable in numerator of state's sales and property factor for income tax apportionment formula because fly-over miles are not "in this state" within meaning of state apportionment statute); Delta Air Lines, Inc. v. Forst, No. 93-1238, Arlington Cty., Va. Cir. Ct., Jan. 27, 1998 (same) (appeal pending).

property tax, which is not applied "on or with respect to any flight of commercial aircraft." Nevertheless, the Oregon Department of Revenue revised its regulation so as to not base an apportionment formula on overflights over which it has no taxing jurisdiction.[267]

[e] Railroad Cars of a Noncarrier

The Florida courts confronted the question whether a property tax imposed on railroad cars and circus equipment owned by Ringling Bros.–Barnum & Bailey, and used in tours around the country, had sufficient "permanence" in Florida (where the property was located on tax day) as to fall within the state's taxing power; and, if so, whether the measure of the tax had to be apportioned on the basis of the portion of the year that the property was located in the state.[268] The Florida statute taxes tangible personal property "permanently" located in the state on tax day. The state courts had construed the term as the equivalent to "tax situs." The court found that the taxpayer's use of the circus property in connection with its business in Florida was sufficient to give it a tax situs in the state.

Turning to the taxpayer's contention that the levy on the full, unapportioned value of the circus property in the state on tax day violated the Commerce Clause, the court rejected as inapplicable decisions involving instrumentalities of interstate commerce, such as boats, trains, and airplanes.[269] It acknowledged that "these cases hold that such items of property are subject to taxation by a nondomiciliary state if there is sufficient activity within the state but then only upon an apportioned basis."[270] But the court declared:

> Although we recognize this well established rule of apportionment and appreciate the reasoning supporting it, there is no constitutional requirement that an apportionment formula be applied to movable property which has not entered or has left the stream of interstate commerce. Clearly, the commerce clause would not be involved. The due process clause does not require that in all circumstances there be *quid pro quo* between the tax paid and the benefits received.[271]

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[267] See Or. Admin. R. 150-308.550(2)-(A) (Sept. 1, 1990).

[268] Mikos v. Ringling Bros.–Barnum & Bailey Combined Shows, Inc., 368 So. 2d 884 (Fla. 1979), cert. denied, 445 US 939, 100 S. Ct. 1334 (1980).

[269] The court cited, among other cases, Ott v. Mississippi Valley Barge Line Co., 336 US 169, 69 S. Ct. 432 (1949), discussed in ¶ 4.12[2][c].

[270] *Mikos*, 368 So. 2d 884, 889–890 (Fla. 1979), cert. denied, 445 US 939, 100 S. Ct. 1334 (1980).

[271] *Mikos*, 368 So. 2d 884, 890 (Fla. 1979), cert. denied, 445 US 939, 100 S. Ct. 1334 (1980).

This decision subjects the circus to a risk of multiple taxation not borne by a circus operating solely in a single state.[272] It therefore cannot be reconcilsed with the Commerce Clause prohibition of multiple taxation.[273] Moreover, the whole course of the development of the Commerce Clause doctrine limiting state taxation of interstate railroads, marine transportation, and airlines over the years has been to reinforce the rule that each of the states that the commerce touches may impose a tax, provided the levies are fairly apportioned to the taxpayer's property or activities in the taxing state. The court's view that the "stream of commerce" had ended while the circus's railroad cars and equipment remained in the state pending the preparation of a new show was true only in the most restricted and artificial sense. The stays in Florida were temporary stopovers in the normal course of a national touring business. This is no different in substance from the temporary presence in a state of airplanes and railroad cars held at a station or airport until needed or when undergoing maintenance. The constitutional and policy considerations that call for apportionment on a time or other pro rata basis in the airline and railroad cases should apply equally to the circus.

[3] Taxes on Goods in Transit

One area of uncertainty regarding the impact of the Court's more recent Commerce Clause decisions on the viability of the traditional case law is whether the states now have power to tax goods in transit in interstate or foreign commerce. In one of its earliest decisions invalidating a state tax under the negative Commerce Clause, the Supreme Court invalidated a tax on goods in transit in interstate commerce.[274] In that case, a Pennsylvania statute taxed freight carried by transportation companies, at rates ranging from three to five cents per ton, depending on the nature of the freight. The amount of tax did not vary with the distance the freight was carried in the state, and the same rate was applicable to interstate and intrastate transportation. The Supreme Court construed the tax as being "laid upon freight carried," rejecting the state's contention that the tax was imposed on the railroad's franchise to conduct a transportation business.[275] Applying the principles of *Cooley v. Board of Wardens*,[276] the Court held that the "transportation of passengers or merchan-

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[272] Cf. Cole Bros. Circus v. Huddleston, 1993 WL 190914, 1993 Tenn. Ct. App. LEXIS 386 (rejecting Commerce Clause challenge to use tax on full value of traveling circus's equipment over objection that tax was not "fairly apportioned" to the number of days the equipment was located in the state).

[273] See supra ¶ 4.08.

[274] Case of the State Freight Tax, 82 US (15 Wall.) 232 (1872); see ¶ 4.07.

[275] *State Freight Tax*, 82 US (15 Wall.) 232, 273 (1872).

[276] Cooley v. Board of Wardens, 53 US (12 How.) 299 (1851).

dise through a State, or from one State to another" is of "such a nature as to require exclusive legislation by Congress."[277] Since the statute imposed "a tax upon freight carried between States and a tax because of its transportation," it was "in effect a regulation of interstate commerce . . . in conflict with the Constitution of the United States."[278]

The Court has since repudiated the premise on which it struck down the Pennsylvania freight tax—namely, "that direct taxes on interstate commerce violate the Commerce Clause."[279] Nevertheless, such a tax still should be struck down on the ground that it would subject interstate commerce to a risk of multiple taxation not borne by intrastate commerce. If Pennsylvania has the power to impose a flat rate tax on each ton of freight carried in the state, regardless of the distance carried, so does every other state. The consequences of recognizing such a taxing power would be that intrastate railroads, truck lines, and similar businesses would pay only a single tax to one state, but interstate transporters could be subjected to a multiplicity of such levies by every state through which freight is carried.[280]

However, a tax on goods in transit that is fairly apportioned to the mileage or ton-miles of freight in the state would not be vulnerable under the multiple taxation doctrine. The question is whether the traditional rule that "the States may not tax property in transit in interstate commerce"[281] is still viable, as applied to such an apportioned tax on freight moving through the state. Although the opinion in *Japan Line*[282] dealt with taxation, not of freight but of an instrumentality of commerce (shipping containers), and with foreign rather than interstate commerce, it is, nevertheless, relevant to our problem. The Court there repeated the current four-fold test of state taxation of interstate commerce, declaring that the tax would have been valid if the shipping containers had been engaged in interstate commerce, because the containers had a "substantial nexus" with the taxing state, the tax was "fairly apportioned," it did not discriminate against the commerce, and it was "fairly related to the services provided by the State."[283] A tax on freight in transit apportioned under the widely used ton-mileage formulas applied to transportation companies

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[277] *State Freight Tax*, 82 US (15 Wall.) 232, 280 (1872).

[278] *State Freight Tax*, 82 US (15 Wall.) 232, 279 (1872).

[279] See ¶ 4.10[2].

[280] Such a tax might also be invalid because it could be seen as violating the Commerce Clause prohibition against discriminatory taxation. The Court has recognized the inherent tendency of flat rate and fixed fee license taxes to impose greater burdens on interstate than intrastate businesses. See the drummers' license cases, infra ¶ 4.13[2][a] and the flat rate trucking tax case, infra ¶ 4.13[2][g].

[281] Minnesota v. Blasius, 290 US 1, 9, 54 S. Ct. 34 (1933).

[282] Japan Line, Ltd. v. County of Los Angeles, 441 US 434, 99 S. Ct. 1813 (1979). The *Japan Line* case is considered supra ¶ 4.12[2][c].

[283] *Japan Line*, 441 US 434, 444–445, 99 S. Ct. 1813 (1979).

would readily satisfy three of the four tests, for it would be "fairly apportioned," nondiscriminatory, and "be fairly related to the services provided by the State."[284] However, the existence of a substantial nexus presents a more difficult question.

On the one hand, the shipping containers involved in *Japan Line* and the freight in our hypothetical case share one feature in common, namely, that just as some of the shipper's containers in *Japan Line* were present at all times in the state, so an interstate railroad or truck line is likely to have some freight present at all times in each of the states through which its lines run. On the other hand, the duration of the freight's presence in a state is likely to be substantially less than the average of less than three weeks that Japan Line's shipping containers remained in Los Angeles County.[285] The question is whether this distinction makes a constitutional difference for purposes of the substantial nexus requirement. Although there may be circumstances in which the freight's presence in the state is so ephemeral as to fall short of the "substantial nexus" required by the Commerce Clause—even though the freight is physically present in the state[286]—we believe that in most circumstances a fairly apportioned, nondiscriminatory property tax on goods in transit will be sustained under the Commerce Clause.

This conclusion is reinforced by the U.S. Supreme Court's decision in *DH Holmes Co. v. McNamara*.[287] There the Court considered the question whether the Commerce Clause forbade Louisiana from imposing a use tax on catalogs shipped from outside the state directly to the taxpayer's customers in Louisiana. The taxpayer, Holmes, was a Louisiana corporation with thirteen department stores and approximately 1.5 million customers throughout the state. Holmes argued that Louisiana could not impose the tax on Holmes's use of the catalogs because they were still in the stream of commerce when the tax attached. The Supreme Court found that this contention was beside the point.

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[284] To some extent at least, both the containers and the freight benefit from services rendered and facilities furnished by the state. These include police and fire protection and the availability of the state's courts to entertain suits for damages or loss of the property while it is in the state. For the alleged "emasculation" of the requirement that taxes be fairly related to services provided by the state, see infra ¶ 4.17[2][e].

[285] *Japan Line*, 441 US 434, 437, 99 S. Ct. 1813 (1979).

[286] See Quill Corp. v. North Dakota, 504 US 298, 112 S. Ct. 1904 (1992) (reaffirming bright-line, physical-presence standard of "substantial nexus" under the Commerce Clause with respect to a state's ability to require an out-of-state vendor to collect use taxes on sales to in-state customers). The *Quill* case is considered in detail in ¶¶ 6.02, 19.02[5][g].

[287] DH Holmes Co. v. McNamara, 486 US 24, 108 S. Ct. 1619 (1988).

Declaring that in *Complete Auto*[288] it had abandoned the "abstract notion that interstate commerce 'itself' cannot be taxed by the States,[289] the Court held:

> Accordingly, in the present case it really makes little difference for Commerce Clause purposes whether appellant's catalogs "came to rest" in the mailboxes of its Louisiana customers or whether they were still considered in the stream of interstate commerce. This distinction may be of some importance for other purposes (in determining, for instance, whether a "taxable moment" has occurred [under state law]), but for Commerce Clause analysis it is largely irrelevant.[290]

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[288] Complete Auto Transit, Inc. v. Brady, 430 US 274, 97 S. Ct. 1076 (1977).

[289] *Holmes*, 486 US 24, 30, 108 S. Ct. 1619 (1988).

[290] *Holmes*, 486 US 24, 31, 108 S. Ct. 1619 (1988). The *Holmes* case is considered in more detail in ¶ 16.03[3][a][ii]. See also Pledger v. Arkla, Inc., 309 Ark. 10, 827 SW2d 126 (1992), cert. denied, 506 US 870, 113 S. Ct. 203 (1992); Tennessee Gas Pipeline Co. v. Marx, 594 So. 2d 615 (Miss. 1992) ; Questar Pipeline Co. v. Utah State Tax Comm'n, 817 P2d 316 (Utah 1991), all of which relied on *Holmes* in sustaining state use taxes on compressor fuel used to propel natural gas through interstate pipelines. In light of *Holmes* and the cases construing it, one may question the continuing validity of Helson & Randolph v. Kentucky, 279 US 245, 49 S. Ct. 279 (1929), which held that a tax on the mere consumption of fuel in the state by an instrumentality of interstate commerce violated the Commerce Clause because there was no "taxable moment." Cf. United Air Lines, Inc. v. Mahin, 410 US 623, 93 S. Ct. 1186 (1973) (sustaining state tax on storage of fuel consumed on interstate flights and narrowly distinguishing *Helson & Randolph*).

Indeed, in Columbia Gulf Transmission Co. v. Broussard, 653 So. 2d 522 (La. 1995), cert. denied, 516 US 908, 116 S. Ct. 276 (1995), which relied on the *Arkla, Tennessee Gas Pipeline*, and *Questar Pipeline* cases in reaching a similar conclusion, the court specifically observed that "*Helson* has been superseded by *Complete Auto Transit, Inc.*" *Columbia Gulf Transmission*, 653 So. 2d 522, 524 (La. 1995), cert. denied, 516 US 908, 116 S. Ct. 276 (1995). But see Union Elec. Co. v. Department of Revenue, 180 Ill. App. 3d 1, 534 NE2d 1028 (4th Dist. 1989), aff'd on other grounds, 136 Ill. 2d 385, 556 NE2d 236 (1990) (no local taxable event occurred to justify imposition of use tax on coal purchased by out-of-state utility when coal was shipped directly by Illinois seller to common carrier for transport to out-of-state location).

In Big Boy's Toy, Ltd. v. Limbach, 64 Ohio St. 3d 448, 597 NE2d 76 (1992), the court, relying on *Holmes*, rejected Ohio's earlier Commerce Clause jurisprudence that had focused on whether there was a "taxable moment" to justify the imposition of a use tax and refocused the question on whether there was substantial nexus. In remanding the case to the trial court to determine whether a boat that was temporarily brought into the state to undergo repairs could be subjected to use tax, the court stressed that the Supreme Court's decisions in *Complete Auto, Holmes*, and Quill Corp. v. North Dakota, 504 US 298, 112 S. Ct. 1904 (1992), required that "the use be *substantial*; any use is not sufficient." *Big Boy's Toy*, 64 Ohio St. 3d 448, 597 NE2d 76, 79 (1992) (emphasis in original).

¶ 4.13 STATE TAXES DISCRIMINATING AGAINST INTERSTATE COMMERCE

The rule prohibiting state taxes discriminating against interstate commerce has been a fundamental tenet of the Court's Commerce Clause jurisprudence from the very beginning.[291] Although the concept of discrimination is not self-defining and the scope of the doctrine forbidding discriminatory taxes has never been precisely delineated by the Court, the central meaning of discrimination as a criterion for adjudicating the constitutionality of state taxes on interstate business emerges unmistakably from the Court's numerous decisions addressing the issue: A tax that by its terms or operation imposes greater burdens on out-of-state goods, activities, or enterprises than on competing in-state goods, activities, or enterprises will be struck down as discriminatory under the Commerce Clause.

In contrast to the deference that the Court has accorded the states when confronted with allegations that a tax lacks sufficient nexus with or is unfairly apportioned to the taxing state, the Court has scrutinized claims that a tax discriminates against interstate commerce with considerable vigilance. In recent years, the Court has been quick to strike down state taxes that in its view favor local over out-of-state products,[292] activities,[293] or enterprises[294] it has invalidated discriminatory levies whether or not the discrimination is intentional.[295] Although the Court has occasionally sanctioned different treatment of interstate and local business,[296] its decisions strongly adhere to the principle that "[n]o State, consistent with the Commerce Clause, may 'impose a tax

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[291] See Welton v. Missouri, 91 US (1 Otto) 275 (1876). In *Welton*, the first case in which the Court invalidated a discriminatory tax under the Commerce Clause, the Court struck down a peddlers' license tax imposed only upon dealers in out-of-state goods, as applied to an out-of-state merchant, on the grounds that it discriminated against interstate commerce and was contrary to Congress's will "that interstate commerce shall be free and untrammeled." *Welton*, 91 US (1 Otto) 275, 282 (1876).

[292] See, e.g., Bacchus Imports, Ltd. v. Dias, 468 US 263, 104 S. Ct. 3049 (1984) (invalidating excise tax on liquor from which locally produced beverages were exempt). *Bacchus* is considered further infra ¶ 4.13[2][b][ii].

[293] See, e.g., Westinghouse Elec. Corp. v. Tully, 466 US 388, 104 S. Ct. 1856 (1984) (invalidating income tax credit limited to corporations engaging in export-related activity in the state). *Westinghouse* is considered further infra ¶ 4.13[2][b][iii].

[294] See, e.g., Fulton Corp. v. Faulkner, 516 US 325, 116 S. Ct. 848 (1996) (invalidating state intangible property tax that favored investment in in-state over out-of-state corporations). *Fulton* is considered further infra ¶ 4.13[2][c][ii].

[295] See, e.g., Halliburton Oil Well Cementing Co. v. Reily, 373 US 64, 83 S. Ct. 1201 (1963). *Halliburton* is considered further infra ¶ 4.13[2][d].

[296] See, e.g., General Motors Corp. v. Tracy, 519 US 278, 117 S. Ct. 811 (1997) (sustaining use tax exemption applicable only to purchases of natural gas from local distribution companies). *General Motors* is considered further infra ¶ 4.13[2][i].

which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.'"[297]

Justice Powell articulated the constitutional justification for invalidating state taxes that discriminate against interstate commerce as follows:

> It is a basic principle of Commerce Clause jurisprudence that "[n]either the power to tax nor the police power may be used by the state of destination with the aim and effect of establishing an economic barrier against competition with the products of another state or the labor of the residents." Those barriers would constitute "an unreasonable clog upon the mobility of commerce."[298]

The Commerce Clause evinces a "constitutional preference for an open economy."[299]

Justice Stone grounded the prohibition against discriminatory taxation in part on political grounds.[300]

> [T]he decisions appear to be predicated on a practical judgment as to the likelihood of the tax being used to place interstate commerce at a competitive disadvantage. . . . Lying back of these decisions is the recognized danger that, to the extent that the burden falls on economic interests without the state, it is not likely to be alleviated by those political restraints which are normally exerted on legislation where it affects adversely interests within the state.[301]

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[297] Boston Stock Exch. v. State Tax Comm'n, 429 US 318, 329, 97 S. Ct. 599 (1977) (quoting Northwestern States Portland Cement Co. v. Minnesota, 358 US 450, 457–458, 79 S. Ct. 357 (1959)).

[298] Moorman Mfg. Co. v. Bair, 437 US 267, 287–288, 98 S. Ct. 2340 (1978) (Powell, J., dissenting) (citations omitted).

[299] *Moorman Mfg.*, 437 US 267, 289, 98 S. Ct. 2340 (1978) (Powell, J., dissenting).

[300] See McGoldrick v. Berwind-White Coal Mining Co., 309 US 33, 60 S. Ct. 388 (1940).

[301] *McGoldrick*, 309 US 33, 45–46 n.2, 60 S. Ct. 388 (1940). In Robbins v. Shelby County Taxing Dist., 120 US 489, 501, 7 S. Ct. 592 (1887), one of the earliest cases in which the Court struck down a tax on the privilege of engaging in interstate selling, Chief Justice Waite (joined by Justices Field and Grey) dissented in an opinion that was premised on the view that nondiscriminatory taxes on interstate commerce do not conflict with the Commerce Clause, declaring:

> As the law is valid so far as the inhabitants are concerned, no inhabitant can engage in this business unless he pays the tax. If citizens of other states cannot be taxed in the same way for the same business, there will be discrimination against the inhabitants of Tennessee and in favor of those of other states. This could never have been intended by the legislature and I cannot believe the Constitution of the United States makes such a thing necessary. The Constitution gives the citizens of each state all the privileges and immunities of citizens in the several states, but this certainly does not guarantee to those who are doing business in states other than their own immunities from taxation on that business to which citizens of the state where the business is carried on are subjected.

[1] Types of Discrimination in General

[a] Facial Discrimination

When a state taxing statute discriminates on its face against interstate commerce (i.e., when the taxing statute explicitly subjects out-of-state products, out-of-state taxpayers, or interstate transactions to higher tax burdens than competing local products, taxpayers, or transactions), the Court has adopted "a virtually *per se* rule of invalidity" for such taxes.[302] Most cases involving allegations of discrimination against interstate commerce, however, involve more subtle or complex taxing schemes that are not so easily characterized as unconstitutionally discriminatory.

It should be noted that, over the Court's history, some of the Justices have taken the position that state taxes may be invalidated by the Court in the silence of Congress if they discriminate against interstate commerce, but not otherwise. See Justices Wayne and Davis, dissenting in the landmark Case of the State Freight Tax, 82 US (15 Wall.) 232 (1872), discussed supra ¶ 4.07; Justice Black in JD Adams Mfg. Co. v. Storen, 304 US 307, 58 S. Ct. 913 (1938); Justice Douglas in Southern Pac. Co. v. Sullivan, 325 US 761, 788, 65 S. Ct. 1515 (1945). Justice Black's partial dissent in *JD Adams Mfg. Co.* contains a searching and perspicacious review of the history of the Court's approaches to state taxation under the Commerce Clause. See also Justice Scalia's views, discussed supra ¶ 4.11[2], and the writings of Professor Thomas Reed Powell ("Indirect Encroachment on Federal Authority by the Taxing Powers of the States," 31 Harv. L. Rev. 572, 721 (1918), 32 Harv. L. Rev. 374, 377 (1918), 32 Harv. L. Rev. 234, 236 (1919); "Contemporary Commerce Clause Controversies Over State Taxation," 76 U. Pa. L. Rev. 773, 958 (1928)), who for decades was the most authoritative and incisive critic of the Court's Commerce Clause decisions and who supported the view that only discriminatory state taxes should be invalidated under the dormant Commerce Clause.

[302] See, e.g., Camps Newfound/Owatonna, Inc. v. Town of Harrison, Me., 520 US 564, 117 S. Ct. 1590, 1598 (1997) (striking down Maine property tax exemption for charitable institutions that was limited to institutions serving principally state residents); Fulton Corp. v. Faulkner, 516 US 325, 331, 116 S. Ct. 848 (1996) (striking down intangible property tax that applied to corporate stock only to the extent that the issuing corporation engaged in out-of-state activity); Oregon Waste Sys., Inc. v. Department of Envtl. Quality, 511 US 93, 99, 114 S. Ct. 1345 (1994) (striking down tax on in-state disposal of out-of-state waste that was higher than tax on in-state disposal of in-state waste); Chemical Waste Management, Inc. v. Hunt, 504 US 334, 344 note 6, 112 S. Ct. 2009 (1992) (same); cf. Wyoming v. Oklahoma, 502 US 437, 454, 112 S. Ct. 789 (1992) (striking down requirement that coal-fired electric utilities burn a mixture containing at least 10 percent in-state coal); Philadelphia v. New Jersey, 437 US 617, 624, 98 S. Ct. 2531 (1978) (striking down ban on in-state disposal of out-of-state waste). Indeed, the first case invalidating a discriminatory state tax under the Commerce Clause was a facially discriminatory peddlers' license tax imposed only on dealers in out-of-state goods. Welton v. Missouri, 91 US (1 Otto) 275 (1876).

[b] Discrimination in Effect

State taxes that discriminate in practical effect against interstate commerce are as offensive to the Commerce Clause as are taxes that explicitly discriminate against such commerce. The Court has consequently made it clear that the Commerce Clause bars taxes effectively discriminating against interstate commerce no less than taxes that do so by their terms. "The Commerce Clause," the Court has observed, "forbids discrimination whether forthright or ingenious."[303] Accordingly, the Court has stated that "[i]n each case it is our duty to determine whether the statute under attack . . . will in its practical operation work discrimination against interstate commerce."[304]

[c] Discriminatory Purpose

A determination that a state tax violates the Commerce Clause "may be made on the basis of either discriminatory purpose or discriminatory effect."[305] Thus the Court will strike down a tax if it finds that it was "enacted for protectionist purposes."[306] Indeed, it has been suggested that the U.S. Supreme Court has been largely concerned with purposeful economic protectionism in adjudicating challenges to state legislation under the Commerce Clause,[307] although it is clear that the prohibition against state tax discrimination is not so limited.[308]

[d] De Minimis Discrimination

A tax that is found to discriminate against interstate commerce will not be sustained on the ground that the amount of the discrimination is inconsequential. As the U.S. Supreme Court has declared, "we have never recognized a 'de minimis' defense to a charge of discriminatory taxation under the Commerce Clause."[309] The Court has also observed that "[a]ctual discrimination, wherever it is found is impermissible, and the magnitude and scope of the discrimination have no bearing on the determinative question whether the discrimination has

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[303] Best & Co. v. Maxwell, 311 US 454, 455, 61 S. Ct. 34 (1940).

[304] *Best & Co.*, 311 US 454, 456, 61 S. Ct. 34 (1940).

[305] Bacchus Imports, Ltd. v. Dias, 468 US 263, 270, 104 S. Ct. 3049 (1984) (citations omitted).

[306] *Bacchus*, 468 US 263, 272, 104 S. Ct. 3049 (1984).

[307] D. Regan, "The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause," 84 Mich. L. Rev. 1091 (1986).

[308] W. Hellerstein, "Commerce Clause Restraints on State Taxation: Purposeful Discrimination and Beyond," 85 Mich. L. Rev. 758 (1987).

[309] Fulton Corp. v. Faulkner, 516 US 325, 334 n.3, 116 S. Ct. 848 (1996).

occurred."[310] Furthermore, the Court has noted that "[w]e need not know how unequal the Tax is before concluding that it unconstitutionally discriminates."[311]

[e] Discrimination and "Local Events" Preceding or Succeeding Interstate Commerce

The entire rubric of learning as to when commerce begins and ends, and the highly refined distinctions the Court drew in earlier cases in delineating the "stream of commerce"[312] are essentially irrelevant to the determination as to whether a tax violates the Commerce Clause on the ground that it discriminates against interstate commerce. In 1876, in the first decision striking down a discriminatory tax under the Commerce Clause, the Court declared that the protection of the clause

> continues until the commodity has ceased to be the subject of discriminating legislation by reason of its foreign character. That power protects it, even after it has entered the State, from any burdens imposed by reason of its foreign origin.[313]

A century later, the Court reiterated this point in adjudicating the constitutionality of New York's stock transfer tax:

> Because of the discrimination inherent in [the statute], we . . . reject the Commission's argument that the tax should be sustained because it is a local event at the end of interstate commerce. While it is true that, absent an undue burden on interstate commerce, the Commerce Clause does not prohibit the States from taxing the transfer of property within the state, the tax may not discriminate between transactions on the basis of some interstate element.[314]

[f] Discrimination Burdening In-State Consumers

Although Commerce Clause discrimination more often than not focuses on the burden it imposes upon out-of-state competitors with local businesses,

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[310] Associated Indus. of Mo. v. Lohman, 511 US 641, 650, 114 S. Ct. 1815 (1994).

[311] Maryland v. Louisiana, 451 US 725, 760, 101 S. Ct. 2114 (1981); cf. Wyoming v. Oklahoma, 502 US 437, 455, 112 S. Ct. 789 (1992) ("The volume of commerce affected measures only the *extent* of the discrimination; it is of no relevance to the determination whether a State has discriminated against interstate commerce") (emphasis in original).

[312] See supra ¶¶ 4.01–4.04.

[313] Welton v. Missouri, 91 US (1 Otto.) 275, 282 (1876).

[314] Boston Stock Exch. v. State Tax Comm'n, 429 US 318, 332 n.12, 97 S. Ct. 599 (1977). The *Boston Stock Exchange* case is considered infra ¶ 4.13[2][b][i].

discrimination that burdens in-state consumers is no less repugnant to the Commerce Clause. However, in 1989, in an unfortunate dictum, the Court declared that "[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes."[315] In fact, the Court could not have meant what it said. If a state imposes a tax on state residents' purchases of out-of-state but not in-state goods, the tax would be struck down in short order. A more blatant discrimination against interstate commerce in violation of the "free trade" principles underlying the Commerce Clause is difficult to imagine. It is a cardinal purpose of the Commerce Clause to protect state residents from their own state taxes when those taxes discriminate against interstate commerce. Fortunately, in 1994 the Court repudiated its ill-considered dictum (at least implicitly) by observing that "[s]tate taxes are ordinarily paid by in-state businesses and consumers, yet if they discriminate against out-of-state products, they are unconstitutional."[316]

[2] Types of Discriminatory and Allegedly Discriminatory Taxes

[a] Drummers' License Taxes

[i] Historical background. Beginning shortly after the Civil War, the Court confronted a large crop of drummers' and merchants' license taxes imposed on vendors of goods from other states. The taxes were enacted chiefly by the southern and western states, and they were aimed at an army of northern drummers descending upon rural sections of the country with order blanks for the products of industrial centers. Many of these enactments required the payment of license fees in flat amounts, bearing no relation to the volume of the business done. It has been estimated that almost 800 municipal ordinances directed at drummers were enacted for the purpose of embarrassing this competition with local merchants.[317]

The levies generally prohibited the drummer, under the pain of criminal penalties, from seeking to sell his wares. The Court invariably invalidated these taxes as to drummers who obtained shipment of the goods into the state.[318] The Court did sustain vendors' license taxes, however, as to peddlers

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[315] Goldberg v. Sweet, 488 US 252, 266, 109 S. Ct. 582 (1989).

[316] West Lynn Creamery, Inc. v. Healy, 512 US 186, 203, 114 S. Ct. 2205 (1994).

[317] See J. Hemphill, "The House to House Canvasser in Interstate Commerce," 60 Am. L. Rev. 641 (1926); McGoldrick v. Berwind–White Coal Mining Co., 309 US 33, 60 S. Ct. 388 (1940).

[318] Welton v. Missouri, 91 US (1 Otto.) 275 (1876), is the first case in which the Court invalidated such a tax under the Commerce Clause. The Court had invalidated a similar tax in Ward v. Maryland, 79 US (12 Wall.) 418 (1870), under the Privileges and

who brought their goods into the state for sale directly from their wagons.[319] Some of the taxes invalidated were unmistakably discriminatory against interstate business, since they were expressly limited to the merchants or products of other states.[320] In others, the discrimination was less clear. They involved taxes limited either to persons not having an established place of business in the taxing jurisdiction, or to selected articles not produced in the state.[321] Another equally offensive form of discrimination that the Court readily condemned under the Commerce Clause were levies that subjected nonresident businesses to higher tax rates than those applied to local businesses.[322] In still other cases the problem was more subtle, for they involved fixed sum license fees payable by local as well as out-of-state solicitors as conditions to negotiating or making sales. Nevertheless, the Court found many of these taxes unconstitutionally discriminatory.[323]

Immunities Clause of Article IV, § 2, although Justice Bradley's concurring opinion stated that the tax violated the Commerce Clause as well.

[319] Wagner v. City of Covington, 251 US 95, 40 S. Ct. 93 (1919); Bacchus v. Louisiana, 232 US 334, 34 S. Ct. 439 (1914); Kehrer v. Stewart, 197 US 60, 25 S. Ct. 403 (1905); American Steel & Wire Co. v. Speed, 192 US 500, 24 S. Ct. 365 (1904); Emert v. Missouri, 156 US 296, 15 S. Ct. 367 (1895); Howe Mach. Co. v. Gage, 100 US 676 (1879).

[320] Walling v. Michigan, 116 US 446, 6 S. Ct. 454 (1886); Webber v. Virginia, 103 US 344 (1880); Cook v. Pennsylvania, 97 US 566 (1878); Welton v. Missouri, 91 US (1 Otto) 275 (1876).

[321] Stewart v. Michigan, 232 US 665, 34 S. Ct. 476 (1914); Dozier v. Alabama, 218 US 124, 30 S. Ct. 649 (1910); Norfolk & W. Ry. v. Sims, 191 US 441, 24 S. Ct. 151 (1903); Caldwell v. North Carolina, 187 US 622, 23 S. Ct. 229 (1903); Robbins v. Shelby County Taxing Dist., 120 US 489, 7 S. Ct. 592 (1887); cf. West Point Wholesale Grocery Co. v. City of Opelika, 354 US 390, 77 S. Ct. 1096 (1957). The leading case in this line of vendors' license tax cases is *Robbins v. Shelby County Taxing District*, which involved a license tax as applied to an out-of-state merchant. The statute imposed a tax on "[a]ll drummers, and all persons not having a regular licensed house of business in the Taxing District, offering for sale or selling goods . . . by sample." *Robbins*, 120 US 489, 490–491, 7 S. Ct. 592 (1887). After holding that the local activity of soliciting interstate sales was an integral part of interstate commerce protected by the Commerce Clause, the Court rejected the contention that the tax was nevertheless valid, because it made no distinction between out-of-state and local drummers. Not only was interstate commerce wholly immune from state taxation under the Court's then-prevailing view of the Commerce Clause (a view the Court has since repudiated, see supra ¶¶ 4.10, 4.11) but, more importantly for present purposes, the tax was invalidated on the ground that it discriminated *in effect* against interstate commerce. Because such commerce is more likely to be conducted by drummers than is the domestic commerce with which it competes, the tax on drummers therefore operates to the disadvantage of business conducted across state lines. *Robbins*, 120 US 489, 498, 7 S. Ct. 592 (1887).

[322] See, e.g., Memphis Steam Laundry Cleaners, Inc. v. Stone, 342 US 389, 72 S. Ct. 424 (1952).

[323] Real Silk Hosiery Mills v. Portland, 268 US 325, 45 S. Ct. 525 (1925); Western Oil Ref. Co. v. Lipscomb, 244 US 346, 37 S. Ct. 623 (1917); Davis v. Virginia, 236 US

[ii] The modern precedents. In *Nippert v. City of Richmond*,[324] the Court relied on the Commerce Clause in striking down a license tax laid by the City of Richmond, Virginia, on engaging "in business as solicitors." The tax was imposed at the rate of $50 plus one-half percent of gross earnings for the preceding year in excess of $1,000. The defendant, who was convicted below for failing to obtain the required license, solicited orders for an out-of-state garment company. In setting aside the levy, the Court stressed its prohibition against taxes that "in their practical operation worked discriminatorily against interstate commerce to impose upon it a burden, either in fact or by the very threat of its incidence. . . ."[325] In *Nippert*, as in "the long line of so-called 'drummer cases' beginning with *Robbins v. Shelby County Taxing District*"[326] involving taxes on itinerant merchants, "[t]o ignore the variations in effect which follow from application of the tax, uniform on the face of the ordinance, . . . is only to ignore those practical consequences."[327] The Court also emphasized the risks to the out-of-state vendor of the fixed-fee license tax required to be paid before any business is done and the burdens such a levy imposes on "the small operator particularly and more especially the casual or occasional one."[328]

Dunbar–Stanley Studios, Inc. v. Alabama[329] involved the application of Alabama's license tax of $5 per week on "each transient or traveling photographer." The state applied the tax to a foreign corporation that sent photographers into Alabama to take children's photographs. The photographers sent the undeveloped film back to their North Carolina studios for developing. The business was conducted under a contractual arrangement between the taxpayer and J.C. Penney stores located in Alabama. The Penney stores advertised the services and recruited customers. When the photos were completed, the taxpayer sent them to the Penney stores for delivery to the customers. The Penney stores took all the orders for the photographs, which were sent to the taxpayer's offices in North Carolina for acceptance.

In sustaining the tax, the Supreme Court held that the taking of photographs in the state was a locally taxable event, separable from the interstate as-

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697, 35 S. Ct. 479 (1915); Rogers v. Arkansas, 227 US 401, 33 S. Ct. 298 (1913); Crenshaw v. Arkansas, 227 US 389, 33 S. Ct. 294 (1913); Rearick v. Pennsylvania, 203 US 507, 27 S. Ct. 159 (1906); Stockard v. Morgan, 185 US 27, 22 S. Ct. 576 (1902); Brennan v. Titusville, 153 US 289, 14 S. Ct. 829 (1894); Stoutenburgh v. Hennick, 129 US 141, 9 S. Ct. 256 (1889); Asher v. Texas, 128 US 129, 9 S. Ct. 1 (1888).

[324] Nippert v. City of Richmond, 327 US 416, 66 S. Ct. 586 (1946).

[325] *Nippert*, 327 US 416, 425, 66 S. Ct. 586 (1946).

[326] *Nippert*, 327 US 416, 66 S. Ct. 586 (1946); see supra note 321 (discussing *Robbins*).

[327] *Nippert*, 327 US 416, 431, 66 S. Ct. 586 (1946).

[328] *Nippert*, 327 US 416, 429, 66 S. Ct. 586 (1946).

[329] Dunbar-Stanley Studios, Inc. v. Alabama, 393 US 537, 89 S. Ct. 757 (1969).

pects of the operations, and that the taxpayer was carrying on a local business at the Penney stores. The Court also rejected the contention that the tax operated to discriminate against interstate commerce:

> Alabama's tax is levied equally upon all transient or traveling photographers whether their travel is interstate or entirely within the State. On the record before us, there is no basis for concluding that the $5 per week tax on transient out-of-state photographers is so disproportionate to the tax imposed on photographers with a fixed location [which generally amounted to $25 per year] as to bear unfairly on the former.[330]

The *Dunbar-Stanley* decision seems strangely out of harmony with the "long line" of drummers' license cases of which *Nippert* is the outstanding modern example. It is even more surprising because it is the Court's most recent decision in this line. Perhaps it can be explained by the taxpayer's failure to show, as a factual matter, that the tax was relatively more burdensome to out-of-state than to in-state photographers. However, this would mean that out-of-state photographers could average no more than five visits a year into the state. In any event, the New York Court of Appeals has more recently followed *Nippert* (and not *Dunbar-Stanley*) in striking down an Albany, New York, tax on "transient retailers."[331]

[b] State Tax Incentives[332]

State tax incentives, whether in the form of credits, exemptions, abatements, or other favorable treatment typically share two features that render them suspect under the rule barring taxes that discriminate against interstate commerce. First, state tax incentives single out for favorable treatment activities, investments, or other actions that occur within the taxing state. Second, state tax incentives, as integral components of the state's taxing apparatus, are intimately associated with the coercive machinery of the state.

The Court's treatment of state tax incentives suggests that the constitutional suspicion surrounding such measures is well justified. Since 1977, the Court has considered four taxing schemes involving measures explicitly designed to encourage economic activity within the state.[333] In each case the

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[330] *Dunbar-Stanley*, 393 US 537, 542, 89 S. Ct. 757 (1969).

[331] Homier v. City of Albany, 90 NY2d 153, 681 NE2d 390, 659 NYS2d 223 (1997).

[332] The following discussion draws freely from W. Hellerstein & D. Coenen, "Commerce Clause Restraints on State Business Development Incentives," 81 Cornell L. Rev. 789 (1996).

[333] See New Energy Co. v. Limbach, 486 US 269, 108 S. Ct. 1803 (1988); Bacchus Imports, Ltd. v. Dias, 468 US 263, 104 S. Ct. 3049 (1984); Westinghouse Elec. Corp. v. Tully, 466 US 388, 104 S. Ct. 1856 (1984); Boston Stock Exch. v. State Tax Comm'n, 429 US 318, 97 S. Ct. 599 (1977).

Court invalidated the measure and did so with rhetoric so sweeping as to cast a constitutional cloud over all state tax incentives.

[i] Discrimination against out-of-state competitors by preferential taxation of those trading with a local business. In *Boston Stock Exchange v. State Tax Commission*,[334] the Court considered a New York stock transfer tax that included an incentive designed to assist the New York brokerage industry. The transfer tax applied to "all sales, or agreements to sell, or memoranda of sales and all deliveries or transfers of shares or certificates of stock" in New York.[335] Because the "bulk of stock transfers . . . funnels through New York,"[336] New York's stock transfer tax applied to the lion's share of stock *transfers*, regardless of where the stock *sale* occurred. In order to encourage nonresident stock sellers and sellers of large blocks of stock to effectuate their sales through New York—rather than through out-of-state—brokers, New York amended the statute to offer these sellers a tax break. In lieu of the tax that had previously applied uniformly to the transfer of securities through a New York stock transfer agent without regard to the situs of the sale, New York provided a reduced stock transfer tax for these sellers if they made their sales through New York brokers.

The Court found that this reduction in tax liability, designed to encourage in-state business activity, offended the Commerce Clause's nondiscrimination principle. Prior to the statute's amendment, the New York transfer tax was "neutral as to in-state and out-of-state sales"[337] because, regardless of where the sale occurred, the same tax applied to all securities transferred through a New York transfer agent. The amendment, however, "upset this equilibrium"[338] because a seller's decision as to where to sell would no longer be made "*solely* on the basis of *nontax* criteria."[339] Instead, a seller would be induced to trade through a New York broker to reduce his or her transfer tax liability.

By providing a tax incentive for sellers to deal with New York rather than out-of-state brokers, the state had, in the Court's eyes, "*foreclose[d] tax-neutral decisions.*"[340] Moreover, it had done so through the coercive use of its taxing authority. As the Court noted, "the State is using its power to tax an in-state operation as a means of requiring other business operations to be performed in the home State."[341]

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[334] Boston Stock Exch. v. State Tax Comm'n, 429 US 318, 97 S. Ct. 599 (1977).

[335] NY Tax Law § 270.1 (McKinney 1966).

[336] *Boston Stock Exch.*, 429 US 318, 327 n.19, 97 S. Ct. 599 (1977).

[337] *Boston Stock Exch.*, 429 US 318, 330, 97 S. Ct. 599 (1977).

[338] *Boston Stock Exch.*, 429 US 318, 330, 97 S. Ct. 599 (1977).

[339] *Boston Stock Exch.*, 429 US 318, 331, 97 S. Ct. 599 (1977) (emphasis supplied).

[340] *Boston Stock Exch.*, 429 US 318, 331, 97 S. Ct. 599 (1977) (emphasis supplied).

[341] *Boston Stock Exch.*, 429 US 318, 336, 97 S. Ct. 599 (1977).

Because tax incentives, by their nature, are designed to "foreclose tax-neutral decisions" by bringing "tax criteria" to bear on business decision making, courts could easily read *Boston Stock Exchange* to mean that a constitutional infirmity afflicts every state tax incentive. Perhaps for this reason, the Court felt moved to observe that its "decision . . . does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry."[342] The Court did not explain, however, how states could effectively pursue this objective under the constraints of its reasoning in *Boston Stock Exchange*. If a state may not "use discriminatory taxes to assure that nonresidents direct their commerce to businesses within the State,"[343] and "discriminatory taxes" include those that reduce the effective tax rate when economic activity is conducted inside rather than outside the state's borders, the effectiveness of tax policy as a means "to encourage the growth and development of intrastate commerce and industry" would be severely curtailed.[344]

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[342] *Boston Stock Exch.*, 429 US 318, 336, 97 S. Ct. 599 (1977).

[343] *Boston Stock Exch.*, 429 US 318, 334–335, 97 S. Ct. 599 (1977).

[344] The *Boston Stock Exchange* case confronted the Court with an aspect of discriminatory taxation that it had not previously encountered, namely, discrimination that involved differential treatment of *two types of nonresidents*, those who made in-state sales and those who made out-of-state sales. The Court disposed of the argument that only discrimination *against nonresidents in favor of residents* is proscribed by the Commerce Clause by first observing that "nonresident, in-state sales . . . may also be considered as interstate commerce," and concluded:

> A State may no more use discriminatory taxes to assure that nonresidents direct their commerce to businesses within the State than to assure that residents trade only in intrastate commerce. As we stated at the outset, the fundamental purpose of the Clause is to assure that there be free trade among the several States. This free trade purpose is not confined to the freedom to trade with only one State; it is a freedom to trade with any State, to engage in commerce across all state boundaries.

Boston Stock Exch., 429 US 318, 334–335, 97 S. Ct. 599 (1977).

Following the decision of the New York Court of Appeals in Boston Stock Exch. v. State Tax Comm'n, 37 NY2d 535, 337 NE2d 758 (1975), but prior to the Supreme Court's decision reversing the Court of Appeals, Congress amended the Federal Securities Act to prohibit the imposition of a stock transfer tax where the sole event taking place in the state is the delivery, or transfer to, or by, a registered clearing agency or registered transfer agent. Pub. L. No. 94-29, 89 Stat. 97, codified at 15 USC § 78bb(d). Wholly apart from the Court's decision in *Boston Stock Exchange*, the federal legislation limited New York's ability to "coerce" stock purchasers to trade in New York, since New York could no longer rely solely on the existence of New York transfer agent as the basis for assertion of stock transfer tax liability. These developments may have resulted in a substantial diminution of NewYork stock transfer taxes collectible on sales on the regional exchanges, without reference to the decision in the case.

[ii] Tax exemption for local products. In *Bacchus Imports, Ltd. v. Dias*,[345] the Court encountered an exemption from Hawaii's excise tax on wholesale liquor sales for certain locally produced alcoholic beverages. It was "undisputed that the purpose of the exemption was to aid Hawaii industry."[346] The exemption for one of the beverages at issue—okolehao, a brandy distilled from the root of an indigenous Hawaiian shrub—was "to 'encourage and promote the establishment of a new industry.'"[347] The exemption for the other—pineapple wine—was "intended 'to help' in stimulating 'the local fruit wine industry.'"[348]

These lofty purposes, however, could not sanctify a tax incentive that unmistakably defied the prohibition against taxes that favor in-state over out-of-state products. However legitimate the goal of stimulating local economic development, the Court explained, "the Commerce Clause stands as a limitation on the means by which a State can constitutionally seek to achieve that goal."[349] The means the state chose in *Bacchus*—taxing out-of-state but not in-state products—could not have been more offensive to the Commerce Clause's nondiscrimination principle.

Hawaii sought to avoid the force of this principle on several grounds. First, it argued that okolehao and pineapple wine, the locally produced beverages in question, did not compete with the other products sold by the wholesalers. Presumably, if it could have been demonstrated that no competition existed between the locally produced beverages and the other beverages sold by the wholesalers, the Commerce Clause would not bar the discrimination in favor of the former because it could not be said to burden interstate commerce.[350] Despite statistics showing that okolehao and pineapple wine constituted less than one percent of liquor sales in Hawaii,[351] and the Hawaii Supreme Court's conclusion that the exempted liquors posed "no competitive threat" to taxable liquors,[352] the Court disparaged such evidence as going merely to the extent of competition rather than to the existence of it.[353] The

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[345] Bacchus Imports, Ltd. v. Dias, 468 US 263, 104 S. Ct. 3049 (1984).

[346] *Bacchus*, 468 US 263, 271, 104 S. Ct. 3049 (1984).

[347] *Bacchus*, 468 US 263, 270, 104 S. Ct. 3049 (1984) (quoting In re Bacchus Imports, Ltd., 65 Haw. 566, 656 P2d 724, 730 (1982) (quoting SLH 1960, c. 26, Sen. Stand. Comm. Rep. No. 87, in 1960 Senate Journal, at 224)).

[348] *Bacchus*, 468 US 263, 270, 104 S. Ct. 3049 (1984) (quoting In re Bacchus Imports, Ltd., 65 Haw. 566, 656 P2d 724, 730 (1982) (quoting SLH 1976, c. 39, Sen. Stand. Comm. Rep. No. 408-76, in 1976 Senate Journal, at 1056)).

[349] *Bacchus*, 468 US 263, 270, 104 S. Ct. 3049 (1984).

[350] See General Motors Corp. v. Tracy, 519 US 278, 117 S. Ct. 811 (1997), discussed infra ¶ 4.13[2][i].

[351] *Bacchus*, 468 US 263, 268, 104 S. Ct. 3049 (1984).

[352] In re Bacchus Imports, Ltd., 65 Haw. 566, 656 P2d 724, 735 n.21 (1982).

[353] *Bacchus*, 468 US 263, 269, 104 S. Ct. 3049 (1984).

Court viewed the exemption as creating an effective price advantage for the locally produced beverages that would attract drinkers of taxable beverages or nondrinkers to purchase the tax-exempt liquors.

The Court gave short shrift to Hawaii's other defenses. The Court gave no weight to the allegation that the tax was borne by Hawaii consumers, because the Commerce Clause protects the market for out-of-state products regardless of who consumes them.[354] Nor was the Court willing to draw the line suggested by the state between thriving industries, which allegedly had been the beneficiary of protectionist legislation that the Court had struck down in the past, and struggling industries like Hawaii's local liquor industry:

> We perceive no principle of Commerce Clause jurisprudence supporting a distinction between thriving and struggling enterprises. . . . [T]he propriety of economic protectionism may not be allowed to hinge upon the State's—or this Court's—characterization of the industry as "thriving" or "struggling."[355]

Finally, the Court refused to accept the state's view that the Commerce Clause does not bar taxes whose asserted purpose is to promote local industry and not to discriminate against foreign products. The Court said:

> Virtually every discriminatory statute allocates benefits or burdens unequally; each can be viewed as conferring a benefit on one party and a detriment on the other. . . . Consequently it is irrelevant to the Commerce Clause inquiry that the motivation of the legislature was the desire to aid the makers of the locally produced beverages rather than to harm out-of-state producers.[356]

The Court in *Bacchus* recognized that "a State may enact laws pursuant to its police powers that have the purpose and effect of encouraging domestic industry"[357] and even declared "that competition among the States for a share of interstate commerce is a central element of our free-trade policy."[358] It was also true, however, that "the Commerce Clause limits the manner in which the States may legitimately compete for interstate trade."[359]

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[354] *Bacchus*, 468 US 263, 272, 104 S. Ct. 3049 (1984).

[355] *Bacchus*, 468 US 263, 272–273, 104 S. Ct. 3049 (1984).

[356] *Bacchus*, 468 US 263, 273, 104 S. Ct. 3049 (1984). In striking down the Hawaii levy, the Court also rejected the claim that the tax was authorized by the Twenty-First Amendment. The Court's disposition of this issue is considered infra ¶ 4.18.

[357] *Bacchus*, 468 US 263, 271, 104 S. Ct. 3049 (1984).

[358] *Bacchus*, 468 US 263, 272, 104 S. Ct. 3049 (1984).

[359] *Bacchus*, 468 US 263, 272, 104 S. Ct. 3049 (1984). The Florida Supreme Court followed *Bacchus* in holding that the state's preferential tax treatment of alcoholic beverages made from citrus fruits and certain other agricultural products violated the Commerce Clause. Division of Alcoholic Beverages & Tobacco v. McKesson Corp., 524 So. 2d 1000

[iii] Income tax credit for engaging in in-state activities. *Westinghouse Electric Corp. v. Tully*[360] provides the most useful constitutional instruction about state tax incentives because the case involved the most common form of tax incentive, an income tax credit. *Westinghouse* arose out of New York's response to Congress's provision of tax incentives for American corporations to increase their exports. In 1971, Congress accorded preferred status to any entity that qualified as a domestic international sales corporation (DISC).[361] Under the federal tax laws, DISCs were not taxable on their income, and their shareholders were taxable on only a portion of such income. If New York had incorporated the federal DISC legislation into its corporate income tax, it would have suffered a substantial loss of revenue.[362] On the other hand, if New York had sought to tax DISC income in full, it risked discouraging the manufacture of export goods within the state.[363]

With these conflicting considerations in mind, New York enacted legislation that: (1) provided that a DISC's income be combined with the income of its parent for state tax purposes; and (2) in an effort to "provide a positive incentive for increased business activity in New York State,"[364] adopted a partial

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(Fla. 1988), rev'd on other grounds, 496 US 18, 110 S. Ct. 2238 (1990). Florida's tax preference was granted to any alcoholic beverage made from the specified product, regardless of where the product was grown or the beverage manufactured, whereas the Hawaiian tax preference was limited to locally produced alcoholic beverages. Despite evidence that the agricultural products in question were grown outside of Florida, the court struck down the tax preference. It observed that "the mere fact that not all out-of-state competitors are disadvantaged by a state statute does not preclude a finding that the statute places a discriminatory burden on interstate commerce," *Division of Alcoholic Beverages & Tobacco*, 524 So. 2d 1000, 1007 (Fla. 1988), rev. on other grounds, 496 US 18, 110 S. Ct. 2238 (1990) that "manufacturers and distributors of beverages which qualify for preferential treatment under this scheme are in direct competition with manufacturers and distributors of alcoholic beverages which do not," *Division of Alcoholic Beverages & Tobacco*, 524 So. 2d 1000, 1008 (Fla. 1988), rev'd on other grounds, 496 US 18, 110 S. Ct. 2238 (1990) and that "the beverages targeted for preferential treatment are those manufactured from specified crops, all of which will grow in Florida." *Division of Alcoholic Beverages & Tobacco*, 524 So. 2d 1000, 1009 (Fla. 1988), rev'd on other grounds, 496 US 18, 110 S. Ct. 2238 (1990). The Court concluded that the benefits accorded to local industry over out-of-state industry by the tax preferences were not justified by any legitimate state interests and that the scheme therefore could not survive Commerce Clause scrutiny. See also Ivey v. Bacardi Imports Co., 541 So. 2d 1129 (Fla. 1989).

[360] Westinghouse Elec. Corp. v. Tully, 466 US 388, 104 S. Ct. 1856 (1984).

[361] IRC §§ 991–997. In 1984, Congress largely repealed the DISC legislation and replaced it with special provisions governing new entities it described as foreign sales corporations (FSCs). IRC §§ 921–927.

[362] *Westinghouse*, 466 US 388, 392, 104 S. Ct. 1856 (1984).

[363] *Westinghouse*, 466 US 388, 392–393, 104 S. Ct. 1856 (1984).

[364] *Westinghouse*, 466 US 388, 393, 104 S. Ct. 1856 (1984) (quoting New York State Division of the Budget, Report on A.12108-A and S. 10544 (May 23, 1972), reprinted in Bill Jacket of 1972 N.Y. Laws, ch. 778, p. 18).

credit for the parent against the tax on the income attributable to the DISC. The parent's maximum credit was determined by applying 70 percent of the parent's tax rate to the parent's share of the DISC income, as apportioned to New York by the parent's business allocation percentage.[365] (In substance, this lowered the effective tax rate on DISC income taxable by New York to 30 percent of the otherwise applicable rate.) The maximum credit figure, however, was then adjusted to reflect the DISC's "New York export ratio"[366]—the ratio of the DISC's receipts from New York export shipments to its receipts from all export shipments. For example, if 100 percent of the DISC's exports were shipped from New York, the parent could claim the full credit and in effect pay 30 percent of the otherwise applicable rate on the DISC income. If, however, only 50 percent of the DISC's exports were shipped from New York, the parent could claim only one half of the maximum credit (i.e., half of 70 percent, or 35 percent) and would pay taxes on DISC income at 65 percent of the applicable rate.

It was this latter aspect of the credit—its limitation by reference to the DISC's New York export ratio—that proved to be constitutionally fatal. The New York State Tax Commission contended that "multiplying the allowable credit by the New York export ratio . . . merely insures that the State is not allowing a parent corporation to claim a tax credit with respect to income that is not taxable by . . . New York."[367] The Court responded:

> This argument ignores the fact that the percentage of the DISC's accumulated income that is subject to New York franchise tax is determined by the parent's business allocation percentage, not by the export ratio. In computing the allowable credit, the statute requires the parent to factor in its business allocation percentage. This procedure alleviates the State's fears that it will be overly generous with its tax credit, for once the adjustment of multiplying the allowable DISC export credit by the parent's business allocation percentage has been accomplished, the tax credit has been fairly apportioned to apply only to the amount of the accumulated DISC income taxable to New York. From the standpoint of fair apportionment of the credit, the additional adjustment of the credit to reflect the DISC's New York export ratio is both inaccurate and duplicative.[368]

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[365] A corporation's New York business allocation percentage, which is employed to determine the amount of a multistatetaxpayer's income that is fairly attributable to New York, is determined by taking the average of the ratio of the taxpayer's property, payroll, and receipts in New York to its total property, payroll, and receipts wherever located. N.Y. Tax Law § 210.3 (McKinney 1986, Supp. 1997).

[366] *Westinghouse*, 466 US 388, 394, 104 S. Ct. 1856 (1984).

[367] *Westinghouse*, 466 US 388, 399, 104 S. Ct. 1856 (1984).

[368] *Westinghouse*, 466 US 388, 399, 104 S. Ct. 1856 (1984) (citation omitted).

Although this analysis of the propriety of reducing the credit by reference to the DISC's New York export ratio may seem technical, it lies at the heart of *Westinghouse* and is critical to understanding *Westinghouse*'s implications for the constitutionality of state income tax incentives. In effect, the Court was saying that New York was done providing the only kind of DISC income tax credit it could constitutionally offer when it lowered the effective tax rate on accumulated DISC income apportioned to New York.[369] In other words, the credit had to be apportioned to New York on the same basis that the DISC income was apportioned to New York, so that the effective New York tax rate on DISC income, though lower than the effective New York tax rate on other income, would not vary depending on the amount of the taxpayer's DISC activity in New York.

When New York took the step of limiting the credit by reference to the DISC's New York export ratio, it was tying the credit to New York activities in a manner that no longer corresponded evenhandedly to the DISC income being taxed. Rather, the effective New York tax rate on the DISC income being taxed (i.e., the DISC income apportioned to New York by the parent's business allocation percentage) varied directly with the extent of the taxpayer's New York DISC-related activities. The greater the percentage of a DISC's export shipments from New York, the greater the relative credit[370] for taxes paid upon DISC income within New York's tax power, and the lower the effective New York tax rate on such income. The lower the percentage of a DISC's export shipments from New York, the lower the relative credit for taxes paid upon DISC income within New York's tax power, and the higher effective New York tax rate on such income. New York thus released its grip on DISC income within its taxing power only to the extent that DISC-related activities were carried on in the state. It kept its grip firmly upon DISC income within its taxing power to the extent that DISC-related activities were carried on outside the state.

After examining the operation of New York's DISC credit scheme, the Court in *Westinghouse* found that New York's effort to encourage export activity in the state suffered from constitutional infirmities similar to those that had disabled New York's earlier effort to encourage brokerage activity in the

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[369] New York had accomplished this objective by providing a credit against 70 percent of the tax otherwise due on the DISC income, thereby reducing the effective tax rate to 30 percent of the original rate.

[370] One would expect the *absolute* amount of credit to increase as DISC-related activity in New York increased even under an evenhanded crediting scheme, such as described in the preceding paragraph, simply because more DISC-related income was taxable by New York and therefore there would be more DISC-related income tax available for the credit. The unacceptable feature of the New York scheme was that the proportional amount of credit (i.e., the credit allowable per dollar of DISC income being taxed) increased or decreased according to the extent of DISC-related activity in New York.

state.[371] Like the reduction in tax liability offered to sellers of securities who effectuated their sales in New York, the reduction in tax liability offered to exporters who effectuated their shipments from New York "'creates . . . an advantage' for firms operating in New York by placing 'a discriminatory burden on commerce to its sister States.'"[372] It was of no consequence "[w]hether the discriminatory tax diverts new business into the State or merely prevents current business from being diverted elsewhere";[373] it was "still a discriminatory tax that 'forecloses tax-neutral decisions.'"[374] It was likewise "irrelevant"[375] to the constitutional analysis that the earlier tax incentives the Court had considered "involved transactional taxes rather than taxes on general income,"[376] because a state cannot "circumvent the prohibition of the Commerce Clause against placing burdensome taxes on out-of-state transactions by burdening those transactions with a tax that is levied in the aggregate rather than on individual transactions."[377]

The Court was not moved by New York's remonstrations that the tax credit merely forgave a portion of the tax that New York had constitutional power to impose and amounted to no more than a benign incentive to industry to carry on activity in the state. The Court's opinions had plainly established that the states can no more favor local over out-of-state interests by "forgiving" taxes within their constitutional power than they can favor local interests by imposing taxes that discriminate against out-of-state enterprise in the first place.[378]

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[371] See supra ¶ 4.13[2][b][i].

[372] *Westinghouse*, 466 US 388, 406, 104 S. Ct. 1856 (1984) (quoting Boston Stock Exch. v. State Tax Comm'n, 429 US 318, 331, 97 S. Ct. 599 (1977)).

[373] *Westinghouse*, 466 US 388, 406, 104 S. Ct. 1856 (1984).

[374] *Westinghouse*, 466 US 388, 406, 104 S. Ct. 1856 (1984) (quoting Boston Stock Exch. v. State Tax Comm'n, 429 US 318, 331, 97 S. Ct. 599 (1977)). The New York DISC credit had one particularly problematic effect not encountered in the Court's previous tax incentive cases: the credit decreased when the taxpayer increased its DISC-related activities elsewhere, even if the taxpayer's New York DISC-related activities remained unchanged. The Court in *Westinghouse* described this as "the most pernicious effect of the credit scheme." *Westinghouse*, 466 US 388, 401 n.9, 104 S. Ct. 1856 (1984). As the Court explained, "not only does the New York tax scheme 'provide a positive incentive for increased business activity in New York State,' but also it penalizes increases in the DISC's shipping activities in other States." *Westinghouse*, 466 US 388, 400–401, 104 S. Ct. 1856 (1984) (quoting New York State Division of the Budget, Report on A.12108-A and S. 10544 (May 23, 1972), reprinted in Bill Jacket of 1972 N.Y. Laws, ch. 778, p. 18).

[375] *Westinghouse*, 466 US 388, 404, 104 S. Ct. 1856 (1984).

[376] *Westinghouse*, 466 US 388, 404, 104 S. Ct. 1856 (1984).

[377] *Westinghouse*, 466 US 388, 404, 104 S. Ct. 1856 (1984).

[378] See Maryland v. Louisiana, 451 US 725, 101 S. Ct. 2114 (1981), discussed infra ¶ 4.13[2][c]; Boston Stock Exch. v. State Tax Comm'n, 429 US 318, 97 S. Ct. 599 (1977), discussed supra ¶ 4.13[2][b][i].

Nor did the state's desire to encourage the development of industry within its borders, which has long been viewed as a legitimate state objective, justify the credit. While the states are free to mold their tax systems to foster local economic activity, the Court held that they are not free to do so by discriminating against the conduct of such activity in other states.[379]

Tracking the reasoning of *Westinghouse*, a Maryland court invalidated an exemption from the state corporate income tax for DISC dividends if at least 50 percent of the net taxable income of the DISC is subject to Maryland taxation.[380] The state taxing authority sought to distinguish *Westinghouse* on the ground that the place of exportation was immaterial under the Maryland statute. The court responded that this was a "distinction without a difference"[381] because, as the court below had explained, "the Maryland criteria, as well as the New York criterion, all relate to the amount of business done by the taxable entity in the taxing state."[382] It was immaterial whether "that business is measured by the location of payroll or property in the state instead of by the amount of another type of business activity (exportation) in the State."[383] A similar burden on out-of-state activity existed under either standard, and "the favoritism conferred by the Maryland statute on Maryland-oriented DISCs"[384] therefore violated the Commerce Clause.

[iv] Tax credit for product produced locally or in state granting reciprocal tax benefits. The Court's most recent encounter with a state tax incentive involved an Ohio tax credit designed to encourage the production of ethanol (ethyl alcohol) in the state. Ethanol, which is typically made from corn, can be mixed with gasoline to produce the motor fuel called gasohol. Ohio provided a credit against the state's motor fuel tax for each gallon of ethanol sold as a component of gasohol, but only if the ethanol was produced in Ohio or in a state that granted similar tax benefits to Ohio-produced ethanol.

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[379] The *Westinghouse* case is considered in J. Michael, "The Constitutionality of Minnesota's Business Tax Credits After *Westinghouse Electric Corp.*," 4 J. St. Tax'n 163 (1985) and W. Seago & W. Schell, "Tax Credits and the Commerce Clause After *Westinghouse Electric Corporation*," 3 J. St. Tax'n 101 (1984).

[380] Comptroller of the Treasury v. Armco, Inc., 70 Md. App. 403, 521 A2d 785 (Ct. Spec. App. 1987).

[381] *Comptroller of the Treasury*, 70 Md. App. 403, 521 A2d 785, 790 (Ct. Spec. App. 1987).

[382] Comptroller of the Treasury v. Armco, Inc., slip op. at 7 (Baltimore City Cir. Ct., Apr. 29, 1986).

[383] Comptroller of the Treasury v. Armco, Inc., slip op. at 7 (Baltimore City Cir. Ct., Apr. 29, 1986).

[384] Comptroller of the Treasury v. Armco, Inc., slip op. at 7 (Baltimore City Cir. Ct., Apr. 29, 1986).

In *New Energy Co. v. Limbach*,[385] the Court had little difficulty concluding that this tax incentive failed to satisfy the strictures of the Commerce Clause. It observed that the Ohio provision at issue "explicitly deprives certain products of generally available beneficial tax treatment because they are made in certain other States, and thus on its face appears to violate the cardinal requirement of nondiscrimination."[386] The Court gave short shrift to the state's arguments in support of its disparate treatment of in-state and out-of-state products.

The Court had previously rejected a "reciprocity" defense to a statute that discriminated against out-of-state products, observing that a state "may not use the threat of economic isolation as a weapon to force sister States to enter into even a desirable reciprocity agreement."[387] As for the claim that Ohio could have achieved the same objective by way of a cash subsidy, the Court responded that the Commerce Clause does not prohibit all state action favoring local over out-of-state interests, but only such action that arises out of the state's regulation of interstate commerce.[388] While "direct subsidization of domestic industry does not ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufactures does."[389]

[v] Concluding observations regarding the constitutionality of state tax incentives under the Commerce Clause. A literal reading of the Court's opinions might well suggest that all state tax incentives are unconstitutional.[390] After all, it is the rare state tax incentive that results in "tax-neutral decisions" made "solely on the basis of nontax criteria."[391] By providing a tax benefit for in-state investment that is not available for identical out-of-state investment, these incentives skew a taxpayer's decision in favor of the former. Each such incentive, in purpose and effect, "diverts new business into the State."[392] Put another way, these incentives deprive out-of-state investments "of generally available beneficial tax treatment because they are made in . . . other States,

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[385] New Energy Co. v. Limbach, 486 US 269, 108 S. Ct. 1803 (1988).

[386] *New Energy*, 486 US 269, 274, 108 S. Ct. 1803 (1988).

[387] Great Atl. & Pac. Tea Co. v. Cottrell, 424 US 366, 379, 96 S. Ct. 923 (1976) (quoted in *New Energy*, 486 US 269, 274, 108 S. Ct. 1803 (1988)). Retaliatory taxes are considered generally infra ¶ 4.13[2][f].

[388] *New Energy*, 486 US 269, 278, 108 S. Ct. 1803 (1988). The distinction between tax credits and subsidies is considered further infra ¶ 4.14.

[389] *New Energy*, 486 US 269, 278, 108 S. Ct. 1803 (1988).

[390] See Note, "Problems With State Aid to New or Expanding Business," 58 S. Cal. L. Rev. 1019, 1049 (1985) ("all state inducement programs are likely to be unconstitutional"); cf. P. Enrich, "Saving the States From Themselves: Commerce Clause Constraints on State Tax Incentives," 110 Harv. L. Rev. 377 (1996).

[391] Boston Stock Exch. v. State Tax Comm'n, 429 US 318, 331, 97 S. Ct. 599 (1977).

[392] Westinghouse Elec. Corp. v. Tully, 466 US 388, 406, 104 S. Ct. 1856 (1984).

and thus on [their] . . . face appear [] to violate the cardinal requirement of nondiscrimination."[393]

The foregoing analysis jeopardizes almost every income, sales, and property tax incentive designed to encourage economic development in the taxing state. Yet most states offer just such incentives. Indeed, virtually every state with an income tax offers a credit for investing in particular types of facilities, hiring a specified number of new employees, or spending a certain amount of money in the state on particular activities.[394] Similarly, many states provide sales and use tax exemptions (or credits or refunds) for sales of property purchased for construction of new or improved facilities within the state; others give favorable sales or use tax treatment to property purchased in connection with the relocation or expansion of a business in the state; still others provide sales and use tax exemptions for property used in an enterprise zone in the state.[395] Likewise, a number of states provide property tax incentives for new or expanded facilities in the state.[396]

The unsettling implications that a literal reading of the Court's opinions would signify raise the question of whether these opinions can and should be read less expansively. In our judgment, the answer to both questions is yes. Our view rests in part on an instinctive sense that virtually all state tax incentives cannot *really* be unconstitutional. Such incentives, after all, constitute long-standing, familiar, and central features of every state's taxing system. Even more important, a somewhat narrower interpretation of the Court's opinions is more consonant with accepted dormant Commerce Clause policy and the core rationales of the incentive decisions themselves.

Two core principles, identified at the outset of this discussion, seem to underlie the Court's state tax incentive decisions and should guide their proper interpretation. First, the provision must favor in-state over out-of-state activities; second, the provision must implicate the coercive power of the state. If, but only if, both of these conditions are met, should courts declare the tax incentive unconstitutional.

All four of the Court's tax incentive decisions fall comfortably within this analytical framework. First, in each of the four cases, the state favored in-state over out-of-state activities: in-state over out-of-state sales in *Boston Stock Exchange*; in-state over out-of-state production in *Bacchus* and *New Energy*; and in-state over out-of-state exportation in *Westinghouse*. Second, in each of the four cases, the coercive power of the state gave the tax incentive its bite. In *Boston Stock Exchange*, taxpayers would pay higher stock transfer taxes unless they engaged in in-state sales. In *Bacchus* and *New Energy*, taxpayers

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[393] *New Energy*, 486 US 269, 274, 108 S. Ct. 1803 (1988).

[394] See Hellerstein & Coenen, supra note 332, at 802–803.

[395] See Hellerstein & Coenen, supra note 332, at 803.

[396] See Hellerstein & Coenen, supra note 332, at 803.

would pay higher liquor wholesaling or motor fuel taxes unless they sold products manufactured in the state. In *Westinghouse*, taxpayers would pay higher income taxes unless their subsidiaries shipped their exports from within the state.[397]

That each of these cases comes out the same way under the in-state-favoritism/state-coercion approach reveals that it provides no panacea for state taxing authorities.[398] At least one significant category of tax incentives, however,

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[397] See also Maryland v. Louisiana, 451 US 725, 101 S. Ct. 2114 (1981). In *Maryland v. Louisiana*, the Court held that Louisiana's First-Use Tax on natural gas, which applied to gas extracted from the Outer Continental Shelf (OCS) and subsequently "used" in Louisiana, unconstitutionally discriminated against interstate commerce because various credits and exclusions available only to local interests effectively immunized local interests from the tax. The Court's condemnation of the First-Use Tax credit against the state's severance tax, which was paid only by those who sever gas in Louisiana, would similarly condemn any such credit specifically designed to encourage economicdevelopment in the state:

> On its face, this credit favors those who both own OCS gas and engage in Louisiana production. The obvious economic effect of this Severance Tax Credit is to encourage natural gas owners involved in the production of OCS gas to invest in mineral exploration and development within Louisiana rather than to invest in further OCS development or in production in other States.

Maryland v. Louisiana, 451 US 725, 757, 101 S. Ct. 2114 (1981). By thus denouncing the levy's inducement for firms to shift business activities into the state, *Maryland v. Louisiana* (like the cases discussed in the text) casts a cloud over the whole range of state tax incentives. *Maryland v. Louisiana* is considered further infra ¶¶ 4.13[2][c], 4.13[2][d].

[398] Indeed, the case law from state courts involving challenges to provisions that may be characterized as state tax incentives strongly reinforces the conclusion that many such incentives cannot withstand Commerce Clause scrutiny. See Sprint Communications Co. v. Kelly, 642 A2d 106 (DC 1994) (property tax exemption for personal property used by a telecommunications company to produce taxable gross receipts and sales tax exemption for property purchased by a telecommunications company for use in producing services subject to gross receipts tax discriminate against interstate commerce), cert. denied, 513 US 916, 115 S. Ct. 294 (1994); Division of Alcoholic Beverages & Tobacco v. McKesson Corp., 524 So. 2d 1000 (Fla. 1988), rev'd on other grounds, 496 US 18, 110 S. Ct. 2238 (1990) (tax preference for alcoholic beverages made from citrus fruits and other agricultural products grown primarily, though not exclusively, within the state discriminates against interstate commerce); Delta Air Lines, Inc. v. Department of Revenue, 455 So. 2d 317 (Fla. 1984) (corporate income tax credit for fuel taxes limited to Florida-based air carriers discriminates against interstate commerce); Russell Stewart Oil Co. v. Department of Revenue, 124 Ill. 2d 116, 529 NE2d 484 (1988) (tax preference for gasohol made from products that were used by almost all in-state producers but not many out-of-state producers discriminates against interstate commerce); Comptroller of the Treasury v. Armco, Inc., 70 Md. App. 403, 521 A2d 785 (Ct. Spec. App. 1987) (exemption from state corporate income tax for DISC dividends if at least 50 percent of the net taxable income of the DISC is subject to taxation in the state discriminates against interstate commerce); Archer Daniels Midland Co. v. State ex rel. Allen, 315 NW2d 597 (Minn. 1982) (tax reduction for gasohol produced in state discriminates against interstate commerce); Northwest Aerospace Training Corp. v. Commissioner of Revenue, No. 6523, Minn. Tax Ct., Apr. 4, 1995, 1995 WL 221639 (exemption for receipts from leases of flight equipment if lessees

should escape invalidation: those tax incentives that are framed not as exemptions from or reductions of *existing* state tax liability but rather as exemptions from or reductions of *additional* state tax liability to which the taxpayer would be subjected only if the taxpayer were to engage in the targeted activity in the state. In our view, such incentives neither favor in-state over out-of-state investment (except in a sense that should be constitutionally irrelevant), nor do

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made three or more flights into the state discriminates against interstate commerce); Worldcorp v. Nevada Dep't of Tax'n, 113 Nev. 1032, 944 P2d 824 (1997) (sales and use tax exemption for aircraft leased to air carriers headquartered in Nevada, but not to air carriers headquartered outside the state, discriminates against interstate commerce); Giant Indus. of Ariz., Inc. v. Taxation & Revenue Dep't, 110 NM 442, 796 P2d 1138 (Ct. App. 1990) (gasoline excise tax deduction for ethanol-blended gasoline manufactured exclusively within the state discriminates against interstate commerce); American Tel. & Tel. Co. v. New York State Dep't of Tax'n & Fin., 84 NY2d 31, 637 NE2d 257, 614 NYS2d 366 (1994) (deduction for access charges paid by long-distance telephone companies to local telephone companies, which is reduced only for interstate long-distance companies by their state apportionment percentage, discriminates against interstate commerce); RJ Reynolds Tobacco Co. v. City of NY Dep't of Fin., 237 AD2d 6, 667 NYS2d 4 (1997) (accelerated depreciation deduction limited to in-state property discriminates against interstate commerce); Burlington N., Inc. v. City of Superior, 131 Wis. 2d 564, 388 NW2d 916 (1986) (exemption from occupation tax on iron ore dock operators for iron ore taxed under occupation tax on local mineral producers discriminates against interstate commerce), cert. denied, 479 US 1034, 107 S. Ct. 833 (1987); Wisconsin Dep't of Revenue v. NCR Corp., Nos. 92 CV 1516 and 92 CV 1525, Wis. Cir. Ct., Dane Cty., Apr. 30, 1993 (deduction for dividends received from subsidiaries limited to subsidiaries more than 50 percent of whose income was taxable by the state discriminates against interstate commerce); Beatrice Cheese, Inc. v. Wisconsin Dep't of Revenue, 1993 WL 57202 (Wis. Tax App. Com. 1993) (accelerated depreciation deduction limited to in-state property discriminates against interstate commerce); cf. Pelican Chapter, Associated Builders & Contractors, Inc. v. Edwards, 128 F3d 910 (5th Cir. 1997) (property tax exemption for new manufacturing establishments, limited to taxpayers maintaining 80 percent in-state work force and using 80 percent in-state materials, discriminates against interstate commerce). But see Archer Daniels Midland Co. v. State, 690 P2d 177 (Colo. 1984) (gasoline tax reduction for certain gasohol that benefited only in-state producers is a permissible incentive for development of fuel-grade alcohol industry) (post-*Bacchus*); Caterpillar, Inc. v. Department of Treasury, 440 Mich. 400, 488 NW2d 182 (deduction for capital acquisitions, which was limited by percentage of taxpayer's property and payroll in the state, is a legitimate incentive for encouragement of in-state business), cert. denied, 506 US 1014, 113 S. Ct. 636 (1992); Williams Cos. v. Director of Revenue, 799 SW2d 602 (Mo. 1990) (restricting right to file consolidated state tax return to affiliated groups of corporations that derive more than 50 percent of their income from sources within the state does not discriminate against interstate commerce), cert. denied, 501 US 1260, 111 S. Ct. 2916 (1991). In our judgment, the Colorado Supreme Court's decision in *Archer Daniels Midland*, the Michigan Supreme Court's decision in *Caterpillar*, and the Missouri Supreme Court's decision in *Williams* cannot be reconciled with the U.S. Supreme Court's doctrine in this area, or with the decisions of the overwhelming majority of other state tribunals that have found similar schemes favoring local over out-of-state investment unconstitutionally discriminatory.

they rely on the coercive power of the state to compel a choice favoring in-state investment.

For example, a real property exemption for new construction in a state, or a sales tax exemption for the purchase of property in the state, favors in-state over out-of-state investment only if one takes account of the taxing regimes of other states and assumes that a tax would be due if the property were constructed or purchased in such other state. But the Court generally has refused to consider other states' taxing regimes in determining the constitutionality of a state's taxing statutes. As the Court has explained, "[t]he immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment."[399] If a state's taxing statute must stand or fall on its own terms, a real property tax exemption for new construction or a sales tax exemption for the purchase of property in a state would be sustained because no *additional* tax liability could be presumed to result from new construction or the purchase of property outside the state. By contrast, each of the tax measures at issue in the Court's tax incentive cases resulted in differential tax liability that was created entirely by the state's own taxing regime, depending on whether the taxpayer engaged in in-state or out-of-state activities.

Beyond the lack of a constitutionally significant favoritism for local over interstate commerce, a property tax exemption for new construction, or a sales tax exemption for in-state purchases, does not implicate the coercive power of the state, at least not in a way that can fairly be characterized as "the State's regulation of interstate commerce."[400] By adopting such an exemption, the state is saying, in effect: "Come to our state and we will not saddle you with any additional property or sales tax burdens. Moreover, should you choose not to accept our invitation, nothing will happen to your tax bill—at least nothing that depends on our taxing regime."[401]

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[399] Freeman v. Hewit, 329 US 249, 256, 67 S. Ct. 274 (1946). See also supra ¶ 4.08[1][a].

[400] New Energy Co. v. Limbach, 486 US 269, 278, 108 S. Ct. 1803 (1988).

[401] A Pennsylvania decision supports the thesis that property tax incentives of this nature will survive scrutiny under the Commerce Clause. The court sustained a capital stock tax exemption limited to "the capital stock of entities organized for manufacturing, processing, research or development purposes which is invested in and actually and exclusively employed in carrying on manufacturing, processing, research or development within the state. . . ." Pa. Stat. Ann. tit. 72, § 7602(a) (Supp. 1996). In PPG Indus., Inc. v. Commonwealth, 681 A2d 824, 826 (Pa. Commw. 1995), aff'd en banc, 681 A2d 832 (Pa. Commw. 1996), the taxpayer, only some of whose manufacturing activities were carried on in the state, attacked the exemption on the ground that it discriminated against interstate commerce. Relying on *Westinghouse* and *Boston Stock Exchange*, it argued that there is a discriminatory effect upon multistate corporations with a low proportion of man-

The state's posture in such circumstances stands in contrast to its posture in the tax incentive cases the Court has confronted in the past. In each of those cases the state was saying, in effect: "You are already subject to our taxing power because you have engaged in taxable activity in this state. If you would like to reduce those burdens, you may do so by directing additional business activity into this state. Should you decline our invitation, we will continue to exert our taxing power over you as before, and your tax bill might even go up." These two messages are very different. The latter, but not the former, reflects a use of the taxing power to coerce in-state business activity.[402]

[c] The Complementary Tax Doctrine[403]

[i] The origins and development of the doctrine. There is a strain of constitutional doctrine that protects an apparently discriminatory state tax from

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ufacturing within Pennsylvania who are allegedly placed at a commercial disadvantage to those businesses that conduct more of their manufacturing within the state.

The court rejected this argument on the ground that the tax exemption was coterminous with the tax base and that there was no tax cost to the taxpayer in conducting economic activity across state lines. As the court observed,

> Once the capital stock is apportioned to only that within Pennsylvania, then a manufacturing exemption applies to exempt property within the state that is related to manufacturing within the state. Both the tax and the exemption is [*sic*] based on in-state property and does not affect out-of-state property. The fact that a proportion of the corporate headquarters is taxed is a result of locating the corporate headquarters within the Commonwealth, not on locating some or most of the manufacturing out-of-state. Regardless of the location of the manufacturing, nothing moving in interstate commerce is affected by the exemption.

PPG Indus., 681 A2d 824, 830, 826 (Pa. Commw. 1995), aff'd en banc, 681 A2d 832 (Pa. Commw. 1996).

The court's decision is significant in that it refuses to extend the teachings of cases like *Westinghouse* and *Boston Stock Exchange* beyond their proper limits. Here the state was refraining from even extending its taxing power to certain property if it was dedicated to specified in-state uses. Hence, in contrast to cases like *Westinghouse* and *Boston Stock Exchange*, the state was not using its coercive taxing power to pressure taxpayers to engage in in-state activities. Rather it was inviting taxpayers to bring their property to the state with the inducement that it would not be subject to additional capital stock liability once it was located there.

[402] The thesis in these concluding comments regarding statetax incentives is developed in much more detail in Hellerstein & Coenen, supra note 332. One important exception to the view expressed here—that sales and property tax incentives should survive constitutional scrutiny—is that they may not contain any collateral requirements discrete from the use or location of the property itself. If they do, then they may be as vulnerable to attack as the typical state income tax incentive.

[403] For a detailed exposition of the complementary tax doctrine, see W. Hellerstein, "Complementary Taxes as a Defense to Unconstitutional State Tax Discrimination," 39 Tax Law. 405 (1986), from which the ensuing discussion freely draws.

attack when the state can identify a "complementary" exaction that cures the apparent discrimination. The doctrine is invoked most frequently in Commerce Clause cases where the Court has found that a tax that singles out interstate commerce for discriminatory treatment is nevertheless constitutional because of a substantially equivalent levy imposing a comparable burden on local commerce.

Hinson v. Lott,[404] was the first case in which the doctrine seems to have been articulated. In *Hinson*, the Court considered an Alabama tax of fifty cents per gallon upon spirituous liquor dealers "introducing any such liquors into the State for sale."[405] The Court acknowledged that "[i]f this section stood alone in the legislation of Alabama on the subject of taxing liquors,"[406] it would discriminate against products of other states in violation of the Commerce Clause.[407] The Court observed, however, that other sections of the statute imposed a tax of fifty cents per gallon upon whiskey and brandy from fruits manufactured in the state. In light of this "complementary provision," the Court concluded that the tax on out-of-state liquor did not discriminate against out-of-state products, but "merely subject[ed] them to the same rate of taxation which similar articles pay that are manufactured within the State."[408]

Later decisions have applied the complementary tax doctrine to a variety of levies. In *General American Tank Car Corp. v. Day*,[409] the Court considered a Louisiana tax upon the railroad rolling stock of nonresident corporations without a domicile in the state. The tax was levied at the rate of twenty-five mills (2.5 percent) of the rolling stock's assessed value. The taxpayers challenged the exaction on the ground that it discriminated against interstate commerce by imposing a greater burden upon nonresident than upon resident taxpayers. Considered alone, the tax appeared vulnerable to such an attack. The Louisiana Constitution provided, however, that taxpayers subjected to the state tax were exempt from local taxes. In the absence of any evidence of intentional or effective discrimination against the nonresident in light of the local tax burden imposed on residents, the Court sustained "the complementary tax scheme."[410]

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[404] Hinson v. Lott, 75 US (8 Wall.) 148 (1869).

[405] *Hinson*, 75 US (8 Wall.) 148 (1869) (quoting Act of Feb. 22, 1866, 1866 Ala. Acts).

[406] *Hinson*, 75 US (8 Wall.) 148, 150 (1869).

[407] *Hinson*, 75 US (8 Wall.) 148, 152 (1869).

[408] *Hinson*, 75 US (8 Wall.) 148, 153 (1869). The Court did not dwell on the fact that the tax on out-of-state liquor was imposed on the dealer while the tax on in-state liquor was imposed on the distiller.

[409] General Am. Tank Car Corp. v. Day, 270 US 367, 46 S. Ct. 234 (1926).

[410] *General Am.*, 270 US 367, 374, 46 S. Ct. 234 (1926). The Court subsequently disapproved of the broad reading of the complementary tax doctrine set forth in *General*

In *Gregg Dyeing Co. v. Query*,[411] the Court likewise sustained an allegedly discriminatory tax on the ground that it was offset by a complementary exaction. South Carolina had imposed a license tax of six cents per gallon upon persons importing gasoline and other petroleum products into the state for use or consumption there. In rejecting the claim that the tax discriminated against out-of-state petroleum products, the Court pointed to the fact that other South Carolina statutes imposed an equivalent tax on dealers in petroleum products sold in the state. In so holding, the Court declared:

> The question of constitutional validity is not to be determined by artificial standards. What is required is that state action, whether through one agency or another, or through one enactment or more than one, shall be consistent with the restrictions of the Federal Constitution. There is no demand in the Constitution that a State shall put its requirements in any one statute. It may distribute them as it sees fit, if the result, taken in its totality, is within the State's constitutional power.[412]

Perhaps the leading precedent sustaining an apparently discriminatory tax under the complementary tax doctrine is *Henneford v. Silas Mason Co.*,[413] which established the constitutionality of compensatory use taxes. Washington had imposed a use tax on property purchased outside the state on which no sales tax had been paid. The purpose of the tax was to complement Washington's sales tax by imposing a tax equal in amount to the sales tax that would have been imposed on the sale if it had occurred within the state's taxing jurisdiction. If a sales tax had been paid on the purchase of the property in Washington or elsewhere, Washington granted a credit against its use tax, so that there was no possibility of double taxation. Viewed in isolation, the use tax effectively applied only to goods purchased out of state or in interstate commerce, since any in-state purchase would already have been subjected to sales tax and thus have been exempted from use tax. Despite the facial discrimination in the use tax, the Court sustained it because the "practical effect" of the overall tax structure imposed a burden on the out-of-state purchase of goods identical to that imposed on an equivalent in-state purchase.[414]

American. See Associated Indus., Inc. v. Lohman, 511 US 641, 114 S. Ct. 1815 (1994), discussed infra ¶ 4.13[2][c][ii].

[411] Gregg Dyeing Co. v. Query, 286 US 472, 52 S. Ct. 631 (1932).

[412] *Gregg*, 286 US 472, 480, 52 S. Ct. 631 (1932).

[413] Henneford v. Silas Mason Co., 300 US 577, 57 S. Ct. 524 (1937).

[414] *Henneford*, 300 US 577, 581, 57 S. Ct. 524 (1937). See also Dunbar-Stanley Studios, Inc. v. Alabama, 393 US 537, 89 S. Ct. 757 (1969) (tax on transient photographers complemented by tax on photographers conducting business from a fixed location), discussed supra ¶ 4.13[2][a][ii]; Alaska v. Arctic Maid, 366 US 199, 81 S. Ct. 929 (1961) (business license tax on freezer ships complemented by tax on local canners); Interstate Busses Corp. v. Blodgett, 276 US 245, 48 S. Ct. 230 (1928) (tax of one cent per mile on

On a number of occasions, the Court has rejected the claim that a discriminatory tax was complemented by an allegedly equivalent exaction. In *Walling v. Michigan*,[415] the Court considered a $300 annual charge on persons engaged in the business of selling liquor in the state when their principal business was outside the state. The state sought to defend the discriminatory levy on out-of-staters by pointing to a tax on manufacturing liquor within the state. The Court rejected the argument on the ground that the challenged levy was imposed upon "the business of selling for . . . non-resident parties, or soliciting orders for them for sale in Michigan of liquors imported in the State," whereas the purportedly complementary levy was imposed "on the manufacturer or dealer . . . [where] his distillery or principal place of business is situated."[416] "In one case," the Court continued, "it is a single tax on the principal; in the other, it is a tax not on the principal, for he cannot be taxed in Michigan, but on each and all of his servants and agents selling or soliciting orders for him."[417] The Court concluded that it was "manifest" that "this must give an immense advantage to the products manufactured in Michigan, and to the manufacturers and dealers of that state."[418]

More recently, the Court has also spurned states' attempts to redeem their facially discriminatory levies from constitutional condemnation by characterizing them as part of a scheme of complementary taxes the overall impact of which is nondiscriminatory. In *Maryland v. Louisiana*,[419] Louisiana imposed a levy on the "first use" within Louisiana of any gas that was not subject to a severance or production tax imposed by any other state. In defending the facially discriminatory levy, which applied only to gas produced outside the state, the state sought to analogize the levy to the compensating use tax sustained in *Henneford v. Silas Mason Co.* Just as the use tax complemented the sales tax, the state argued, so the First-Use Tax complemented Louisiana's severance tax on local production. The Court rejected the analogy on the ground that the First-Use Tax and the state severance tax were not imposed on a "substantially equivalent event" as "a use tax complements a sales tax."[420] As the Court explained:

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vehicles used in interstate commerce complemented by gross receipts tax on local vehicles); Public Util. Dist. v. Washington, 82 Wash. 2d 232, 510 P2d 206, appeal dismissed, 414 US 1106, 94 S. Ct. 833 (1973) (sustaining sale for resale exemption for intrastate but not for interstate resales of electricity on the ground that the intrastate sales will be taxed at a later stage in the economic process).

[415] Walling v. Michigan, 116 US 446 (1886).

[416] *Walling*, 116 US 446, 459 (1886).

[417] *Walling*, 116 US 446, 459 (1886).

[418] *Walling*, 116 US 446, 459 (1886).

[419] Maryland v. Louisiana, 451 US 725, 101 S. Ct. 2114 (1981). *Maryland v. Louisiana* is also discussed infra ¶ 4.13[2][d].

[420] Maryland v. Louisiana, 451 US 725, 759, 101 S. Ct. 2114 (1981).

> The concept of a compensatory tax first requires identification of the burden for which the State is attempting to compensate. Here, Louisiana claims that the First-Use Tax compensates for the effect of the State's severance tax on local production of natural gas. To be sure, Louisiana has an interest in protecting its natural resources, and, like most States, has chosen to impose a severance tax on the privilege of severing resources from its soil. But the First-Use Tax is not designed to meet these same ends since Louisiana has no sovereign interest in being compensated for the severance of resources from the federally owned [Outer Continental Shelf].[421]

Moreover, the tax failed to qualify as a "complementary" tax because of the various credits and exemptions in the tax that favored local over out-of-state interests. The first-use tax therefore "violate[d] th[e] principle of equality," which the Court characterized as "the common thread running through the cases upholding compensatory taxes."[422]

In *Armco, Inc. v. Hardesty*,[423] West Virginia sought to defend its tax on out-of-state wholesalers by arguing that local manufacturers who wholesaled in the state and were exempt from the wholesaling tax nevertheless paid a manufacturing tax that complemented the wholesaling tax. The Court rejected the state's characterization of the tax on Armco's wholesaling activities as "a 'compensating tax' for the manufacturing tax imposed on its West Virginia competitors.'"[424] Tracking its reasoning in *Maryland v. Louisiana*, the Court declared:

> Here, too, manufacturing and wholesaling are not "substantially equivalent events" such that the heavy tax on in-state manufacturers can be said to compensate for the admittedly lighter burden placed on wholesalers from out of state. Manufacturing frequently entails selling in the State, but we cannot say which portion of the manufacturing tax is attributable to manufacturing, and which portion to sales. The fact that the manufacturing tax is not reduced when a West Virginia manufacturer sells its goods out of state, and that it is reduced when part of the manufacturing takes place out of state, makes clear that the manufacturing tax is just that, and not in part a proxy for the gross receipts tax imposed on Armco and other sellers in other States.[425]

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[421] Maryland v. Louisiana, 451 US 725, 758–759, 101 S. Ct. 2114 (1981).

[422] Maryland v. Louisiana, 451 US 725, 759, 101 S. Ct. 2114 (1981).

[423] Armco, Inc. v. Hardesty, 467 US 638, 194 S. Ct. 2620 (1984). *Armco* is discussed further infra ¶ 4.15[1][a].

[424] Armco, Inc. v. Hardesty, 467 US 638, 642, 194 S. Ct. 2620 (1984).

[425] Armco, Inc. v. Hardesty, 467 US 638, 643, 194 S. Ct. 2620 (1984). See also Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 US 232, 107 S. Ct. 2810 (1987); Allis-Chalmers Corp. v. City of N. Bonneville, 113 Wis. 2d 108, 775 P2d 953 (1959).

In *American Trucking Ass'ns, Inc. v. Scheiner*,[426] the state contended that Pennsylvania's flat tax on trucks did not discriminate against interstate commerce because it was only part of an overall scheme of taxes designed to finance the state's highway system and that such taxes, considered in the aggregate, imposed a greater tax burden on Pennsylvania-based trucks than on trucks registered in other states. The Court rejected this argument on the ground that "the Commerce Clause does not permit compensatory measures for the disparities that result from each State's choice of tax levels."[427] As the Court, quoting the first edition of this treatise, observed, "implementation of a rule of law that a tax is nondiscriminatory because other taxes of at least the same magnitude are imposed by the taxing State on other transactions would plunge the Court into the morass of weighing comparative tax burdens."[428]

Indeed, this point is well-illustrated by the unhappy results of judicial interpretation of federal legislation designed to prevent the states from imposing more burdensome taxes on national banks than on local state banks.[429] The judicial efforts to determine whether a state's taxes on national banks are more burdensome than its taxes on state banks have given rise to endless litigation, esoteric refinements, and dubious distinctions.[430] Consequently, both in principle and on practical grounds, there is much to be said for a judicial test of discrimination that, in general at least, does not take into account other taxes on other transactions, but limits itself to the transactions at issue.

[ii] The Court's recent complementary tax decisions. The Court's most recent encounters with the "complementary" or "compensatory" tax doc-

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[426] American Trucking Ass'ns, Inc. v. Scheiner, 483 US 266, 107 S. Ct. 2829 (1987), discussed infra ¶ 4.13[2][g].

[427] American Trucking Ass'ns v. Scheiner, 483 US 266, 288, 107 S. Ct. 2829 (1987).

[428] American Trucking Ass'ns v. Scheiner, 483 US 266, 289, 107 S. Ct. 2829 (1987). Several decisions of state and lower federal courts have rejected the contention that a facially discriminatory tax was rendered constitutionally tolerable by an allegedly compensatory tax on local commerce. National Meat Ass'n v. Deukmejian, 743 F2d 656 (9th Cir. 1984), aff'd without opinion, 469 US 1100, 105 S. Ct. 768 (1985) (per pound tax on imported beef not compensated by head fee on intrastate sales of cattle); Huie v. Private Truck Council of Am., 466 NE2d 435 (Ind. 1984) (tax on interstate motor carriers' indefinite situs property not compensated by local property tax on intrastate carriers); American Trucking Ass'ns, Inc. v. Quinn, 437 A2d 623 (Me. 1981) (permit fees on out-of-state trucks not compensated by personal property taxes imposed on in-state trucks).

[429] The statute, which was generally known as Revised Statutes § 5219, was codified as 12 USC § 548. The statute was amended in 1976 permitting the states to tax national banks just as they tax state banks, thereby eliminating the question of "discrimination" to which the interpretation of Revised Statutes § 5219 gave rise.

[430] These issues are described in the Report of Study under Pub. L. Nos. 91-156 and 92-213, State and Local Taxation of Banks, prepared for the Board of Governors of the Federal Reserve System for Senate Comm. on Banking, Housing and Urban Affairs, 92d Cong., 2d Sess. 231 et seq. and App. 6, 25 et seq. (1972).

trine continue its modern trend of evaluating states' "complementary tax" arguments with considerable skepticism. In particular, the Court's decisions in *Oregon Waste Systems, Inc. v. Department of Environmental Quality*,[431] *Associated Industries of Missouri v. Lohman*,[432] and *Fulton Corp. v. Faulkner*,[433] reveal the Court's hostility to a defense that relies on the "overall" tax burden borne by local interests as an acceptable antidote to a facially discriminatory levy on interstate commerce. Unless the state can identify a specific tax on local activities that complements the allegedly offensive tax on interstate commerce, the state's defense is likely to be given short shrift.

In *Oregon Waste Systems*, Oregon imposed a fee for the in-state disposal of waste that was generated outside the state at the rate of $2.25 per ton while imposing a fee of only $0.85 per ton for the disposal of waste generated within Oregon. Oregon's principal defense of the facially discriminatory tax on out-of-state waste was that it was "a 'compensatory tax' necessary to make shippers of such waste pay their 'fair share' of the costs imposed on Oregon by the disposal of their waste in the state."[434] In rejecting this argument, the Court carefully delineated its current understanding of the scope of the complementary tax doctrine.

The Court first noted that the complementary tax doctrine was not a "doctrine unto itself" but "merely a specific way of justifying a facially discriminatory tax as achieving a legitimate local purpose that cannot be achieved through nondiscriminatory means."[435] Under the doctrine, the Court observed, "a facially discriminatory tax that imposes on interstate commerce the rough equivalent of an identifiable and 'substantially similar' tax on intrastate commerce does not offend the negative Commerce Clause."[436] Significantly, the Court insisted that the complementary exaction must be both *identifiable* and *substantially similar*. Broad allegations that intrastate commerce is subject to tax burdens equivalent to those imposed by a specific tax on interstate commerce will not suffice.

Extracting from its earlier cases, the Court articulated a three-prong inquiry for determining whether the complementary tax doctrine applies:

1. The state must identify the intrastate tax burden for which the state is attempting to compensate.
2. The tax on interstate commerce must be shown roughly to approximate, but not exceed, the amount of the tax on intrastate commerce.

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[431] Oregon Waste Sys., Inc. v. Department of Envtl. Quality, 511 US 93, 114 S. Ct. 1345 (1994).

[432] Associated Indus. of Mo. v. Lohman, 511 US 641, 114 S. Ct. 1815 (1994).

[433] Fulton Corp. v. Faulkner, 516 US 325, 116 S. Ct. 848 (1996).

[434] *Oregon Waste*, 511 US 93, 102, 114 S. Ct. 1345 (1994).

[435] *Oregon Waste*, 511 US 93, 102, 114 S. Ct. 1345 (1994).

[436] *Oregon Waste*, 511 US 93, 102–103, 114 S. Ct. 1345 (1994).

3. The events on which the interstate and intrastate taxes are imposed must be "substantially equivalent" (i.e., they must be sufficiently similar in substance to serve as mutually exclusive proxies for each other).[437]

Applying these criteria to Oregon's taxing scheme, the Court had little difficulty concluding that the complementary tax doctrine could not be invoked to salvage Oregon's discriminatory levy on out-of-state waste. First, the state had failed to identify a specific charge on intrastate commerce equal to or exceeding the charge on interstate commerce. This failure by itself was "fatal" to the state's claim.[438] Second, in response to the state's contention that intrastate commerce "through general taxation" bore taxes equivalent to the levy on interstate commerce, the Court declared that, even assuming the burdens were equivalent, the argument "fails because the in-state and out-of-state levies are not imposed on substantially equivalent events."[439]

Finally, and perhaps most significantly, the Court indicated its own disenchantment with an expansive view of the complementary tax doctrine. It explicitly acknowledged its "recent reluctance to recognize new categories of compensatory taxes."[440] Moreover, it unequivocally rejected the state's effort to expand the scope of the complementary tax doctrine by comparing the specific tax on out-of-state waste with general taxes imposed on intrastate commerce. The consequence of such an approach "would allow a state to tax interstate commerce more heavily than in-state commerce any time the entities involved in interstate commerce happened to use facilities supported by general state tax funds."[441] The Court declined the state's "invitation to open such an expansive loophole in our carefully confined compensatory tax jurisprudence."[442]

In *Associated Industries*, the Court considered whether a statewide use tax that was designed to complement local sales taxes could be justified under the complementary tax doctrine when, in some instances, the state use tax exceeded the local sales tax. Missouri imposed a series of statewide sales taxes that, in the aggregate, subjected Missouri sales to a tax of 4.225 percent. These

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[437] *Oregon Waste*, 511 US 93, 103, 114 S. Ct. 1345 (1994).

[438] *Oregon Waste*, 511 US 93, 104, 114 S. Ct. 1345 (1994).

[439] *Oregon Waste*, 511 US 93, 104, 114 S. Ct. 1345 (1994).

[440] *Oregon Waste*, 511 US 93, 105, 114 S. Ct. 1345 (1994).

[441] *Oregon Waste*, 511 US 93, 105 n.8, 114 S. Ct. 1345 (1994) (quoting Government Suppliers Consolidating Servs., Inc. v. Bayh, 975 F2d 1267 (7th Cir. 1992), cert. denied, 506 US 1053, 113 S. Ct. 977 (1993)).

[442] *Oregon Waste*, 511 US 93, 105 n.8, 114 S. Ct. 1345 (1994). The California Supreme Court, relying heavily on *Oregon Waste* and rejecting arguments similar to those raised by the state in that case, struck down an inspection fee that applied to ships and airplanes carrying agricultural goods from foreign countries but did not apply to ships and airplanes carrying agricultural goods from other states. Pacific Merchant Shipping Ass'n v. Voss, 12 Cal. 4th 503, 907 P2d 430, 48 Cal. Rptr. 2d 582 (1995).

levies were paralleled by statewide use taxes aggregating 4.225 percent on goods purchased outside Missouri for use in the state.

In addition, however, Missouri imposed a statewide 1.5 percent use tax on goods purchased outside the state that did not complement any equivalent statewide sales tax. Instead, the statewide use tax was designed to complement local sales taxes, ranging from 0.5 percent to 3.5 percent, which were authorized by state legislation. Although the statewide 1.5 percent use tax exceeded the local sales tax in more than half of Missouri's local taxing jurisdictions, over 93 percent of the dollar volume of sales for the tax year at issue occurred in jurisdictions where the local sales tax exceeded the statewide use tax. Indeed, if there had been a statewide local sales tax equal to the 1.5 percent statewide use tax, the local sales tax burden on in-state sales would have decreased by $100 million. In light of the high average rate of local sales taxes, the Missouri Supreme Court rejected the taxpayers' claim that Missouri's taxing scheme impermissibly discriminated against interstate commerce by imposing a higher use tax on out-of-state purchases than the equivalent sales tax on local purchases. Rather, the state court concluded, the overall effect of the use tax scheme across the state was to place a lighter aggregate tax burden on interstate than on intrastate commerce.

A unanimous U.S. Supreme Court reversed the state court decision. Based on the criteria it had recently set forth in *Oregon Waste Systems*, the Court concluded that the Missouri tax could not survive constitutional scrutiny as a complementary tax. Missouri had satisfied the threshold requirement of identifying the intrastate burden for which the tax on interstate commerce is attempting to compensate by pointing to the local sales taxes as the complement to the 1.5 percent statewide use tax. Nor was there any dispute that the Missouri taxing scheme satisfied the third criterion set forth in *Oregon Waste Systems*—namely, that the sales and use taxes be imposed on "substantially equivalent event[s]."[443] Sales and use taxes plainly meet that test.

The difficulty with the Missouri use tax structure was that it failed the second test set forth in *Oregon Waste Systems*—"the basic requirement that, for a tax system to be 'compensatory,' the burdens imposed on interstate and intrastate commerce must be equal."[444] In contrast to complementary tax regimes it had sustained,

> in Missouri, whether the 1.5% use tax is equal to (or lower than) the local sales tax is a matter of fortuity, depending entirely on the locality in which the Missouri purchaser happens to reside. Where the use tax exceeds the sales tax, the discrepancy imposes a discriminatory burden on interstate commerce. Out-of-state goods brought into such a jurisdiction are subjected to a higher levy than goods sold locally. The resulting dis-

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[443] Maryland v. Louisiana, 451 US 725, 759, 101 S. Ct. 2114 (1981).

[444] Associated Indus. of Mo. v. Lohman, 511 US 641, 648, 114 S. Ct. 1815 (1994).

parity is incompatible with what we have termed the "strict rule of equality adopted in *Silas Mason*."[445]

Like the state respondents in *Oregon Waste Systems*, the state respondents in *Associated Industries* contended that the determination of discrimination should not rest on a narrow comparison of the particular levy (or on the levy as applied to a particular transaction), but rather on the "overall impact" of the taxing scheme "across the State as a whole."[446] As in *Oregon Waste Systems*, the Court unequivocally rejected the invitation to broaden the complementary tax inquiry. The Court repudiated the suggestion that "patent discrimination" in one part of a taxing scheme could be "rendered inconsequential for Commerce Clause purposes by advantages given to interstate commerce in other facets of a tax plan or in other regions of a State."[447] Rather, except for narrow rules justifying discrimination (e.g., where a state's purpose cannot be served by nondiscriminatory alternatives), "actual discrimination, wherever it is found is impermissible, and the magnitude and scope of discrimination have no bearing on the determinative question whether discrimination has occurred."[448]

The Court further observed that the adoption of a rule that would determine the existence of discrimination by reference to the aggregate burdens on interstate commerce across an entire state, rather than by reference to the burden imposed by a particular state subdivision, would frustrate the central purposes of the Commerce Clause of providing an area of free trade among the states. Under the state's view, the Commerce Clause would not bar the Balkanization of the interstate market through discriminatory local taxes, as long

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[445] *Associated Indus.*, 511 US 641, 649, 114 S. Ct. 1815 (1994) (citation omitted).

[446] *Associated Indus.*, 511 US 641, 649, 114 S. Ct. 1815 (1994).

[447] *Associated Indus.*, 511 US 641, 649, 114 S. Ct. 1815 (1994).

[448] *Associated Indus.*, 511 US 641, 650, 114 S. Ct. 1815 (1994). The state had relied on General Am. Tank Car Corp. v. Day, 270 US 367, 46 S. Ct. 234 (1926), discussed supra ¶ 4.13[2][c][i], as supporting its view that a statewide tax on interstate commerce could complement local taxes on intrastate commerce and that "mathematical exactness" in the comparison between interstate and local tax burdens was not required. *General Am* ., 270 US 367, 373, 46 S. Ct. 234 (1926) (quoted in *Associated Indus.*, 511 US 641, 651, 114 S. Ct. 1815 (1994)). The Court found the state's reliance misplaced on two grounds. First, *General American* was analyzed largely under the Equal Protection Clause, which, unlike the Commerce Clause, tolerates discrimination as long as it is rationally related to a legitimate state purpose. Second, insofar as *General American* might be regarded as a Commerce Clause precedent, the Court observed that "it has been bypassed by later decisions, and particularly by the 'strict rule of equality adopted in *Silas Mason*.'" *Associated Indus.*, 511 US 641, 652, 114 S. Ct. 1815 (1994) (citation omitted). In short, insofar as *General American* is inconsistent with the Court's Commerce Clause requirement of "strict parity" (*Associated Indus.*, 511 US 641, 652, 114 S. Ct. 1815 (1994)) in complementary tax cases, it is no longer good law.

as each state, on balance, did not discriminate against interstate trade. Indeed, the Court had already rejected this view in other cases.[449]

In *Fulton Corp. v. Faulkner*,[450] the Court considered a North Carolina intangible property tax as applied to corporate stock that varied inversely with the corporation's presence in North Carolina. Prior to the levy's repeal in late 1995, North Carolina imposed an intangible property tax on, among other things, shares of stock owned by resident individuals and corporations and on shares of stock having a business situs in the state. The tax was imposed at the rate of 0.25 percent of the fair market value of the stock. The value of the stock assessed under the tax, however, was reduced by a percentage equal to the percentage of the corporation's income subject to tax in North Carolina. This percentage was determined by the familiar three-factor income apportionment formula of property, payroll, and sales.

Under this taxing regime, the stock of a corporation doing all of its business in North Carolina would be subject to no North Carolina intangible property tax. Such a corporation would have a 100 percent income tax apportionment percentage that would, in turn, permit a 100 percent reduction in the value of the corporation's stock subject to tax in the hands of its shareholders. Similarly, the stock of a corporation doing 50 percent of its business in North Carolina would be subject to an intangible property tax on 50 percent of the stock's value. Such a corporation would have a 50 percent income tax apportionment percentage that would, in turn, permit a 50 percent reduction in the value of the corporation's stock subject to tax in the hands of its shareholders. Finally, the stock of a corporation doing no business in North Carolina would be subject to an intangible property tax measured by all of the stock's value. Such a corporation would have a zero percent income tax apportionment percentage that would in turn permit no reduction in the value of the corporation's stock subject to tax in the hands of its shareholders.

Fulton Corporation was a North Carolina corporation that owned stock in other corporations that did business outside the state. During the year at issue (1990), Fulton owned shares in six corporations. Five of these corporations did no business in North Carolina, paid no corporate income tax, and had a zero North Carolina income apportionment percentage. Consequently, 100 percent of the value of these corporations' stock was taxable to Fulton under the intangible property tax. Fulton also owned stock in a corporation that did 46 percent of its business in North Carolina. Consequently, the stock was subject to intangible property tax on 54 percent of its value.

Fulton sued for a refund of the tax, claiming that the deduction from the intangible tax base of corporate stock value tied to the in-state activities of the

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[449] See Fort Gratiot Sanitary Landfill, Inc. v. Michigan Dep't of Natural Resources, 504 US 353, 112 S. Ct. 2019 (1992).

[450] Fulton Corp. v. Faulkner, 516 US 325, 116 S. Ct. 848 (1996).

corporation whose stock was being taxed discriminated against interstate commerce in violation of the Commerce Clause. There was no dispute over the question of whether North Carolina's intangible tax regime discriminated on its face against interstate commerce in violation of first principles of the Court's Commerce Clause jurisprudence.[451] Plainly it did. As the Court observed in *Fulton*, "[a] regime that taxes stock only to the degree that its issuing corporation participates in interstate commerce favors domestic corporations over their foreign competitors in raising capital among North Carolina residents and tends, at least, to discourage domestic corporations from plying their trades in interstate commerce."[452]

The only disputed question in the case, then, was whether the facially discriminatory tax could be saved by the complementary tax doctrine. Applying the three-prong test it had articulated in *Oregon Waste* and applied in *Associated Industries*, the Court found the tax impermissible.

Identifying the Intrastate Tax Burden for Which the State Is Attempting to Compensate. North Carolina contended that its general corporate income tax, which is imposed on corporations doing business in North Carolina to the extent that they do business there, compensated for its intangible property tax on corporate stock, which was reduced for corporations doing business in North Carolina to the extent that they did business there. As the Court observed in *Fulton*, however, "North Carolina has no general sovereign interest in taxing income earned out of state."[453] Accordingly, North Carolina's intangible property tax would fail the first prong of the Court's compensatory tax test unless North Carolina could "identify some in-state activity or benefit in order to justify the compensatory levy."[454]

North Carolina argued that the in-state benefit justifying the compensatory levy was "access to North Carolina capital markets."[455] Under the state's theory, such access was available to corporations paying North Carolina income tax as well as to corporations that, to a varying degree, were not subject to North Carolina income tax. In the eyes of the state, it could demand that these non-income-tax-paying corporations pay their fair share for access to North Carolina capital markets through the allegedly compensating intangible property tax.

The problem with this argument was two-fold. First, the Court was concerned about the "danger of treating general revenue measures"—like a broad-based income tax—"as relevant intrastate burdens for purposes of the compen-

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[451] See supra ¶ 4.13[1][a].

[452] *Fulton*, 516 US 325, 333, 116 S. Ct. 848, 855 (1996).

[453] *Fulton*, 516 US 325, 334, 116 S. Ct. 848 (1996).

[454] *Fulton*, 516 US 325, 334, 116 S. Ct. 848 (1996).

[455] *Fulton*, 516 US 325, 335, 116 S. Ct. 848 (1996).

satory tax doctrine."[456] The Court had rejected a similar effort in *Oregon Waste.*[457] Second, and more fundamentally, North Carolina's general income tax could not reasonably be characterized as a levy designed to support the maintenance of the state's capital markets. The Court saw the state's argument for what it was: a post hoc rationalization designed to force the levy within the confines of the compensatory tax doctrine. Not only had North Carolina failed to offer this "capital markets" justification in the courts below, but even taken on its own terms, it lacked substance. North Carolina regulated access to its capital markets through its Blue Sky laws, and it charged fees for the privilege of selling securities in the state. As the Court concluded, "[a]bsent probative evidence to the contrary, which the Secretary has not supplied, we can reasonably assume that North Carolina has provided for the upkeep of its capital market through these provisions, not through the general corporate income tax."[458]

Equivalence Between the Tax on Interstate Commerce and the Tax on Intrastate Commerce. North Carolina sought to satisfy this requirement by comparing the North Carolina income taxes that a corporation pays to the intangible property tax to which such a corporation's stock would be subjected.[459] The flaw in this argument according to the Court was Fulton's failure to fine-tune the comparative burden analysis to the justification the state had offered for the intangible property tax. Inasmuch as the state's justification for the intangibles tax rested only on the maintenance of a capital market for corporations, "the relevant comparison for our analysis has to be between the size of the intangibles tax and that of the corporate income taxes component that purportedly funds the capital market."[460] The corporate income tax, after all, funded a wide range of state activities, including construction and maintenance of the state's transportation network, its educational institutions, and other state programs. Because the state could not "tell us what proportion of the corporate income tax goes to support the capital market, or whether that proportion represents a burden greater than the one imposed on interstate commerce by the intangibles tax,"[461] it failed to carry its burden of proof on the equivalence is-

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[456] *Fulton*, 516 US 325, 335, 116 S. Ct. 848 (1996).

[457] See supra notes 434–442 and accompanying text.

[458] *Fulton*, 516 US 325, 336, 116 S. Ct. 848 (1996).

[459] It did so by reference to the corporation's price/earnings (P/E) ratios. Since the intangible property tax is applied to "price" at the rate of 0.25 percent, and the corporate income tax is applied to "earnings" at the rate of 7.75 percent, the state contended a corporation would have to have a P/E ratio of less than 31 (7.75 ÷ 0.25) in order for a corporation's income tax to exceed the intangible property tax that would be levied against its stock. Since few corporations have P/E ratios exceeding 31, the state contended that the intangibles tax was no more burdensome than the corporate income tax.

[460] *Fulton*, 516 US 325, 337–338, 116 S. Ct. 848 (1996).

[461] *Fulton*, 516 US 325, 338, 116 S. Ct. 848 (1996).

sue. In the Court's view, the state's failure in this regard reinforced the Court's "general unwillingness 'to permi[t] discriminatory taxes on interstate commerce to compensate for charges purportedly included in general forms of intrastate taxation,'"[462] because "[w]here general forms of taxation are involved, we ordinarily cannot even begin to make the sorts of quantitative assessments that the compensatory tax doctrine requires."[463]

The "Substantially Equivalent Event" Requirement. North Carolina's intangible property tax fared no better under this criterion than it had under the first two prongs of the Court's compensatory tax doctrine. The reason for this is apparent. Despite some plausible analogies between the intangible property tax and the corporate income tax (both employed the same apportionment formula, although in reverse, to attribute the taxable base to the state, and both were predicated on similar values insofar as income affects stock price), the taxes were different in a number of fundamental respects fully justifying the Court's conclusion that "the intangibles tax is not functionally equivalent to the corporate income tax."[464] Thus the taxes fell on different taxpayers (the in-state shareholders in one case, corporations doing business outside the state, in the other); they were imposed at different rates; they were imposed on different tax bases; and they raised revenue for different purposes.

Despite these striking differences between the nature of the two allegedly compensatory levies, the Court was nevertheless willing to entertain the taxpayer's theory that the taxes were equivalent in their economic impact. However, it held the state to a high standard in establishing such a claim: "A State defending such a scheme as one of complementary taxation . . . has the burden of showing that the actual incidence of the two tax burdens are different enough from the nominal incidences so that the real taxpayers are within the same class, and that therefore a finding of combined neutrality on interstate competition would at least be possible."[465]

To make its case, then, North Carolina would have had to prove that "the economic impact of [its] corporate income tax is passed through to shareholders of corporations doing business in state in a way that offsets the disincentive imposed by the intangibles tax to buying stock in corporations doing business out of state."[466] Here North Carolina's case stumbled on the complexities of economic incidence analysis. As the Court observed, the economic incidence of a tax depends on such factors as elasticities of supply and demand,

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[462] *Fulton*, 516 US 325, 338, 116 S. Ct. 848 (1996) (quoting Oregon Waste Sys., Inc. v. Department of Env'tl Quality, 511 US 93, 105 n.8, 114 S. Ct. 1345 (1994).

[463] *Fulton*, 516 US 325, 338, 116 S. Ct. 848 (1996) (quoting *Oregon Waste*, 511 US 93, 105 n.8, 114 S. Ct. 1345 (1994)).

[464] *Fulton*, 516 US 325, 339, 116 S. Ct. 848 (1996).

[465] *Fulton*, 516 US 325, 340, 116 S. Ct. 848 (1996).

[466] *Fulton*, 516 US 325, 341, 116 S. Ct. 848 (1996).

the ability of producers and consumers to substitute one product for another, the structure of the relevant market, and the time frame over which the tax is imposed.[467] In *Fulton*, not only did "the State fai[l] to proffer any analysis addressing the complexity of its burden,"[468] but the Court was highly skeptical of the state's claim that corporate income taxes are so reflected in stock values as to offset the effects of the intangibles tax. The state had thus failed to meet its burden of showing that the requirements of the compensatory tax burden are "clearly met."[469]

[d] Use Taxes on Goods Purchased or Manufactured by Taxpayer Outside the State

States imposing sales taxes have adopted use taxes, both to safeguard their revenues and to protect local merchants against the diversion of purchases

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[467] *Fulton*, 516 US 325, 341, 116 S. Ct. 848 (1996) (citing W. Hellerstein, "Complementary Taxes as a Defense to Unconstitutional Tax Discrimination," 39 Tax Law. 405 (1986)).

[468] *Fulton*, 516 US 325, 343, 116 S. Ct. 848 (1996).

[469] *Fulton*, 516 US 325, 344, 116 S. Ct. 848 (1996). The Court's conclusion that North Carolina's intangible property tax failed all three tests of its complementary tax doctrine did not quite end the matter. It remained for the Court to deal with Darnell v. Indiana, 226 US 390, 33 S. Ct. 120 (1912), on which the North Carolina Supreme Court had principally relied. *Darnell* had sustained an Indiana tax on intangibles that taxed shares in all foreign corporations owned by Indiana residents but taxed shares in domestic corporations only to the extent that the corporations' property was not subject to Indiana's general property tax. The Court found that the only difference in treatment was that "the State taxes the property of domestic corporations and the stock of foreign ones in similar cases" (*Fulton*, 516 US 325, 345, 116 S. Ct. 848 (1996)) and that this arrangement "is consistent with substantial equality notwithstanding the technical differences." *Fulton*, 516 US 325, 345 n.9, 116 S. Ct. 848 (1996). The Court in *Fulton* observed that *Darnell* had relied essentially on an equal protection standard in sustaining the levy, even though the taxpayer had challenged the tax under both the Commerce and Equal Protection Clauses. To the extent that *Darnell* evaluated an allegation of discrimination against interstate commerce under equal protection standards, the Court continued, "time simply has passed it by." *Fulton*, 516 US 325, 345, 116 S. Ct. 848 (1996). "While we continue to measure the equal protection of economic legislation by a 'rational basis' test, we now understand the dormant Commerce Clause to require 'justifications for discriminatory restrictions on commerce [to] pass the "strictest scrutiny."'" *Fulton*, 516 US 325, 345, 116 S. Ct. 848 (1996) (citations omitted). Accordingly, while *Darnell* may still be good law under the Equal Protection Clause, it is "no longer good law under the Commerce Clause." *Fulton*, 516 US 325, 116 S. Ct. 848 (1996). See also St. Ledger v. Kentucky Revenue Cabinet, 942 SW2d 893 (Ky. 1997) (invalidating, in light of *Fulton*, exemption for shareholders in corporations that paid tax to Kentucky on at least 75 percent of their total property); cf. Annenberg v. Commonwealth ___ Pa. ___, ___ A2d ___ (1998) (concluding that county personal property tax imposed only on stock of companies subject to Pennsylvania tax facially discriminates interstate commerce, but remanding case for consideration of complementary tax doctrince).

by local residents or businesses to non–sales tax jurisdictions (of which there are now only five[470]) or to jurisdictions with lower sales tax rates. Early in the modern-day development of general sales taxation, the Supreme Court considered the question whether use taxes are invalid as levies discriminating against interstate commerce, in view of the fact that goods purchased within the state typically are not subject to the tax. Relying on the complementary tax doctrine,[471] the court sustained such taxes, on the ground that the use tax, viewed in connection with the sales, is designed to put out-of-state and in-state purchases on a level of equality.[472]

Some states, however, have sought to impose higher use taxes on goods purchased by local users than the sales taxes that would have been incurred had the goods been purchased within the taxing jurisdiction. Automobile purchases have been a prime target for this device, doubtless under pressure from local automobile dealers and because, unlike most household purchases of goods, out-of-state purchases can be policed through automobile registrations. In one case, Pennsylvania assessed a use tax against a resident who purchased an automobile in New Jersey. The state measured the tax by the full purchase price of the car. If the purchaser had bought the car in Pennsylvania, however, she would have paid a sales tax on only the net price paid, after reduction for the trade-in allowance for her old car. The court invalidated the tax as discriminating against interstate commerce, rejecting the state's contention that the additional administrative burdens imposed on the state in collecting the tax directly from the user warranted the differential.[473] Other state courts have reached the same conclusion.[474]

The U.S. Supreme Court likewise rebuffed Louisiana in imposing a sales-use tax differential in the case of equipment manufactured by a taxpayer outside the state for use within Louisiana. Halliburton Oil Well Cementing Company, a leading company engaged in servicing oil wells in Louisiana and

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[470] Only Alaska, Delaware, Montana, New Hampshire, and Oregon have no general retail sales tax. Retail sales taxes are imposed at the local level in Alaska.

[471] ¶ 4.13[2][c].

[472] Henneford v. Silas Mason Co., 300 US 577, 57 S. Ct. 524 (1937), discussed supra ¶ 4.13[2][c][i].

[473] Commonwealth v. Smith, 75 Dauph. 22 (Pa. Dauphin County 1960).

[474] Woosley v. California, 3 Cal. 4th 758, 838 P2d 758, 13 Cal. Rptr. 2d 80 (1992), cert. denied, 508 US 940, 113 S. Ct. 2416 (1993); Matthews v. State Dep't of Revenue, 193 Colo. 44, 562 P2d 415 (1977); Robert Emmet & Son Oil Supply Co. v. Sullivan, 158 Conn. 234, 259 A2d 636 (1969); Iowa Auto Dealers Ass'n v. Iowa State Appeal Bd., 420 NW2d 460 (Iowa 1988); Nuckols v. Athey, 149 W. Va. 40, 138 SE2d 344 (1964), noted in 67 W. Va. L. Rev. 261 (1964); but see Brunner & Lay, Inc. v. Pledger, 308 Ark. 512, 825 SW2d 599 (1992), cert. denied, 506 US 824, 113 S. Ct. 78 (1992) (sustaining a use tax applicable to used property only if it had not previously borne a state sales or use tax). See Note, "The Trade-In Deduction: Discrimination Under the Sales and Use Taxes," 37 NYU L. Rev. 306 (1962).

other states, manufactured at its plant in Oklahoma special equipment that it used in its operations. During the tax period at issue, it shipped to Louisiana a number of units of the equipment it had manufactured in Oklahoma, for use by it in servicing wells in Louisiana. Halliburton paid use taxes to Louisiana on all materials it purchased outside the state and used in the manufacture of the equipment, but Louisiana assessed a use tax on the full value of the assembled equipment, including Halliburton's labor and shop overhead attributable to the manufacturing process in Oklahoma. If Halliburton had purchased the materials in Louisiana and had assembled the equipment in that state, Halliburton would have been subject to a sales tax only on the cost of the articles purchased, without inclusion of its labor costs or overhead.

In holding the tax repugnant to the Commerce Clause, the Court declared that "equal treatment for in-state and out-of-state taxpayers similarly situated is the condition precedent for a valid use tax on goods imported from out-of-state."[475] The Court also observed that the tax was "an incentive to locate within Louisiana," that it would tend to "neutralize advantages belonging to the place of origin," and that, like the drummers' license taxes, the levy was "discriminatory in favor of the local merchant."[476] The Court concluded that "approval of the Louisiana use tax in this case would 'invite a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause.'"[477]

Perhaps the most significant feature of the *Halliburton* case, in terms of the sweep of the Court's Commerce Clause doctrine, was the Court's position that it was irrelevant whether the discrimination was intentional or inadvertent. Louisiana pointed out, no doubt correctly, that the legislature had not intended to discriminate against interstate commerce. It had simply used "cost price" as the normal measure of the use tax—the cost price being the cost of the assembled equipment (without any deduction for labor or overhead). In the garden variety use tax case, when finished products are purchased in one state for use in another, cost price as the measure of the use tax produces the intended equality between the sales tax and the use tax. In *Halliburton*, however, because the equipment was self-assembled, the utilization of cost price produced a differential burden on the out-of-state equipment. Consequently, "[w]hile the inequality in question may have been an accident of statutory drafting,"[478] it nonetheless was forbidden by the Commerce Clause because "equality for the

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[475] Halliburton Oil Well Cementing Co. v. Reily, 373 US 64, 70, 83 S. Ct. 1201 (1963).

[476] *Halliburton*, 373 US 64, 72, 83 S. Ct. 1201 (1963).

[477] *Halliburton*, 373 US 64, 72, 83 S. Ct. 1201 (1963) (quoting Dean Milk Co. v. Madison, 340 US 349, 356, 71 S. Ct. 295 (1951)).

[478] *Halliburton*, 373 US 64, 72, 83 S. Ct. 1201 (1963).

purposes of competition and the flow of commerce is measured in dollars and cents, not legal abstractions."[479]

The Court subsequently struck down another Louisiana use tax: Louisiana's First-Use Tax on natural gas extracted on the Outer Continental Shelf (OCS) but piped into Louisiana for refining and subsequent transport elsewhere.[480] In considering the claimed discrimination against interstate commerce, the Court analyzed the exemptions and credits allowed by the statutes for the use of the gas in Louisiana. Thus, OCS gas consumed in Louisiana for (1) producing oil, natural gas, or sulphur; (2) processing natural gas for the extraction of liquefiable hydrocarbons; or (3) manufacturing fertilizer and anhydrous ammonia, was exempt from the First-Use Tax. Moreover, credits granted under the tax favored local interests. Under the Louisiana severance tax, an owner paying the First-Use Tax on OCS gas received an equivalent tax credit on any state severance tax that was owed in connection with production in Louisiana. The Court concluded that the obvious economic effect of the severance tax credit was to encourage natural gas owners producing OCS gas to invest in mineral exploration and development within Louisiana, rather than in further OCS development or in production in other states. In addition, any utility producing electricity with OCS gas, any natural gas distributor dealing in OCS gas, or any direct purchaser of OCS gas for consumption by the purchaser within the state, could recoup any increase in the cost of gas attributable to the First-Use Tax through credits against various taxes owed the state. Given these preferences for Louisianians, as compared with out-of-staters, the Court had no difficulty in concluding that "the Louisiana First-Use Tax unquestionably discriminates against interstate commerce in favor of local interests as the necessary result of various tax credits and exclusions."[481]

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[479] *Halliburton*, 373 US 64, 70, 83 S. Ct. 1201 (1963).

[480] Maryland v. Louisiana, 451 US 725, 101 S. Ct. 2114 (1981). We have already considered the case in connection with state tax incentives, supra ¶ 4.13[2][b] note 397, and in connection with the complementary tax doctrine, supra ¶ 4.13[2][c][i].

[481] Maryland v. Louisiana, 451 US 725, 756, 101 S. Ct. 2114 (1981). The Court also held that certain features of the First-Use Tax were in conflict with federal legislation regulating natural gas and, accordingly, violated the Supremacy Clause of the Constitution. See infra ¶ 4.24[1][d]. The case is considered in W. Hellerstein, "State Taxation in the Federal System: Perspectives on Louisiana's First Use Tax on Natural Gas," 55 Tul. L. Rev. 601 (1981) and "The Supreme Court, 1980 Term," 95 Harv. L. Rev. 93, 102 (1981). In *Connecticut v. New Hampshire*, Connecticut, Massachusetts, and Rhode Island filed a declaratory judgment suit in the U.S. Supreme Court challenging the constitutionality of New Hampshire's 1991 Tax on Nuclear Station Property. There was only one nuclear power plant in New Hampshire, the Seabrook Plant, which was jointly owned by utilities in New Hampshire and the plaintiff states. The electricity generated by the Seabrook Plant was sold to the consumers in the other states. The plaintiffs contended that the tax bore disproportionately on them and their consumers, in part because New Hampshire utilities that own an interest in the Seabrook Plant benefitted from a credit allowed them against the nuclear power station tax for the New Hampshire business profits tax that they paid.

The Court likewise struck down as unconstitutionally discriminatory a statewide use tax designed to complement a local sales tax insofar as the rate of the use tax exceeded the rate of the local sales tax.[482] The Court so held even though more than 90 percent of the sales subject to the use tax were in jurisdictions in which the local sales tax exceeded the statewide use tax.

[e] Differential Treatment of Interest From In-State and Out-Of-State Institutions and Governments

In *Dominion National Bank v. Olsen*,[483] the U.S. Court of Appeals for the Sixth Circuit held that Tennessee's exemption from its tax on intangible income of interest from certificates of deposit issued by in-state—but not by out-of-state—financial institutions violated the Commerce Clause. Relying heavily on *Boston Stock Exchange*,[484] the court held that the tax exemption provided a direct commercial advantage to Tennessee financial institutions over out-of-state financial institutions by inducing Tennessee residents to invest in certificates of deposit issued by in-state, rather than out-of-state, banks.[485] The Kentucky Supreme Court has similarly held that providing a lower ad valorem tax rate for in-state bank deposits than for out-of-state bank

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The out-of-state utilities, however, obtained no such credit, since they were not subject to the New Hampshire business profits tax. The plaintiffs contended that the tax violated the Commerce Clause, among other constitutional provisions. A Special Master, relying heavily on *Maryland v. Louisiana*, determined that the tax discriminated against interstate commerce in violation of the Commerce Clause and violated the federal statute forbidding discriminatory taxation of electricity. See infra ¶ 4.24[1][d]. Thereafter New Hampshire repealed the credit and the parties settled the dispute out of court.

[482] Associated Indus. of Mo. v. Lohman, 511 US 641, 114 S. Ct. 1815 (1994). The case is discussed in supra ¶ 4.13[2][c][ii].

[483] Dominion Nat'l Bank v. Olsen, 771 F2d 108 (6th Cir. 1985).

[484] Boston Stock Exch. v. State Tax Comm'n, 429 US 318, 97 S. Ct. 599 (1977), discussed supra ¶ 4.13[2][b][i].

[485] There were two interesting procedural aspects to the case. First, the taxing scheme was challenged not by a taxpayer, but by an out-of-state bank that allegedly suffered competitive harm from the tax. Despite the fact that the banks were not the taxpayers—the tax was imposed on Tennessee residents—the court held that the banks had standing to sue because they had "suffered an injury in fact and . . . they were within the 'zone of interests' regulated by the statute here under assault." *Dominion*, 771 F2d 108, 112 (6th Cir. 1985). Second, the suit was brought in federal court, a rarity in a state tax case in light of the federal antitax injunction act, 28 USC § 1341, which provides that "the district courts shall not enjoin, suspend, or restrain the collection of any tax under State law where a plain, speedy, and efficient remedy may be had in the courts of such State." The banks' remedy in the state court was found to be inadequate because the state court had held that only Tennessee taxpayers had standing to challenge Tennessee state taxes. Dominion Nat'l Bank v. Olsen, 651 SW2d 215 (Tenn. 1983).

deposits violates the Commerce Clause.[486] And the New Hampshire Supreme Court has held that New Hampshire's income and dividends tax, which exempted from tax any interest and dividends received from New Hampshire financial institutions, violates the Commerce Clause.[487]

These decisions cast doubt on the constitutionality of the widespread practice among states of exempting from income tax the interest from federally tax-exempt bonds issued by the state or its political subdivisions while taxing the income from tax-exempt bonds issued by other states or their political subdivisions.[488] Indeed, if ever one needed proof that such discriminatory state taxes Balkanize our national capital markets, one need look no further than the state-specific municipal bond funds that have arisen directly as a result of these discriminatory state taxes. Nevertheless, the Ohio Supreme Court has sustained over Commerce Clause objections Ohio's taxation of the interest of bonds of other states while exempting interest from Ohio bonds.[489]

[f] Retaliatory Taxes

Although the Supreme Court has sustained the constitutionality of retaliatory state taxes under the Equal Protection Clause,[490] it has invalidated retaliatory state tax and regulatory legislation under the Commerce Clause. In *New Energy Co. v. Limbach*,[491] the Supreme Court struck down an Ohio fuel tax credit for fuel dealers who used gasohol because the credit was limited to gas-

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[486] St. Ledger v. Kentucky Revenue Cabinet, 912 SW2d 34 (Ky. 1995), vacated and remanded on other grounds, 517 US 1206, 116 S. Ct. 1821 (1996).

[487] Smith v. New Hampshire, 141 NH 681, 692 A2d 486 (1997). An opinion of the Massachusetts Supreme Judicial Court indicated that a substantial Commerce Clause issue is raised by the state's tax on interest deposited in out-of-state financial institutions at the rate of 10 percent, while interest deposited in Massachusetts's financial institutions was taxed at 5 percent. Aronson v. Commonwealth, 401 Mass. 244, 516 NE2d 137 (1987), cert. denied, 488 US 818, 109 S. Ct. 58 (1989). The court remanded for a trial on the Commerce Clause issue because the record was sparse, and it believed a fuller record was necessary to adjudicate the constitutional issue properly.

[488] See also J. Blumstein, "Some Intersections of the Negative Commerce Clause and the New Federalism: The Case of Discriminatory State Income Tax Treatment of Out-Of-State Tax-Exempt Bonds," 31 Vand. L. Rev. 473 (1978); cf. Forbes, Inc. v. Department of Fin., 66 NY2d 243, 487 NE2d 251, 496 NYS2d 394 (1985), cert. denied, 475 US 1109, 106 S. Ct. 1517 (1986).

[489] Shaper v. Tracy, 97 Ohio App. 3d 760, 647 NE2d 550 (1994), rev. denied, 171 Ohio St. 3d 1477, 645 NE2d 1257 (1995), cert. denied, 516 US 907, 116 S. Ct. 274 (1995); see also S. Attaway, "The Case for Constitutional Discrimination in Taxation of Out-Of-State Municipal Bonds," 76 BU L. Rev. 737 (1996).

[490] See Western & S. Life Ins. Co. v. State Bd. of Equalization, 451 US 648, 101 S. Ct. 2070 (1981), and other cases discussed at ¶ 3.05[3][a].

[491] New Energy Co. v. Limbach, 486 US 269, 108 S. Ct. 1803 (1988). The *New Energy* case is discussed supra ¶ 4.13[2][b][iv], dealing with state tax incentives.

ohol produced in Ohio or in states that provided reciprocal tax advantages to Ohio-produced gasohol. The Court observed that the tax credit discriminated on its face against interstate commerce by explicitly depriving "certain products of generally available beneficial tax treatment because they are made in certain other States."[492] In response to the claim that Ohio was really promoting interstate commerce by encouraging other states to enact similar tax advantages that would spur the interstate sale of gasohol, the Court responded that a state "may not use the threat of economic isolation as a weapon to force sister States to enter into even a desirable reciprocity agreement."[493]

The Maine Supreme Court applied the Supreme Court's view of retaliatory state legislation in striking down a retaliatory tax on out-of-state truckers under the Commerce Clause.[494] Maine imposed a tax on all trucks entering the state that were registered in any of the thirteen states levying so-called third-structure taxes[495] on Maine-registered trucks operating in those states.[496] The tax was designed to mirror exactly the third-structure tax that was levied on Maine-registered trucks traveling in states with such taxes.[497]

Because the Maine tax, like most retaliatory taxes, discriminated on its face against interstate commerce, the question was whether Maine could justify the otherwise unlawful discrimination. The state's principal justification was

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[492] *New Energy*, 486 US 269, 274, 108 S. Ct. 1803 (1988).

[493] *New Energy*, 486 US 269, 274, 108 S. Ct. 1803 (1988) (quoting Great Atl. & Pac. Tea Co. v. Cottrell, 424 US 366, 378, 96 S. Ct. 923 (1976)). In Russell Stewart Oil Co. v. Department of Revenue, 124 Ill. 2d 116, 529 NE2d 484 (1988), the court followed the *New Energy* case in invalidating an Illinois tax preference for gasohol containing ethanol distilled in Illinois or in states offering reciprocal benefits. Although Illinois amended its definition of "gasohol" in one of the statutes at issue to limit the preference to gasohol made from certain cereal grains (rather than gasohol distilled in Illinois), the court found that the statute nevertheless discriminated against interstate commerce because all Illinois-distilled gasohol was made from cereal-based grain, whereas significant amounts of gasohol made outside the state were derived from raw materials other than cereal-based grain.

[494] Private Truck Council of Am., Inc. v. Quinn, 503 A2d 214 (Me. 1986), cert. denied (on refund issue), 476 US 1129, 106 S. Ct. 1997 (1986).

[495] "Third-structure" taxes are so denominated because they exist in addition to registration fees and motor fuel taxes thatare imposed by all states upon the trucking industry.

[496] The statute provided:

> So long as another jurisdiction imposes a tax or fee on a class of motor vehicles registered in Maine and traveling in that jurisdiction and that tax or fee is additional to those imposed by Maine upon the same class of motor vehicles not registered in that jurisdiction, the Secretary of State, Commissioner of Finance and Administration and Commissioner of Transportation acting together shall levy the same or substantially the same tax or fee upon the same class of motor vehicles registered in that jurisdiction and traveling in Maine.

Former Me. Rev. Stat. Ann. § 2243-C. The rules implementing the statute identified thirteen states whose registered vehicles were subject to Maine's retaliatory levy.

[497] Me. Rev. Stat. Ann. § 2243-C, quoted supra note 496.

that it had no discriminatory purpose in enacting its tax. It was seeking only to promote interstate commerce in an attempt "to make treatment of foreign-registered vehicles in Maine comparable with treatment of similar Maine-registered motor vehicles traveling in those [foreign] vehicles' jurisdictions of registration."[498] The Maine court held that the Commerce Clause would not tolerate such a tax policy. A state may not impose a facially discriminatory tax in an attempt through self-help to coerce another state into adopting tax policies it views as appropriate.[499]

Courts in Florida, Georgia, Nebraska, New Hampshire, New Jersey, Oklahoma, and Vermont have followed the Maine Supreme Court in striking down state retaliatory taxes on out-of-state trucks under the Commerce Clause.[500]

[g] Flat Annual Highway Taxes as Applied to Interstate Truckers

In *American Trucking Ass'ns, Inc. v. Scheiner*,[501] the Supreme Court abandoned a half-century of precedent in striking down Pennsylvania's flat annual highway taxes as applied to truckers engaged in interstate commerce. The

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[498] *Private Truck Council*, 503 A2d 214, 218 (Me. 1986), cert. denied (on refund issue), 476 US 1129, 106 S. Ct. 1997 (1986) (quoting Legislative Digest 2412, Statement of Fact (111th Legislature, 1984)).

[499] *Private Truck Council*, 503 A2d 214, 218 (Me. 1986), cert. denied (on refund issue), 476 US 1129, 106 S. Ct. 1997 (1986).

[500] Florida v. Private Truck Council of Am., 531 So. 2d 367 (Fla. Dist. Ct. App. 1988); State v. Private Truck Council of Am., 258 Ga. 531, 371 SE2d 378 (1988); Dennis v. State, 234 Neb. 427, 451 NW2d 676 (1990), rev'd on other grounds, 498 US 439, 111 S. Ct. 865 (1991); Private Truck Council of Am. v. State, 128 NH 466, 517 A2d 1150 (1986); Private Truck Council of Am. v. State, 221 NJ Super. 89, 534 A2d 13 (1987), aff'd, 111 NJ 214, 544 A2d 33 (1988); Private Truck Council of Am. v. State, 806 P2d 598 (Okla. 1990), judgment vacated on other grounds, 501 US 1247, 111 S. Ct. 2882 (1991); American Trucking Ass'ns, Inc. v. Conway, 146 Vt. 574, 508 A2d 405 (1986), cert. denied, 483 US 1019, 107 S. Ct. 3262 (1987); American Trucking Ass'ns, Inc. v. Conway, 152 Vt. 363, 566 A2d 1323 (1989). See also Division of Alcoholic Beverages & Tobacco v. McKesson Corp., 524 So. 2d 1000 (Fla. 1988) (retaliatory tax on alcoholic beverages violates Commerce Clause), reversed on other grounds, 496 US 18, 110 S. Ct. 2238 (1990).

[501] American Trucking Ass'ns v. Scheiner, 483 US 266, 107 S. Ct. 2829 (1987). The *American Trucking Ass'ns* case is also discussed supra ¶ 4.13[2][c][i], dealing with the complementary tax doctrine, and infra ¶ 4.15[1], dealing with the internal consistency doctrine. The analysis of *American Trucking Associations* draws freely from W. Hellerstein, "State Taxation of Interstate Business: Perspective on Two Centuries of Constitutional Adjudication," 41 Tax Law. 37 (1987), and is used with the consent of the American Bar Association Section of Taxation. In considering these comments on the *American Trucking Ass'ns* case, the reader should be aware that Walter Hellerstein was counsel to the American Trucking Associations in the *American Trucking Associations* case.

taxes at issue, an axle tax ranging from $72 to $180 per truck, and a $25 identification marker fee, were imposed in addition to the annual registration fees and fuel consumption taxes that all states, including Pennsylvania, impose on the trucking industry.

The truckers attacked the levies on the ground that the taxes discriminated against interstate commerce by imposing a substantially higher effective tax rate on trucks registered outside the state than on trucks registered in the state. Because flat taxes are not apportioned to the vehicle's use of Pennsylvania's roads, they necessarily result in per-mile costs much lower for heavy users than for light users of the state's highways. Since the average Pennsylvania-registered truck used the state roads far more extensively than the average out-of-state truck, the lower effective tax rate inured to the local trucker's benefit by comparison to his out-of-state competitor.

The problem with this argument was that, in a series of earlier cases, the Court had upheld flat state highway taxes that were not proportioned to the vehicle's use of the roads in the state.[502] The Court responded to this line of cases by observing at the outset that many of the earlier cases had turned on the fact that the taxes were exacted in consideration for the "privilege" of using the state's highways, a taxable "local" subject, rather than the privilege of doing interstate business.[503] In recent years, however, the Court had taken considerable pains to discredit the privilege doctrine and to eliminate it from its Commerce Clause analysis.[504] Consequently, the Court declared that

> the precedents upholding flat taxes can no longer support the broad proposition . . . that every flat tax for the privilege of using a State's highways must be upheld even if it has a clearly discriminatory effect on commerce by reason of that commerce's interstate character. Although out-of-state carriers obtain a privilege to use Pennsylvania's highways that is nominally equivalent to that which local carriers receive, imposition of the flat taxes for a privilege that is several times more valuable to a local

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[502] See, e.g., Capitol Greyhound Lines v. Brice, 339 US 542, 70 S. Ct. 806 (1950); Aero Mayflower Transit Co. v. Board of RR Comm'rs, 332 US 495, 68 S. Ct. 167 (1947); Aero Mayflower Transit Co. v. Georgia Pub. Serv. Comm'n, 295 US 285, 55 S. Ct. 709 (1935).

[503] *American Trucking Ass'ns*, 483 US 266, 294–295, 107 S. Ct. 2829 (1987).

[504] See Commonwealth Edison Co. v. Montana, 453 US 609, 614–617, 101 S. Ct. 2946 (1981), overruling Heisler v. Thomas Colliery Co., 260 US 245, 43 S. Ct. 43 (1922); Department of Revenue v. Washington Stevedoring Cos., 435 US 734, 743–750, 98 S. Ct. 1388 (1978), overruling Puget Sound Stevedoring Co. v. State Tax Comm'n, 302 US 90, 58 S. Ct. 72 (1937) and Joseph v. Carter & Weekes Stevedoring Co., 330 US 422, 67 S. Ct. 815 (1947); Complete Auto Transit, Inc. v. Brady, 430 US 274, 278–289, 97 S. Ct. 1076 (1977), overruling Spector Motor Serv., Inc. v. O'Connor, 340 US 602, 71 S. Ct. 508 (1951).

business than to its out-of-state competitors is unquestionably discriminatory and thus offends the Commerce Clause.[505]

Moreover, the Court cited the long line of drummers' license cases in which taxes on the privilege of doing business had been invalidated because "the tax on drummers operates greatly to their disadvantage in comparison with merchants and manufacturing" of the taxing jurisdiction.[506]

The Court nevertheless reaffirmed the principle that the Commerce Clause does not prevent the states from employing flat taxes if they are the only practicable means of collecting revenue from highway users and if more refined methods of taxation would impose genuine administrative burdens. There was no basis for such a disposition of the case at hand, since Pennsylvania routinely used mileage figures to determine motor carriers' fuel taxes and registration fees (when such fees are figured on an apportioned basis). It likewise apportioned its corporate net income tax imposed on interstate carriers on a mileage basis. Hence, administrative necessity did not save Pennsylvania's marker fee and axle tax.[507]

The Rhode Island Supreme Court sustained an annual $10 fuel decal fee, which applied only to nonresident motor carriers.[508] The court found the fee nondiscriminatory, because resident motor carriers were subject to comparable burdens as part of their registration fees. The court distinguished the $10 decal fee from the $25 decal fee invalidated in *American Trucking Ass'ns* on the ground that the taxpayer presented no evidence that it had a higher cost per mile than resident motor carriers, or that the $10 fee did not fairly approximate the cost of administering the decal provision.

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[505] *American Trucking Ass'ns*, 483 US 266, 296, 107 S. Ct. 2829 (1987).

[506] *American Trucking Ass'ns*, 483 US 266, 284 n.16, 107 S. Ct. 2829 (1987). The drummers' license cases are discussed supra ¶ 4.13[2][a].

[507] The Court also relied on the "internal consistency" doctrine in striking down Pennsylvania's flat highway taxes. See infra ¶ 4.15[1]. See also Trailer Marine Transp. Corp. v. Rivera, 977 F2d 1 (1st Cir. 1992) (striking down flat fee designed to fund accident-compensation plan as applied to trailers used to transport goods to and from Puerto Rico); American Trucking Ass'ns, Inc. v. Secretary of State, 595 A2d 1014 (Me. 1991) (invalidating flat license fee on trucks transporting hazardous materials because state failed to establish that imposition of more finely calibrated user charges for benefit of state's hazardous materials program was impracticable); American Trucking Ass'ns, Inc. v. Secretary of Admin., 415 Mass. 337, 613 NE2d 95 (1993) (invalidating flat license and hazardous waste transportation fees on interstate truckers and discussing other similar cases); cf. Riverton Produce Co. v. State, 871 P2d 1213 (Colo. 1994) (invalidating registration fees and property taxes that discriminated against out-of-state trucks but sustaining temporary disparities in tax treatment of interstate and intrastate trucks resulting from phase-in of nondiscriminatory taxing regime).

[508] Seibert v. Clark, 619 A2d 1108 (RI 1993).

[h] Discrimination Against Charitable Institutions Operating Principally for Nonresidents

In *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine*,[509] the U.S. Supreme Court held that a Maine property tax exemption for charitable institutions violated the Commerce Clause because the exemption excluded charitable institutions that "are in fact conducted or operated principally for persons who are not residents of Maine."[510] After rejecting the taxing authority's argument that the Commerce Clause was inapplicable because the discrimination did not affect "interstate commerce,"[511] the Court addressed the substantive Commerce Clause claim—whether the denial of a tax exemption to a nonprofit summer camp on the ground that it principally served nonresidents discriminated against interstate commerce.

The Court observed that the case would be easy if the statute had been directed at profit-making entities, because it would violate the rule that "State laws discriminating against interstate commerce on their face are 'virtually per se invalid.'"[512] The Maine law would violate this rule because it

> expressly distinguishes between entities that serve a principally interstate clientele and those that primarily serve an intrastate market, singling out camps that serve mostly in-staters for beneficial tax treatment, and penalizing those camps that do a principally interstate business. As a practical matter, the statute encourages affected entities to limit their out-of-state clientele, and penalizes the principally nonresident customers of businesses catering to a primarily interstate market.[513]

In the Court's opinion, the Maine case (if viewed as a case involving a profit-making entity) would be indistinguishable from cases in which the Court prohibited states from providing a preferred access to their residents, over out-of-staters, to natural resources located within their borders or the products derived therefrom.[514]

The novel question in the case was whether the Court's traditional rules barring state taxes that discriminate against interstate commerce should apply

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[509] Camps Newfound/Owatonna, Inc. v. Town of Harrison, Me., 520 US 564, 117 S. Ct. 1590 (1997).

[510] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1594 (1997) (quoting Me. Rev. Stat. Ann. tit. 36, § 652(1)(A) (Supp. 1996)).

[511] This aspect of the Court's opinion is considered supra ¶ 4.05[2].

[512] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1598 (1997) (quoting Fulton Corp. v. Faulkner, 516 US 325, 116 S. Ct. 848, 854 (1996) (quoting, in turn, Oregon Waste Sys., Inc. v. Department of Env'tl Quality, 511 US 93, 114 S. Ct. 1345 (1994)).

[513] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1598 (1997).

[514] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1598 (1997) (citing New England Power Co. v. New Hampshire, 455 US 331, 388, 102 S. Ct. 1096 (1982)).

to tax exemptions for charitable and benevolent institutions. The Court held that they should. It observed that nonprofit entities engage in a number of lines of commerce in which profit-making entities likewise engage (including education and hospital care) and that any effort to distinguish between the two types of entities would be "wholly illusory."[515] "Protectionism," the Court declared, "whether targeted at for-profit entities, or serving, as here, to encourage nonprofits to keep their efforts close to home is forbidden under the dormant Commerce Clause."[516]

The Court also rejected the taxing authority's claim that the exemption was simply a form of "subsidy" favoring in-state interests, which the Court has generally approved.[517] The Court reiterated its view that there is a constitutionally significant difference between a discriminatory tax exemption, in which the state is acting in its sovereign capacity, and a discriminatory subsidy, in which the state acts as a market participant (and thus is immune from Commerce Clause restraints). In the Court's view,

> Maine's tax exemption—which sweeps to cover broad swathes of the nonprofit sector—must be viewed as an action taken in the State's sovereign capacity rather than a proprietary decision to make an entry into all of the markets in which the exempted charities function.[518]

[i] Differential Treatment of Transactions in Different Markets

In *General Motors Corp. v. Tracy*,[519] the Court confronted the question whether a taxing scheme that exempted sales of natural gas from a local public utility while taxing sales of natural gas from an interstate gas marketer violated the Commerce Clause bar against state tax discrimination. Like most states, Ohio imposes a sales tax on tangible personal property purchased in the state and a complementary use tax on tangible personal property purchased outside the state but used within the state. The sale or use of natural gas in Ohio is generally subject to sales or use tax under this taxing regime. However, when natural gas is purchased from a "natural gas company," it is exempt from Ohio sales and use tax. The Ohio Supreme Court has construed this definition as limited to companies that own or operate the transportation and distribution equipment and deliver natural gas to consumers in Ohio. Accordingly, only

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[515] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1603 (1997).

[516] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1604 (1997).

[517] See infra ¶ 4.14, dealing with the Commerce Clause distinction between taxes and subsidies.

[518] *Camps Newfound*, 520 US 564, 117 S. Ct. 1590, 1607 (1997).

[519] General Motors Corp. v. Tracy, 519 US 278, 117 S. Ct. 811 (1997).

purchases of natural gas from local distribution companies (i.e., public utilities) are exempt from Ohio sales and use tax.

Public utilities, however, are not the only sellers of natural gas to ultimate consumers in today's natural gas market. Although natural gas was traditionally sold to interstate pipeline companies, who transported gas to public utilities for sale to the end user, federal law now requires interstate pipeline companies to serve as common carriers (rather than merchants) of natural gas. As a consequence, natural gas producers and independent gas marketers may now arrange for interstate pipelines to transport natural gas and may thus compete directly with local public utilities for sales of natural gas to burner-tip consumers.

General Motors Corporation (GM) purchased natural gas from independent natural gas marketers to heat its manufacturing plants. These marketers obtained natural gas from producers outside the state and arranged for transportation to the initial receiving pipeline outside the state. These marketers did not own the facilities used to transport the gas. Instead, they paid a fee to the pipelines to transport the gas to the out-of-state delivery point, where GM took title to the gas. GM then arranged to have the gas transported into Ohio and delivered to its various plants in the state. Because GM purchased the gas outside the state for use in Ohio, and did not purchase the gas from a "natural gas company," the Ohio Tax Commissioner assessed a use tax against GM on the natural gas that it used in the state.

Despite the apparent discrimination in favor of local over out-of-state purchases, the U.S. Supreme Court sustained the tax. The Court recognized, of course, that the Commerce Clause prohibits state taxes that discriminate against interstate commerce. But the alleged discrimination in question was inextricably connected to the differential treatment of regulated and unregulated sellers of natural gas. Accordingly, the Court found it appropriate to analyze the claim of discrimination against the background of the "historical development of the contemporary retail market for natural gas."[520]

After an extensive discussion of the history of natural gas regulation, the Court found that the existence of two different natural gas "products"—the regulated product consisting of natural gas "bundled" with services and protections required by regulatory authorities, which is provided by regulated local distribution companies (LDCs), and the unregulated product consisting of "unbundled" gas provided by unregulated marketers—raised a more complex Commerce Clause issue than might have appeared at first glance. As the Court observed:

> Conceptually, of course, any notion of discrimination assumes a comparison of substantially similar entities. Although this central assumption has more often than not remained dormant in the Court's opinions on

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[520] *General Motors*, 519 US 278, 117 S. Ct. 811, 819 (1997).

> state discrimination subject to review under the dormant Commerce Clause, when the allegedly competing entities provide different products, as here, there is a threshold question whether the companies are indeed similarly situated for constitutional purposes. This is so for the simple reason that the different entities service different markets and would continue to do so even if the supposedly discriminatory burden were removed. If in fact that should be the case, eliminating the tax . . . would not serve the Commerce Clause's fundamental objective of preserving a national market for competition undisturbed by preferential advantages conferred by a State upon its residents or resident competitors.[521]

After analyzing the nature of the markets in question, the Court concluded that the market for exempt natural gas purchases from local public utilities was discrete from the market for taxable natural gas purchases from interstate gas marketers. The Court declared:

> [I]n the absence of actual or prospective competition between the supposedly favored and disfavored entities in a single market there can be no local preference, whether by express discrimination against interstate commerce or undue burden upon it, to which the dormant Commerce Clause may apply. The dormant Commerce Clause protects markets and participants in markets, not taxpayers as such.[522]

General Motors is significant because it takes what might have been viewed as a garden-variety case of unconstitutional discrimination and subjects it to a much more complex inquiry by asking the "threshold question"[523] whether the favored and disfavored economic actors are "similarly situated for constitutional purposes."[524] In substance, the Court is saying that the precondition to a claim of Commerce Clause discrimination is that the discrimination affects economic choices in competitive markets. If the discrimination does not affect economic decision making in a competitive market, it is irrelevant (at least for Commerce Clause purposes).[525]

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[521] *General Motors*, 519 US 278, 117 S. Ct. 811, 824 (1997).

[522] *General Motors*, 519 US 278, 117 S. Ct. 811, 825 (1997).

[523] *General Motors*, 519 US 278, 117 S. Ct. 811, 824 (1997).

[524] *General Motors*, 519 US 278, 117 S. Ct. 811, 824 (1997).

[525] In several earlier cases, the Court had adverted to this point, but it had never confronted it as squarely as it did in *General Motors*. For example, in Alaska v. Arctic Maid, 366 US 199, 81 S. Ct. 929 (1961), the Court sustained an Alaska business license tax levied on freezer ships and other floating cold storages. The tax was imposed at the rate of 4 percent of the value of fish bought or otherwise obtained for processing through freezing. After noting that Alaskan canneries paid a 6 percent tax on the value of salmon obtained for canning and the local fish processors selling to the fresh-frozen consumer market paid a one percent tax, the Court concluded there was no Commerce Clause discrimination against the freezer ships. The Court observed that the lower rate for the local fish processors raised no issue of discrimination because the freezer ships, which took their catches

Accordingly, the critical factual predicate underlying the Court's determination was the absence of demonstrated competition between sales of natural gas by regulated local public utilities and sales of natural gas by unregulated gas marketers. Thus in an important footnote the Court observed:

> [P]etitioner contended at oral argument that during the tax period in question here, Ohio permitted some natural gas sales by public utilities at unregulated, negotiated rates, and that those sales were not subject to sales tax. The record provides no support for this contention, and the constitutionality of Ohio exempting from state sales tax utility sales that are not price-regulated is therefore not before the Court in this case.[526]

If the petitioner's assertion had been substantiated by record support, the case might well have been decided differently. Future disputes over the constitutionality of state tax discrimination in regulated markets are likely to focus on this important factual issue, namely, whether there is competition between the regulated and deregulated taxpayers.[527]

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south for canning, did not "compete with those who freeze fish for the retail market." *Arctic Maid*, 366 US 199, 205, 81 S. Ct. 929 (1961).

In Bacchus Imports, Ltd. v. Dias, 468 US 263, 104 S. Ct. 3049 (1984), on the other hand, the Court, took a different view of the competition question in striking down a Hawaii liquor excise tax that exempted certain locally produced beverages from tax on the ground that it discriminated against interstate commerce. See supra ¶ 4.13[2][b][ii]. The state court had agreed with the state's argument that the locally produced beverages did not compete with the liquors sold by the taxpayers and therefore raised no issue of discrimination under the Commerce Clause. The Supreme Court responded by observing that "the fact that the exempted liquors do not constitute a present 'competitive threat' to other liquors is [not] dispositive of the question whether competition exists between the locally produced beverages and the foreign beverages." *Bacchus*, 468 US 263, 269, 104 S. Ct. 3049 (1984). Moreover, the Court was willing to speculate about the ways in which the exemption might encourage increased consumption of the local beverages as the predicate for its unwillingness to find a lack of competition between the exempted and the nonexempted liquors (e.g., by encouraging their substitution for the foreign beverages and by encouraging nondrinkers to consume them).

[526] *General Motors*, 419 US 278, 117 S. Ct. 811, 823 n.11 (1997).

[527] In Smith v. New Hampshire Dep't of Revenue Admin., 141 NH 681, 692 A2d 486 (1997), the state conceded that the New Hampshire income and dividends tax, which exempted from tax any interest and dividends received from New Hampshire financial institutions, violated the Commerce Clause. In determining whether taxpayers who had received interest and dividends from out-of-state corporate entities were entitled to relief, however, the Court invoked *General Motors* to suggest that the taxpayers would not be entitled to relief unless they could demonstrate that the out-of-state corporate entities in which they invested competed in the same market with New Hampshire banks. The court declared:

> In fashioning a remedy . . . the trial court must determine whether the petitioners can prove their claim that the effect of the exemptions for New Hampshire bank interest and dividends was to discriminate unlawfully against other sources of interest and dividend income, as opposed to discriminating solely against income earned on

[j] Discrimination in Favor of Domestic Over Foreign Entities

It is, of course, clear that a state tax that discriminates in favor of local over out-of-state interests violates the Commerce Clause bar against discriminatory taxes. Indeed, if there is a single theme that characterizes the Court's Commerce Clause cases it is that out-of-state economic actors are entitled to equal treatment with their in-state competitors. The principle is easy enough to state and, in many cases, easy enough to apply. The vendor of out-of-state products is entitled to equal treatment with the vendor of in-state products;[528] the out-of-state assembler of equipment used in the state is entitled to equal treatment with the in-state assembler of equipment used in the state;[529] and the disposer of out-of-state waste in the state is entitled to equal treatment with the disposer of in-state waste in the state.[530]

It is a slightly different question, however, whether a state tax that discriminates against out-of-state entities (e.g., a foreign corporation) automatically falls within the rule articulated above. In other words, it is possible (though not, as an intuitive matter, plausible) that a tax discriminating against a foreign entity would not in substance amount to a discrimination against out-of-state interests or interstate commerce. Presumably, if a state could prove that a statute discriminating against foreign corporations, for example, did not in fact burden out-of-state interests or interstate commerce because foreign corporations actually were no more likely to reflect out-of-state interests or to engage in interstate commerce than domestic corporations, then it would have a good defense to a charge of discrimination against interstate commerce.

The courts appear to have ignored this counterintuitive proposition—in part, no doubt, because there was no evidence to support it—in ruling on state taxes that discriminate against out-of-state entities. They have simply assumed (properly in our view) that a discrimination against such an entity amounts to a discrimination against interstate commerce, without requiring taxpayers to es-

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> investments in out-of-state banks, as the State maintains. The negative commerce clause is intended to preserve free market competition. If there has been no actual effect on the market because New Hampshire bank interest does not compete with other corporate investments, then the Federal Constitution has not been violated as to entities other than out-of-state banks. Cf. *General Motors Corp. v. Tracy*. . . . In order to determine the extent of the discrimination in this case, the trial court must make a factual determination whether New Hampshire bank interest competes with other sources of investment income such as stock dividends and bond interest.

Smith, 141 NH 681, 692 A2d 486, 497 (1997). The *Smith* case suggests that state taxing authorities will invoke *General Motors* to require taxpayers to demonstrate, as a threshold matter, that the alleged Commerce Clause discrimination in fact affects economic decision making in competitive markets.

[528] See supra ¶ 4.13[2][b][ii] (discussing *Bacchus*).

[529] See supra ¶ 4.13[2][d] (discussing *Halliburton*).

[530] See supra ¶ 4.13[2][c][ii] (discussing *Oreg. Waste).*

tablish the factual basis for that assumption. Given the likelihood that discrimination against interstate commerce in fact exists in such cases, it should be the state's burden to overcome this presumption, if it can, when its statutes impose a greater burden on domestic than on foreign entities.

The New York courts, for example, struck down a higher rate of license tax on foreign corporations than the organization tax on domestic corporations without inquiring into the question whether interstate commerce or foreign interests were in fact burdened by the discrimination.[531] The taxpayer was able to demonstrate, through the legislative history of the statutes, that the higher license tax rate imposed on foreign corporations had been enacted in order to exert pressure on foreign businesses to incorporate in New York.[532] Citing *Boston Stock Exchange*,[533] the court concluded: "[W]here, as here, a statute creates an advantage for New York businesses while imposing a burden on

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[531] Aurora Corp. of Ill. v. Tully, 60 NY2d 338, 457 NE2d 735, 469 NYS2d 630 (1983).

[532] The disparity had existed for more than half a century. The original New York license tax on foreign corporations, first enacted in 1895, was levied at the rate of one eighth of one percent of capital stock employed in the state. The same rate was applied at that time to a domestic corporation's total authorized capital. The explicit purpose of the 1895 provision had been to ensure that foreign corporations doing business in New York were subjected to as high a license tax as the organization tax paid by New York corporations. The legislature found, however, that "[w]hile the tax was somewhat effective in preventing businesses from avoiding the New York organization tax by incorporating in New Jersey," the difference in the taxation of domestic and foreign corporations nevertheless "provided a continued incentive for a number of corporations doing business in New York to organize in New Jersey." *Aurora Corp.*, 60 NY2d 338, 457 NE2d 735, 737, 469 NYS2d 630 (1983). In the hope of "exerting further pressure on foreign corporations to incorporate in New York," the legislature in 1901 reduced the organization tax rate from one eighth of one percent to one twentieth of one percent of authorized capital stock. *Aurora Corp.*, 60 NY2d 338, 1457 NE2d 735, 738, 469 NYS2d 630 (1983). The license tax rate on foreign corporations, however, remained unchanged at one eighth of one percent. Apparently, the lowered rate on domestic corporations succeeded in "fulfilling the lawmakers' goal of forcing many corporations to incorporate in New York." *Aurora Corp.*, 60 NY2d 338, 457 NE2d 735, 738, 469 NYS2d 630 (1983). The court dealt with the state's contention that the differentiation in tax was justified, because domestic corporations were taxed on all their authorized capital stock, whereas foreign corporations were taxed only on issued stock, by saying:

> Nor are we persuaded by respondent's claim that the discrimination here is justified because domestic corporations are subject to New York's organization tax on all of their authorized shares while foreign corporations are taxed by New York only on issued shares employed in New York. This argument is flawed because petitioner must also pay organization taxes to its home state on all its authorized stock. Thus, any attempt by New York to "compensate" for lower organizational taxes in other states by imposing an excessive license fee on foreign corporations is really nothing more than an unlawful attempt to tax that portion of petitioner's stock which has no nexus to New York. Such actions are clearly unconstitutional.

Aurora Corp., 60 NY2d 338, 457 NE2d 735, 739, 469 NYS2d 630 (1983).

[533] Boston Stock Exch. v. State Tax Comm'n, 429 US 318, 97 S. Ct. 599 (1977).

foreign corporations, tax-neutral decisions as to where to incorporate or do business are foreclosed and the resulting discriminatory burden on interstate commerce requires that the statute be declared invalid."[534]

The Massachusetts Supreme Court invalidated the state's corporate excise tax as applied to intangible property corporations because it permitted domestic intangible property corporations to deduct from their taxable net worth the value of an 80-percent-or-more owned subsidiary, but only if the subsidiary was incorporated in Massachusetts.[535] Foreign intangible property corporations were permitted to deduct from their taxable net worth the value of 80-percent-or-more owned subsidiaries, but only if they were incorporated outside of Massachusetts and did no business in the state. The court found that the statute discriminated against interstate commerce because

> it draws a distinction solely on the basis of the domicile of the subsidiary, and treats a domestic corporation more favorably if it chooses to acquire a domestic subsidiary rather than a foreign subsidiary. Consequently, the statutory scheme imposes a heavier burden on domestic corporations who own foreign subsidiaries than on domestic corporations that own domestic subsidiaries. . . . The challenged deductions also create an incentive for domestic corporations to acquire in-state subsidiaries, and penalize corporations that choose to cross state lines.[536]

A Kentucky court struck down a requirement of Kentucky's capital stock tax limiting the right to file on a combined basis or to exclude investments in

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[534] *Aurora Corp.*, 60 NY2d 338, 457 NE2d 735, 469 NYS2d 630, 633–634 (1983).

[535] Perini Corp. v. Commissioner of Revenue, 419 Mass. 763, 647 NE2d 52 (1995), cert. denied, 516 US 822, 116 S. Ct. 83 (1995).

[536] *Perini*, 419 Mass. 763, 647 NE2d 52, 56 (Mass.), cert. denied, 516 US 822, 116 S. Ct. 83 (1995). The court rejected the argument that the deduction provided to foreign corporations for certain foreign subsidiaries adequately compensated for the deduction given to domestic corporations for domestic subsidiaries. In the first place, the deduction given to a foreign corporation for a foreign subsidiary was less favorable than the deduction given to domestic corporations for a domestic subsidiary. Moreover, even assuming that the deductions were substantially the same, the court found that the statute as a whole imposed an impermissible burden on interstate commerce:

> [O]nly those corporate structures that are exclusively domestic or exclusively foreign are given a deduction. Once a domestic corporation acquires a subsidiary outside of its home state, and regardless of whether that subsidiary does business in Massachusetts, the parent corporation must include the value of that subsidiary in its net worth calculation. Thus, the effect of this taxing scheme is to encourage single-state corporate structures and to penalize parent corporations that choose to cross state lines in order to acquire or create foreign subsidiaries.
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> *Perini*, 419 Mass. 763, 647 NE2d 52, 57 (Mass.), cert. denied, 516 US 822, 116 S. Ct. 83 (1995).

subsidiaries from the apportionable tax base to domestic corporations.[537] Relying on *Boston Stock Exchange*[538] and *Maryland v. Louisiana*,[539] the court held that the Kentucky tax structure "imposes a higher tax burden on non-domestic corporations than on similarly situated domestic corporations, thus creating a direct commercial advantage to local business."[540] The court did not dwell on the question as to whether a discrimination in favor of domestic corporations is in fact a discrimination in favor of local business.

It is possible, of course, that in these cases there was, as a factual matter, no discrimination against interstate commerce. In other words, it might be possible to demonstrate that it would be no more burdensome for a corporation doing business in New York, Massachusetts, or Kentucky to incorporate in those states and there presumably was no requirement that corporations incorporated in New York, Massachusetts, or Kentucky must do any business in those states. Nevertheless, the courts properly found such additional inquiries unnecessary, at least in the absence of any showing by the states that there was some evidentiary basis for the defense.[541]

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[537] USX Corp. v. Revenue Cabinet, Ky. Cir. Ct., Franklin Cty., No. 91-CI-01864, Nov. 9, 1992.

[538] *Boston Stock Exch.*, 429 US 318, 97 S. Ct. 599 (1977), discussed supra ¶ 4.13[2][b][i].

[539] Maryland v. Louisiana, 451 US 725, 101 S. Ct. 2114 (1981), discussed supra ¶¶ 4.13[2[c], 4.13[2][d].

[540] *USX*, Ky. Cir. Ct., Franklin Cty., No. 91-CI-01864, Nov. 9, 1992. The Revenue Cabinet appealed the decision on the ground, among others, that the court improperly awarded USX a refund of the tax due. Revenue Cabinet v. USX Corp., Ky. Ct. App., Nos. 93-CA-000072, 93-CA-000123, July 1, 1994. It did not, however, appeal from the portion of the judgment declaring the statute unconstitutionally discriminatory.

[541] In Kraft General Foods, Inc. v. Iowa Dep't of Revenue & Fin., 505 US 71, 112 S. Ct. 2365 (1992), discussed infra ¶ 4.20, the Court struck down an Iowa taxing scheme that taxed dividends from foreign but not domestic corporations on the ground that it discriminated against interstate commerce. In that case, the United States, as amicus curiae, had in fact made the argument that a discrimination against foreign corporations does not necessarily translate into discrimination against foreign commerce:

> *Amicus* United States notes that a subsidiary's place of incorporation does not necessarily correspond to the locus of its business operations. A domestic corporation might do business abroad, and its dividends might reflect earnings from its foreign activity. Conversely, a foreign corporation might do business in the United States, with its dividend payments reflecting domestic business operations. On this basis, the United States contends that the disparate treatment of dividends from foreign and domestic subsidiaries does not translate into discrimination based on the location or nature of business activity and is thus not prohibited by the Commerce Clause.

Kraft, 505 US 71, 75–76, 112 S. Ct. 2365 (1992).

The Court recognized that "the domicile of a corporation does not necessarily establish that it is engaged in either foreign or domestic commerce." *Kraft*, 505 US 71, 76, 112 S. Ct. 2365 (1992). The Court nevertheless found the favoritism in the Iowa taxing structure for domestic over foreign dividends constituted a discrimination against foreign com-

[k] Recent Cases Involving Allegations of Other Forms of State Tax Discrimination Against Interstate Commerce

[i] Limiting accelerated depreciation to investments in in-state property. The Wisconsin Tax Appeals Commission invalidated Wisconsin's disallowance of accelerated depreciation under the federal Accelerated Cost Recovery System (ACRS) rules for property that was located outside of Wisconsin.[542] Relying on the Supreme Court's decisions in *Westinghouse*[543] and *American Trucking Ass'ns*,[544] the Commission declared:

> The effect of this differential treatment, apparent from the language of the statutes under attack, is to impose a higher franchise tax burden on a business solely because some or all of its depreciable property is located outside rather than inside the confines of the state of Wisconsin. This is clearly facial discrimination against interstate commerce and runs afoul of a long line of court decisions invalidating such state tax provisions as violative of the Commerce Clause of the United States Constitution.[545]

[ii] Requiring interstate business to deduct local expense from preapportioned tax base. The New York Court of Appeals struck down as unconstitutionally discriminatory a provision of the state's telephone gross receipts tax that required interstate carriers to deduct local access charges from their *unapportioned* rather than from their *apportioned* gross receipts.[546]

[iii] Reducing in-state tax base by reference to extent of in-state activities. In *Fulton Corp. v. Faulkner*,[547] the U.S. Supreme Court held that an ad valorem intangible property tax on the value of corporate stock that varied

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merce because it was stipulated that the foreign subsidiaries in fact operated in foreign commerce and that "through the interplay of the federal and Iowa tax statutes, the applicability of the Iowa tax necessarily depends not only on the domicile of the subsidiary, but also on the location of the subsidiary's business activities." *Kraft*, 505 US 71, 76, 112 S. Ct. 2365 (1992).

[542] Beatrice Cheese, Inc. v. Wisconsin Dep't of Revenue, Wis. Tax Appeals Comm'n, Feb. 24, 1993, 1993 WL 57202.

[543] Westinghouse Elec. Corp. v. Tully, 466 US 388, 104 S. Ct. 1856 (1984), discussed supra ¶ 4.13[2][b][iii].

[544] American Trucking Ass'ns v. Scheiner, 483 US 266, 107 S. Ct. 2829 (1987), discussed supra ¶ 4.13[2][g].

[545] *Beatrice Cheese*, Wis. Tax Appeals Comm'n, Feb. 24, 1993, 1993 WL 57202; accord RJ Reynolds Tobacco Co. v. New York Dep't of Fin., 237 AD2d 6, 667 NYS2d 4 (1997).

[546] American Tel. & Tel. Co. v. New York State Dep't of Tax'n & Fin., 84 NY2d 3, 637 NE2d 257, 614 NYS2d 366 (1994). The case is discussed in ¶ 18.07.

[547] Fulton Corp. v. Faulkner, 516 US 325, 116 S. Ct. 848 (1996).

inversely to the corporation's exposure to state income taxation discriminated against interstate commerce in violation of the Commerce Clause. As the Court observed in *Fulton*, "[a] regime that taxes stock only to the degree that its issuing corporation participates in interstate commerce favors domestic corporations over their foreign competitors in raising capital among North Carolina residents and tends, at least, to discourage domestic corporations from plying their trades in interstate commerce."[548]

[iv] Impact fee on cars previously titled outside the state. Florida imposed a $295 "impact fee" on cars purchased or titled in other states that are then registered in Florida by persons having or establishing permanent residency in the state. As later amended, the statute provided a credit against the impact fee for sales or use taxes paid to Florida on the vehicle, but not to such taxes paid to other states. In striking down the tax as violative of the Commerce Clause, the court declared:

> We are mindful of the State's argument that every vehicle titled in Florida by some point in time will pay at least $295 in taxes or impact fees to Florida. Certainly this will be true in the vast majority of cases, but that fact in itself does not dispose of the Commerce Clause problem. The Commerce Clause is not concerned with the overall history of taxes paid to a state during the life of a vehicle; rather, the Commerce Clause looks to the question of "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."[549]

[v] Reduction of deductible expenses by nontaxable income. California's corporate income statute provides that the amount of deductible interest "shall be an amount equal to interest income subject to apportionment . . . , plus the amount, if any, by which the balance of interest expense exceeds interest and dividend income . . . not subject to apportionment."[550] This so-called interest offset provision requires taxpayers to reduce their interest expense on a dollar-for-dollar basis with any nonbusiness income not allocable to California. In substance, this means that corporations not domiciled in California must reduce their California interest deduction by the amount of their nonbusiness dividend income, which is not taxable by California.

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[548] *Fulton*, 516 US 325, 116 S. Ct. 848, 855 (1996). The case is considered in detail supra ¶ 4.13[2][c][ii], dealing with the complementary tax doctrine.

[549] Department of Revenue v. Kuhnlein, 646 So. 2d 717, 724 (Fla. 1994). The court also found that the tax violated the "internal consistency" doctrine. See infra ¶ 4.15[1]. If every state imposed an "impact fee" for vehicles first titled in other states, it would plainly favor in-state over out-of-state commercial interests.

[550] Cal. Rev. & Tax. Code § 24344(b) (West 1992).

A California trial court has held that the interest-offset provision violates the Commerce Clause.[551] California-domiciled corporations are able to offset their interest expense against income taxable by California, because the nonbusiness dividend income of California-domiciled corporations is allocable to California. The nonbusiness dividend income of nondomiciliary corporations, however, is allocated to states other than California. Hence, by requiring nondomiciliary corporations to offset their interest expense by nonbusiness dividend income that is not subject to tax in California, California effectively denies them an interest expense deduction while providing such a deduction to corporations domiciled in California.

In rejecting the Franchise Tax Board's argument that the tax did not discriminate on the basis of domicile but rather on whether the income in question was taxable by California, the court declared:

> Such linguistic analysis ignores the impact of the words being dealt with. No matter how one expresses the concept, the amount of tax on a foreign [i.e., nondomiciliary] corporation under [the statute] will be higher than that of a domestic [i.e., domiciliary] corporation where both have a) the same taxable business income; b) the same interest expense deductions; and c) the same dividend income. The constitutionality of such a result cannot possibly be determined by the statutory words used to create it, i.e., whether the discriminatory tax burden was caused by a "tax" or a "reduction of deduction due to nontaxable income."[552]

¶ 4.14 DISCRIMINATORY TAXES VERSUS DISCRIMINATORY SUBSIDIES

The U.S. Supreme Court has drawn a distinction in its cases between subsidies that discriminate in favor of local interests and taxes that discriminate in favor of local interests. The former are generally constitutional whereas the latter almost always are not.[553] Thus the Court has declared that "[d]irect subsidization

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[551] Hunt-Wesson, Inc. v. Franchise Tax Bd., No. 976628, Cal. Superior Ct., City and County of San Francisco, Dep't 17, June 6, 1997. The court also held that the statute violates the Due Process and Equal Protection Clauses. Those aspects of the case are considered, respectively, in ¶¶ 3.05[2][f] and 9.10[1][e][ii].

[552] Hunt-Wesson, Inc. v. Franchise Tax Bd., No. 976628, Cal. Superior Ct., City and County of San Francisco, Dep't 17, June 6, 1997.

[553] We use the word "almost" here in deference to the Court's suggestion in some cases that if there are no nondiscriminatory alternatives to a challenged state tax, the tax might be sustained. See, e.g., New Energy Co. v. Limbach, 486 US 269, 278, 108 S. Ct. 1803 (1988). The Court has never sustained a discriminatory tax on such a basis, however, perhaps because there is virtually always a nondiscriminatory alternative to a dis-

of domestic industry does not ordinarily run afoul of th[e] prohibition" against state regulation of interstate commerce whereas "discriminatory taxation of out-of-state manufactures does."[554] The leading U.S. Supreme Court decision addressing this distinction is *West Lynn Creamery, Inc. v. Healy*.[555]

In *West Lynn Creamery*, the Court held that Massachusetts could not constitutionally require milk dealers to make a "premium payment" for milk sold in the state when the proceeds from the payments were earmarked for distribution to Massachusetts' milk producers. The Court found that Massachusetts' pricing and rebate scheme could not withstand scrutiny under its precedents striking down discriminatory regulations and taxes:

> Under these cases, Massachusetts' pricing order is clearly unconstitutional. Its avowed purpose and its undisputed effect are to enable higher cost Massachusetts dairy farmers to compete with lower cost dairy farmers in other States. The "premium payments" are effectively a tax which makes milk produced out of State more expensive. Although the tax also applies to milk produced in Massachusetts, its effect on Massachusetts is entirely (indeed more than) offset by the subsidy provided exclusively to Massachusetts dairy farmers. Like an ordinary tariff, the tax is thus effectively imposed only on out-of-state products.[556]

Massachusetts defended its pricing and rebate program on the ground that, since each component of the program—a nondiscriminatory tax and a local subsidy—was valid, the combination of the two was equally valid. The Court disagreed. Without questioning that "[a] pure subsidy funded out of general revenues ordinarily imposes no burden on interstate commerce,"[557] the Court found that the combination of the subsidy and the tax could not survive scrutiny:

> [R]espondent errs in assuming that the constitutionality of the pricing order follows logically from the constitutionality of its component parts. By conjoining a tax and a subsidy, Massachusetts has created a program more dangerous to interstate commerce than either part alone. Nondiscriminatory measures, like the evenhanded tax at issue here, are generally upheld, in spite of any adverse effects on interstate commerce, in part because "[t]he existence of major in-state interests adversely affected . . . is a powerful safeguard against their legislative abuse." However, when a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by

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criminatory tax—namely, a nondiscriminatory tax that raises the same amount of revenues as the discriminatory exaction.

[554] *New Energy*, 486 US 269, 278, 108 S. Ct. 1803 (1988).

[555] West Lynn Creamery, Inc. v. Healy, 512 US 186, 114 S. Ct. 2205 (1994).

[556] *West Lynn Creamery*, 512 US 186, 194, 114 S. Ct. 2205 (1994).

[557] *West Lynn Creamery*, 512 US 186, 199, 114 S. Ct. 2205 (1994).

the tax, a State's political processes can no longer be relied upon to prevent legislative abuse. . . .

Respondent's argument would require us to analyze separately two parts of an integrated regulation, but we cannot divorce the premium payments from the use to which the payments are put. It is the entire program—not just the contributions to the fund or the distributions from that fund—that simultaneously burdens interstate commerce and discriminates in favor of local producers. The choice of constitutional means—nondiscriminatory tax and local subsidy—cannot guarantee the constitutionality of the program as a whole.[558]

Whether or not the Court's distinction between taxes and subsidies is legally or economically sound—and there has been a considerable amount of scholarly debate over this issue[559]—courts have had to struggle with the question whether a state subsidy is constitutional. In so doing, they have had to balance the general principle that subsidies are constitutional against the rule of *West Lynn Creamery* that subsidies linked with taxes may be suspect.[560]

In *Cumberland Farms, Inc. v. Mahany*,[561] for example, the court, faced a situation virtually identical to that in *West Lynn Creamery*, except for the fact that the subsidies to the in-state dairy farmers were paid out of the general fund. The court found that *West Lynn Creamery* was not on point "since the

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[558] *West Lynn Creamery*, 512 US 186, 200–201, 114 S. Ct. 2205 (1994). The Court also rejected the state's claim that the pricing and rebate program was defensible because milk dealers who pay the tax did not compete with the milk producers who were the beneficiaries of the subsidy. "For over 150 years, our cases have rightly concluded that the imposition of a differential burden on any part of the stream of commerce—from wholesaler to retailer to consumer—is invalid, because a burden placed at any point will result in a disadvantage to the out-of-state producer." *West Lynn Creamery*, 512 US 186, 202, 114 S. Ct. 2205 (1994). The Court likewise rejected the state's argument that the incidental burden on interstate commerce was outweighed by the local benefits of preserving the Massachusetts dairy industry. It observed that "[p]reservation of local industry by protecting it from the rigors of interstate competition is the hallmark of the economic protectionism that the Commerce Clause prohibits." *West Lynn Creamery*, 512 US 186, 205, 114 S. Ct. 2205 (1994). It also observed that, for Commerce Clause purposes, the Court had "rejected any distinction 'between thriving and struggling enterprises.'" *West Lynn Creamery*, 512 US 186, 205, 114 S. Ct. 2205 (1994) (quoting Bacchus Imports, Ltd. v. Dias, 468 US 263, 104 S. Ct. 3049 (1984), discussed supra ¶ 4.13[2][b][ii].

[559] See, e.g., C. Drahozal, "On Tariffs v. Subsidies in Interstate Trade: A Legal and Economic Analysis," 74 Wash. U. LQ 1127 (1996); P. Enrich, "Saving the States From Themselves: Commerce Clause Constraints on State Tax Incentives for Business," 110 Harv. L. Rev. 377 (1996); W. Hellerstein & D. Coenen, "Commerce Clause Restraints on State Business Development Incentives," 81 Cornell L. Rev. 789 (1996).

[560] This issue is explored in considerable detail in D. Coenen & W. Hellerstein, "Suspect Linkage: The Interplay of State Taxing and Spending Measures in the Application of Constitutional Antidiscrimination Rules," 95 Mich. L. Rev. 2167 (1997).

[561] Cumberland Farms, Inc. v. Mahany, 943 F. Supp. 83 (D. Me. 1996), rev'd on other grounds, 116 F3d 943 (1st Cir. 1997).

Supreme Court did not address the constitutionality of a 'non-integrated' statutory scheme" (i.e., one in which the legislature "had intentionally linked together a tax on milk sales and a rebate to dairy farmers").[562] The court therefore sustained the Maine tax and subsidy because

> a direct link between the tax revenue paid by Cumberland Farms and the subsequent appropriations to Maine dairy farmers from the State's General Fund is lacking. Indeed, assuming the tax . . . is nondiscriminatory[563], Justice Scalia's concurrence in *West Lynn Creamery* contemplates the factual scenario that is before this Court with approval: "I would . . . allow a State to subsidize its domestic industry so long as it does so from nondiscriminatory taxes that go into the State's general revenue fund."[564]

The Minnesota Supreme Court likewise sustained a tax-and-subsidy scheme involving nondiscriminatory waste management fees imposed on all solid waste generated within the jurisdiction where a portion of the fees was used to finance the cost of operating local waste processing facilities.[565] A public waste-processing facility charged high "tipping fees" to cover the cost of running and financing the facility as well as the cost of a variety of waste and recycling programs. When a major hauler of local waste announced plans to discontinue use of the facility and haul materials out of state, the public facility operator: (1) imposed a charge on all waste generated within the waste facility district; (2) directed that a portion of the resulting revenue be used to pay for the operation of the waste facility; and (3) reduced the tipping fees.

The consequence of these actions was that persons who hauled waste out of state continued to pay full tipping fees (to out-of-state facilities) plus the new in-state waste charge, while persons who hauled waste to the local facility paid the new waste charge but also paid lower tipping fees attributable to that charge. The Minnesota Court of Appeals struck down the tax-and-subsidy scheme under the Commerce Clause on the theory that, as in *West Lynn Creamery*, the linking of a nondiscriminatory tax with a subsidy that inured only to the benefit of local facilities and their users discriminated against interstate commerce.[566] In effect, the portion of the "nondiscriminatory" in-state

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[562] *Cumberland Farms*, 943 F. Supp. 83, 87 (D. Me. 1996), rev'd on other grounds, 116 F3d 943 (1st Cir. 1997).

[563] The court held that it was.

[564] *Cumberland Farms*, 943 F. Supp. 83, 88 (D. Me. 1996), rev'd on other grounds, 116 F3d 943 (1st Cir. 1997).

[565] Zenith/Kremer Waste Sys., Inc. v. Western Lake Superior Sanitary Dist., 572 NW2d 300 (Minn. 1997), cert. denied, __ US __, 118 S. Ct 1857 (1998).

[566] Zenith/Kremer Waste Sys., Inc. v. Western Lake Superior Sanitary Dist., 558 NW2d 288 (Minn. Ct. App. 1997).

waste charge that was used to reduce in-state tipping fees was imposed only on haulers of waste to out-of-state landfills.

The Minnesota Supreme Court disagreed, finding *West Lynn* "inapposite":

> It is constitutionally significant that the waste management tax is levied on residents and occupants of the district rather than upon the waste haulers because it demonstrates that the focus, purpose, and reach of the tax is entirely local. Furthermore, while we recognize that discrimination may occur at many different levels of commerce, we do not believe that the tax in this case imposes any differential burden on out-of-state commerce. The use of the waste generation taxes to pay the debt service on a government owned facility, which benefits users of the facility indirectly through lowered tipping fees, is a far cry from the direct cash subsidy found in *West Lynn*. . . . Like schools and parks, the waste facility is a municipal service that the government has the right to finance through public fees and taxes, irrespective of whether there may be competing, out-of-state providers. Additionally, unlike in *West Lynn*, the waste generators and in-state waste haulers adversely affected had the opportunity to participate in the political process under which the tax was determined.[567]

¶ 4.15 INTERNAL CONSISTENCY AND EXTERNAL CONSISTENCY

Prior to 1983, the U.S. Supreme Court had never uttered the phrases "internal consistency" or "external consistency" in a state tax opinion. In 1983, however, in delineating the constitutional limitations imposed on state income tax apportionment formulas, the Court declared:

> Such an apportionment formula must, under both the Due Process and Commerce Clauses, be fair. The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business income being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportion-

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[567] Zenith/Kremer Waste Sys., Inc. v. Western Lake Superior Sanitary Dist., 572 NW2d 300, 305 (Minn. 1997), cert. denied, ___ US ___, 118 S. Ct. 1857 (1998).

ment formula must actually reflect a reasonable sense of how income is generated.[568]

Since 1983, the U.S. Supreme Court, and state courts following its lead, have applied the internal and external consistency tests in adjudicating Commerce Clause challenges to state taxes under the Commerce Clause. In so doing, they have extended the internal consistency test beyond its original context (as a criterion for determining the fairness of an apportionment formula) to a more general rule barring taxes that discriminate against interstate commerce.[569]

[1] Internal Consistency

[a] U.S. Supreme Court Decisions Delineating the Internal Consistency Test

In *Oklahoma Tax Commission v. Jefferson Lines, Inc.*,[570] the U.S. Supreme Court described the "internal consistency" test in the following terms:

> Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with intrastate commerce. A failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction, since allowing such a tax in one State would place interstate commerce at the mercy of those remaining States that might impose an identical tax.[571]

Since first articulating the internal consistency test in *Container*, the Court has applied it to a wide variety of taxes and in a wide variety of contexts. In *Container* itself, the apportionment formula clearly passed the internal consistency test: If every state had adopted the identical three-factor apportionment formula there at issue,[572] an interstate business would bear no greater tax burden than the intrastate business. The interstate enterprise would be subject to

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[568] Container Corp. of Am. v. Franchise Tax Bd., 463 US 159, 169, 103 S. Ct. 2933 (1983).

[569] See infra ¶ 4.15[1].

[570] Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 US 175, 115 S. Ct. 1331 (1995).

[571] *Jefferson Lines*, 514 US 175, 185, 115 S. Ct. 1331 (1995).

[572] The *Container* case is discussed in detail at ¶¶ 8.08[2][d], 8.16[1].

tax on 100 percent of its tax base, divided among the states in which it did business according to the hypothesized uniform formula, whereas the interstate enterprise would be subject to tax on 100 percent of its tax base in the state in which it did business.

Less than a year after *Container*, the Court attributed broader significance to the internal consistency doctrine in *Armco, Inc. v. Hardesty.*[573] In *Armco*, the Court considered a claim of state tax discrimination under West Virginia's business and occupation (B&O) tax.[574] The B&O tax was a broad-based excise upon the privilege of engaging in most business activity in the state, including manufacturing and wholesaling. The tax was measured by gross receipts from the business. In general, if a taxpayer engaged in two different business activities, it paid a tax upon the privilege of engaging in each activity. However, there was a "multiple activities" exemption that relieved manufacturers who were subject to the manufacturing tax from liability for the wholesaling tax.

As applied to an out-of-state manufacturer like Armco engaged in wholesaling in West Virginia, the exemption plainly failed the internal consistency test. If every state had adopted a regime like West Virginia's, a taxpayer who manufactured in one state and made wholesale sales in another would pay a tax to both the state where it manufactured and the state where it wholesaled. By contrast, the wholly intrastate business, which manufactured and wholesaled in the same state, would pay only a manufacturing tax, owing to the multiple activities exemption.

Although the Court had previously invoked the internal consistency test in the context of the Commerce (and Due Process) Clause's fair apportionment requirement, it did not hesitate to extend it to the Commerce Clause bar against state tax discrimination. In rejecting the state's contention that Armco had "to prove actual discriminatory impact upon it by pointing to a State that imposes a manufacturing tax that results in a total burden higher than that imposed on Armco's competitors in West Virginia,"[575] the Court declared:

> This is not the test. In *Container*... the Court noted that a tax must have "what might be called internal consistency—that is the [tax] must be such that, if applied by every jurisdiction," there would be no impermissible interference with free trade. In that case, the Court was discussing the requirement that a tax be fairly apportioned to reflect the business conducted in the State. A similar rule applies where the allegation is that a tax on its face discriminates against interstate commerce.... Any other rule would mean that the constitutionality of West Virginia's tax laws would depend on the shifting complexities of the tax laws of 49 other

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[573] Armco, Inc. v. Hardesty, 467 US 638, 104 S. Ct. 2620 (1984).

[574] West Virginia's B&O tax was repealed effective July 1, 1987.

[575] *Armco*, 467 US 638, 644, 104 S. Ct. 2620 (1984).

States, and that the validity of the taxes imposed on each taxpayer would depend on the particular other States in which it operated.[576]

Three years after its decision in *Armco*, the Court considered a related challenge to Washington's B&O tax in *Tyler Pipe Industries, Inc. v. Washington Department of Revenue*.[577] Like West Virginia, Washington imposed its B&O tax on the gross receipts from various business activities carried on in the state, including manufacturing and wholesaling. Like West Virginia, Washington had a "multiple activities" exemption that assured that taxpayers engaged in both manufacturing and wholesaling in the state would pay tax on only one activity. However, instead of exempting local manufacturer-wholesalers from the state's wholesaling tax, as West Virginia had done, Washington exempted local manufacturer-wholesalers from the state's manufacturing tax.

Judged by the standard of internal consistency, Washington's levy was as constitutionally infirm as West Virginia's. Just as the interstate manufacturer-wholesaler in *Armco* was put at a competitive disadvantage to the intrastate manufacturer-wholesaler on the assumption that every state had adopted West Virginia's taxing scheme, so the interstate manufacturer-wholesaler in *Tyler Pipe* was put at a competitive disadvantage to the intrastate manufacturer-wholesaler on the assumption that every state had adopted Washington's taxing scheme. For in each instance, the interstate manufacturer-wholesaler would pay both a manufacturing tax to the state of manufacture and a wholesaling tax to the state of sale, whereas the intrastate manufacturer-wholesaler would pay but one tax—a manufacturing tax, under West Virginia's statute, and a wholesaling tax under Washington's. In short, the Court's conclusion that the Washington taxing scheme was the "practical equivalent"[578] of the West Virginia taxing scheme from the standpoint of internal consistency was fully justified; there was little doubt that if internal consistency is the test, Washington's tax failed it.

On the same day as it rendered its decision in *Tyler Pipe*, the Supreme Court applied the internal consistency test in invalidating Pennsylvania's lump sum annual taxes on the operation of trucks in the state. In *American Trucking Ass'ns, Inc. v. Scheiner*,[579] The taxes at issue, an axle tax ranging from $72 to $180 per truck and a $25 identification marker fee, were imposed in addition to the annual registration fees and fuel consumption taxes that all states, including Pennsylvania, impose on the trucking industry.

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[576] *Armco*, 467 US 638, 644–645, 104 S. Ct. 2620 (1984) (brackets in original, quoting *Container*, 463 US 159, 169, 103 S. Ct. 2933 (1983)).

[577] Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 US 232, 107 S. Ct. 2810 (1987).

[578] *Tyler Pipe*, 483 US 232, 241, 107 S. Ct. 2810 (1987).

[579] American Trucking Ass'ns, Inc. v. Scheiner, 483 US 266, 107 S. Ct. 2829 (1987).

The truckers attacked these levies under the Commerce Clause on the ground, among others, that if Pennsylvania had the right to impose a flat tax on their operations, so could every other state, and the cumulative consequences of such a regime would impose a crippling financial burden on the interstate motor carriers. The Court's consideration of this argument gave it an opportunity to elaborate still further on the internal consistency test to which it could now refer almost casually as a "test . . . we have applied in other contexts."[580]

Although registration fees can be characterized as flat taxes imposed by every state, they nevertheless pass the internal consistency test because, as a result of reciprocity and apportionment provisions, they place the interstate carrier at no competitive disadvantage created by cumulative tax burdens.

> Under this test, even though the registration fee is assessed, as indeed it has been, by every jurisdiction, it causes no impermissible interference with free trade because every State respects the registration of every other State. Payment of one registration fee enables a carrier to operate a vehicle either locally or in the interstate market. Having paid one registration fee, a vehicle may pass among the States as freely as it may roam the State in which it is based; the Commerce Clause is not offended when state boundaries are economically irrelevant.[581]

In addition, even though they were imposed by every jurisdiction, the motor fuel taxes imposed by Pennsylvania did not run afoul of the internal consistency test. Because they are apportioned to mileage traveled in Pennsylvania, they impose no greater burden on the interstate than on the intrastate carrier. Each pays the same amount "for traveling a certain distance that happens to be in Pennsylvania."[582]

However, Pennsylvania's unapportioned flat taxes for the use of its roads plainly failed the internal consistency test. Unlike registration fees, payment of the tax to Pennsylvania provided no immunity from payment of similar taxes to other states. Unlike motor fuel taxes, payment was not apportioned to some neutral factor (such as extent of road use) that made state lines irrelevant. While registration fees and motor fuel taxes could thus be replicated by every state without placing the interstate carrier at a competitive disadvantage, the same could not be said of unapportioned flat taxes. "If each State imposed flat taxes for the privilege of making commercial entrances into its territory, there

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[580] *American Trucking Ass'ns*, 483 US 266, 283, 107 S. Ct. 2829 (1987).

[581] *American Trucking Ass'ns*, 483 US 266, 283, 107 S. Ct. 2829 (1987).

[582] *American Trucking Ass'ns*, 483 US 266, 283, 107 S. Ct. 2829 (1987).

is no conceivable doubt that commerce among the States would be deterred."[583]

The Court in *American Trucking Ass'ns* reiterated its view expressed in *Armco* and *Tyler Pipe* that the application of the internal consistency test does not depend on whether states other than the taxing state have in fact imposed similar taxes so as to place an actual burden on interstate commerce.[584] Yet it went on to note that other states had in fact adopted flat taxes so that the threat to free trade was in no sense hypothetical.

In *Goldberg v. Sweet*,[585] the Court sustained an Illinois tax on the full charge for interstate telecommunications that originated or terminated in the state, if they were charged to an Illinois service address. The Court found that the tax satisfied the internal consistency test, since "if every State taxed only those interstate phone calls which are charged to an in-state service address, only one State would tax each interstate telephone call."[586] Similarly, in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*,[587] the Court found that an Oklahoma sales tax on the full price of a ticket for interstate bus transportation

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[583] *American Trucking Ass'ns*, 483 US 266, 284, 107 S. Ct. 2829 (1987). The Court elaborated on this point in an instructive footnote:

> A line of cases invalidating unapportioned flat taxes that provided general revenue also illustrates the principle that the very nature of the market that interstate operators serve prevents them from making full use of the privilege of doing business for which they have paid the State. Thus, we found that a tax on drummers in the city of Memphis for the privilege of doing business there on behalf of out-of-state firms discriminated against out-of-state manufacturers. We reasoned that their local competitors, "having regular licensed houses of business [in Memphis], have no occasion for such agents, and, if they had, they are not subject to any tax therefor. They are taxed for their licensed houses, it is true; but so, it is presumable, are the merchants and manufacturers of other states in the places where they reside; and the tax on drummers operates greatly to their disadvantage in comparison with the merchants and manufacturers of Memphis." Robbins v. Shelby County Taxing Dist., 120 US 489, 498 (1887). See also Best & Co. v. Maxwell, 311 U.S. 454, 456–457 (1940) (annual flat tax on those who were not regular retail merchants in the state invalid because its actual effect "is to discriminate in favor of intrastate businesses, whatever may be the ostensible reach of the language"); Nippert v. Richmond, 327 US 416 (1946). As one commentator observed almost half a century ago:
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> > "True, each fee is imposed upon the use of different states' highways, but the cumulative effect does not result from the mileage or distance traveled, but from the interstate character of the journey. The same mileage in one state would result in only one tax." Lockhart, State Tax Barriers to Interstate Trade, 53 Harv. L. Rev. 1253, 1269 (1940).
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> *American Trucking Ass'ns*, 483 US 266, 284 n.16, 107 S. Ct. 2829 (1987).

[584] *American Trucking Ass'ns*, 483 US 266, 285, 107 S. Ct. 2829 (1987).

[585] Goldberg v. Sweet, 488 US 252, 109 S. Ct. 582 (1989). The case is considered in more detail in ¶ 18.07.

[586] *Goldberg*, 488 US 252, 261, 109 S. Ct. 582 (1989).

[587] Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 US 175, 115 S. Ct. 1331 (1995).

satisfied the internal consistency test because "[i]f every State were to impose a tax identical to Oklahoma's, that is, a tax on ticket sales within the State for travel originating there, no sale would be subject to more than one State's tax."[588]

[b] State Court Decisions Applying the Internal Consistency Test

The District of Columbia Court of Appeals invalidated the district's telecommunications gross receipts tax on the ground that it violated the internal consistency doctrine.[589] The tax applied to all gross receipts from telecommunications that originated or terminated in the district and that were charged to a service address in the district. However, the taxing statute provided a property tax exemption for personal property used by a telecommunications company to produce taxable gross receipts and a sales tax exemption for property purchased by a telecommunications company for use in producing services subject to taxable gross receipts. As the court explained:

> The discriminatory consequences of the . . . Act arise from the circumstance that, if the same limited exceptions existed in every state, then out-of-state carriers would pay more than in-state carriers whenever the former had property subject to their home state's personal property tax but used to produce out-of-state revenues subject to another state's gross receipts tax.[590]

As the court further observed,

> the District of Columbia may not enact a tax scheme whereby the only company that can fully benefit from the available exemptions is one that sells in the District of Columbia only what it produces there, and does not afford the same benefits to a company outside the District that sells within it or indeed to a District company that sells outside it.[591]

The court noted, however, that the constitutional defect in the district's statute could be cured if the legislature granted a credit against the gross receipts tax for personal property and sales taxes imposed by other states on property used to produce taxable gross receipts in the district.

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[588] *Jefferson Lines*, 514 US 175, 185, 115 S. Ct. 1331 (1995).

[589] Sprint Communications Co. v. Kelly, 642 A2d 106 (DC), cert. denied, 513 US 916, 115 S. Ct. 294 (1994).

[590] *Sprint Communications*, 642 A2d 106, 116 (DC), cert. denied, 513 US 916, 115 S. Ct. 294 (1994).

[591] *Sprint Communications*, 642 A2d 106, 116–117 (DC), cert. denied, 513 US 916, 115 S. Ct. 294 (1994).

The Massachusetts Supreme Court has likewise invoked the internal consistency principle in striking down a statute that permitted intangible property corporations a deduction from the state's excise tax measured by net worth for their investments in subsidiary corporations, but only if the subsidiaries were domestic in the case of domestic parents and foreign in the case of foreign parents.[592] The court declared:

> Clearly, if every State applied a similar excise, the acquisition of foreign subsidiaries would be reduced and multi-State corporate structures would be significantly burdened. Such a scheme clearly interferes with free trade among the States and cannot be considered consistent with the commerce clause.[593]

Florida imposed a $295 "impact fee" on cars purchased or titled in other states that are then registered in Florida by persons having or establishing permanent residency in the state. As later amended, the statute provided a credit against the impact fee on sales or use taxes paid to Florida on the vehicle, but not to such taxes paid to other states.[594] The court found that the tax violated the internal consistency doctrine. If every state imposed an "impact fee" for vehicles first titled in other states, it would plainly favor in-state over out-of-state commercial interests.

The New York Tax Appeals Tribunal applied the internal consistency test in striking down the application of New York's sales tax as applied to receipts from a waste removal service.[595] The tax was measured by the gross receipts from the "integrated" service of picking up, transporting, and disposing of waste. In the case in question, the taxpayer's waste was picked up in New York and transported to Arkansas where it was incinerated. In holding that New York's tax on all of the receipts from the service violated the internal consistency doctrine, the tribunal observed that, on the assumption that every state had adopted New York's scheme, "Arkansas could also impose a tax on both the transportation and waste treatment charges paid by petitioner."[596]

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[592] Perini Corp. v. Commissioner of Revenue, 419 Mass. 763, 647 NE2d 52 (1995), cert. denied, 516 US 822, 116 S. Ct. 83 (1995).

[593] *Perini*, 419 Mass. 763, 647 NE2d 52, 57, cert. denied, 516 US 822, 116 S. Ct. 83 (1995). The case is also considered supra ¶ 4.13[2][j] note 536. See also Wabash RR Co. v. Department of Revenue, Ill. Cir. Ct., Mar. 23, 1995 (applying internal consistency test).

[594] Department of Revenue v. Kuhnlein, 646 So. 2d 717, 724 (Fla. 1994).

[595] In re General Elec. Co., 1992 WL 51149 (NY Tax App. Trib.) . The case is considered further in ¶ 15.08[1]. See also In re Rollins Envtl. Servs. (NJ), Inc., 1994 WL 518887 (NY Tax App. Trib.).

[596] In re General Elec. Co., 1992 WL 51149 (NY Tax App. Trib.). The New York Tax Appeals Tribunal subsequently sustained a similar tax where the tax was apportioned based on the miles traveled in New York. In re Olin Corp., 1997 WL 589117 (NY Tax App. Trib.).

The U.S. Court of Appeals for the Second Circuit applied the internal consistency test in striking down a Vermont statute that was construed to deny a credit against the Vermont use tax on motor vehicles to sales taxes paid to any other state where the vehicle was previously registered.[597] If every state adopted such a statute, vehicles previously registered in one state and then used in another would bear a higher tax burden than vehicles that never crossed state lines.

[i] Hypothetical tax distinguished from hypothetical taxpayer. As the foregoing discussion reveals, the internal consistency test does not require that taxpayers demonstrate that they have actually suffered injury from the challenged tax, but only that the hypothetical application of the challenged tax by other states would subject them to a more onerous tax burden than that shouldered by taxpayers engaged in intrastate commerce. This does not mean, however, that a taxpayer can successfully attack a tax on internal consistency grounds by establishing that a *hypothetical taxpayer* would be burdened by a state's tax if it were imposed by every state.

Rejecting such an argument, the Minnesota Supreme Court held that to make out a case of unconstitutional internal inconsistency a taxpayer must demonstrate that the hypothetical application of the same tax by every state to the *actual taxpayer* would burden interstate commerce more than intrastate commerce.[598] As the court declared:

> Appellants correctly observe that the internal consistency test involves the hypothetical imposition of the same tax by every state. But what is objectionable is appellants' use of a hypothetical plaintiff, X Corporation, to establish a violation of this principle.[599]

[c] Evaluation of the Internal Consistency Doctrine

In some respects, the internal consistency doctrine, though branded by several Justices as "an entirely novel enterprise"[600] that will "revolutionize the law of state taxation,"[601] adds little of substance to preexisting Commerce

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[597] Barringer v. Griffes, 1 F3d 1331 (2d Cir. 1993), cert. denied, 510 US 1072, 114 S. Ct. 879 (1994).

[598] In re Alternative Minimum Tax Refund Cases, 546 NW2d 285 (Minn. 1996), cert. denied, ___ US ___, 117 S. Ct. 387 (1996).

[599] In re Alternative Minimum Tax Refund Cases, 546 NW2d 285, 290 (Minn. 1996), cert. denied, ___ US ___, 117 S. Ct. 387 (1996).

[600] American Trucking Ass'ns v. Scheiner, 483 US 266, 303, 107 S. Ct. 2829 (1987) (O'Connor, J., dissenting).

[601] Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 US 232, 257, 107 S. Ct. 2810 (1987) (Scalia, J., dissenting).

Clause jurisprudence.[602] For example, an internally inconsistent apportionment formula which, if employed by every state, would expose the taxpayer to taxation of more than 100 percent of its tax base would be invalid under the settled rule barring multiple taxation of interstate commerce, wholly apart from the internal consistency doctrine. And the U.S. Supreme Court's invalidation of flat taxes imposed on interstate truckers follows a long tradition of judicial disapproval of flat taxes on interstate enterprises as discriminating against interstate commerce.[603] Nevertheless, even though the results in some of the judicial decisions applying the internal consistency doctrine might have been reached under traditional Commerce Clause criteria that existed long before the Court's embrace of the doctrine, the doctrine is not without independent significance.

First, the internal consistency doctrine reinforces the principle that it is the *risk* rather than the actuality of multiple taxation or discrimination that is the test for evaluating the constitutionality of facial attacks on state statutes under the Commerce Clause. If a state taxing statute will expose an interstate enterprise to a greater burden than that imposed upon a comparable intrastate enterprise, on the assumption that the statute has been adopted by every state, the danger of subjecting interstate commerce to greater tax burdens than those imposed on intrastate commerce suffices to constitute a Commerce Clause violation. The taxpayer need not demonstrate that it has in fact suffered *actual* multiple taxation or discrimination. This is a sound principle, because the possibility that one might encounter multiple taxation or discrimination by engaging in interstate commerce can inhibit interstate activity as much as actual multiple taxation or discrimination.

Second, the internal consistency doctrine may well have been instrumental in determining the outcome of the cases in which the Court has invoked the doctrine. Indeed, in both *Tyler Pipe* and *American Trucking Ass'ns*, the Court explicitly overruled earlier cases in invalidating the taxes at issue.[604] Although in retrospect it may have seemed that those cases were not in accord with the Court's contemporary Commerce Clause doctrine, the internal consistency test

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[602] For a detailed treatment of the internal consistency doctrine, see W. Hellerstein, "Is 'Internal Consistency' Foolish?: Reflections on an Emerging Commerce Clause Restraint on State Taxation," 87 Mich. L. Rev. 138 (1988).

[603] See supra ¶ 4.13[2][a].

[604] *Tyler Pipe* overruled General Motors Corp. v. Washington, 377 US 436, 84 S. Ct. 1564 (1964), which had sustained Washington's B&O tax as applied to an out-of-state manufacturer selling into Washington. *American Trucking Ass'ns* overruled a series of cases that had sustained flat highway use taxes over the objection that they violated the Commerce Clause. See, e.g., Capitol Greyhound Lines v. Brice, 339 US 542, 70 S. Ct. 806 (1950); Aero Mayflower Transit Co. v. Board of RR Comm'rs, 332 US 495, 68 S. Ct. 167 (1947); Aero Mayflower Transit Co. v. Georgia Pub. Serv. Comm'n, 295 US 285, 55 S. Ct. 709 (1935).

may well have been the critical factor in inducing the Court to jettison its earlier precedents.

Third, and most importantly, the internal consistency doctrine does put in constitutional jeopardy a number of state taxing schemes that may have seemed constitutionally sound prior to the Court's articulation of the doctrine.[605] For example, the imposition of *any* unapportioned flat state or local tax on a multistate business would appear to be vulnerable to attack under the internal consistency doctrine, unless administrative considerations make "more finely calibrated" levies "impracticable."[606] This conclusion follows inexorably from a simple application of the internal consistency principle. If every state were to impose an unapportioned flat tax on business activities in which both intrastate and interstate enterprises engage, the interstate business would pay the tax in each state in which it did business, whereas its intrastate competitor would pay but a single tax in the state in which it did business.

Under this analysis, many of the initial fees and taxes that states impose on domestic corporations when first organizing or qualifying to do business in the state may not survive Commerce Clause scrutiny. Similarly, the annual business license taxes imposed by states and localities for carrying on particular trades or occupations—many of which are unapportioned flat taxes—are in constitutional jeopardy. The hypothetical replication of these taxes by every state or locality imposes a cumulative tax burden on the multistate enterprise not borne by its intrastate competitor solely because the multistate business has chosen to do business in more than one state. Professional and similar licensing fees might be subject to a like challenge. Beyond unapportioned flat taxes, there is a strong case that can be made that any unapportioned tax—even if not flat—cannot survive scrutiny under the internal consistency doctrine.[607]

In short, the internal consistency doctrine is a significant addition to the Court's Commerce Clause doctrine, even though its jurisprudential underpinnings lie in the Court's preexisting Commerce Clause jurisprudence and many of its applications reflect familiar law.

[2] External Consistency

In first articulating the external consistency doctrine in the *Container* case, the Court declared:

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[605] These implications are spelled out in detail in W. Hellerstein, "Is 'Internal Consistency' Foolish?: Reflections on an Emerging Commerce Clause Restraint on State Taxation," 87 Mich. L. Rev. 138, 148–188 (1988).

[606] American Trucking Ass'ns v. Scheiner, 483 US 266, 297, 107 S. Ct. 2829 (1987).

[607] This argument is detailed in Hellerstein, supra note 605, at 159–163. See M&J Assocs., Inc. v. City of Irondale, ___ So.2d ___ (Ala. 1998) (invalidating unapportioned city business license tax on the ground that it violates the internal consistency doctrine).

> The second and more difficult requirement [of a fair apportionment formula] is what might be called external consistency—the factor or factors used must actually reflect a reasonable sense of how income is generated. . . . We will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted in that State.'"[608]

More recently the Court has described the external consistency doctrine in the following terms:

> For over a decade now, we have assessed any threat of malapportionment by asking whether the tax is "internally consistent" and, if so, whether it is "externally consistent" as well. . . .
>
> External consistency . . . looks . . . to the economic justification for the state's claim upon the value taxed, to discover whether a state's tax reaches beyond that portion of value that is fairly attributable to activity within the taxing state.[609]

In contrast to the internal consistency test, which does articulate some novel doctrine,[610] the external consistency test in substance is nothing more than another label for the fair apportionment requirement. The fair apportionment requirement has long been a central tenet of the Court's Commerce (and Due Process) Clause jurisprudence, and using the phrase "external consistency" to describe this requirement has not added (or subtracted) anything from its substance.[611]

In *Goldberg v. Sweet*,[612] in challenging the constitutionality of the Illinois telecommunications excise tax on the unapportioned charge for interstate telephone calls, the taxpayer relied, inter alia, on the external consistency test. He contended that "any tax assessed on the gross charge of an interstate activity cannot reasonably reflect in-state business activity and, therefore, must be apportioned."[613] The Court rejected the argument on the ground that sales taxes on interstate sales have the same economic effect as the Illinois telecommunications excise tax, and the Court's precedents had sustained the taxation by the purchaser's state of the full sales price of interstate sales. Moreover, while the Court recognized that "some interstate telephone calls could be subject to mul-

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[608] Container Corp. of Am. v. Franchise Tax Bd., 463 US 159, 169–170, 103 S. Ct. 2933 (1983).

[609] Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 US 175, 185 115 S. Ct. 1331 (1995). *Jefferson Lines* is considered in more detail in ¶ 18.08.

[610] See supra ¶ 4.15[1].

[611] The fair apportionment requirement is treated in detail in Chapters 8 and 9.

[612] Goldberg v. Sweet, 488 US 252, 262, 109 S. Ct. 582 (1989). The case is considered in more detail in ¶ 18.07.

[613] *Goldberg*, 488 US 252, 262, 109 S. Ct. 582 (1989).

tiple taxation" if customers split service and billing addresses between two states, "[t]his limited possibility of multiple taxation . . . is not sufficient to invalidate the statutory scheme."[614]

In so holding, the Court took a pragmatic view of the external consistency test:

> It should not be overlooked, moreover, that the external consistency test is essentially a practical inquiry. In previous cases we have endorsed apportionment formulas based upon the miles a bus, train, or truck traveled within the taxing State. But those cases all dealt with the movement of large physical objects over identifiable routes, where it was practicable to keep track of the distance actually traveled within the taxing State. This case, by contrast, involves the more intangible movement of electronic impulses through computerized networks. An apportionment formula based on mileage or some other geographic division of individual telephone calls would produce insurmountable administrative and technological barriers. See *[American Trucking Ass'ns, Inc. v.] Scheiner*, 483 U.S., at 296, . . . (apportionment does not require State to adopt a tax which would "pose genuine administrative burdens"). We thus find it significant that Illinois' method of taxation is a realistic legislative solution to the technology of the present-day telecommunications industry.[615]

In *Oklahoma Tax Commission v. Jefferson Lines, Inc.*,[616] the Court found that Oklahoma's sales tax on the full price of a bus ticket for interstate travel satisfied the external consistency requirement, even though the tax base was not divided between Oklahoma and other states. Employing the same "pragmatic" approach to the fair apportionment issue in the context of sales taxation

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[614] *Goldberg*, 488 US 252, 263–264, 109 S. Ct. 582 (1989). The Court observed:

> To the extent that other States' telecommunications taxes pose a risk of multiple taxation, the credit provision contained in the Tax Act operates to avoid actual multiple taxation. *D.H. Holmes [Co. v. McNamara]*, [486 US] at 31, ("[t]he . . . taxing scheme is fairly apportioned, for it provides a credit against its use tax for sales taxes that have been paid in other States").

Goldberg, 488 US 252, 264, 109 S. Ct. 582 (1989).

[615] *Goldberg*, 488 US 252, 264–265, 109 S. Ct. 582 (1989) (some citations omitted). For a more comprehensive treatment of *Goldberg v. Sweet*, see ¶ 18.07. The Court invoked the external consistency test in Trinova Corp. v. Michigan Dep't of Treasury, 498 US 358, 111 S. Ct. 818 (1991). The taxpayer contended that the apportionment of Michigan's single business tax—a form of value added tax—violated the test. Analyzing the challenge under traditional fair apportionment criteria, the Court concluded that Trinova had failed to carry its burden of demonstrating "that there is no rational relationship between the tax base measure attributed to the State and the contribution of Michigan business activity to the entire value added process." *Trinova Corp.*, 498 US 358, 380, 111 S. Ct. 818 (1991).

[616] Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 US 175, 115 S. Ct. 1331 (1995).

that it had taken in *Goldberg v. Sweet*, the Court concluded that Oklahoma's sales tax does not

> raise any greater threat of multiple taxation than those sales taxes that have passed muster time and again. There is thus no reason to leave the line of longstanding precedent and lose the simplicity of our general rule sustaining sales taxes measured by full value, simply to carve out an exception for the subcategory of sales of interstate transportation services. We accordingly conclude that Oklahoma's tax on ticket sales for travel originating in Oklahoma is externally consistent as reaching only the activity taking place within the taxing State, that is, the sale of the service.[617]

A Missouri court recognized that "[a]lthough the Court coined the term 'external consistency' for the first time in *Container*," the test reflected the well-established principle that "a tax should only be levied on that interstate activity which reasonably represents activity within the taxing jurisdiction."[618] Applying the test, the court held that Kansas City's gross receipts tax was unconstitutional as applied to General Motors because it taxed an unapportioned share of GM's receipts derived from interstate activities. The case is unusual in properly recognizing—contrary to weight of earlier authority[619]—that a tax on gross receipts should be apportioned to values derived from activities conducted in the taxing jurisdiction, even if the subject of the tax is technically imposed on a local privilege or occupation.

¶ 4.16 REMEDIES FOR UNCONSTITUTIONALLY DISCRIMINATORY TAXES: PROSPECTIVITY, RETROACTIVITY, REFUNDS, AND MEANINGFUL BACKWARD-LOOKING RELIEF

The question of remedy is treated here because the Court first articulated the relevant doctrine in the context of state tax discrimination under the Commerce Clause. Nevertheless, as will soon become clear, much of the doctrine is

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[617] *Jefferson Lines*, 514 US 175, 196, 115 S. Ct. 1331 (1995). *Jefferson Lines* is considered in more detail in ¶ 18.08.

[618] General Motors Corp. v. City of Kan. City, Mo., 1994 WL 49620, 1994 Mo. App. LEXIS 278 (Ct. App. 1994), refund denied on other grounds, 895 SW2d 59 (Mo. Ct. App.), cert. denied, ___ US ___, 116 S. Ct. 217 (1995).

[619] See, e.g., Standard Pressed Steel Co. v. Department of Revenue, 419 US 560, 95 S. Ct. 706 (1975); see generally W. Hellerstein, "State Taxation of Interstate Business and the Supreme Court, 1974 Term: *Standard Pressed Steel* and *Colonial Pipeline*," 62 Va. L. Rev. 149 (1976).

equally relevant to remedies for state tax discrimination under constitutional provisions other than the Commerce Clause and, indeed, to remedies for unconstitutional state taxation on grounds other than discrimination.

In 1990, the Supreme Court for the first time squarely addressed the question of the appropriate relief to which a taxpayer is entitled when he or she has paid a tax that is unconstitutionally discriminatory under the Commerce Clause.[620] In *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*,[621] a unanimous Court held that when taxpayers have paid a tax under duress that violates settled principles of Commerce Clause adjudication, they are entitled to "meaningful backward-looking relief."[622] In the companion case of *American Trucking Associations, Inc. v. Smith*,[623] a badly splintered Court held that a Commerce Clause decision establishing a new principle of law may under some circumstances be applied prospectively. The two cases have broken important new ground in delineating the taxpayers' right to retrospective relief from unconstitutionally discriminatory taxes.

[1] *McKesson* and the Right to "Meaningful Backward-Looking Relief"

McKesson involved a Florida liquor excise tax that favored local over out-of-state products. The Florida Supreme Court had invalidated the tax on the basis of the Supreme Court's decision in *Bacchus Imports, Ltd. v. Dias*.[624] Nevertheless, the Florida court refused to order a refund of the tax, holding that its decision should apply only prospectively. The principal issue before the Supreme Court was "whether prospective relief, by itself, exhausts the requirements of federal law"[625] when a taxpayer has involuntarily paid a tax that has been held unconstitutionally discriminatory under settled Commerce Clause principles.[626] Hence, the precise issue to which most of the Court's opinion in *McKesson*

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[620] The ensuing discussion draws freely from W. Hellerstein, "Preliminary Reflections on *McKesson* and *American Trucking Associations*," Tax Notes, July 16, 1990, p.325. In considering this material, readers should note that Walter Hellerstein was counsel to McKesson in the *McKesson* case.

[621] McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, 496 US 18, 110 S. Ct. 2238 (1990).

[622] *McKesson*, 496 US 18, 31, 110 S. Ct. 2238 (1990).

[623] American Trucking Ass'ns, Inc. v. Smith, 496 US 167, 110 S. Ct. 2323 (1990).

[624] Bacchus Imports, Ltd. v. Dias, 468 US 263, 104 S. Ct. 3049 (1984), discussed supra ¶ 4.13[2][b][ii] note 359.

[625] *McKesson*, 496 US 18, 31, 110 S. Ct. 2238 (1990).

[626] *McKesson*, 496 US 18, 31, 110 S. Ct. 2238 (1990). It is important to note that there was no serious question that the *substantive rule* announced in the Florida case should be applied retroactively (i.e., within the applicable statute of limitations). For reasons that will be considered below in connection with the *American Trucking Ass'ns* case,

was addressed was whether prospective relief, by itself, exhausts the requirements of federal law when the substantive rule of the case has retroactive effect.

The Court's answer to this question was unequivocal:

> The answer is no: if a State places a taxpayer under duress promptly to pay a tax when due and relegates him to a postpayment refund action in which he can challenge the tax's legality, the Due Process Clause of the Fourteenth Amendment obligates the State to provide meaningful backward-looking relief to rectify any unconstitutional deprivation.[627]

The Court's conclusion followed from a number of its earlier cases that had established the rule that "because the exaction of a tax constitutes a deprivation of property, the State must provide procedural safeguards against unlawful exactions in order to satisfy the demands of the Due Process Clause."[628]

The question, then, became exactly what "meaningful backward-looking relief" entailed. The Court first observed that, in some circumstances, such relief must consist of a refund. For example, if a state has levied a tax it is wholly without constitutional power to impose because it lacks jurisdiction over the taxpayer or because the taxpayer is immune from taxation under federal law, then the state would have "no choice but to 'undo' the unlawful deprivation by refunding the tax previously paid under duress, because allowing the state to 'collect these unlawful taxes by coercive means and not incur any obligation to pay them back . . . would be in contravention of the Fourteenth Amendment.'"[629]

Florida, however, was not wholly without power to impose the liquor excise tax in question. Florida unquestionably possessed power to impose a liquor excise tax. The vice of the Florida tax was that the state's taxing power had been exercised so as to discriminate against interstate commerce, and the tax was unconstitutional only insofar as it operated in that manner. As a consequence, Florida was not limited to providing "meaningful backward-looking relief" through a refund remedy. To be sure, "[t]he State may . . . choose to

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all of the Justices concurred on this point. See *McKesson*, 496 US 18, 31 n.15, 110 S. Ct. 2238 (1990).

[627] *McKesson*, 496 US 18, 31, 110 S. Ct. 2238 (1990).

[628] *McKesson*, 496 US 18, 36, 110 S. Ct. 2238 (1990).

[629] *McKesson*, 496 US 18, 39, 110 S. Ct. 2238 (1990) (quoting Ward v. Love County Bd. of Comm'rs, 253 US 17, 24, 40 S. Ct. 419 (1920)). Two courts have held that the failure to pay interest on refunds of illegally collected taxes does not constitute the denial of "meaningful backward-looking relief" under *McKesson*. Chicago Freight Leasing Co. v. Limbach, 62 Ohio St. 2d 489, 584 NE2d 690 (1992); Pendell v. Department of Revenue, 315 Or. 608, 847 P2d 846 (1993); cf. Rosewell v. LaSalle Nat'l Bank, 450 US 503, 101 S. Ct. 1221 (1981) (payment of refunds without interest, even when taxpayers must prepay taxes and wait up to two years before receiving refunds, constitutes a "plain, speedy and efficient" remedy under the federal antitax injunction act, 28 USC § 1341).

erase the property deprivation itself by providing petitioner with a full refund of its tax payments."[630] But the Court also made it clear that "a State found to have imposed an impermissibly discriminatory tax retains flexibility in responding to this determination."[631]

Florida was free to "reformulate and enforce the liquor tax during the contested period in any way that treats petitioner and its competitors in a manner consistent with the dictates of the Commerce Clause."[632] Even though this might not provide a taxpayer with a refund, it would provide the taxpayer with "meaningful backward-looking relief" because the taxpayer, by hypothesis, would be subjected to a tax that conformed to the commands of the Commerce Clause. Any deprivation of the taxpayer's property would therefore be pursuant to a valid scheme and would thus provide the taxpayer with "all of the process it is due: an opportunity to contest the validity of the tax and a 'clear and certain remedy' designed to render the opportunity meaningful by preventing any permanent unlawful deprivation of property."[633]

The Court then suggested the options available to Florida that would satisfy its constitutional obligation to provide the taxpayer with meaningful retrospective relief. Florida could do so by refunding to McKesson the difference between the taxes it paid and the tax it would have paid had it enjoyed the same rate reductions as its favored competitors.[634] Alternatively, consistent with federal and state constitutional restrictions on retroactive legislation, Florida might assess back taxes from those of McKesson's competitors that received favored tax treatment, thereby retrospectively eliminating the discrimination.[635] Furthermore, Florida might devise some combination of these two forms of relief, providing partial refunds and imposing a partial retroactive tax on the taxpayer's favored competitors.[636]

Finally, it is worth noting that the state's obligation to provide meaningful "postdeprivation" relief was a consequence of its decision not to provide the taxpayer with a meaningful opportunity to contest the tax prior to the payment. Thus, if the state had authorized the taxpayer to bring suit to enjoin the tax or to assert its constitutional objections in a defense to a tax enforcement proceeding, the state would have satisfied its due process obligation to provide the taxpayer with an opportunity to be heard before it was deprived of any significant property interest. Under such circumstances, the obligation to provide meaningful retrospective relief would never arise because the taxpayer would

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[630] *McKesson*, 496 US 18, 39, 110 S. Ct. 2238 (1990).

[631] *McKesson*, 496 US 18, 40, 110 S. Ct. 2238 (1990).

[632] *McKesson*, 496 US 18, 40, 110 S. Ct. 2238 (1990).

[633] *McKesson*, 496 US 18, 40, 110 S. Ct. 2238 (1990).

[634] *McKesson*, 496 US 18, 40, 110 S. Ct. 2238 (1990).

[635] *McKesson*, 496 US 18, 40, 110 S. Ct. 2238 (1990).

[636] *McKesson*, 496 US 18, 41, 110 S. Ct. 2238 (1990).

have received all the process to which it is due prior to paying the tax. However, because states are not required to provide such "predeprivation process," and because Florida, like most states, chose to require taxpayers to tender their tax payments before their objections were entertained and resolved in a meaningful hearing,[637] it had to "provide taxpayers with, not only a fair opportunity to challenge the accuracy and legal validity of their tax obligation, but also a 'clear and certain remedy' for any erroneous or unlawful tax collection to ensure that the opportunity to contest the tax is a meaningful one."[638]

[2] "Equitable Considerations," "Windfalls," and Other Defenses to Providing "Meaningful Backward-Looking Relief"

[a] The "Presumptively Valid Statute" Defense

In denying McKesson's claim for a refund, the Florida Supreme Court relied on two "equitable considerations" that it believed justified its refusal to order retroactive relief. First, it observed that the state had implemented the taxing scheme "in good faith reliance on a presumptively valid statute."[639] The U.S. Supreme Court characterized this consideration as reflecting "a concern

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[637] A Florida court has subsequently suggested, however, that a taxpayer does have an adequate predeprivation remedy depriving it of the right to backward-looking relief, namely, the right to file suit and to pay the contested tax into the court registry. Sharper Image Corp. v. Department of Revenue, 704 So. 2d 657 (Fla. Dist. Ct. App. 1997). But see Newsweek, Inc. v. Florida Dep't of Revenue, ___ US ___, 118 S. Ct. 904 (1998) (per curiam) (summarily vacating Florida decision in which state court had denied refund relief using "bait and swich" tactics). See infra ¶ 4.16[5].

[638] *McKesson*, 496 US 18, 37–38, 110 S. Ct. 2238 (1990) (footnotes and citations omitted). The Court's analysis also served to place the common-law rule that taxpayers have no right to the refund of a tax that is "voluntarily" paid in constitutional perspective. The Due Process Clause requires meaningful retrospective relief only when a tax is paid involuntarily or under duress. The Court observed, however, that

> if a State chooses not to secure payments under duress and instead offers a meaningful opportunity for taxpayers to challenge their validity in a predeprivation hearing, payments tendered may be deemed "voluntary." The availability of a predeprivation hearing constitutes a procedural safeguard against unlawful deprivations sufficient by itself to satisfy the Due Process Clause, and taxpayers cannot complain if they fail to avail themselves of this procedure.

McKesson, 496 US 18, 38 n.21, 110 S. Ct. 2238 (1990). The question whether a tax is paid "voluntarily" or "under duress" thus becomes a threshold question in the constitutional inquiry. The Court has held that a "tax is paid under 'duress' in the sense that the State has not provided a fair and meaningful predeprivation procedure" when a tax must be paid to avoid economic sanctions or the seizure of the taxpayer's property. *McKesson*, 496 US 18, 38 n.21, 110 S. Ct. 2238 (1990).

[639] Division of Alcoholic Beverages & Tobacco v. McKesson Corp., 524 So. 2d 1000, 1010 (Fla. 1988).

that a State's obligation to provide refunds for what later turns out to be an unconstitutional tax would undermine the State's ability to engage in sound fiscal planning."[640] The Court, however, found this justification insufficient to override Florida's constitutional obligation to provide meaningful retroactive relief on several grounds. With regard to future cases, the state's ability to impose various procedural requirements on actions for refunds met this concern. The Court adverted specifically to a number of procedural measures a state might adopt to limit its exposure to unanticipated refund claims such as limiting the availability of refunds to taxes paid under protest; enforcing relatively short statutes of limitations for tax refund actions; refraining from collecting taxes pursuant to taxing schemes that have been held unconstitutional; and placing challenged tax payments into an escrow account.

As for the fiscal concerns generated by the *McKesson* case itself, the Court noted that the state's failure to avail itself of any of these methods of self-protection weakened its claim. Furthermore, the notion that the state was relying on a "presumptively valid statute" was hard to reconcile with the fact that it had made only cosmetic changes from the preexisting liquor tax that expressly discriminated against out-of-state products. Hence the state could not credibly claim that it was surprised by the invalidation of the levy.

[b] The "Pass-On" Defense

The second "equitable consideration" invoked by the Florida Supreme Court in denying the taxpayer its claim for a refund was that, if given a refund, McKesson would probably receive a "windfall" because the cost of the tax has likely been passed on to its customers. The Court dismissed this defense on both factual and doctrinal grounds. Even assuming a state were obligated to refund an unconstitutional tax only insofar as the taxpayer bore the economic burden of the levy, the Florida court's assumption that the tax was in fact passed on by McKesson had no support in the record and therefore was "purely speculative."[641] The Court declared:

> We repeatedly have recognized that determining whether a particular business cost has in fact been passed on to customers or suppliers entails a highly sophisticated theoretical and factual inquiry; a court certainly cannot withhold part of a refund otherwise required to rectify an unconstitutional deprivation without first satisfactorily engaging in this inquiry.[642]

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[640] *McKesson*, 496 US 18, 20, 110 S. Ct. 2238 (1990).

[641] *McKesson*, 496 US 18, 46 n.30, 110 S. Ct. 2238 (1990).

[642] *McKesson*, 496 US 18, 47, 110 S. Ct. 2238 (1990). The Court cited antitrust cases in support of this proposition. Illinois Brick Co. v. Illinois, 431 US 720, 741–745, 97 S. Ct. 2061 (1977); Hanover Shoe Co. v. US Mach. Corp., 392 US 481, 492–493, 88 S. Ct. 2224 (1968). See *McKesson*, 496 US 18, 45 n.29, 110 S. Ct. 2238 (1990). As the Court

The Court, however, rejected the contention on more fundamental grounds. In contrast to a pass-on defense in the context of a tax that "merely exceed[s] the amount authorized by statute,"[643] Florida's tax unconstitutionally discriminated against interstate commerce. The tax injured McKesson not only because it was poorer than if it had not paid the tax (a problem that might be mitigated to the extent that it had passed the tax on to others), but also because it was placed at a competitive disadvantage to its competitors who were not burdened with the levy.

> To whatever extent petitioner succeeded in passing on the economic incidence of the tax through higher prices to its customers, it most likely lost sales to the favored distributors or else incurred other costs (*e.g.*, for advertising) in an effort to maintain its market share. The State cannot persuasively claim that "equity" entitles it to retain tax moneys taken unlawfully from petitioner due to its pass-on of the tax where the pass-on itself furthers the very competitive disadvantage constituting the Commerce Clause violation that rendered the deprivation unlawful in the first place. We thus reject respondents' reliance on a pass-on defense in this context.[644]

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observed, in *Illinois Brick*, "[a]n overcharge imposed by an antitrust violator . . . is analytically equivalent to an excise tax imposed on the violator's product in the amount of the overcharge" *Illinois Brick*, 431 US 720, 742 note 25, 97 S. Ct. 2061 (1977))—precisely the situation before the Court in *McKesson*. The question whether a tax will be passed on or not depends on the relative elasticities of supply and demand in the market in question. The fact that the price of a product rises after a tax is imposed does not necessarily mean that the tax has been passed on. See W. Hellerstein, "Complementary Taxes as a Defense to Unconstitutional State Tax Discrimination," 39 Tax Law. 405, 438–443 (1986).

[643] The Court had approved such a defense in United States v. Jefferson Elec. Mfg. Co., 291 US 386, 54 S. Ct. 443 (1934) involving a statutorily created pass-on defense in a refund action to redress a tax overassessment.

[644] McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, 496 US 18, 48–49, 110 S. Ct. 2238 (1990) (footnotes omitted). The Court did not address the state's contention that the pass-on defense may nevertheless be invoked as a matter of state law because it found that the state had misdescribed state law in claiming that such a pass-on defense existed. *McKesson*, 496 US 18, 49 n.34, 110 S. Ct. 2238 (1990). If such a pass-on defense did exist as a matter of state law, it would raise the question whether federal due process and Commerce Clause principles nevertheless required the granting of meaningful retroactive relief, assuming as a factual matter that the tax was passed on to the taxpayer's customers. It may be worth noting that the Court did not list the pass-on defense as one of the "procedural requirements" a state might adopt to protect itself from unanticipated refund claims. Moreover, the pass-on defense really establishes only that the party who passed on the tax has no right to a refund, not that no refund should exist at all. As a matter of equity, if not as a matter of law, one would think that those who bore the economic burden of an unlawful tax would have the right to a refund when the state declines to refund such a tax on the ground that the statutory "taxpayer" has passed the burden of the tax on to others. In any event, a state's invocation of the pass-on defense would not necessarily protect the public fisc if those who bore the economic burden of the

The Court properly rejected the state's pass-on defense. Insofar as there is any "windfall" in these cases, it is surely more appropriate to allow a taxpayer whose litigation has vindicated constitutional policies to enjoy the fruits of its victory than it is to allow a state, which has violated constitutional strictures, to enjoy the fruits of its unconstitutional exaction.

[c] The "Financial Stability" Defense

The Court addressed the state's claim that the requirement that it provide meaningful retroactive relief "would plainly cause serious economic and administrative dislocation for the State."[645] While acknowledging that state interests have a legitimate role to play in shaping the contours of the relief that the Due Process Clause requires, the Court concluded that "the State's interest in financial stability does not justify a refusal to provide relief."[646] Instead, the Court adverted to the various procedural measures the state could take to protect itself in the future from unforeseen refund claims. It also observed that the state could minimize the administrative burdens imposed by its due process obligations by "fine-tuning" the relief accorded the taxpayer in accord with the flexible standards the Court had earlier delineated.[647]

In accordance with its determination that the taxpayer was entitled to "meaningful backward-looking relief," the Court in *McKesson* remanded the case to the Florida Supreme Court for further proceedings. In so doing, the Court reiterated that the state was free, within the minimum due process constraints it had delineated in *McKesson*, to fashion the remedy it deemed most appropriate to cure the unconstitutional discrimination.

[3] *American Trucking Associations* and Prospectivity Doctrine

American Trucking Ass'ns, Inc. v. Smith[648] grew out of an earlier decision by the same name that invalidated Pennsylvania's flat taxes on trucks. In *American Trucking Ass'ns, Inc. v. Scheiner*[649] (hereinafter *American Trucking Ass'ns I*), the Court held that Pennsylvania's flat highway use taxes discrimi-

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levy have a refund remedy. And, insofar as the pass-on defense would protect the state under state law from issuing any tax refunds, the question remains whether such a defense may be raised as a barrier to meaningful retroactive relief.

[645] *McKesson*, 496 US 18, 21, 110 S. Ct. 2238 (1990) (quoting from Brief for Respondents on Rearg. 20).

[646] *McKesson*, 496 US 18, 50, 110 S. Ct. 2238 (1990).

[647] See supra text accompanying notes 632–636.

[648] American Trucking Ass'ns, Inc. v. Smith, 496 US 167, 110 S. Ct. 2323 (1990).

[649] American Trucking Ass'ns, Inc. v. Scheiner, 483 US 266, 107 S. Ct. 2829 (1987), discussed supra ¶ 4.13[2][g].

nated against interstate commerce, and, in so doing, the Court explicitly overruled its earlier precedents that had rejected Commerce Clause challenges to flat highway taxes. At the time of the Court's decision in *American Trucking Ass'ns I*, the Court had pending before it a similar case arising in Arkansas in which the taxpayers had challenged Arkansas's flat tax on trucks.

American Trucking Ass'ns I was decided on June 23, 1987. Three days later, the Court vacated the judgment of the Arkansas Supreme Court that had sustained Arkansas's highway use tax and remanded the case for further consideration in light of *American Trucking Ass'ns I*.[650] Following the taxpayers' unsuccessful efforts to have the Arkansas courts enjoin further collection of the highway use tax or to order an escrow of the taxes pending reconsideration of the merits of the case, Justice Blackmun ordered Arkansas to escrow such taxes on August 14, 1987, until a final decision on the merits of the case was reached.[651] In March 1988, the Arkansas Supreme Court held that the challenged highway use tax was unconstitutional in light of *American Trucking Ass'ns I*.[652] Despite its decision on the merits, the Arkansas court refused to order refunds to the taxpayers for all taxes paid prior to Justice Blackmun's August 14, 1987, escrow order. The court based its prospectivity holding on the U.S. Supreme Court's decision in *Chevron Oil Co. v. Huson*,[653] which held that, in some circumstances, decisions may be given only prospective effect.

In *American Trucking Ass'ns, Inc. v. Smith*[654] (hereinafter *American Trucking Ass'ns II*), the Supreme Court held that its decision in *American Trucking Ass'ns I* should be applied prospectively and that the taxpayers were entitled to meaningful retrospective relief under *McKesson* only with respect to taxes imposed for highway use after *American Trucking Ass'ns I* was handed down. Four Justices (O'Connor, Rehnquist, White, and Kennedy) subscribed to Justice O'Connor's plurality opinion, which expressed the view that *American Trucking Ass'ns I* should not be given retroactive effect under *Chevron*. Four Justices (Stevens, Brennan, Marshall, and Blackmun) subscribed to Justice Stevens's dissenting opinion, which expressed the view that *American Trucking Ass'ns I* should be applied retroactively and that *Chevron*'s prospectivity doctrine should apply in only the most limited circumstances. The actual decision in the case turned on Justice Scalia's concurrence in the judgment, which expressed sympathy for the dissenters' views about ret-

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[650] American Trucking Ass'ns, Inc. v. Gray, 483 US 1014, 107 S. Ct. 3252 (1987).

[651] American Trucking Ass'ns, Inc. v. Gray, 483 US 1306, 108 S. Ct. 2 (1987).

[652] American Trucking Ass'ns, Inc. v. Gray, 295 Ark. 43, 746 SW2d 377 (1988).

[653] Chevron Oil Co. v. Huson, 404 US 97, 92 S. Ct. 349 (1971).

[654] American Trucking Ass'ns, Inc. v. Smith, 496 US 167, 110 S. Ct. 2323 (1990).

roactivity in general but nevertheless joined t e plurality for reasons relating to his distaste for the Court's Commerce Clause doctrine.[655]

[a] The Plurality Opinion

In the eyes of the plurality, the only question before the Court in *American Trucking Ass'ns II* was: "Did the Arkansas Supreme Court apply *Chevron Oil* correctly?"[656] In this respect, as the plurality observed,[657] it is important to distinguish the "retroactivity" question at issue in *American Trucking Ass'ns II* from the "remedial" question at issue in *McKesson*. *McKesson* involved the question of the appropriate remedy when a taxpayer involuntarily pays a tax that is unconstitutional under existing precedent. There was no substantial question of prospectivity in *McKesson* because, under any view of the prospectivity doctrine set forth below, a decision that a tax violates settled Commerce Clause principles would not be applied prospectively. However, when there is some question as to the clarity of the law under which a tax has been declared unconstitutional, as there was in *American Trucking Ass'ns II*, the question may be raised of whether that decision should be applied prospectively (i.e., "whether the decision applies to conduct or events that occurred before the date of the decision").[658]

Put another way, the question in a case like *McKesson*, where the constitutional principles are clearly established, is what relief the Due Process Clause requires to remedy the constitutional violation. The question in a case like *American Trucking Ass'ns II*, where the constitutional principles are not clearly established, is "whether there has been a constitutional violation in the first place"[659] with respect to conduct occurring prior to the date of the Court's decision. If the answer to that question is yes, then the principles of *McKesson*, which dictate the constitutionally appropriate relief, come into play. If the answer to that question is no, then, of course, there is no constitutional violation with respect to which *McKesson*'s remedial principles need be applied.

The answer to the question whether a decision of the U.S. Supreme Court should be applied prospectively turned in the plurality's view on an application of the three-part test the Court had established in *Chevron*:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose

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[655] See supra ¶ 4.11[2] for a consideration of Justice Scalia's views of the Commerce Clause.

[656] *American Trucking Ass'ns II*, 496 US 167, 178, 110 S. Ct. 2323 (1990).

[657] *American Trucking Ass'ns II*, 496 US 167, 178, 110 S. Ct. 2323 (1990).

[658] *American Trucking Ass'ns II*, 496 US 167, 177, 110 S. Ct. 2323 (1990).

[659] *American Trucking Ass'ns II*, 496 US 167, 182, 110 S. Ct. 2323 (1990).

> resolution was not clearly foreshadowed. Second, . . . we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation. Finally, we [must] weig[h] the inequity imposed by retroactive application, for where a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the injustice or hardship by a holding of nonretroactivity.[660]

The plurality concluded that *Scheiner* met *Chevron*'s test for prospective application of the Court's decisions. They thought it "obvious"[661] that *Scheiner* met the first prong of the *Chevron* test because the Court's decision in *Scheiner* expressly overruled earlier Supreme Court precedents and thereby established a "new principle of law." It likewise concluded that *Scheiner* met the second prong of the *Chevron* test—whether retroactive application will further the purpose of the rule in question—because "it is not the purpose of the Commerce Clause to prevent legitimate state taxation of interstate commerce."[662] Because the Arkansas highway use tax was consistent with preexisting Commerce Clause doctrine, the plurality took the position that the purpose of the Commerce Clause would not be served by applying the new rule to past conduct.

Finally, the plurality found that the balance of the equities weighed in favor of prospective application. The plurality pointed to a number of considerations as the basis for its conclusion on this score. Arkansas legislators, courts, and state tax authorities could justifiably rely on the Court's earlier precedents in enacting, sustaining, and administering the statute. While a state's reliance interests might merit little concern when the unconstitutionality of a state statute could have reasonably been foreseen, when a state cannot reasonably foresee such a development, as in a case when the Court overrules past precedents in holding a tax unconstitutional, "the inequity of unsettling actions taken in reliance on those precedents is apparent."[663] In light of the financial burdens and administrative costs that would be imposed on the state by virtue of retroactive application of *Scheiner*, the plurality concluded that "we think it unjust to impose this burden when the State relied on valid, existing precedent in enacting and implementing its tax."[664]

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[660] Chevron Oil Co. v. Huson, 404 US 97, 106–107, 92 S. Ct. 349 (1971) (quoted in *American Trucking Ass'ns II*, 496 US 167, 179, 110 S. Ct. 2323 (1990)).

[661] *American Trucking Ass'ns II*, 496 US 167, 179, 110 S. Ct. 2323 (1990).

[662] *American Trucking Ass'ns II*, 496 US 167, 181, 110 S. Ct. 2323 (1990).

[663] *American Trucking Ass'ns II*, 496 US 167, 182, 110 S. Ct. 2323 (1990).

[664] *American Trucking Ass'ns II*, 496 US 167, 183, 110 S. Ct. 2323 (1990).

[b] The Dissenting Opinion

Four justices shared the view that *American Trucking Ass'ns II* should be dealt with precisely like *McKesson*—that is, that the case should be remanded to the state court for it to determine, consistent with the due process standards articulated in *McKesson*, the meaningful retrospective relief to which the taxpayers were entitled. They based their opinion on two propositions: (1) that "fundamental notions of fairness and legal process dictate that the same rules should be applied to all similar cases on direct review";[665] and (2) that *Chevron* merely stated a narrow "remedial principle for the exercise of equitable discretion by federal courts and not, as the plurality states, a choice of law principle applicable to all cases on direct review."[666]

The dissenters' position that all decisions of the Court should be given retroactive effect was based on the views of Justice Harlan developed in a series of concurring and dissenting opinions addressed to the subject of retroactivity. Essentially, Justice Harlan believed that once the Supreme Court had decided a new rule in a particular case, the rule should apply to all cases with respect to which the parties' rights had not been finally adjudicated. As Justice Harlan explained in an opinion that the dissenters in *American Trucking Ass'ns II* quoted at length:

> The critical factor in determining when a new decisional rule should be applied to a transaction consummated prior to the decision's announcement is, in my view, the point at which the transaction has acquired such a degree of finality that the rights of the parties should be considered frozen. Just as in the criminal field the crucial moment is, for most cases, the time when a conviction has become final, so in the civil area that moment should be when the transaction is beyond challenge either because the statute of limitations has run or the rights of the parties have been fixed and have become *res judicata.*
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> * * *
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> To the extent that equitable considerations, for example, "reliance," are relevant, I would take this into account in the determination of what relief is appropriate in any given case. There are, of course, circumstances when a change in the law will jeopardize an edifice which was reasonably constructed on the foundation of prevailing legal doctrine. Thus, it may be that the law of remedies would permit rescission, for example, but not an award of damages to a party who finds himself able to avoid a once-valid contract under new notions of public policy. . . . The essential point is that while there is flexibility in the law of remedies, this does not affect

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[665] *American Trucking Ass'ns II*, 496 US 167, 212, 110 S. Ct. 2323 (1990) (Stevens, J., dissenting).

[666] *American Trucking Ass'ns II*, 496 US 167, 220, 110 S. Ct. 2323 (1990) (Stevens, J., dissenting).

> the underlying substantive principle that short of a bar of *res judicata* or statute of limitations, courts should apply the prevailing decisional rule to the cases before them.[667]

Relying on these views, which they believed were reflected in other decisions of the Court, the dissenters concluded that the taxpayers were "plainly entitled to an adjudication that the Arkansas . . . tax violated the Constitution both before and after our decision in *Scheiner*."[668]

[c] Justice Scalia's Concurring Opinion

With a 4–4 split on the issue of retroactivity in *American Trucking Ass'ns II*, it fell upon Justice Scalia to cast the decisive vote, which he did, though for reasons different from those of the plurality he joined.[669] Justice Scalia first expressed his sympathies for the position taken by the dissent "that prospective decisionmaking is incompatible with the judicial role, which is to say what the law is, not to prescribe what it shall be."[670] Despite Scalia's rejection of prospective constitutional decision making, his singular views about the Court's "negative" Commerce Clause jurisprudence[671] induced him to deviate from his general position on retroactivity in *American Trucking Ass'ns II*.

Justice Scalia's repudiation of the Court's negative Commerce Clause jurisprudence significantly colored his views about *American Trucking Ass'ns I*'s retroactivity. While reiterating his position that prospective judicial decision making by the Supreme Court "is fundamentally beyond judicial power,"[672] Scalia did not believe that this led inexorably to the conclusion that the pre-*Scheiner* Arkansas highway use taxes were unconstitutional. Declaring that stare decisis "would normally cause me to adhere to a decision of this Court already rendered as to the constitutionality of a particular type of state law,"[673] thus inducing him to apply that decision (retroactively) to similar cases arising

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[667] United States v. Estate of Donnelly, 397 US 286, 295–297, 90 S. Ct. 1033 (1970) (Harlan, J., concurring) (citations omitted), quoted in *American Trucking Ass'ns II*, 496 US 167, 215, 110 S. Ct. 2323 (1990) (Stevens, J., dissenting).

[668] *American Trucking Ass'ns II*, 496 US 167, 218, 110 S. Ct. 2323 (1990) (Stevens, J., dissenting).

[669] Justice Scalia joined the plurality in holding *American Trucking Ass'ns II* prospective, but he did not join its opinion.

[670] *American Trucking Ass'ns II*, 496 US 167, 201, 110 S. Ct. 2323 (1990) (Scalia, J., concurring).

[671] See supra ¶ 4.11[2].

[672] *American Trucking Ass'ns II*, 496 US 167, 204, 110 S. Ct. 2323 (1990) (Scalia, J., concurring).

[673] *American Trucking Ass'ns II*, 496 US 167, 204, 110 S. Ct. 2323 (1990) (Scalia, J., concurring).

before the Court, he was unwilling to extend that position to the pre–*American Trucking Ass'ns I* taxes at issue in *American Trucking Ass'ns II*:

> Though I do not believe I have the option of suspending the principle of retroactive judicial decisionmaking, the doctrine of *stare decisis* is a flexible command. I do not think that a sensible understanding of it requires me to vote contrary to my view of the law where such a vote would not only impose upon a litigant liability I think to be wrong, *but would also upset that litigant's settled expectations* because the earlier decision for which *stare decisis* effect is claimed [*American Trucking Ass'ns I*] overruled prior law. That would turn the doctrine of *stare decisis* against the very purpose for which it exists. I think it appropriate, in other words—indeed, I think it necessary—for a judge whose view of the law causes him to dissent from an overruling to persist in that position (at least where his vote is necessary to the disposition of the case) with respect to action taken before the overruling occurred.[674]

In short, because Justice Scalia's views of the Commerce Clause and the appropriate application of the doctrine of stare decisis led to the conclusion that the pre–*American Trucking Ass'ns I* taxes were constitutional whereas the post–*American Trucking Ass'ns I* taxes were unconstitutional, he was able to join the plurality that had reached the same conclusion under the Court's prospectivity doctrine.[675]

[4] *James Beam, Harper*, and "Selective" Prospectivity

In *James B. Beam Distilling Co. v. Georgia*,[676] the question was whether the Court's 1984 decision in *Bacchus Imports, Ltd. v. Dias*[677] should apply retroactively. In *Bacchus*, the Court held that a Hawaii liquor tax that exempted lo-

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[674] *American Trucking Ass'ns II*, 496 US 167, 205, 110 S. Ct. 2323 (1990) (Scalia, J., concurring) (emphasis in original).

[675] The *McKesson* and *American Trucking Ass'ns II* decisions are analyzed in W. Hellerstein, "Preliminary Reflections on *McKesson* and *American Trucking Associations*," __ Tax Notes; July 16, 1990, p.325. See also R. Fallon & D. Meltzer, "New Law, Non-Retroactivity, and Constitutional Remedies," 104 Harv. L. Rev. 1733 (1991); Note, "Nonretroactivity in Constitutional Tax Refund Cases," 43 Hastings LJ 419 (1992). In two per curiam decisions handed down after *McKesson*, involving the West Virginia business and occupation tax that had been invalidated as discriminatory against interstate commerce in Armco, Inc. v. Hardesty, 467 US 638, 104 S. Ct. 2620 (1984), discussed supra ¶ 4.13[2][c][i], the Court held that *Armco* must be applied retroactively. National Mines Corp. v. Caryl, 497 US 922, 110 S. Ct. 3205 (1990); Ashland Oil Co. v. Caryl, 497 US 916, 110 S. Ct. 3202 (1990).

[676] James B. Beam Distilling Co. v. Georgia, 501 US 529, 111 S. Ct. 2439 (1991).

[677] Bacchus Imports, Ltd. v. Dias, 468 US 263, 104 S. Ct. 3049 (1984), discussed supra ¶ 4.13[2][b][ii].

cally produced beverages discriminated against out-of-state alcoholic beverages in violation of the Commerce Clause. In so holding, the Court rejected the view that the Twenty-First Amendment, which repealed prohibition, shielded states' discriminatory liquor taxes from Commerce Clause scrutiny.

In *James Beam*, the taxpayer sought a refund of $2.4 million in liquor excise taxes paid in 1982, 1983, and 1984 under a Georgia statute that imposed a higher tax on alcoholic beverages imported into the state than on those manufactured in Georgia. The Georgia court summarily concluded that the tax violated the Commerce Clause because "the purpose and effect of the statute was simple economic protectionism which is virtually per se invalid under the Commerce Clause of the U.S. Constitution."[678] Applying the *Chevron* doctrine,[679] however, the Georgia court found that its decision established a "new rule"[680] derived from *Bacchus* and that the balance of the equities weighed in favor of the state because of the "severe financial burden"[681] that retroactive application would impose on the state. It therefore concluded that "prospective application of the decision is appropriate,"[682] and it refused to provide the taxpayers with refunds.

The Supreme Court reversed and held that *Bacchus* applied retroactively. Without reaching the question whether *Bacchus* should be applied prospectively under the *Chevron* doctrine, the Court held that because *Bacchus* itself had been applied retroactively to the taxpayer in that case, the rule of *Bacchus* likewise had to be applied retroactively to all other taxpayers whose claims were not barred by the statute of limitations, res judicata, or other procedural requirements. Justice Souter declared in his opinion announcing the judgment of the Court that "it is simply in the nature of precedent, as a necessary component of any system that aspires to fairness and equality, that . . . the applicability of rules of law are not to be switched on and off according to individual hardship."[683] Hence, "[o]nce retroactive application is chosen for any assertedly new rule, it is chosen for all others who might seek its prospective application."[684] The Court thus rejected a rule of "selective prospectivity," whereby the new rule announced in the case is applied to the litigants, but the old rule is applied to all others whose cause of action arose with respect to facts predating the court's pronouncement.

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[678] James B. Beam Distilling Co. v. Georgia, 259 Ga. 363, 382 SE2d 95, 96 (1990).

[679] See supra ¶ 4.16[3] note 653.

[680] *James Beam*, 259 Ga. 363, 382 SE2d 95, 96 (1990).

[681] *James Beam*, 259 Ga. 363, 382 SE2d 95, 97 (1990).

[682] *James Beam*, 259 Ga. 363, 382 SE2d 95, 97 (1990).

[683] James B. Beam Distilling Co. v. Georgia, 501 US 529, 543, 111 S. Ct. 2439 (1991) (opinion of Souter, J.).

[684] *James Beam*, 501 US 529, 543, 111 S. Ct. 2439 (1991) (opinion of Souter, J.).

The relatively narrow and straightforward holding of *James Beam*—"when the Court has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata"[685]—cannot mask the deep divisions in the Court over the role of the prospectivity doctrine. There were five separate opinions in the case, and none reflected the views of more than three Justices.

Justice Souter's opinion that announced the judgment of the Court rejecting a doctrine of "selective prospectivity" was joined only by Justice Stevens. Justice White, writing only for himself, agreed with Justice Souter's analysis, except for the cloud he may have cast on *Chevron*. Justice White dissociated himself from Justice Souter's speculation about the "propriety of pure prospectivity," and made clear his view that "[t]he propriety of prospective application of decision in this Court, in both constitutional and statutory cases, is settled by our prior decisions."[686]

Justices Blackmun, Marshall, and Scalia, while agreeing with Justice Souter's conclusion, nevertheless did so on the ground that the Court's decisions must be applied retroactively in all cases. In two separate opinions, one by Justice Blackmun and the other by Justice Scalia, the three justices expressed the view that prospectivity, whether "pure" or "selective," "breaches our obligation to discharge our constitutional function"[687] and is "beyond our power."[688]

Justice O'Connor, joined by Chief Justice Rehnquist and Justice Kennedy, dissented from the Court's judgment. In their view, not only was prospective application of the Court's decisions appropriate as a matter of principle under the *Chevron* doctrine, it was also proper in *James Beam* itself. In their view, *Bacchus* announced a new principle of law by departing from the Court's earlier precedents sustaining discriminatory state liquor taxes over Commerce Clause objections on the ground that they were protected by the Twenty-First Amendment. Moreover, Justice O'Connor believed that the purpose of the new rule would not be served by retroactive application because, prior to *Bacchus*, discriminatory liquor taxation did not violate the Commerce Clause. She also believed that the equities weighed heavily against retroactive application because the parties expected to pay the tax at issue and the state could reasonably rely on the validity of the Court's earlier precedents.

There is much to be said for the view of Justices Blackmun, Marshall, and Scalia that the new rules should apply retroactively to all cases. Moreover,

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[685] *James Beam*, 501 US 529, 544, 111 S. Ct. 2439 (1991) (opinion of Souter, J.).

[686] *James Beam*, 501 US 529, 546, 111 S. Ct. 2439 (1991) (opinion of White, J.).

[687] *James Beam*, 501 US 529, 548, 111 S. Ct. 2439 (1991) (opinion of Blackmun, J.).

[686] *James Beam*, 501 US 529, 549, 111 S. Ct. 2439 (1991) (opinion of Scalia, J.).

as the Court has observed in other cases,[689] once a decision has been made, it would violate "the integrity of judicial review" to apply "principles determined to be wrong to litigants who are in or may still come to court."[690] In addition, as commentators have suggested, a per se retroactivity rule can be tempered by the ability of the courts to limit the remedies when new rules are commenced. Courts have discretion to determine "the appropriate remedial policy in a particular context" by weighing "the benefits and burdens of retroactive relief."[691]

In *Harper v. Virginia Department of Taxation*,[692] the Supreme Court applied the rule announced in *James Beam* to hold that its decision in *Davis v. Michigan Department of Treasury*,[693] must be applied retroactively. *Davis* held that Michigan violated principles of intergovernmental tax immunity by taxing the retirement benefits paid by the federal government while exempting retirement benefits paid by state and local governments. Although the Court's opinion in *Davis* did not clearly indicate whether the Court was applying the rule announced in the case retroactively,[694] the Court in *Harper* concluded that it had in fact applied the rule announced in *Davis* to the parties before the Court.[695] On this understanding of *Davis*, the conclusion that *Davis* must be applied retroactively inescapably followed from the Court's opinion in *James Beam*:

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[689] Griffith v. Kentucky, 479 US 314, 311–323, 107 S. Ct. 708 (1987).

[690] *James Beam*, 501 US 529, 547–548, 111 S. Ct. 2439 (1991) (opinion of Blackmun, J.).

[691] Note, "The Supreme Court—Leading Cases," 105 Harv. L. Rev. 177, 348 (1991); see also R. Fallon & D. Metzer, "New Law, Non-Retroactivity and Congressional Remedies," 104 Harv. L. Rev. 1731 (1991).

[692] Harper v. Virginia Dep't of Tax'n, 509 US 86, 113 S. Ct. 2510 (1993).

[693] Davis v. Michigan Dep't of Treasury, 489 US 803, 109 S. Ct. 1500 (1989), considered in ¶ 22.04[3].

[694] The cause of the uncertainty was Michigan's concession in *Davis* that the taxpayer was entitled to a refund if the taxpayer prevailed on the merits. *Davis*, 489 US 803, 817, 109 S. Ct. 1500 (1989). In light of this concession on the retroactivity issue, there was no reason for the Court to rule on it. Thus the Virginia Supreme Court in *Harper* concluded that the U.S. Supreme Court "made no . . . ruling" about the application of the rule announced in *Davis* "retroactively to the litigants in that case." Harper v. Virginia Dep't of Tax'n, 242 Va. 322, 410 SE2d 629, 631 (1992).

[695] The Court reasoned that its observation regarding Michigan's concession (see supra note 694)—"to the extent appellant has paid taxes pursuant to this invalid tax scheme, he is entitled to a refund," *Davis*, 489 US 803, 817, 109 S. Ct. 1500 (1989)—

> constituted a retroactive application of the rule announced in *Davis* to the parties before the Court. Because a decision to accord solely prospective effect to *Davis* would have foreclosed any discussion of remedial issues, our "consideration of remedial issues" meant "necessarily" that we retroactively applied the rule we announced in *Davis* to the litigants before us.

Harper, 509 US 86, 98, 113 S. Ct. 2510 (1993).

> *Beam* controls this case, and we accordingly adopt a rule that fairly reflects the position of a majority of Justices in *Beam*: When this Court applies a rule of federal law to the parties before it, that rule is the controlling interpretation of federal law and must be given full retroactive effect in all cases still open on direct review and as to all events, regardless of whether such events predate or postdate our announcement of the rule.[696]

Although the Court's division regarding the proper approach to the retroactivity issue that was evident in *Beam* was likewise evident in *Harper*,[697] there are some indications in the Court's opinion that it may be moving toward the adoption of the view that its decisions should apply retroactively in all instances. First, the Court declared that:

> [w]hen this Court does not "reserve the question whether its holding should be applied to the parties before it," . . . an opinion announcing a rule of federal law "is properly understood to have followed the normal rule of retroactive application" and must be "read to hold . . . that its rule should apply retroactively to the litigants before the Court."[698]

Accordingly, unless the Court explicitly reserves the question of retroactivity in the case under consideration, under the rule barring "selective prospectivity" the decision will be retroactive as to all affected taxpayers.[699]

Second, while the Court left open the theoretical possibility that a rule could be applied prospectively—assuming that the rule was so applied to the parties before it, the Court's heavy reliance on *Griffith v. Kentucky*,[700] holding that the Court's decisions in criminal cases must all be applied retroactively,

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[696] *Harper*, 509 US 86, 97, 113 S. Ct. 2510 (1993).

[697] Justice Thomas wrote the Court's opinion in which four other Justices (Blackmun, Stevens, Scalia, and Souter) joined; Justice Scalia wrote a separate concurring opinion reiterating his view that the Court's decisions should be retroactively applied in all instances; Justice Kennedy wrote a concurring opinion, which now-retired Justice White joined, reiterating his view that the *Chevron* doctrine should continue to govern questions of retroactivity, but that, under that doctrine, *Davis* should be retroactive because it did not announce a new principle of law; Justice O'Connor wrote a dissenting opinion, joined by Chief Justice Rehnquist, reiterating her view that the *Chevron* doctrine should continue to govern questions of retroactivity, and that, under the *Chevron* doctrine, *Davis* should be applied prospectively.

[698] *Harper*, 509 US 86, 97–98, 113 S. Ct. 2510 (1993) (quoting James B. Beam Distilling Co. v. Georgia, 501 US 529, 539, 111 S. Ct. 2439 (1991)).

[699] The Court's approach effectively compels any taxpayer or taxing authority that seeks a prospective application of an adverse Court decision to raise the prospectivity issue with the Court in the hope that the Court will rule on or reserve the issue. Otherwise, as the Court indicates, the decision will be deemed to have been applied to the parties and thus to all affected taxpayers and taxing authorities.

[700] Griffith v. Kentucky, 479 US 314, 107 S. Ct. 708 (1987).

suggests that it may believe the rule of *Griffith* should be applicable to civil as well as criminal cases. As Justice O'Connor observed in her dissenting opinion, "[r]ather than limiting its pronouncements to the question of selective prospectivity, the Court intimates that pure prospectivity may be prohibited as well,"[701] citing the Court's references to its "lack of constitutional authority . . . to disregard current law"[702] and the "fundamental rule of 'retrospective operation' of judicial decisions."[703]

While holding that *Davis* must be applied retroactively, the Court reiterated its view that a state retains "flexibility"[704] regarding the appropriate remedy a state must afford a taxpayer once it has been determined that a state has imposed an unconstitutionally discriminatory tax. If the state "offers a meaningful opportunity for taxpayers to withhold contested tax assessments and to challenge their validity in a predeprivation hearing," the "availability of a predeprivation hearing constitutes a procedural safeguard . . . sufficient by itself to satisfy the Due Process Clause."[705] On the other hand, if no such predeprivation remedy exists, then the Due Process Clause obligates the state "to provide meaningful backward-looking relief to rectify any unconstitutional violation."[706] Such relief, as the Court had indicated in *McKesson*, may consist either of an award of full refunds or some other order that "create[s] in hindsight a nondiscriminatory scheme,"[707] such as retroactively taxing those who had previously benefited from the tax exemption.

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[701] *Harper*, 509 US 86, 115, 113 S. Ct. 2510 (1993) (O'Connor J., dissenting).

[702] *Harper*, 509 US 86, 115, 113 S. Ct. 2510 (1993) (O'Connor J., dissenting).

[703] *Harper*, 509 US 86, 115, 113 S. Ct. 2510 (1993) (O'Connor J., dissenting).

[704] *Harper*, 509 US 86, 100, 113 S. Ct. 2510 (1993).

[705] *Harper*, 509 US 86, 101, 113 S. Ct. 2510 (1993) (quoting McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, 496 US 18, 38 n.21, 110 S. Ct. 2238 (1990), discussed supra ¶ 4.16[1]). The predeprivation relief that is sufficient to satisfy the demands of due process presumably embraces the ability to litigate the merits of the case until a final judgment is rendered by the state supreme court. If the mere provision of a predeprivation administrative hearing were sufficient to satisfy due process, then taxpayers could be deprived of "meaningful backward-looking relief" by being forced to pay over taxes after an administrative determination but long before a final adjudication on the merits of their claim.

[706] *Harper*, 509 US 86, 101, 113 S. Ct. 2510 (1993) (quoting *McKesson*, 496 US 18, 31, 110 S. Ct. 2238 (1990)).

[707] *Harper*, 509 US 86, 101, 113 S. Ct. 2510 (1993) (quoting *McKesson*, 496 US 18, 40, 110 S. Ct. 2238 (1990)). For a detailed analysis of *Harper* and its implications, see E. Rakowski, "*Harper* and Its Aftermath," 1 Fla. Tax Rev. 445 (1993).

[a] An End to the Prospectivity Doctrine in State Tax Cases?

In *Fulton Corp. v. Faulkner*,[708] the Court struck down a North Carolina intangible property tax, as applied to corporate stock, on the ground that the tax discriminated against interstate commerce because it varied inversely with the North Carolina presence of the corporation whose stock was subject to tax.[709] In so holding, the Court overruled *Darnell v. Indiana*,[710] which had sustained a similar statute over Commerce Clause objections. In the proceedings below, the North Carolina Court of Appeals, although finding the tax discriminatory, had held that its ruling should apply only prospectively, because to apply the rule retroactively would be "inequitable."[711] It observed that "[b]oth the United States Supreme Court and the North Carolina Supreme Court 'have recognized that in some cases it would be inequitable to apply newly announced rules retroactively if prior to the enunciation of the rules parties had reasonably relied on certain principles in ordering their affairs.'"[712] The North Carolina Supreme Court did not reach the question of prospectivity, since it sustained the tax.

In light of the fact that the U.S. Supreme Court in *Fulton* overruled *Darnell* for Commerce Clause purposes, *Fulton* would appear to have been a case in which there was at least some room for argument that prospective application of the decision is appropriate, if, in fact, there is anything left to the prospectivity doctrine in civil cases. The Court's treatment—or, more accurately, nontreatment—of the prospectivity issue in *Fulton*, however, raises additional questions (beyond those suggested in *James Beam* and *Harper*) as to whether the Court's decisions may *ever* be applied prospectively.

Without even adverting to the possibility that the decision in *Fulton* might be applied prospectively (as the North Carolina Court of Appeals had held), and thus remanding to the state court to consider the prospectivity question along with others that might arise should the lower courts determine that prospective application was inappropriate, the Court remanded solely to consider questions of *remedy* under *McKesson*. The Court in *Fulton* adverted to the remedial alternatives set forth in *McKesson*[713] (as well as to some related state law issues) in remanding to the state courts to consider these matters "in the

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[708] Fulton Corp. v. Faulkner, 516 US 325, 116 S. Ct. 848 (1996).

[709] The substantive issues raised by the Fulton case are considered supra ¶ 4.13[2][c][ii].

[710] Darnell v. Indiana, 226 US 390, 33 S. Ct. 120 (1912).

[711] Fulton Corp. v. Justus, 110 NC App. 493, 430 SE2d 494, 501 (1993).

[712] *Fulton*, 110 NC App. 493, 430 SE2d 494, 501 (1993).

[713] In *McKesson*, the Court observed that, in fulfilling its mandate to provide a taxpayer with "meaningful backward-looking relief" from a discriminatory state tax, a state may provide a refund; it may, consistent with other constitutional provisions, retroactively impose equal burdens on the those who had received favored treatment under the levy; and it may combine these two approaches.

first instance."[714] But in so doing, the Court necessarily pretermitted any consideration of prospectivity, because issues of remedy simply do not arise if the rule of law announced in the case is to be applied on a prospective basis only. In short, the Court, without saying so explicitly, may well have put the final nail in the coffin of the civil prospectivity doctrine by refusing even to entertain the notion that the prospectivity issue was an appropriate matter to be addressed on remand. Indeed, in other cases (not involving state taxation), the Court has cast further doubt about the viability of the civil prospectivity doctrine articulated in *Chevron*.[715]

[5] Right of a Taxpayer to Rely on an Apparently Available Statutory Refund Remedy

In *Reich v. Collins*,[716] the taxpayer, a federal military retiree, sued Georgia for refunds based on Georgia's failure to exempt the retirement income of former federal employees as it had exempted the retirement income of former state employees. Georgia's refund statute provided that "[a] taxpayer shall be refunded any and all taxes or fees which are determined to have been errone-

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[714] *Fulton*, 516 US 325, 116 S. Ct. 848, 347 (1996).

[715] See Ryder v. United States, 515 US 177, 184–185, 115 S. Ct. 2031 (1995) ("But whatever the continuing validity of *Chevron Oil* after *Harper v. Virginia Dept. of Taxation*, 509 U.S. 86 (1993) and *Reynoldsville Casket Co. v. Hyde*, 514 U.S. 749 (1995), there is not the sort of grave disruption or inequity involved in awarding retrospective relief to this petitioner that would bring that doctrine into play"); Landgraf v. USI Film Prods., 511 US 244, 279, 114 S. Ct. 1483 (1994) ("While it was accurate in 1974 to say that a new rule announced in a judicial decision was only presumptively applicable to pending cases, we have since established a firm rule of retroactivity. See *Harper v. Virginia Dept. of Taxation*, 509 US 86 (1993); *Griffith v. Kentucky*, 479 U.S. 314 (1987)." In *Reynoldsville Casket*, the Court held that the Supreme Court of Ohio erred in not giving the Court's decision in Bendix Autolite Corp. v. Midwesco Enters., Inc., 486 US 888, 108 S. Ct. 2218 (1995), retroactive effect. *Bendix* established that a statute tolling the statute of limitations in lawsuits against out-of-state defendants placed an unconstitutional burden on interstate commerce. In *Reynoldsville Casket*, the Court ruled that the plaintiff's lawsuit had to be dismissed, since it was timely only if the tolling statute (analogous to the tolling statute invalidated in *Bendix*) applied. The Court rejected the plaintiff's argument, based on the theory that the *Chevron* doctrine was a remedial doctrine rather than a choice-of-law doctrine and that the Court should allow the Supreme Court of Ohio to fashion a remedy limiting *Bendix* in light of the plaintiff's reliance on the tolling statute, even if the "law" as articulated in *Bendix* applied retroactively. Justices Kennedy and O'Connor, concurring in the judgment, observed: "When a hard case presents the question of our authority to deny relief in a retroactivity case, that will be soon enough to resolve it; for the law in this area is, as it ought to be, shaped by the urgent necessities we confront when there is a strong case to be made for limiting relief despite the retroactive application of the law." *Reynoldsville Casket*, 514 US 749, 762 (1995).

[716] Reich v. Collins, 513 US 106, 115 S. Ct. 547 (1994).

ously or illegally assessed and collected from him under the laws of this state, whether paid voluntarily or involuntarily."[717] Moreover, there was no question that the rule of law on which the taxpayer relied—the rule announced in *Davis*[718]—was to be given retroactive effect under *Harper*.[719] Nevertheless, when the taxpayer sought to enforce its right to a refund in the Georgia courts, the Georgia Supreme Court held that the taxpayer had no right to a refund under the Georgia statute and had no right to a refund under *McKesson* on the ground that Georgia allegedly provided meaningful predeprivation remedies in the form of a declaratory judgment action, injunctive remedies, and administrative predeprivation relief.[720]

A unanimous U.S. Supreme Court held that Georgia's attempt to deny taxpayers the right to a refund based on the existence of a predeprivation remedy when it held out to taxpayers the right to a postdeprivation remedy on which they could reasonably rely was unconstitutional. The Court recognized that "Georgia has the flexibility to maintain an exclusively predeprivation scheme, so long as the scheme is 'clear and certain.'"[721] "But what a State may *not* do," the Court continued,

> and what Georgia did here, is to reconfigure its scheme, unfairly, in *midcourse*—to "bait and switch," as some have described it. Specifically, in the mid-1980's, Georgia held out what plainly appeared to be a "clear and certain" postdeprivation remedy, in the form of its tax refund statute, and then declared, only after Reich and others had paid the disputed taxes, that no such remedy exists. In this regard, the Georgia Supreme Court's reliance on Georgia's predeprivation procedures was entirely beside the point (and thus error), because even assuming the constitutional adequacy of these procedures—an issue on which we express no view—no reasonable taxpayer would have thought that they represented, in light of the apparent applicability of the refund statute, the *exclusive* remedy for unlawful taxes.[722]

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[717] *Reich*, 513 US 106, 109, 115 S. Ct. 547 (1994) (quoting Ga. Code Ann. § 48-2-35(a)).

[718] See supra ¶ 4.16[4].

[719] See supra ¶ 4.16[4].

[720] Reich v. Collins, 263 Ga. 602, 437 SE2d 320 (1993).

[721] Reich v. Collins, 513 US 106, 110–111, 115 S. Ct. 547 (1994).

[722] *Reich*, 513 US 106, 111, 115 S. Ct. 547 (1994) (emphasis in original). See also Newsweek, Inc. v. Florida Dep't of Revenue, ___ US ___, 118 S. Ct. 904 (1998) (per curiam) (summarily vacating Florida decision in which state court had denied tax refund relief using same "bait and switch" approach previously condemned in *Reich*).

[6] Severability Issues

If a tax has been struck down as unconstitutionally discriminatory under the Commerce Clause, the question arises whether the appropriate remedy is to provide all taxpayers with the favored treatment provided to in-staters or to treat in-staters in the same manner as out-of-staters. As the foregoing discussion makes clear, states do enjoy the flexibility as a matter of federal constitutional law to adopt either approach, subject to federal and state constitutional restraints on retroactive lawmaking[723] and subject to the states' ability to provide equal treatment in fact on a retroactive basis.[724] On a prospective basis, of course, the states may freely choose either alternative, because they are not subject to any obligation to provide "meaningful backward-looking relief."

Insofar as the states do enjoy the ability as a matter of federal constitutional law either to extend the favored tax treatment to all potential taxpayers or to remove it altogether, the question of which approach is proper—at least from a judicial standpoint—becomes a state law question of severability. This, in turn, is largely a question of perceived legislative intent: What would the legislature have done had it known that it could not constitutionally provide the beneficial tax treatment only to the favored class—provide it to all or provide it to none?[725]

In *Westinghouse Electric Corp. v. Tully*,[726] for example, the U.S. Supreme Court invalidated New York's credit for DISC income because it was limited to income from export shipments from New York. On remand from the U.S. Supreme Court, the New York Court of Appeals held that the appropriate remedy was to extend the tax credit to income generated by DISC shipments regardless of the state from which the exports were shipped.[727] In so holding, it

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[723] In other words, even if a state sought to tax the previously favored class of taxpayers in the same manner as the previously disfavored class of taxpayers had been taxed in the past, it might not have the authority to impose such taxes retroactively.

[724] Even if a state seeks to satisfy its Commerce Clause obligations by "back taxing" the previously favored class of potential taxpayers, it may not be able to provide such equality, if, for example, it cannot, as a practical matter, effectively identify and tax such potential taxpayers, or if the statute of limitations precludes imposition of tax liability for those years.

[725] In Florida, there is a statutory presumption that when any sales or use tax exemption is declared unconstitutional, the exempted sale or use should be subjected to tax to the same extent as if the exemption had never been enacted. Fla. Stat. Ann. § 212.21(2) (Morrision 1990). See Department of Revenue v. Magazine Publishers of Am., Inc., 604 So. 2d 459 (Fla. 1997) (although exemption from use tax granted to religious publications violated First Amendment, exemption was severable and taxpayer was responsible for tax on real estate advertising publications).

[726] Westinghouse Elec. Corp. v. Tully, 466 US 388, 104 S. Ct. 1856 (1984), discussed supra ¶ 4.13[2][b][iii].

[727] Westinghouse Elec. Corp. v. Tully, 63 NY2d 191, 470 NE2d 853, 481 NYS2d 55 (1984).

rejected two more extreme alternative solutions suggested by the parties: (1) invalidating the entire legislative scheme for taxing DISC income and (2) eliminating any credit whatsoever for DISC-related income. The court felt only the first of these alternatives furthered the dual legislative purposes of the law:

> The effect is to extend the DISC tax credit to all the DISC accumulated income allocated to New York under the parent corporation's business allocation percentage. The statute, as so interpreted, promotes the Legislature's intent to provide a strong incentive for the continuation and expansion of export-related business in New York by lowering the effective tax rate of any business that owns a DISC and it also advances the Legislature's purpose of minimizing losses because even with an extension of the credit the law will continue to produce substantial tax revenues.[728]

In a similar Maryland case, the court invalidated an income tax exemption for DISC dividends if at least 50 percent of the DISC's taxable income was subject to tax in Maryland.[729] Like the New York Court of Appeals, the court extended rather than denied the favored treatment to all DISCs, thus providing an exemption for all DISC dividends.[730]

The severability issue sometimes has constitutional overtones, even when there is no question of "meaningful backward-looking relief." For example, in *Associated Industries of Missouri v. Lohman*,[731] the Court found that Missouri's 1.5 percent statewide use (designed to complement local option sales taxes) was unconstitutional insofar as localities either did not impose such taxes or imposed them at lower rates than the statewide tax. Although finding the tax unconstitutionally discriminatory, the Court rejected the taxpayers' claim that Missouri's 1.5 percent use tax should be struck down in its entirety rather than only in those counties where the use tax exceeded the local sales tax. The taxpayers contended that, in the absence of a statewide sales tax equal to the statewide use tax, or of legislation ensuring that local sales taxes never exceed the statewide use tax, there is always the potential for discrimination against interstate commerce. The Court refused to award the taxpayers a windfall based on this "hypothetical possibility of favoritism."[732] Rather, the Court stressed that Commerce Clause analysis is rooted in the "effect" of a tax, that "equality for the purposes of . . . the flow of commerce is measured in dollars and cents, not legal abstractions," and that "[d]iscrimination, like interstate

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[728] *Westinghouse*, 63 NY2d 191, 470 NE2d 853, 481 NYS2d 55, 59 (1984).

[729] Comptroller of the Treasury v. Armco, Inc., 70 Md. App. 403, 521 A2d 785 (Ct. Spec. App. 1987).

[730] *Armco*, 70 Md. App. 403, 521 A2d 785, 791–792 (Ct. Spec. App. 1987).

[731] Associated Indus. of Mo. v. Lohman, 511 US 641, 114 S. Ct. 1815 (1994). The *Associated Industries* case is discussed supra ¶ 4.13[2][c][ii].

[732] *Associated Indus.*, 511 US 641, 654, 114 S. Ct. 1815 (1994).

commerce itself, is a practical conception."[733] Consequently, the tax impermissibly discriminated only in those localities where the local sales tax was less than 1.5 percent.

¶ 4.17 SEVERANCE AND OTHER TAXES ON NATURAL RESOURCES SOLD LARGELY OUT-OF-STATE

Severance taxes on natural resources, such as coal, oil, and minerals, as well as timber, have a long history in state taxation.[734] Severance taxes typically are selective excises on the severance, extraction, or production of a natural resource in the state that are measured by the value or quantity of the resource severed, extracted, or produced. Because the resources are often destined for out-of-state consumption, taxpayers have challenged them under the Commerce Clause on the theory that the resource-rich states are unconstitutionally "exporting" their tax burden to other states.[735]

[1] The Traditional Analytical Framework

The controversy over the Commerce Clause restraints on state taxation of natural resources destined for other states is a venerable one. The traditional Commerce Clause doctrine applicable to such levies was established in the 1920s by three decisions of the U.S. Supreme Court. The first and, in many respects, most significant of these decisions was *Heisler v. Thomas Colliery Co.*[736] The case involved a Pennsylvania tax of 1.5 percent of the value of "each and every ton of anthracite coal . . . mined, washed, screened, or otherwise prepared for market" in the state.[737] The plaintiff, a stockholder in the Thomas Colliery Company, sought to enjoin the state from enforcing and the company from complying with the tax. His efforts were reinforced by nine northeastern states

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[733] *Associated Indus.*, 511 US 641, 654, 114 S. Ct. 1815 (1994).

[734] See W. Hellerstein, State and Local Taxation of Natural Resources in the Federal System ch. 1 (1986).

[735] See generally W. Hellerstein, "Constitutional Limitations on State Tax Exportation," 1982 Am. B. Found. Res. J. 1; W. Hellerstein, "Constitutional Constraints on State and Local Taxation of Energy Resources," 31 Nat'l Tax J. 245 (1978). The ensuing discussion draws freely from these sources.

[736] Heisler v. Thomas Colliery Co., 260 US 245, 43 S. Ct. 83 (1922).

[737] 1921 Pa. Laws, No. 225, at 479.

that appeared in the Supreme Court as amici curiae to challenge the validity of the levy.[738]

In addressing the Commerce Clause challenge,[739] the Court turned to the plea of the nine northeastern states that the levy discriminated against interstate commerce because, in design and effect, the exaction fell on a commodity destined for out-of-state consumption, with the ultimate tax burden being borne by residents of other states. The states asserted that it was immaterial whether the coal had actually begun to move in interstate commerce, since the Commerce Clause would forbid any tax that discriminated against outward-moving commerce regardless of the taxable moment formally designated by the state taxing statute.[740] Thus the states argued:

> Pennsylvania has a natural monopoly of anthracite coal in this country. That coal is a prime necessity of life, especially in the northeastern States. Eight percent of such coal is shipped out of Pennsylvania. . . .
>
> The declared intention at the time this act was passed was so to use the natural monopoly which Pennsylvania possesses as to compel the inhabitants of other States to pay a tax to Pennsylvania by collecting a special tax from the colliery which would inevitably pass such tax on to the consumer.
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> * * *
>
> As this coal has already borne its full share of ordinary, non-discriminatory property taxes . . . , to sustain this additional and discriminatory tax imposed upon anthracite coal alone would permit the holder of a natural monopoly to use the channels of interstate commerce to tax persons in other States to the extent of about $6,000,000 a year. . . .
>
> The question at issue extends far beyond the validity or invalidity of the particular tax in question. It will establish a far reaching principle for good or ill. If the tax be upheld, it is inevitable that every State which possesses natural resources essential to other States will impose similar taxes in order to make those whom it cannot directly and constitutionally tax contribute to its exchequer through the channels of commerce. . . . Such a situation would bring back the commercial conflicts between the States which the commerce clause was enacted to prevent. A result so absolutely repugnant to both the letter and the purpose of the commerce clause ought not to be permitted.[741]

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[738] The states of Connecticut, Delaware, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont.

[739] The Court first disposed of an equal protection challenge to the tax, holding that the state had a rational basis for imposing a tax on anthracite but not bituminous coal, given the differences in the physical property of the coal and in their uses as fuel. See ¶¶ 3.02, 3.03.

[740] *Heisler*, 260 US 245, 249–252, 43 S. Ct. 83 (1922).

[741] *Heisler*, 260 US 245, 251–253, 43 S. Ct. 83 (1922).

The Supreme Court's unequivocal rejoinder must be viewed in light of the then-prevailing doctrine that interstate commerce enjoyed an absolute immunity from state taxation while local activities enjoyed a corresponding immunity from Commerce Clause scrutiny:[742]

> The reach and consequences of the contention repel its acceptance. If the possibility, or, indeed, certainty of exportation of a product or article from a State determines it to be in interstate commerce before the commencement of its movement from the State, it would seem to follow that it is such commerce from the instant of its growth or production, and in the case of coals, as they lie in the ground. The result would be curious. It would nationalize all industries, it would nationalize and withdraw from state jurisdiction and deliver to federal commercial control the fruits of California and the South, the wheat of the West and its meats, the cotton of the South, the shoes of Massachusetts and the woolen industries of other States, at the very inception of their production or growth, that is, the fruits unpicked, the cotton and wheat ungathered, hides and flesh of cattle yet "on the hoof," wool yet unshorn and coal yet unmined, because they are in varying percentages destined for and surely to be exported to states other than those of their production.[743]

The Court concluded that the coal Pennsylvania sought to tax was "too definitely situated to be misunderstood"[744] and that no claim predicated on the Commerce Clause could properly be made, since the coal had not yet entered the stream of commerce.

The Court's disposition of the Commerce Clause objections raised in *Heisler* may, in retrospect, seem highly formalistic and essentially unresponsive to the underlying claim of unconstitutional state tax exportation. *Heisler* and its progeny,[745] nevertheless established the fundamental principles that laid the cornerstone for Commerce Clause adjudication of state severance taxes for the next half century: the imposition of a facially nondiscriminatory[746] excise tax upon the severance or production of natural resources in the state fell outside the pale of Commerce Clause protection, even though a substantial

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[742] See supra ¶¶ 4.01–4.04.

[743] *Heisler*, 260 US 245, 259–260, 43 S. Ct. 83 (1922).

[744] *Heisler*, 260 US 245, 261, 43 S. Ct. 83 (1922).

[745] Hope Natural Gas Co. v. Hall, 274 US 284, 47 S. Ct. 639 (1927) (sustaining West Virginia business and occupation tax on production of natural gas); Oliver Iron Mining Co. v. Lord, 262 US 172, 43 S. Ct. 526 (1923) (sustaining Minnesota occupation tax on the production of iron ore).

[746] Presumably the Court would have invalidated a severance tax that explicitly discriminated against interstate commerce, e.g., one that by its terms was imposed only on resources to be shipped outside the state, regardless of whether the resources had entered the stream of commerce. Cf. Welton v. Missouri, 91 US (1 Otto) 275 (1876), discussed supra ¶ 4.13[2][a][ii].

portion of the resources would be shipped and consumed beyond the state's borders and notwithstanding the allegation that the tax could thereby be freely exported along with the resource. The rationale for this position was that the activities taxed occurred prior to the commencement of interstate commerce and objections based on later events were immaterial.

[2] Contemporary Commerce Clause Analysis of Challenges to State Severance Taxes Imposed on Resources Exported From the Taxing State

More than fifty years after the Court's severance tax decisions of the 1920s, a group of Montana coal producers and eleven of their out-of-state utility customers, which were major consumers of Montana coal, mounted a Commerce Clause attack on Montana's 30 percent severance tax on the value of coal mined in the state.[747] At the time, Montana imposed the highest severance tax rate on coal in the country. Its coal was important to the rest of the nation, with the state having 25 percent of all known U.S. coal reserves and 50 percent of the nation's low-sulphur coal reserves.[748] Ninety percent of the coal mined in Montana was shipped to other states.[749]

[a] The Disapproval of *Heisler* and Its Progeny

At the outset, the Court was confronted by its decision in the *Heisler* and related precedents holding that "a state severance tax is . . . immunized from Commerce Clause scrutiny . . , [if] it is imposed on goods prior to their entry into the stream of interstate commerce."[750] The Court repudiated this rationale of the earlier cases and held instead that the validity of the Montana tax should be determined under the four-prong test enunciated in *Complete Auto*:[751] "Under that test, a state tax does not offend the Commerce Clause if it 'is applied to an activity with a substantial nexus with the taxing State, is fairly ap-

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[747] Commonwealth Edison Co. v. Montana, 453 US 609, 101 S. Ct. 2946 (1981). The reader should note that Walter Hellerstein was counsel to the state of Montana in the *Commonwealth Edison* case.

[748] *Commonwealth Edison*, 453 US 609, 638, 101 S. Ct. 2946 (1981) (Blackmun, J., dissenting).

[749] *Commonwealth Edison*, 453 US 609, 639, 101 S. Ct. 2946 (1981).

[750] *Commonwealth Edison*, 453 US 609, 617, 101 S. Ct. 2946 (1981). See supra ¶ 4.17[1] for a discussion of these cases.

[751] Complete Auto Transit, Inc. v. Brady, 430 US 274, 97 S. Ct. 1076 (1977).

portioned, does not discriminate against interstate commerce, and is fairly related to services provided by the State.'"[752]

The plaintiffs conceded that Montana's severance tax satisfied two of these four tests, since there was a substantial nexus of the activities taxed with the state, and there was no risk of multiple taxation, since the subject of the tax was coal mining and no other state can tax the mining of coal in Montana. The plaintiffs contended that the tax was vulnerable under the other two tests, in that it discriminated against interstate commerce and was not fairly related to the services provided the taxpayers by the state.

[b] Discrimination Against Interstate Commerce

The taxpayers' claim of discrimination did not fit neatly within the Court's proscription against discriminatory levies. Severance taxes generally are nondiscriminatory on their face, applying to every ton of coal or barrel of oil or 1,000 cubic feet of gas extracted in the state. No distinction is drawn in such taxing schemes between local and out-of-state interests. Montana's severance tax was no exception.

The claim that Montana's severance tax discriminated against interstate commerce was predicated on two interrelated propositions. First, the taxpayer contended that the burden of the tax was in fact borne largely by out-of-state consumers, a fact that depended on whether the tax was exported along with the resource.[753] Second, it was alleged that the amount of the tax exceeded the costs imposed on and the benefits provided by the state in connection with the extraction of the resource. The second contention was a necessary element of the Commerce Clause argument because the states do not violate the Commerce Clause when they demand from those consuming their resources reimbursement for a fair share of such costs and benefits.[754]

The Court rejected the taxpayers' discrimination claim for several reasons. First, it was unwilling to accept the premise that the tax was necessarily ex-

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[752] *Commonwealth Edison*, 453 US 609, 617, 101 S. Ct. 2946 (1981) (quoting *Complete Auto*, 430 US 274, 279, 97 S. Ct. 1076 (1977)).

[753] That this proposition is not necessarily true is easily demonstrated by considering the likely result of a proposed severance tax on corn that was proposed by one Kansas legislator to "retaliate" for Montana's severance tax on coal. If corn is selling for $10 a bushel in Kansas (as well as in Nebraska and other states), and Kansas imposes a 30 percent severance tax on corn, it is unlikely that the price will rise to $13 a bushel, if it rises at all, due to the availability of $10 per bushel corn in other states.

[754] As the Court observed in *Commonwealth Edison*, "Since this Court has held that interstate commerce must bear its fair share of state tax burden, appellants cannot argue that *no* severance tax may be imposed on coal primarily destined for interstate commerce." *Commonwealth Edison*, 453 US 609, 620 n.9, 101 S. Ct. 2946 (1981) (emphasis in original) (citation omitted).

ported along with the resource:[755] "We share the *Heisler* Court's misgivings about judging the validity of a state tax by assessing the State's 'monopoly' position or its 'exportation' of the tax burden out of State."[756] Second, the Court disagreed with the taxpayers' assumption

> that the Commerce Clause gives residents of one State a right of access at "reasonable" prices to resources located in another State that is richly endowed with such resources, without regard to whether and on what terms residents of the resource-rich State have access to the resources. We are not convinced that the Commerce Clause, of its own force, gives the residents of one State the right to control in this fashion the terms of resources development and depletion in a sister State.[757]

Third, the Court recognized that the taxpayers' "discrimination theory ultimately collapses into the claim that the Montana tax is invalid under the fourth prong of the *Complete Auto Transit* test: that the tax is not 'fairly related to the services provided by the State.'"[758]

[c] The "Fairly Related to Services Provided by the State" Test

The plaintiffs in the Montana case relied heavily on the fourth prong of the test the Court articluated in *Complete Auto* for adjudicating the validity of state taxes under the Commerce Clause, namely, that the tax be "fairly related to services provided by the State."[759] This requirement was something new in Commerce Clause jurisprudence when it was enunciated by Justice Blackmun in 1977—at least insofar as it applied to general revenue measures as distinguished from user fees, which are imposed as a quid pro quo for specific state-provided benefits, such as the use of a highway maintained by state funds or the use of an airport maintained by municipal revenues. As the Court recognized, the rule does not require a general revenue tax to be "reasonably related to the value of the service provided to the activity."[760] To the contrary, the Court had taken the position that

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[755] See supra note 753.

[756] *Commonwealth Edison*, 453 US 609, 618, 101 S. Ct. 2946 (1981).

[757] *Commonwealth Edison*, 453 US 609, 619, 101 S. Ct. 2946 (1981).

[758] *Commonwealth Edison*, 453 US 609, 620, 101 S. Ct. 2946 (1981).

[759] Complete Auto Transit, Inc. v. Brady, 430 US 274, 279, 97 S. Ct. 1076 (1977).

[760] *Commonwealth Edison*, 453 US 609, 622–623, 101 S. Ct. 2946 (1981). The taxpayers in *Commonwealth Edison* cited Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines, Inc., 405 US 707, 92 S. Ct. 1349 (1972), in support of their argument that there must a "fair relationship" between the amount of the state's tax and the costs of services provided by the state. The Court dismissed the relevance of the case, since it dealt with a user charge for property owned by a political subdivision of the state rather than a levy imposed for the general support of government. As the Court stated:

> "[a] tax is not an assessment of benefits. It is, as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes."[761]

Although the Court had originally articulated the position in the context of the Due Process Clause, the Court extended the same fundamental principle to its Commerce Clause jurisprudence, observing that "[t]here is no reason to suppose that this latitude afforded the States under the Due Process Clause is

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The Montana Supreme Court held that the coal severance tax is "imposed for the general support of the government."—Mont., at—615 P.2d at 856, and we have no reason to question this characterization of the Montana tax as a general revenue tax. Consequently, in reviewing appellant's contentions, we put to one side those cases in which the Court reviewed challenges to "user" fees or "taxes" that were designed and defended as a specific charge imposed by the State for the use of state-owned or state-provided transportation or other facilities and services. See, e.g., *Evansville-Vanderburgh Airport Authority Dist. v. Delta Airlines Inc.*, 405 U.S. 707 (1972); *Clark v. Paul Gray, Inc.*, 306 U.S. 583 (1939); *Ingels v. Morf*, 300 U.S. 290 (1937).

Commonwealth Edison, 453 US 609, 621–622, 101 S. Ct. 2946 (1981). In a footnote to the foregoing statement (*Commonwealth Edison*, 453 US 609, 622 n.12, 101 S. Ct. 2946 (1981)), the Court added:

> As the Court has stated, "such imposition, although termed a tax, cannot be tested by standards which generally determine the validity of taxes." *Interstate Transit, Inc. v. Lindsey*, 283 U.S. 183, 190 (1931). Because such charges are purportedly assessed to reimburse the State for costs incurred in providing specific quantifiable services, we have required a showing, based on factual evidence in the record, that "the fees charged do not appear to be manifestly disproportionate to the services rendered. . . ." *Clark v. Paul Gray, Inc.*, 306 U.S. 583, 599 (1939). *Ingels v. Morf*, 300 U.S. 290, 296–297 (1937). One commentator has stated that
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> > exactions imposed by State and local governments for the use of public facilities . . . have distinct peculiarities of their own. They partake rather of the nature of a rent charged by the State, based upon its proprietary interests in the public property, rather than of a tax, as that term is thought of in a technical sense. Thus such charges for the use of public facilities, although termed a tax, cannot safely be tested by standards which generally determine the validity of taxes.
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> P. Hartman, Federal Limitations on State and Local Taxation, 665–666 (1981).

See Northwest Airlines, Inc. v. County of Kent, 510 US 355 114 S. Ct. 855 (1994) (sustaining user charge over Commerce Clause objections); Alamo Rent-a-Car, Inc. v. Sarasota-Manatee Airport Auth., 906 F2d 516 (11th Cir. 1990), cert. denied, 498 US 1120, 111 S. Ct. 1073 (1991) (sustaining user charge over Commerce Clause objections); but see Reidy Terminal, Inc. v. Director of Revenue, 898 SW2d 540 (Mo. 1995) (Commerce Clause prohibits fee for insurance fund available to operators of underground petroleum storage tanks as applied to petroleum refueler who stored petroleum above ground because payor was ineligible to receive benefit from fund).

[761] *Commonwealth Edison*, 453 US 609, 623, 101 S. Ct. 2946 (1981) (quoting Carmichael v. Southern Coal & Coke Co., 301 US 495, 521–522, 57 S. Ct. 868 (1937)).

somehow divested by the Commerce Clause merely because the taxed activity has some connection to interstate commerce."[762]

The relevant inquiry under the "fairly related to services provided by the state" requirement was not, as claimed by the plaintiffs, a comparison of "the *amount* of the tax or the *value* of the benefits allegedly bestowed as measured by the costs the State incurs on account of the taxpayer's activities."[763] Rather "the test is . . . whether the *measure* of the tax [is] reasonably related to the extent of the contact, since it is the activities or presence of the taxpayer in the State that may properly be made to bear a 'just share of State tax burden.'"[764] Using that legal yardstick, the Court had little difficulty in finding that the Montana severance tax satisfied the test. Since the tax was measured by a percentage of the value of the coal taken, it was by its very nature in "proper proportion" to the taxpayer's activities in the state.[765]

Justice Blackmun, who wrote a dissenting opinion joined by Justices Powell and Stevens, recognized that, under his theory that the plaintiffs were entitled to an opportunity to prove that the amount of the tax was not quantitatively related to the value of the benefits provided by the state, a "trial of this case would require 'complex factual inquiries.'"[766] As a preliminary matter, the Court would have had to determine whether the Montana tax was exported to taxpayers in other states. This initial inquiry would have involved a considerable undertaking, since tax incidence is one of the most elusive matters in public finance.[767]

Under Justice Blackmun's approach, once it has been established that a tax is exported and that the state

> singles out this particular interstate activity and charges it with a grossly disproportionate share of the general costs of government, the court must determine whether there is some reasonable basis for the legislative judg-

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[762] *Commonwealth Edison*, 453 US 609, 623, 101 S. Ct. 2946 (1981).

[763] *Commonwealth Edison*, 453 US 609, 625, 101 S. Ct. 2946 (1981) (emphasis in original).

[764] *Commonwealth Edison*, 453 US 609, 626, 101 S. Ct. 2946 (1981) (emphasis in original) (quoting Western Live Stock v. Bureau of Revenue, 303 US 250, 254, 58 S. Ct. 546 (1938)).

[765] *Commonwealth Edison*, 453 US 609, 626, 101 S. Ct. 2946 (1981).

[766] *Commonwealth Edison*, 453 US 609, 651, 101 S. Ct. 2946 (1981) (Blackmun, J., dissenting).

[767] See, e.g., W. Hellerstein, "Constitutional Limitations on State Tax Exportation," 1982 Am. B. Found. Res. J. 27–42 (summarizing economic literature); Peter Mieszkowski, "Tax Incidence Theory," 7 J. Econ. Literature 1103 (1969); Charles E. McLure, Jr., "The Elusive Incidence of the Corporate Income Tax: The State Case," 9 Pub. Fin. Q. 395 (1981); Charles E. McLure, Jr., "The Interstate Exporting of State and Local Taxes: Estimates for 1962," 20 Nat'l Tax J. 49 (1967).

ment that the tax is necessary to compensate the State for the particular costs imposed by the activity.[768]

The Court took a more realistic position, saying:

> [I]t is doubtful whether any legal test could adequately reflect the numerous and competing economic, geographic, demographic, social, and political considerations that must inform a decision about an acceptable rate or level of state taxation, and yet be reasonably capable of application in a wide variety of individual cases.[769]

The Court put the case in the perspective of a proper division of powers between the legislature and the courts:

> The simple fact is that the appropriate level or rate of taxation is essentially a matter for legislative, and not judicial resolution. . . . In essence, appellants ask this Court to prescribe a test for the validity of state taxes that would require state and federal courts, as a matter of federal constitu-

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[768] Commonwealth Edison Co. v. Montana, 453 US 609, 652, 101 S. Ct. 2946 (1981) (Blackmun, J., dissenting).

[769] *Commonwealth Edison*, 453 US 609, 628, 101 S. Ct. 2946 (1981). Courts have generally rejected Justice Blackmun's position that out-of-state entities or residents have a right to resist a tax if they can show that they do not receive benefits that are quantitatively commensurate with their taxes. In American Commuters Ass'n v. Levitt, 279 F. Supp. 40 (SDNY 1967), aff'd, 405 F2d 1148 (2d Cir. 1969), out-of-state commuters to New York City attacked the constitutionality of the application to them of New York State's income tax on the theory that they were denied most of the public services and benefits granted to resident taxpayers, including schooling, welfare, Medicaid, and reduced-fee fishing licenses. They therefore contended that they should not be subjected to the same level of income taxation as were resident taxpayers. The district court rejected the premise underlying the argument, declaring:

> Plaintiffs, earning all or substantially all their income in New York, derive substantial benefits by reason of these earnings for which the State and City can properly ask a return. These benefits include a place to work, the commercial activity in the State and City, and general services such as transportation, fire and police protection. Clearly plaintiffs derive greater benefits than the visitor who does not work in or regularly commute to New York.
>
> Given the power to tax, the challenged statutes conferring benefits are not unconstitutional even if, as plaintiffs allege, the benefits they receive are not equivalent to the taxes they pay. As the court stated in *Morton Salt Co. v. City of South Hutchinson*, 177 F.2d 889, 892 (10th Cir. 1949):

"When, . . . [a] tax is levied upon all the property for public use, such as schools, the support of the poor, for police and fire protection, for health and sanitation, for waterworks and the like, the tax need not, and in fact seldom does, bear a just relationship to the benefits received. Thus the property of a corporation may be taxed for the support of public schools, asylums, hospitals, and innumerable public purposes, although it is impossible for it to derive any benefits other than privileges which come from living in an organized community."

American Commuters Ass'n, 279 F. Supp. 40, 47 (SDNY 1967), aff'd, 405 F2d 1148 (2d Cir. 1969) (some citations omitted).

tional law, to calculate acceptable rates or levels of taxation of activities that are conceded to be legitimate subjects of taxation. This we decline to do.[770]

[d] Existing Differences in Tax Rates Applied to Various Businesses and Justification for Selective, High-Rate Taxes on Industries That Exploit State's Natural Resources

There is one other line of authority that might be regarded as relevant to the plaintiffs' broad discrimination contention in *Commonwealth Edison.* There are regulatory, as distinguished from tax, cases that recognize the power of the state to regulate the out-of-state shipment of natural resources or other products, provided it is done "evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental."[771] If such cases should be regarded as having any bearing on state taxes, "even-handed" taxation of a state's natural resources (or other products) ought not be equated with substantial identity or equality of taxation of industry generally. For the tax structures of many states are, and long have been, characterized by diversity of rates and methods of taxation of different businesses, trades, and occupations. The southern states, for example, have historically imposed license and occupation taxes at rates that vary markedly among various types of businesses, and that is still true today. Moreover, it is common for the states to tax utilities, banks, and insurance companies differently from businesses generally. Furthermore, a number of states tax various segments of the same industry—manufacturers, wholesalers, and retailers—at differing rates or bases. All this adds up to the proposition that, since diversity in tax rates, bases, and burdens among businesses and industries is established and accepted fiscal policy, the imposition of a higher tax on a natural resource industry than on other industries does not in itself establish that the state is being less than "even-handed."[772]

Furthermore, the states can make out a persuasive case for levying higher taxes on coal, oil, and other natural resources than on other subjects, on the ground that the exploitation of natural resources entails costs and losses to the states and benefits to the industry that far exceed those involved in typical in-

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[770] *Commonwealth Edison,* 453 US 609, 627–628, 101 S. Ct. 2946 (1981).

[771] See Hughes v. Oklahoma, 441 US 322, 331, 99 S. Ct. 1727 (1979); Pike v. Bruce Church, Inc., 397 US 137, 142, 90 S. Ct. 844 (1970).

[772] Cf. Amerada Hess Corp. v. Director, Div. of Tax'n, 490 US 66, 109 S. Ct. 1617 (1989) (states are free to impose differential taxes on industries engaged in interstate commerce as long as they do not distinguish between industries *because* they engage (or do not engage) in interstate commerce); Exxon Corp. v. Governor of Md., 437 US 117, 98 S. Ct. 2207 (1978) (same).

dustrial operations. Former Governor Arthur A. Link of North Dakota outlined some of the extraordinary costs to the state of coal mining in defending his state's coal severance tax—strip mining the land, removing fertile topsoil, consumption of vast amounts of scarce water, and interference with water aquifers.[773] Such evidence helps to justify selective excises on natural resource industries and insulate them from challenges on the ground that they are discriminatory or not even-handed by comparison with the state's taxes on non–natural resource industries.

Finally, in defending high, selective severance taxes on the extractive industries, the states have an additional argument: the extractive industries, unlike most other industries, deplete the natural resources of the state. Manufacturers create the goods they sell, farmers grow their crops, and even the timber industry (at least the large companies engaged in timbering) regrows the forests it cuts down. But mining companies and oil producers extract wealth from the earth that is irreplaceable. Those facts offer a strong justification for high, selective severance taxes on the natural resources. Governor Link may thus have been on sound constitutional ground in asserting that a state whose coal is exploited for the benefit of the rest of the nation is entitled to "just compensation for losing forever a one time harvest."[774]

[e] The "Emasculation" of the "Fairly Related to Services" Test: An Evaluation

In his dissenting opinion in *Commonwealth Edison*, Justice Blackmun complained that the Court's decision "emasculates the fourth prong" of the *Complete Auto* test (i.e., that a tax must be fairly related to services provided by the state) by holding that the test is satisfied as long as a subject of the tax (there the extraction of coal) is related to its measure (there a percentage of the value of the coal taken).[775] That complaint was justified since, as thus construed, the "fairly related" test adds nothing to the preexisting Commerce Clause restraints on state taxation. In the pre–*Complete Auto* cases, the Court had already stated that "the incidence of the tax *as well as its measure* [must be] tied to the earnings which the State . . . has made possible."[776] Moreover, the Court in its actual decisions has not implemented in any meaningful way

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[773] A. Link, "Political Constraints and North Dakota's Coal Severance Tax," in Symposium: Energy Taxation—Conflicting Federal, State and Local Interest, 31 Nat'l Tax J. 207, 263 (1978).

[774] Link, supra note 773, at 264.

[775] Commonwealth Edison Co. v. Montana, 453 US 609, 645, 101 S. Ct. 2946 (1981) (Blackmun, J., dissenting).

[776] Wisconsin v. JC Penney Co., 311 US 435, 444, 61 S. Ct. 246 (1946) (quoted in *Commonwealth Edison*, 453 US 609, 626, 101 S. Ct. 2946 (1981) (emphasis in original)).

its rhetoric as to the required relation between the measure of a state tax imposed on interstate business and the earnings, benefits, and protection provided by the state. Thus, the Court has observed that "a taxpayer's receipt of police and fire protection, the use of public roads and mass transit, and the other advantages of civilized society satisf[y] the requirement that the tax be fairly related to benefits provided by the State to the taxpayer."[777] In practice, courts have rarely struck down a tax for its failure to satisfy the requirement that there be "fair" relationship between the tax measure and the benefits or protection provided by the state, despite strong showings in some cases of overreaching or extraterritoriality measures.[778]

Nevertheless, in our view, the Court properly "emasculated" Justice Blackmun's attempt to graft onto its Commerce Clause jurisprudence the principle that a tax imposed on interstate commerce and exported to nonresident businesses or individuals will not survive scrutiny "unless there is some reasonable basis for the legislative judgment that the tax is necessary to compensate the State for the particular costs imposed by the activity."[779] To be sure, producers and consumers of goods and services in interstate commerce may have legitimate complaints against particular state tax measures that impose a disproportionate burden on nonvoting, nonresident entities or individuals. For example, if Montana had repealed all of its taxes except its coal severance tax and had relied on the revenues from that tax to fund all of its governmental services, there would be strong grounds for maintaining that it had violated the norms of interstate fiscal fair play.

However, the courts, in our view, have neither the constitutional power nor the institutional capacity to develop a proper accommodation of the competing interests in this domain. In the absence of a violation of one of the standard (and judicially manageable) criteria of Commerce Clause adjudication—substantial nexus, fair apportionment, and nondiscrimination—courts are not equipped to determine the appropriate portion of a state's tax burden that ought to be borne by any segment of the state's industry.[780] This is a matter that calls for a reconciliation of the competing interests by Congress, which,

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[777] DH Holmes Co. v. McNamara, 486 US 24, 32, 108 S. Ct. 1619 (1988); see also Goldberg v. Sweet, 488 US 252, 266–267, 109 S. Ct. 582 (1989).

[778] See, e.g., Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 US 175, 115 S. Ct. 1331 (1995); Trinova Corp. v. Michigan Dep't of Treasury, 498 US 358, 111 S. Ct. 818 (1991), discussed in ¶ 8.15[1]. This is not to suggest that these cases were necessarily wrongly decided, but rather only that the Court has never seriously attempted to implement the notion that a general revenue measure must be fairly related to benefits, protections, or services provided by the state.

[779] *Commonwealth Edison*, 453 US 609, 652, 101 S. Ct. 2946 (1981) (Blackmun, J., dissenting).

[780] See J. Hellerstein, "State Taxation Under the Commerce Clause: An Historical Perspective," 29 Vand. L. Rev. 335 (1976).

unlike the Supreme Court, has both the constitutional power and the institutional equipment to prescribe the permissible types, levels, and measures of taxation of various interstate industries and from time to time to adjust the solutions based on changing conditions.

Justice White put the entire matter in proper perspective in his concurring opinion in *Commonwealth Edison*, in which he wrote:

> Montana's levy on consumers in other States may in the long run prove to be an intolerable and unacceptable burden on commerce. Indeed, there is particular force in the argument that the tax is here and now unconstitutional. . . .
>
> But . . . Congress has the power to protect interstate commerce from intolerable or even undesirable burdens. It is also very much aware of the Nation's energy needs, of the Montana tax and of the trend in the energy-rich States to aggrandize their position and perhaps lessen the tax burdens on their own citizens by imposing unusually high taxes on mineral extraction. Yet, Congress is so far content to let the matter rest, and we are counseled by the Executive Branch through the Solicitor General not to overturn the Montana tax as inconsistent with either the Commerce Clause or federal statutory policy in the field of energy or otherwise. The constitutional authority and the machinery to thwart efforts such as those of Montana, if thought unacceptable, are available to Congress, and surely Montana and other similarly situated states do not have the political power to impose their will on the rest of the country. As I presently see it, therefore, the better part of both wisdom and valor is to respect the judgment of the other branches of the Government.[781]

¶ 4.18 COMMERCE CLAUSE AND STATE TAXATION OF INTOXICATING LIQUORS

The Twenty-First Amendment to the Constitution provides in part: "The transportation or importation into any state, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."[782] The Court has characterized its own decisions as making "clear in the early years following adoption of the Twenty-First Amendment that by virtue of its provisions a state is totally unconfined by traditional Commerce Clause limitations when it restricts the importation of

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[781] *Commonwealth Edison*, 453 US 609, 637–638, 101 S. Ct. 2946 (1981) (White, J., concurring).

[782] U.S. Const. amend. XXI.

intoxicants destined for use, distribution, or consumption within its borders."[783] Thus, in *State Board of Equalization v. Young's Market Co.*,[784] the Court sustained a license fee on the privilege of importing beer into California, even though such a fee would plainly have been unconstitutional under traditional Commerce Clause doctrine.[785]

In *Bacchus Imports, Ltd. v. Dias*,[786] however, the Court adopted a more limited view of the Twenty-First Amendment's impact on the Commerce Clause. Hawaii had imposed a 20 percent excise tax on sales of liquor at wholesale but had exempted from the tax okolehao (a brandy distilled from the root of an indigenous Hawaiian shrub) and fruit wine manufactured in the state. In defending the constitutionality of the exemption against the claim of wholesalers of other liquors that the exemption violated the Commerce Clause, Hawaii contended that the Twenty-First Amendment had removed any Commerce Clause barrier to discriminatory taxation of intoxicating liquor shipped into Hawaii from other states.

In rejecting this argument and invalidating the tax, the Court cited "the obscurity of the legislative history" of the governing provision of the Twenty-First Amendment as to its effects on the Commerce Clause.[787] Modifying its earlier sweeping interpretation of the amendment as freeing the states from Commerce Clause restrictions, the Court in *Bacchus* declared: "It is now clear that the Amendment did not entirely remove state regulation of alcoholic beverages from the ambit of the Commerce Clause. . . . [T]he mode of analysis to be employed [is] a 'pragmatic effort to harmonize state and federal powers.'"[788]

Approaching the case in this light, the Court said:

> Doubts about the scope of the Amendment's authorization notwithstanding, one thing is certain: The central purpose of the provision was not to empower States to favor local liquor industries by erecting barriers to competition. It is also beyond doubt that the Commerce Clause itself furthers strong federal interests in preventing economic Balkanization. State laws that constitute mere economic protectionism are therefore not entitled to the same deference as laws enacted to combat the perceived evils of an unrestricted traffic in liquor. Here, the State does not seek to justify its tax on the ground that it was designed to promote temperance or to carry out any other purpose of the Twenty-first Amendment, but instead

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[783] Hostetter v. Idlewild Bon Voyage Liquor Corp., 377 US 324, 330, 84 S. Ct. 1293 (1964).

[784] State Bd. of Equalization v. Young's Mkt. Co., 299 US 59, 57 S. Ct. 77 (1936).

[785] See supra ¶ 4.13.

[786] Bacchus Imports, Ltd. v. Dias, 468 US 263, 104 S. Ct. 3049 (1984).

[787] *Bacchus*, 468 US 263, 274, 104 S. Ct. 3049 (1984).

[788] *Bacchus*, 468 US 263, 275, 104 S. Ct. 3049 (1984).

> acknowledges that the purpose was "to promote a local industry." Consequently, because the tax violates a central tenet of the Commerce Clause but is not supported by any clear concern of the Twenty-First Amendment, we reject the State's belated claim based on the Amendment.[789]

Justice Stevens, joined by Justices Rehnquist and O'Connor, dissented from the Court's disposition of the Twenty-First Amendment issue in *Bacchus*.[790] The dissent invoked the Court's precedents and reaffirmed the earlier view that the broad language of the Twenty-First Amendment "confers power upon the states to regulate commerce in intoxicating liquors unconfined by ordinary limitations imposed on state regulation of interstate goods by the Commerce Clause and other constitutional provisions."[791]

The Court's ruling on the Twenty-First Amendment issue in *Bacchus* has led to Commerce Clause challenges to discriminatory state taxes and regulations that have traditionally escaped Commerce Clause scrutiny. Indeed, because the states have traditionally been permitted to tax alcoholic beverages on a discriminatory basis with impunity (at least from a Commerce Clause standpoint), there has long been a pattern across the country of state tax discrimination (including retaliatory taxation) of out-of-state liquor.[792] In post-*Bacchus* decisions, courts have invalidated discriminatory liquor taxation under the Commerce Clause.[793] In Georgia, however, the legislature appears to have circumvented the *Bacchus* case. After a Georgia trial court struck down the state's liquor excise tax that favored beverages produced with Georgia-grown products over beverages produced with out-of-state products,[794] the legislature amended the statute by imposing a tax on alcoholic beverages imported into

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[789] *Bacchus*, 468 US 263, 276, 104 S. Ct. 3049 (1984) (citations omitted).

[790] *Bacchus*, 468 US 263, 278–287, 104 S. Ct. 3049 (1984) (Stevens, J., dissenting).

[791] *Bacchus*, 468 US 263, 281, 104 S. Ct. 3049 (1984).

[792] Brief Amicus Curiae of Distilled Spirits Council of the United States, Inc., *Bacchus*, 468 US 263, 104 S. Ct. 3049 (1984).

[793] A federal district court struck down as unconstitutional a New York law that allowed food stores to sell wine with an alcoholic content of not more than 6 percent if, but only if, the wine was produced from grapes grown in New York. Loretto Winery, Ltd. v. Gazzara, 601 F. Supp. 850 (SDNY), aff'd on the basis of the opinion below, 761 F2d 140 (2d Cir. 1985). The Florida Supreme Court struck down the state's liquor excise tax that favored alcoholic beverages made from citrus fruits and other products grown in Florida. Division of Alcoholic Beverages & Tobacco v. McKesson Corp., 524 So. 2d 100 (Fla. 1988), rev'd on other grounds, 496 US 18, 110 S. Ct. 2238 (1990); see also Ivey v. Bacardi Imports Co., 541 So. 2d 1129 (Fla. 1989). The Minnesota Supreme Court struck down as unconstitutional the state's excise tax on wine that provided lower rates for wine grown from Minnesota grapes. Johnson Bros. Wholesale Liquor Co. v. Commissioner of Revenue, 402 NW2d 791 (Minn. 1987).

[794] James B. Beam Distilling Co. v. State, 259 Ga. 363, 382 SE2d 95 (1989), rev'd on other grounds, 501 US 529, 111 S. Ct. 2439 (1991).

the state.[795] A preamble to the legislation declared that one of its purposes was to provide for the increased costs of administering the tax on out-of-state spirits and wines.[796] This time, the Georgia Supreme Court yielded to the legislature and sustained the tax, on the ground that its "unchallenged purpose" was "defraying the increased costs of regulating importation into this state of intoxicating liquors."[797] The Supreme Court dismissed a taxpayer's appeal from the decision.[798] Notwithstanding the Supreme Court's failure to review the case, one remains skeptical, for the statute and its history bear all the earmarks of having been enacted to favor Georgia-produced wines and liquors over those produced in other states.

C. STATE TAXATION OF FOREIGN COMMERCE

¶ 4.19 COMMERCE CLAUSE RESTRAINTS ON STATE TAXATION OF FOREIGN COMMERCE

In *Japan Line, Ltd. v. County of Los Angeles*,[799] the Supreme Court held that the Foreign Commerce Clause (i.e., that portion of the Commerce Clause that relates to foreign commerce) imposes restraints on state power to tax foreign commerce beyond those the Commerce Clause generally imposes on state power to tax interstate commerce. All taxes affecting interstate and foreign commerce must satisfy *Complete Auto*'s four-prong test.[800] When a tax affects foreign commerce, however, it must satisfy two additional criteria. First, it must not "create[ ] a substantial risk of international multiple taxation."[801] Second, it must not "prevent[ ] the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'"[802] "If

[795] Heublein, Inc. v. State, 256 Ga. 578, 351 SE2d 190 (1987), appeal dismissed, 483 US 1013, 107 S. Ct. 3253 (1987).

[796] *Heublein*, 256 Ga. 578, 351 SE2d 190, 195 (1987), appeal dismissed, 483 US 1013, 107 S. Ct. 3253 (1987) (quoting 1985 Ga. Laws at 665).

[797] *Heublein*, 256 Ga. 578, 351 SE2d 190, 196 (1987), appeal dismissed, 483 US 1013, 107 S. Ct. 3253 (1987).

[798] *Heublein*, 256 Ga. 578, 351 SE2d 190 (1987), appeal dismissed, 483 US 1013, 107 S. Ct. 3253 (1987). The Colorado Supreme Court addressed an analogous question in Archer Daniels Midland Co. v. State, 690 P2d 177 (Colo. 1984), and it sustained the tax.

[799] Japan Line, Ltd. v. County of Los Angeles, 441 US 434, 99 S. Ct. 1813 (1979).

[800] See supra ¶ 4.11[1].

[801] *Japan Line*, 441 US 434, 451, 99 S. Ct. 1813 (1979).

[802] *Japan Line*, 441 US 434, 451, 99 S. Ct. 1813 (1979).

a state tax contravenes either of these precepts, it is unconstitutional under the Commerce Clause."

In *Japan Line*, a group of Japanese corporations, whose principal places of business and commercial domiciles were located in Japan, succeeded in overturning a Los Angeles property tax on their shipping containers used exclusively in foreign commerce. None of the containers was permanently located in California; they were in the state an average of less than three weeks and were in constant transit, except for the time spent awaiting loading or unloading of cargo or undergoing repair. The tax was based on the value of the containers in Los Angeles on tax lien day, and the assessment was made by reference to the average presence in the county of all the containers during the tax year.

The Supreme Court first concluded that the California levy satisfied the four-prong test of *Complete Auto.*[803] The containers had substantial nexus with California, the tax was fairly apportioned to the containers' presence in California, the tax was nondiscriminatory, and it was fairly related to services provided by the state. The Court also rejected the taxpayers' argument that the tax was invalid under the "home port doctrine," which would assign the exclusive right to tax to the containers' "home port."[804] Because the case involved *foreign* rather than *interstate* commerce, however, the Court held that the tax had to satisfy the two additional criteria set forth above, namely, that it not expose the taxpayer to unconstitutional international multiple taxation and that it not "impair federal uniformity in an area where federal uniformity is essential"[805] by preventing the "Nation from 'speaking with one voice' in regulating foreign trade."[806]

[1] The Multiple Taxation Doctrine Applied to Foreign Commerce

In *Japan Line*, the Court held that, when a state seeks to tax the instrumentalities of foreign commerce, it creates an "enhanced risk of multiple taxation"[807] that requires additional safeguards beyond those ordinarily required to prevent multiple taxation of interstate commerce. Although there had been a few scattered dicta before *Japan Line* suggesting that foreign commerce was entitled to greater constitutional protection from state action than was interstate com-

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[803] See supra ¶ 4.11[1].

[804] For a treatment of this aspect of the case, see supra ¶ 4.12[2][c].

[805] *Japan Line*, 441 US 434, 448, 99 S. Ct. 1813 (1979).

[806] *Japan Line*, 441 US 434, 452, 99 S. Ct. 1813 (1979) (quoting Michelin Tire Corp. v. Wages, 423 US 276, 285, 96 S. Ct. 535 (1976)).

[807] *Japan Line*, 441 US 434, 446, 99 S. Ct. 1813 (1979).

merce,[808] no prior decision of the Supreme Court had so held. The Court justified its more rigorous "multiple taxation" requirement in the context of foreign commerce on the ground that, while it possessed the ability to prevent multiple taxation in interstate commerce by enforcing full apportionment by all potential taxing bodies (i.e., states and localities),

> neither this Court nor this Nation can ensure full apportionment when one of the taxing entities is a foreign sovereign. If an instrumentality of commerce is domiciled abroad, the country of domicile may have the right, consistently with the custom of nations, to impose a tax on its full value. If a State should seek to tax the same instrumentality on an apportioned basis, multiple taxation inevitably results. Hence, whereas the fact of apportionment in interstate commerce means that "multiple burdens logically cannot occur," the same conclusion, as to foreign commerce, logically cannot be drawn. Due to the absence of an authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value, a state tax, even though "fairly apportioned" to reflect an instrumentality's presence within the State, may subject foreign commerce "to the risk of a double tax burden to which [domestic] commerce is not exposed, and which the commerce clause forbids."[809]

The Court concluded that California's ad valorem property tax—even though fairly apportioned and nondiscriminatory—created unconstitutional international multiple taxation because Japan had the right and power to tax the containers in full and had in fact done so.[810]

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[808] For example, in Bowman v. Chicago & Nw. Ry., 125 US 465, 482, 8 S. Ct. 689 (1888), the Court declared:

> It may be argued, however, that, aside from such regulations as these, which are purely local, the inference to be drawn from the absence of legislation by Congress on the subject excludes state legislation affecting commerce with foreign nations more strongly than that affecting commerce among the States.

In Brolan v. United States, 236 US 216, 222, 35 S. Ct. 285 (1915), the Court observed that "decisions of this court dealing with the subject of the power of Congress to regulate interstate commerce" do not govern questions arising under the Foreign Commerce Clause, because of "the broad distinction which exists between the two powers." A three-judge federal district court had stated that "when foreign commerce is involved the national interest is even more clearly paramount" than when state action affecting interstate commerce is involved. Epstein v. Lordi, 261 F. Supp. 921, 931 (DNJ 1966), aff'd, 389 US 29, 88 S. Ct. 106 (1967). See also Michelin Tire Corp. v. Wages, 423 US 276, 285, 96 S. Ct. 535 (1976), considered at ¶ 5.02.

[809] *Japan Line*, 441 US 434, 447–448, 99 S. Ct. 1813 (1979) (citations omitted).

[810] For commentary on the *Japan Line* case, see W. Hellerstein, "State's Power to Tax Foreign Commerce Dominates Supreme Court's 1978 Agenda," 51 J. Tax'n 106 (1979). In the context of state taxation of income from foreign commerce, the Court has limited the force of *Japan Line*. See Barclays Bank PLC v. Franchise Tax Bd., 512 US 298, 114 S. Ct. 2268 (1994) and Container Corp. of Am. v. Franchise Tax Bd., 463 US 159, 103 S. Ct. 2933 (1983) (upholding worldwide combined apportionment of corporate

In a case involving a Tennessee sales tax upon the transfer of possession in Tennessee of domestically owned cargo containers used exclusively in international commerce,[811] the Court found no unconstitutional risk of multiple taxation for several reasons. First, in contrast to *Japan Line*, other nations had chosen not to tax leases of cargo containers, so there was no actual multiple taxation, and

> the foreign commerce clause cannot be interpreted to demand that a state refrain from taxing any business transaction that is also potentially subject to taxation by a foreign sovereign. "*Japan Line* does not require forbearance so extreme or one-sided."[812]

Moreover, Tennessee provided a credit against its tax for any tax properly paid in another jurisdiction, foreign or domestic, upon the same transaction. Consequently, Tennessee's sales tax reduced, if it did not eliminate, the risk of multiple international taxation.[813] Accordingly, the Court concluded that, in the absence of a conflict with a consistent international practice or policy, "the careful apportionment of a state tax on business transactions conducted within state borders does not create the substantial risk of international multiple taxation that implicates foreign commerce clause concerns."[814]

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income despite evidence of multiple taxation); Mobil Oil Corp. v. Commissioner of Taxes, 445 US 425, 100 S. Ct. 1223 (1980) (upholding state taxation of foreign source dividends). In *Container*, the Court distinguished *Japan Line* on the grounds, inter alia, that it involved a property tax, instrumentalities of foreign commerce, and actual—not merely possible—multiple taxation that it found could be remedied only by an allocation approach. For further consideration of the application of the *Japan Line* doctrine in corporate income tax cases and consideration as to whether the theoretical underpinning of the "international multiple taxation" criterion of the Court's Foreign Commerce Clause doctrine is warranted, see ¶ 8.16.

[811] Itel Containers Int'l Corp. v. Huddleston, 507 US 60, 113 S. Ct. 1095 (1993). The *Itel* case is also considered infra ¶¶ 4.19[2] and 4.24[2][c] and at 5.05[2].

[812] *Itel*, 507 US 60, 74, 113 S. Ct. 1095 (1993) (quoting Container Corp. of Am. v. Franchise Tax Bd., 463 US 159, 193, 103 S. Ct. 2933 (1983)).

[813] *Itel*, 507 US 60, 74, 113 S. Ct. 1095 (1993).

[814] *Itel*, 507 US 60, 75, 113 S. Ct. 1095 (1993). In Harris County Appraisal Dist. v. Transamerica Container Corp., 821 SW2d 637 (Tex. Civ. App. 1991), the court held that an ad valorem property tax on containers used in international commerce was invalid under *Japan Line* in view of substantial risk of multiple taxation. The U.S. Supreme Court vacated and remanded the *Harris County* case for further consideration in light of *Itel*. *Harris County*, 821 SW2d 637 (Tex. Ct. Civ. App. 1991), vacated and remanded, 507 US 969, 113 S. Ct. 1407 (1993). On remand from the U.S. Supreme Court, the Texas court reaffirmed its earlier decision that the tax exposed the taxpayer to an unconstitutional risk of international multiple taxation under *Japan Line*. Harris County Appraisal Dist. v. Transamerica Container Leasing, Inc., 920 SW2d 678 (Tex. Ct. Civ. App. 1995). The court found *Itel* distinguishable. In *Itel*, Tennessee (1) taxed a discrete transaction occurring within the state and (2) reduced, if not eliminated, the risk of multiple taxation by crediting against its own tax any taxes paid in other jurisdictions on the same taxation. In *Har-*

[2] Preventing the Federal Government From "Speaking With One Voice"

The second "additional consideration" the Court identified in *Japan Line* as requiring a more extended inquiry when a tax affects foreign commerce than when it affects only interstate commerce is that the levy not "impair federal uniformity in an area where federal uniformity is essential"[815] and "prevent the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'"[816] In *Japan Line*, the Court found the controlling federal policy in a Customs Convention signed by the United States, Japan, and other countries, under which containers temporarily admitted to a country were free of "all duties and taxes whatsoever chargeable by reason of importation."[817] Under that policy, signatory countries refrained completely from taxing the shipping containers owned by foreign companies while retaining the power to tax the shipping containers owned by domestic companies on an unapportioned basis. In finding that the Los Angeles County tax would frustrate federal policy, the Court declared that "California's tax thus creates an asymmetry in international maritime taxation operating to Japan's disadvantage. The risk of retaliation by Japan, under these circumstances, is acute, and such retaliation of necessity would be felt by the Nation as a whole."[818] The Court concluded that the California tax at issue in the *Japan Line* case "will frustrate attainment of federal uniformity" and "prevent[s] the Federal Government from 'speaking with one voice'" in the "conduct of its foreign relations and its foreign trade."[819]

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ris County, by contrast, there was no discrete taxable transaction occurring within the state, and the taxing district did not provide a credit or similar mechanism to avoid international multiple taxation.

[815] Japan Line, Ltd. v. County of Los Angeles, 441 US 434, 448, 99 S. Ct. 1813 (1979).

[816] *Japan Line*, 441 US 434, 451, 99 S. Ct. 1813 (1979).

[817] *Japan Line*, 441 US 434, 453, 99 S. Ct. 1813 (1979).

[818] *Japan Line*, 441 US 434, 453, 99 S. Ct. 1813 (1979). The Court also added in a footnote:

> Retaliation by some nations could be automatic. West Germany's wealth tax statute, for example, provides an exemption for foreign-owned instrumentalities of commerce, but only if the owner's country grants a reciprocal exemption for German-owned instrumentalities. Vermögensteuergesetz (VStG) § 2, ¶ 3, reprinted in I Bundesgesetzblatt (BGBI) 949 (Apr. 23, 1974). The European Economic Community (EEC), when apprised of California's tax on foreign-owned containers, apparently determined to consider "suitable counter-measures." Press Release, 521st Council Meeting—Transport (Luxembourg, June 12, 1978), p. 21.

Japan Line, 441 US 434, 453 n.18, 99 S. Ct. 1813 (1979).

[819] *Japan Line*, 441 US 434, 453, 99 S. Ct. 1813 (1979) (quoting Michelin Tire Corp. v. Wages, 423 US 276, 285, 96 S. Ct. 535 (1976)). In Springfield Rare Coin Galleries, Inc. v. Johnson, 115 Ill. 2d 221, 503 NE2d 300 (1986), the court invalidated the exclusion

In subsequent cases involving challenges to state taxes affecting foreign commerce, the Court has found no violation of the "speaking with one voice" criterion. Thus in several cases involving Foreign Commerce Clause challenges to state income taxation of multinational enterprises, the Court has rejected the claim that the states' failure to follow federal income tax policies violated *Japan Line*'s "speaking with one voice" requirement.[820]

Similarly, the Supreme Court rejected a challenge to a Florida tax on the sale of airline fuel on the ground that, as applied to foreign air carriers engaged exclusively in foreign commerce, the tax violated the precepts of *Japan Line*.[821] Under both bilateral and multilateral agreements, the federal government exempted foreign airlines from excise taxes on aviation fuel if the airlines' home countries exempted U.S. carriers from similar taxes. The United States and Canada were signatories to such agreements. The Court held that the levy did not violate the negative implications of the Foreign Commerce Clause because the federal government had affirmatively decided to permit the states to impose sales taxes on aviation fuel used by foreign airlines.[822] After reviewing the evidence relating to the federal government's policy toward aviation fuel taxes, the Court declared:

> What all of this makes abundantly clear is that the Federal Government has not remained silent with regard to the question of whether States should have the power to impose taxes on aviation fuel used by foreign carriers in international travel. By negative implication arising out of more than 70 agreements . . . , the United States has at least acquiesced in state taxation of fuel used by foreign carriers in international travel. . . . It would turn dormant Commerce Clause analysis entirely upside down to apply it where the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow.[823]

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of South African currency, coins, or medallions from the state's general sales and use tax exemption for such items on the grounds that "disapproval of the political and social policies of a foreign nation does not provide a valid basis for a tax classification by this State." *Springfield*, 115 Ill. 2d 221, 503 NE2d 300, 307 (1986). Although the court referred to the "one voice" doctrine (*Springfield*, 115 Ill. 2d 221, 503 NE2d 300, 305 (1986)), its decision was based on the state constitutional requirement of reasonable classification. Ill. Const. art. IX, § 2.

[820] See Barclays Bank PLC v. Franchise Tax Bd., 512 US 298, 114 S. Ct. 2268 (1994); Container Corp. of Am. v. Franchise Tax Bd., 463 US 159, 103 S. Ct. 2933 (1983); Mobil Oil Corp. v. Commissioner of Taxes, 445 US 425, 100 S. Ct. 1223 (1980). This issue is explored further infra ¶¶ 4.21, 8.16.

[821] Wardair Can., Inc. v. Florida Dep't of Revenue, 477 US 1, 106 S. Ct. 2369 (1986).

[822] *Wardair*, 477 US 1, 7–13, 106 S. Ct. 2369 (1986).

[823] *Wardair*, 477 US 1, 12, 106 S. Ct. 2369 (1986) (emphasis in original).

The Court distinguished *Japan Line* in sustaining a Tennessee sales tax upon the transfer of possession in Tennessee of domestically owned cargo containers used exclusively in international commerce.[824] The containers were leased to participants in the international shipping industry, and the tax was measured by the lease payments. The Tennessee tax did not offend the "speaking with one voice" criterion of *Japan Line* for two reasons. First, the tax did "not create a substantial risk of international multiple taxation that implicates foreign policy concerns."[825] Second, federal policy, reflected both in international agreements and in the United States' amicus brief defending Tennessee's tax, was fully consistent with the imposition of the tax.

As a theoretical matter (although perhaps not as a practical one), it is important to distinguish the foregoing inquiry under *Japan Line* and its progeny, which is an inquiry under the *negative* Foreign Commerce Clause, from the inquiry into whether state action conflicts with federal legislation, which is a question of federal preemption under the Supremacy Clause.[826] In *Japan Line*, for example, if Congress had exercised its affirmative power to regulate foreign commerce under the Commerce Clause by prohibiting states from taxing foreign containers, there would have been no question whether the Foreign Commerce Clause, by its own force, forbade California from imposing such a tax. Rather, the negative Foreign Commerce Clause, which operates only in the *silence* of Congress, would have had no role to play because Congress would have expressed its will through affirmative action. Nevertheless, the search for a federal policy that falls short of outright preemption but that still is discernible enough to bar state taxes is a mystifying one at best. This may explain why the U.S. Supreme Court, since handing down *Japan Line* in 1979, has never again found a tax to violate the "one voice" principle.[827]

¶ 4.20 DISCRIMINATION AGAINST FOREIGN, AS COMPARED WITH INTERSTATE, COMMERCE

In *Kraft General Foods, Inc. v. Iowa Department of Revenue*,[828] the U.S. Supreme Court held that Iowa's corporate income tax unconstitutionally discriminated against foreign commerce, because it included dividends from foreign

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[824] Itel Containers Int'l Corp. v. Huddleston, 507 US 60, 113 S. Ct. 1095 (1993).

[825] *Itel*, 507 US 60, 75, 113 S. Ct. 1095 (1993); see supra ¶ 4.19[1].

[826] See infra ¶ 4.24.

[827] But see Vinmar, Inc. v. Harris County Appraisal Dist., 947 SW2d 554 (Tex. 1997) (striking down ad valorem property tax on goods awaiting export under Foreign Commerce Clause's "speaking with one voice" criterion).

[828] Kraft General Foods, Inc. v. Iowa Dep't of Revenue, 505 US 71, 112 S. Ct. 2365 (1992).

subsidiaries, but not from domestic (U.S.) subsidiaries, in a taxpayer's apportionable tax base. Despite the fact that there was a rational legislative purpose behind Iowa's discrimination, which was based on Iowa's conformity to the federal corporate income tax scheme,[829] the Court held that "the Iowa statute cannot withstand scrutiny . . . for it facially discriminates against foreign commerce and therefore violates the Foreign Commerce Clause."[830]

In so concluding, the Court made it clear that discrimination against foreign, as compared to interstate, commerce is no more tolerable under the Commerce Clause than is discrimination against interstate commerce in favor of local commerce. Iowa had sought to defend the discrimination on the ground, among others, that its tax did not favor Iowa commerce over foreign commerce. While agreeing with Iowa that there was no preference for local commerce, the Court found that the state's discrimination against foreign commerce in favor of domestic (U.S.) commerce, which was "interstate" commerce insofar as Iowa was concerned, could not survive scrutiny:

> We agree that the statute does not treat Iowa subsidiaries more favorably than subsidiaries located elsewhere. We are not persuaded, however, that such favoritism is an essential element of a violation of the Foreign Commerce Clause. In *Japan Line*[831] . . . , we concluded that the constitutional prohibition against state taxation of foreign commerce is broader than the protection afforded to interstate commerce, in part because matters of concern to the entire Nation are implicated. Like the Import-Export Clause, the Foreign Commerce Clause recognizes that discriminatory treatment of foreign commerce may create problems, such as the potential for international retaliation, that concern the Nation as a whole. So here, we think that a State's preference for domestic commerce over foreign commerce is inconsistent with the Commerce Clause even if the State's own economy is not a direct beneficiary of the discrimination. As the absence of local benefit does not eliminate the international implications of the discrimination, it cannot exempt such discrimination from Commerce Clause prohibitions.[832]

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[829] Under the federal corporate income tax, there is a deduction for dividends received from domestic subsidiaries but not for dividends received from foreign subsidiaries. IRC § 243. The purpose of the former deduction is to avoid a second tax on the earnings of domestic corporations, all of which are subject to federal taxation. To avoid double taxation of the earnings of foreign corporations, which are not generally subject to federal taxation, the Internal Revenue Code provides for a credit against foreign taxes paid on such earnings that are also subject to federal taxation, including taxes paid on earnings that are repatriated in the form of dividends. IRC §§ 901, 902.

[830] *Kraft*, 505 US 71, 82, 112 S. Ct. 2365 (1992).

[831] See supra ¶ 4.19.

[832] *Kraft*, 505 US 71, 79, 112 S. Ct. 2365 (1992) (footnote omitted).

In striking down the Iowa levy, the Court also rejected the argument that the discrimination was constitutionally tolerable, because Kraft could have avoided it by operating abroad through domestic subsidiaries. "[W]e do not think that a State can force a taxpayer to conduct its foreign business through a domestic subsidiary to avoid discriminatory taxation of foreign commerce."[833]

The Court likewise found unpersuasive Iowa's claim that the tax did not in fact favor foreign commerce. The Court acknowledged that the aggregate federal and state tax burden on a domestic subsidiary not doing business in Iowa might exceed the aggregate foreign and Iowa burden on a foreign corporation and its repatriated dividends. But this did not cure the discrimination that Iowa visited upon foreign commerce. The Court found "no authority for the principle that discrimination against foreign commerce can be justified if the benefit to domestic subsidiaries might happen to be offset by other taxes imposed not by Iowa, but by other States and by the Federal Government."[834]

Finally, the Court rejected the argument that Iowa's discriminatory tax on foreign commerce was justified by the administrative convenience to Iowa of conforming to the federal corporate tax model. The Court observed that states may not advance even legitimate goals by means that discriminate against interstate commerce, at least in the absence of a compelling justification. Here

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[833] *Kraft*, 505 US 71, 78, 112 S. Ct. 2365 (1992).

[834] *Kraft*, 505 US 71, 81, 112 S. Ct. 2365 (1992). The Court did observe, however, that

> [i]f one were to compare the aggregate tax imposed by Iowa on a unitary business which included a subsidiary doing business throughout the United States (including Iowa) with the aggregate tax imposed by Iowa on a unitary business which included a foreign subsidiary doing business abroad, it would be difficult to say that Iowa discriminates against the business with the foreign subsidiary. Iowa would tax an apportioned share of the domestic subsidiary's entire earnings, but would tax only the amount of the foreign subsidiary's earnings paid as a dividend to the parent.

Kraft, 505 US 71, 80 n.23, 112 S. Ct. 2365 (1992). Relying on this footnote, the Kansas Supreme Court has held that its "water's edge" combination (which includes unitary domestic subsidiaries in the combined report but taxes the dividends of foreign subsidiaries) does not discriminate against foreign commerce under *Kraft*. In re Morton Thiokol, Inc., 254 Kan. 23, 864 P2d 1175 (1993); accord Caterpillar Fin. Servs., Inc. v. Whitley, 288 Ill. App. 3d 389, 680 NE2d 1082 (1997); EI Du Pont de Nemours & Co. v. State Tax Assessor, 675 A2d 82 (Me. 1996); Caterpillar, Inc. v. Commissioner of Revenue, 568 NW2d 695 (Minn. 1997), cert. denied, ___ US ___, 118 S. Ct. 1043 (1998). It is worth noting that in *Kraft*, the Supreme Court went on to observe that its suggestion quoted previously had no bearing on the case before it because

> [a] corporation with a subsidiary doing business in Iowa is not situated similarly to a corporation with a subsidiary doing business abroad. In the former case, the Iowa operations of the subsidiary provide an independent basis for taxation not present in the case of the foreign subsidiary. A more appropriate comparison is between corporations whose subsidiaries do not do business in Iowa.

Kraft, 505 US 71, 80 n.23, 112 S. Ct. 2365 (1992).

there was no compelling justification, because Iowa could easily make adjustments in its taxing scheme (as other states had made in theirs) to eliminate the discrimination. Moreover, whatever loss in convenience Iowa may have suffered, it did not rise to the level of the type of compelling consideration that the Court, in limited circumstances, had found sufficient to justify discriminatory state legislation.[835]

The Court's decision in *Kraft*, therefore, makes explicit what was implicit in *Japan Line*—namely, that the Foreign Commerce Clause provides broad protection to foreign commerce and does not countenance discrimination against foreign commerce regardless of whether local or interstate interests are the beneficiaries of the discrimination. The Court's decision discredits the authority of state court decisions holding that preferences for interstate over foreign commerce are constitutionally permissible.[836]

[1] Including the Foreign Subsidiaries' Factors in the Apportionment Formula as a Defense to Discrimination Under *Kraft*

The New Mexico Supreme Court rejected the state taxing authority's claim that inclusion of the factors of the foreign subsidiaries in the apportionment formula was a defense to *Kraft*-type discrimination against foreign dividends. In *Conoco, Inc. v. Taxation & Revenue Department*,[837] the taxpayers had elected to file under New Mexico's separate company reporting option, which in all relevant respects was identical to the taxing scheme the U.S. Supreme Court struck down in *Kraft*. The Taxation and Revenue Department sought to defend the New Mexico scheme, however, on the ground that New Mexico, unlike Iowa in *Kraft*, permitted the taxpayer to include the foreign subsidiaries' factors in the apportionment formula under the Detroit formula.[838]

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[835] In Dart Indus., Inc. v. Clark, 657 A2d 1062 (RI 1995), the Rhode Island Supreme Court struck down the state's corporate income tax scheme insofar as it favored domestic over foreign dividends, concluding that it contained the same "fatal flaw" that was present in the Iowa statute.

[836] Consolidation Coal Co. v. Department of Treasury, 141 Mich. App. 43, 366 NW2d 587 (1985); Bob-Lo Co. v. Michigan Dep't of Treasury, 112 Mich. App. 231, 315 NW2d 902 (1982). The California Supreme Court has followed the reasoning in *Kraft* in striking down an inspection fee that applied to ships and airplanes carrying agricultural goods from foreign countries but did not apply to ships and airplanes carrying agricultural goods from other states. Pacific Merchant Shipping Ass'n v. Voss, 12 Cal. 4th 503, 907 P2d 430, 48 Cal. Rptr. 2d 582 (1995).

[837] Conoco, Inc. v. Taxation & Revenue Dep't, 122 NM 736, 931 P2d 730 (1996), cert. denied, ___ US ___, 117 S. Ct. 2497 (1997).

[838] The Detroit formula is set forth in ¶ 9.15[2][a], note 487.

The court rejected the department's defense. It noted that the formula does not eliminate dividends paid by foreign subsidiaries and that "it was doubtful that every dollar paid by foreign subsidiaries was excluded from the tax base through the application of the Detroit formula."[839] More to the point, the court declared that "*Kraft* clearly requires that foreign and domestic commerce be treated equally, and the New Mexico tax scheme fails to do this, even with the Detroit formula."[840]

In contrast to the taxpayers in the *Conoco* case, which involved a separate company reporting regime identical to the regime at issue in *Kraft*, taxpayers have been unsuccessful in attacking as unconstitutionally discriminatory states' "water's edge" regimes, which include foreign dividends (and, in some cases, foreign source royalties and interest) in the apportionable tax base but do not include the subsidiaries' factors in the apportionment formula.[841] In such cases, the alleged discrimination is less obvious, because the domestic dividends (or royalties and interest) are not excluded as such; rather they are eliminated as intercompany items in the combined report, which includes the underlying domestic income. Nevertheless, the inclusion of the foreign source income without providing for representation of the factors that produced such income in the apportionment formula clearly treats foreign source income less favorably than it treats domestic source income (whose factors are included in the combined report). Merely because such discrimination may be more difficult to discern than the discrimination the Court invalidated in *Kraft* is no justification for tolerating it.[842]

¶ 4.21 TAXATION OF DIVIDENDS DERIVED FROM FOREIGN COMMERCE

The hope (in some circles) that *Japan Line* might provide a broad new basis for constitutional challenges to state taxation of income derived from foreign

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[839] *Conoco*, 122 NM 736, 931 P2d 730, 735 (1996), cert. denied, __ US __, 117 S. Ct. 2497 (1997).

[840] *Conoco*, 122 NM 736, 931 P2d 730, 735 (1996), cert. denied, __ US __, 117 S. Ct. 2497 (1997).

[841] See Caterpillar Fin. Servs., Inc. v. Whitley, 288 Ill. App. 3d 389, 680 NE2d 1082 (1997); In re Morton Thiokol, Inc., 254 Kan. 23, 864 P2d 1175 (1993); Caterpillar, Inc. v. Commissioner of Revenue, 568 NW2d 695 (Minn. 1997), cert. denied, __ US __, 118 S. Ct. 1043 (1998) ; cf. EI Du Pont de Nemours & Co. v. State Tax Assessor, 675 A2d 82 (Me. 1996) (sustaining "Augusta Formula," described in ¶ 9.15[4][a], note 538, as a proper response to a claim of discrimination under *Kraft*).

[842] See M. McLoughlin, "Is Water's Edge Combination Constitutional Without Factor Representation," State Tax Notes, July 6, 1998, p. 29.

commerce was largely dashed during the succeeding term of the Court in *Mobil Oil Corp. v. Commissioner of Taxes.*[843] The Court removed the underpinning of such a Commerce Clause argument when it adopted a narrow view of the extent of the protection that the Foreign Commerce Clause afforded multinational enterprises against multiple taxation of income.

In *Mobil*, the taxpayer argued that Vermont's taxation of a share of its foreign source dividends exposed it to the risk of multiple international taxation and prevented the federal government from "speaking with one voice" in violation of *Japan Line*. First, the Court found Mobil's analogy to *Japan Line* "forced," since that case involved "instrumentalities of foreign commerce"[844] (a term the Court has used to refer to the means of carrying on such commerce, e.g., transportation and communication). Second, the Court noted that the factors favoring use of the allocation method—as distinguished from the apportionment method—in the property tax context (as in *Japan Line*) have no immediate applicability to an income tax. Third, *Japan Line* involved duplicative taxation by a state and a foreign country, whereas Mobil was complaining of a risk of multiple taxation by more than one state—Vermont and its commercial domicile, New York. The Court pointed out that, whereas it could do nothing to restrict taxation of shipping containers by Japan, that was not the case with respect to the tax risk about which Mobil was complaining:

> [A]ppellant's argument underestimates the power of this Court to correct excessive taxation on the field where appellant has chosen to pitch its battle. A discriminatory effect on foreign commerce as a result of multiple state taxation is just as detectable and corrigible as a similar effect on commerce among the States. Accordingly, we see no reason why the standard for identifying impermissible discrimination should differ in the two instances.[845]

The Court, however, chose not to exercise this power to prevent multiple state taxation of Mobil's foreign source dividends. It held, instead, that the Commerce Clause does not bar a state's inclusion of foreign source dividends in the taxpayer's apportionable base, as long as the dividends are received from a corporation that is part of the taxpayer's unitary business carried on in the state. The Court so held even though the taxpayer's commercial domicile was not in the taxing state; none of its activities relating to the ownership of the dividend-paying stocks occurred there; and no part of the business of the dividend-paying corporations was conducted in the state.

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[843] Mobil Oil Corp. v. Commissioner of Taxes, 445 US 425, 100 S. Ct. 1223 (1980). The *Mobil* case is discussed in ¶ 8.08[2][a].

[844] *Mobil*, 445 US 425, 448, 100 S. Ct. 1223 (1980).

[845] *Mobil*, 445 US 425, 447, 100 S. Ct. 1223 (1980).

The Court therefore did not extend to the problem of multiple state taxation of foreign source dividends the concern it registered in *Japan Line* that "[e]ven a slight overlapping of tax—a problem that might be deemed de minimis in a domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned."[846] Instead, it turned to *Moorman Manufacturing Co. v. Bair*,[847] with its emphasis on the impropriety of the Court's intervention in state apportionment controversies even though the "potential for attribution of the same income to more than one State is plain."[848] The Court's assurance that a "discriminatory effect on foreign commerce as a result of multiple state taxation is just as detectable and corrigible as a similar effect on commerce among the States,"[849] thus becomes little more than hollow rhetoric in view of its refusal to intervene in state tax apportionment controversies, even in cases in which the "discriminatory effect" on, and the "multiple taxation" of, out-of-state-based manufacturers are as "detectable" as they were under Iowa's single-factor receipts formula at issue in *Moorman*.[850]

The Court also considered, but summarily rejected, Mobil's contention that the Vermont tax frustrated federal policy, as embodied in the federal income tax and in tax treaties designed to prevent duplicative taxation of the same income at the national level in more than one country. The Court stated:

> Nor does federal tax policy lend additional weight to appellant's arguments. The federal statutes and treaties that Mobil cites concern problems of multiple taxation at the international level and simply are not germane to the issue of multiple state taxation that appellant has framed. Concurrent federal and state taxation of income, of course, is a well-established norm. Absent some explicit directive from Congress, we cannot infer that treatment of foreign income at the federal level mandates identical treatment by the States. The absence of any explicit directive to that effect is attested by the fact that Congress has long debated, but has not enacted, legislation designed to regulate state taxation of income. Legislative proposals have provoked debate over issues closely related to the present controversy. Congress in the future may see fit to enact legislation requiring a uniform method for state taxation of foreign dividends. To date, however, it has not done so.[851]

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[846] Japan Line, Ltd. v. County of Los Angeles, 441 US 434, 456, 99 S. Ct. 1813 (1979); see supra ¶ 4.19.

[847] Moorman Mfg. Co. v. Bair, 437 US 267, 279, 98 S. Ct. 2340 (1978).

[848] *Moorman*, 437 US 267, 279, 98 S. Ct. 2340 (1978).

[849] *Mobil*, 445 US 425, 447, 100 S. Ct. 1223 (1980).

[850] See ¶ 8.13[2][b][ii].

[851] *Mobil*, 445 US 425, 448, 100 S. Ct. 1223 (1980) (citations omitted). In a number of cases, the NCR Corporation has unsuccessfully contended that the Foreign Commerce Clause barred states from including its foreign dividends, interest, and/or royalties in its

¶ 4.22 PREFERENTIAL TAXATION OF IMPORTS OR EXPORTS

A California statute exempted from ad valorem tax "property manufactured or produced . . . outside the United States and brought into the State for transshipment out of this State, for sale in the ordinary course of trade or business."[852] The Los Angeles County assessor denied the exemption to goods that met the statutory requirements on the ground, inter alia, that the exemption violated the Commerce Clause. The assessor reasoned that the statute discriminated against interstate, as compared to foreign, commerce because it taxed goods manufactured in other *states* (as distinguished from other *countries*) and held in California for transshipment out of the state.

Zee Toys, Inc. v. County of Los Angeles[853] illustrates the factual pattern of the cases in which taxpayers have challenged the denial of the statutory exemption. In *Zee Toys*, the taxpayer, an importer and distributor of goods that were manufactured outside the country, claimed the statutory exemption for imported goods located in a warehouse in Los Angeles County, where the goods had been sorted and stored as inventory awaiting sale. The California Court of Appeals held that the grant of an exemption limited to foreign goods brought into California for shipment outside the state constituted a regulation of foreign and interstate commerce; that the exemption gave goods of foreign origin a competitive advantage over goods manufactured in other states; and that the exemption violated the Commerce Clause because "state taxes which discriminate between classes of interstate and foreign goods on the basis of their origin are not permitted."[854] After argument and reargument of the case, the U.S. Supreme Court remained equally divided on the issues (one Justice did not participate), and, as a consequence, it affirmed the decision of the California court holding the foreign goods exemption unconstitutional.[855]

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apportionable tax base. NCR Corp. v. Commissioner of Revenue, 1996 WL 290047 (Mass. App. Tax Bd.); NCR Corp. v. Taxation & Revenue Dep't, 115 NM 612, 856 P2d 982 (Ct. App. 1993), cert. denied, 115 NM 677, 857 P2d 788 (1993), cert. denied, 512 US 1245, 114 S. Ct. 2763 (1994); NCR Corp. v. South Carolina State Tax Comm'n, 304 SC 1, 402 SE2d 666 (1991); NCR Corp. v. Wisconsin Dep't of Revenue, Nos. 92 CV 1516, 92 CV 1525, Dane County Cir. Ct., Apr. 30, 1993.

[852] Former Cal. Rev. & Tax. Code § 225, repealed in 1984.

[853] Sears, Roebuck & Co. v. County of Los Angeles and Zee Toys, Inc. v. County of Los Angeles (consolidated cases), 85 Cal. App. 3d 763, 149 Cal. Rptr. 750 (2d Dist. 1978).

[854] *Zee Toys*, 85 Cal. App. 3d 763, 149 Cal. Rptr. 750, 758 (2d Dist. 1978).

[855] Sears, Roebuck & Co. v. County of Los Angeles, 449 US 1119, 101 S. Ct. 933 (1981). The *Zee Toys* and *Sears, Roebuck* cases were consolidated. The Solicitor General of the United States filed a brief amicus curiae, on the invitation of the Court, in which he supported the constitutionality of the exemption. He contended that the Commerce Clause prohibits discrimination against out-of-state goods and against foreign goods, but that

In *Star-Kist Foods, Inc. v. County of Los Angeles*,[856] the California Supreme Court revisited the question raised by the *Zee Toys* case. Although the facts and issues in *Star-Kist* were indistinguishable from those in *Zee Toys*, the U.S. Supreme Court's intervening decision in *Japan Line, Ltd. v. County of Los Angeles*[857] had induced the California Court of Appeals in *Star-Kist* to reverse the position it had taken in *Zee Toys* and to hold that the exemption for foreign goods was constitutional.[858] The California Supreme Court disagreed. It declared that the Supreme Court's decision in *Michelin Tire Corp. v. Wages*[859] "teaches that nondiscriminatory ad valorem taxation of business inventories, including inventories linked to foreign commerce, is constitutional and has no impact on the federal government's foreign commerce power."[860] Hence, there was no warrant for concluding, under the authority of *Japan Line*, that an exemption for foreign goods was necessary to preserve Congress's power to regulate foreign commerce, since the tax itself did not interfere with that power. The court also intimated that granting the exemption for foreign but not domestic commerce might actually offend rather than preserve Congress's power to regulate foreign commerce by "nullify[ing] the curative effect of federally imposed tariffs."[861] Finally, the court (like the *Zee Toys* court) held that the exemption violated the Commerce Clause by providing a competitive advantage for foreign over domestic goods.[862] Despite the U.S. Supreme Court's even division over the question of the constitutionality of preferential taxation of foreign vis-à-vis domestic goods in 1981, the Court denied the taxpayer's petition for certiorari.[863]

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there is "no constitutional prohibition against favoring imports over domestic goods." Brief for the United States as amicus curiae in Sears, Roebuck & Co. v. County of Los Angeles, No. 78-1577, at 6.

[856] Star-Kist Foods, Inc. v. County of Los Angeles, 42 Cal. 3d 1, 719 P2d 987, 227 Cal. Rptr. 391 (1986).

[857] Japan Line, Ltd. v. County of Los Angeles, 441 US 434, 99 S. Ct. 1813 (1979), considered supra ¶ 4.19.

[858] Star-Kist Foods, Inc. v. County of Los Angeles, 152 Cal. App. 3d 258, 199 Cal. Rptr. 440 (2d Dist. 1984). Indeed, the court made the gratuitous statement that the exemption was not only constitutionally permitted, but that it was constitutionally required. *Star-Kist*, 152 Cal. App. 3d 258, 199 Cal. Rptr. 440, 441, 443 (2d Dist. 1984). There appears to be no justification for the court's dictum.

[859] Michelin Tire Corp. v. Wages, 423 US 276, 96 S. Ct. 535 (1976). The *Michelin* case is considered at ¶ 5.02.

[860] *Star-Kist*, 42 Cal. 3d 1, 719 P2d 987, 995, 227 Cal. Rptr. 391 (1986).

[861] *Star-Kist*, 42 Cal. 3d 1, 719 P2d 987, 995, 227 Cal. Rptr. 391 (1986).

[862] There was a dissent from the court's opinion.

[863] Star-Kist Foods, Inc. v. County of Los Angeles, 480 US 930, 107 S. Ct. 1565 (1987).

Another case will have to be litigated before this issue is decided, unless Congress legislates in the meantime.[864] In view of the importance of foreign trade to the nation as a whole and to the extensive regulation of various aspects of international trade relations by Congress, the propriety of preferential property tax exemption for imports or exports awaiting transshipment out-of-state is a matter peculiarly within the province of the national government and one that could very well be the subject of congressional regulation.

D. THE EXERCISE OF CONGRESS'S AFFIRMATIVE POWER TO REGULATE STATE TAXATION UNDER THE COMMERCE CLAUSE

¶ 4.23 POWER OF CONGRESS UNDER THE COMMERCE CLAUSE TO RESTRICT AND EXPAND STATE TAX POWER

Congress possesses unquestioned power under the Commerce Clause to regulate state taxation of interstate commerce. Congress may exercise its affirmative Commerce Clause power in one of two ways: (1) it may restrict the taxing power the states otherwise would enjoy under existing judicially developed "negative" Commerce Clause restraints by imposing additional limitations on state taxing authority; and (2) it may expand the taxing power the states otherwise would enjoy under existing judicially developed "negative" Commerce Clause restraints by removing those restraints. The Court emphasized both aspects of Congress's power in *Prudential Insurance Co. v. Benjamin*:[865]

> The power of Congress over commerce exercised entirely without reference to coordinated actions of the states is not restricted, except as the Constitution expressly provides, by any limitation which forbids it to discriminate against interstate commerce and in favor of local trade. Its plenary scope enables Congress not only to promote but also to prohibit interstate commerce, as it has done frequently and for a great variety of reasons. That power does not run down a one-way street or one of nar-

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[864] Virtually all the states that impose personal property taxes have enacted "free port" statutes, pursuant to which goods may be shipped into the state and stored in a warehouse free of property tax while awaiting shipment outside the state. RIA All States Tax Guide ¶ 265 (Chart of State Free Port Law Requirements). Most of the statutes apply equally to goods shipped and to be shipped in interstate and foreign commerce. But see Ga. Code Ann. § 48-5-5 (1991) (providing an exemption for "foreign merchandise in transit").

[865] Prudential Ins. Co. v. Benjamin, 328 US 408, 66 S. Ct. 1142 (1946).

> rowly fixed dimensions. Congress may keep the way open, confine it broadly or closely, or close it entirely, subject only to the restrictions placed upon its authority by other constitutional provisions and the requirement that it shall not invade the domains of action reserved exclusively for the states.[866]

In *Prudential*, the Court sustained a South Carolina insurance premiums tax imposed solely on foreign insurance companies—a levy that clearly would have been struck down under the Commerce Clause if Congress had not consented to such legislation in the McCarran-Ferguson Act.[867]

[1] Possible Limitations on the Congressional Power to Restrict State Taxation of Interstate Commerce

Although the power of Congress to restrict state taxation under the Commerce Clause appeared to be plenary, and unrestricted by competing state interests, a 1976 decision of the Supreme Court put the matter in doubt. In *National League of Cities v. Usery*,[868] the Court held that Congress had exceeded its power under the Commerce Clause by extending the minimum wage and maximum hour requirements of the Fair Labor Standards Act to state and local government employees. The Court held that "there are limits upon the power of Congress to override state sovereignty, even when exercising its otherwise plenary powers to tax or regulate commerce."[869] The Court rested its decision on the Tenth Amendment, which, in the Court's eyes, "expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the State's integrity or their ability to function effectively in a federal system."[870] The Court found that the minimum wages and maximum hours legislation "will impermissibly interfere with the integral governmental functions."[871]

Justice Brennan, who wrote the principal dissenting opinion in *National League of Cities*, viewed the decision as repudiating

> principles governing judicial interpretation of our Constitution settled since the time of Mr. Chief Justice John Marshall, discarding his postulate that the Constitution contemplates that restraints upon exercise by Con-

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[866] *Prudential*, 328 US 408, 434, 66 S. Ct. 1142 (1946).

[867] See also Western & S. Life Ins. Co. v. State Bd. of Equalization, 451 US 648, 655, 101 S. Ct. 2070 (1981) ("McCarran-Ferguson Act removes entirely any Commerce Clause restriction upon California's power to tax the insurance business").

[868] National League of Cities v. Usery, 426 US 833, 96 S. Ct. 2465 (1976).

[869] *National League of Cities*, 426 US 833, 842, 96 S. Ct. 2465 (1976).

[870] *National League of Cities*, 426 US 833, 842, 96 S. Ct. 2465 (1976).

[871] *National League of Cities*, 426 US 833, 851, 96 S. Ct. 2465 (1976).

gress of its plenary commerce power lie in the political process and not in the judicial process.[872]

The reign of *National League of Cities* was short-lived. In 1985, the Court overruled the decision in *Garcia v. San Antonio Metropolitan Transit Authority*.[873] In a 5–4 decision, the Court repudiated the earlier case on both doctrinal and practical grounds, and it sustained the application of the Fair Labor Standards Act to employees of San Antonio's public transportation system. Largely adopting the views of the dissenters in *National League of Cities*, the Court concluded that the states' continued role in the federal system is primarily guaranteed not by any externally imposed limits on the commerce power, but by "the structure of the Federal Government itself."[874] It is through their control over and representation in the federal government that the states are protected from overreaching by Congress. Moreover, the Court found it "difficult, if not impossible" to draw the boundaries of state immunity by reference to "integral operations of areas of traditional governmental functions" described by *National League of Cities*.[875] The Court therefore rejected "as unsound in principle and unworkable in practice, a rule of state immunity from federal regulation that turns on a judicial appraisal of whether a particular governmental function is 'integral' or 'traditional.'"[876]

The dissenting Justices in *Garcia*,[877] reiterated their commitment to the doctrine and holding of *National League of Cities*. Thus, Justice Rehnquist in his brief dissent found it unnecessary "to spell out further the fine points of a principle that will, I am confident, in time again command the support of a majority of this Court."[878] And Justice O'Connor "share[d] Justice Rehnquist's

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[872] *National League of Cities*, 426 US 833, 857, 96 S. Ct. 2465 (1976). Justice Brennan also observed that "[i]t must . . . be surprising that my Brethren should choose this bicentennial year of our independence to repudiate" Chief Justice Marshall's view of the Constitution. *National League of Cities*, 426 US 833, 857, 96 S. Ct. 2465 (1976). He also said: "It is unacceptable that the judicial process should be thought superior to the political process in this area. Under the Constitution the Judiciary has no role to play beyond finding that Congress has not made an unreasonable legislative judgment respecting what is 'commerce.'" *National League of Cities*, 426 US 833, 876, 96 S. Ct. 2465 (1976).

[873] Garcia v. San Antonio Metro. Transit Auth., 469 US 528, 105 S. Ct. 1005 (1985).

[874] *Garcia*, 469 US 528, 556, 105 S. Ct. 1005 (1985).

[875] *Garcia*, 469 US 528, 539, 105 S. Ct. 1005 (1985).

[876] *Garcia*, 469 US 528, 546–547, 105 S. Ct. 1005 (1985).

[877] Justice Powell wrote a dissenting opinion in which Justices Burger, Rehnquist, and O'Connor joined; Justice Rehnquist wrote a dissenting opinion in which no other Justice joined; and Justice O'Connor wrote a dissenting opinion in which Justices Powell and Rehnquist joined.

[878] *Garcia*, 469 US 528, 580, 105 S. Ct. 1005 (1985) (Rehnquist, J, dissenting).

belief that this Court will in time again assume its constitutional responsibility."[879]

Some of the Court's more recent decisions construing Congress's affirmative power under the Commerce Clause have taken a narrower view of that power than the Court articulated during the New Deal era,[880] when it sustained the broad exercise of congressional power to regulate even local activities that may affect interstate commerce.[881] But these decisions do not seriously inhibit the broad powers that Congress plainly possesses to deal with virtually any of the significant contemporary problems raised by state taxation of interstate commerce, such as prescribing uniform division of income tax rules,[882] em-

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[879] *Garcia*, 469 US 528, 589, 105 S. Ct. 1005 (1985) (O'Connor, J., dissenting).

[880] See Printz v. United States, ___ US ___, 117 S. Ct. 2365 (1997) (Congress lacks the power under the Commerce Clause to require state officials to conduct background checks on prospective gun purchasers under the Brady Handgun Violence Prevention Act); United States v. Lopez, 514 US 549, 115 S. Ct. 1624 (1995) (Congress lacks the power under the Commerce Clause to prohibit possession of firearms in school zones because possession of a gun in a local school zone does not affect interstate commerce); cf. Seminole Tribe of Fla. v. Florida, 517 US 44, 116 S. Ct. 1114 (1996) (Eleventh Amendment prevents Congress from exercising its power under the Commerce Clause to authorize suits against states in federal court).

[881] For example, in Wickard v. Filburn, 317 US 111, 124–125, 63 S. Ct. 82 (1942), which sustained Congress' power to regulate under the Commerce Clause the amount of wheat a farmer grew for his own consumption, the Court declared:

> Once an economic measure of the reach of the power granted to Congress in the Commerce Clause is accepted, questions of Federal power cannot be decided simply by finding the activity in question to be "production," nor can consideration of its econonomic effects be foreclosed by calling them "indirect." . . . But even if appellant's activity be local and though it may not be regarded as commerce, it may still, whatever its nature, be reached by Congress if it exerts a substantial economic effect on interstate commerce.

The cases are reviewed in R. Stern, "The Commerce Clause and the National Economy, 1933–1946," 59 Harv. L. Rev. 645, 883 (1945–1946).

Even before the New Deal era, the Court had observed:

> It is unnecessary to repeat what has frequently been said by this court with respect to the complete and paramount character of the power confided to Congress to regulate commerce among the several States. It is of the essence of this power that, where it exists, it dominates. . . . By virtue of the comprehensive terms of the grant, the authority of Congress is at all times adequate to meet the varying exigencies that arise and to protect the national interest by securing the freedom of interstate commercial intercourse from local control.

Houston E&W Tex. Ry. v. United States, 234 US 342, 350–351, 34 S. Ct. 833 (1914).

[882] Moorman Mfg. Co. v. Bair, 437 US 267, 280, 98 S. Ct. 2340 (1978) ("It is clear that the legislative power granted by the Commerce Clause of the Constitution to Congress would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income").

powering the states to collect use taxes on mail-order sales,[883] or limiting the states' power to tax transactions over the Internet,[884] or establishing tax-free trade zones.[885]

[2] The Perceived Inadequacy of Judicial Solutions to the Problems Raised by State Taxation of Interstate Commerce

Although Congress possesses the constitutional power to prescribe the manner in which the states may tax interstate commerce, it has generally refrained from exercising its Commerce Clause power to restrict state taxation. As a consequence, for most of our constitutional history the states have been left largely to their own devices in enacting and applying taxes that affect interstate commerce, subject only to the broad, judicially enforced restraints of the Commerce Clause and, to a lesser extent, the Due Process Clause.

Because the Court has only the limited function of invalidating state action by fixing the "outside limits of decency,"[886] some observers, including a number of Justices, have maintained that it is incapable of reconciling the competing interests involved in a satisfactory manner. They argue that more refined and flexible methods are required. Thus, in *McCarroll v. Dixie Greyhound Lines, Inc.*,[887] Justices Black, Frankfurter, and Douglas wrote a dissenting opinion in which they said:

> Judicial control of national commerce—unlike legislative regulations—must from inherent limitations of the judicial process treat the subject by the hit-and-miss method of deciding single local controversies upon evidence and information limited by the narrow rules of litigation. Spasmodic and unrelated instances of litigation cannot afford an adequate basis for the creation of integrated national rules which alone can afford that full protection for interstate commerce intended by the Constitution. We would, therefore, leave the questions raised by the Arkansas tax for consideration of Congress in a nationwide survey of the constantly increasing barriers to trade among the States. Unconfined by "the narrow

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[883] Quill Corp. v. North Dakota, 504 US 298, 318, 112 S. Ct. 1904 (1992) ("Congress is . . . free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes").

[884] See, e.g., the "Internet Tax Freedom Act," ___ Stat. ___ (Oct. 21, 1998).

[885] Deer Park Independent School Dist. v. Harris County Appraisal District, 132 F3d 1095 (5th Cir. 1998) (sustaining Congress's power under Commerce Clause and Tenth Amendment to exempt goods stored in foreign trade zones from state and local taxes), cert. denied, ___ US ___, 118 S. Ct. 2343 (1998).

[886] T. Powell, "Indirect Encroachment on Federal Authority by the Taxing Powers of the States," 32 Harv. L. Rev. 634, 670 (1919).

[887] McCarroll v. Dixie Greyhound Lines, Inc., 309 US 176, 60 S. Ct. 504 (1940).

scope of judicial proceedings" Congress alone can, in the exercise of its plenary constitutional control over interstate commerce, not only consider whether such a tax as now under scrutiny is consistent with the best interests of our national economy, but can also on the basis of full exploration of the many aspects of a complicated problem devise a national policy fair alike to the States and our Union.[888]

In *Northwestern States Portland Cement Co. v. Minnesota*,[889] Justice Frankfurter observed in dissent:

> At best, this Court can only act negatively; it can determine whether a specific state tax is imposed in violation of the Commerce Clause. Such decisions must necessarily depend on the application of rough and ready legal concepts. We cannot make a detailed inquiry into the incidence of diverse economic burdens in order to determine the extent to which such burdens conflict with the necessities of national economic life. Neither can we devise appropriate standards for dividing up national revenue on the basis of more or less abstract principles of constitutional law, which cannot be responsive to the subtleties of the interrelated economies of Nation and State.
>
> The problem calls for solution by devising a congressional policy. Congress alone can provide for a full and thorough canvassing of the multitudinous and intricate factors which compose the problem of the taxing freedom of the States and the needed limits on such state taxing power.[890]

More recently, Justice Stevens, writing for the majority in a case in which the Court sustained Iowa's single-factor gross receipts formula for apportioning net income, despite substantial claims that it would lead to multiple taxation, put the matter as follows:

> The prevention of duplicative taxation, therefore, would require national uniform rules for the division of income. . . .

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[888] *McCarroll*, 309 US 176, 188–189, 60 S. Ct. 504 (1940).

[889] Northwestern States Portland Cement Co. v. Minnesota, 358 US 450, 79 S. Ct. 357 (1959).

[890] *Northwestern*, 358 US 450, 476, 79 S. Ct. 357 (1959) (Frankfurter, J., dissenting). The Court expressed similar sentiments in Commonwealth Edison Co. v. Montana, 453 US 609, 101 S. Ct. 2946 (1981) and in Moorman Mfg. Co. v. Bair, 437 US 267, 98 S. Ct. 2340 (1978). For other comments as to the inadequacy of a judicial solution of Commerce Clause taxing issues, see P. Hartman, "State Taxation of Corporate Income From a Multistate Business," 13 Vand. L. Rev. 21 (1959); J. Hellerstein, "State Taxation Under the Commerce Clause: An Historical Perspective," 29 Vand. L. Rev. 335 (1976); L. Kust, "State Taxation of Interstate Income: New Developments of an Old Problem," 11 Tax Exec. 45 (1959); P. Studenski, "The Need for Federal Curbs on State Taxes on Interstate Commerce: An Economist's Point of View," 46 Va. L. Rev. 1121 (1960).

> While the freedom of the States to formulate independent policy in this area may have to yield to an overriding national interest in uniformity, the content of any uniform rules to which they must subscribe should be determined only after due consideration is given to the interests of all affected States. It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income. It is to that body, and not this Court, that the Constitution has committed such policy decisions.[891]

[3] Constitutionality of Public Law 86-272

It was not until 1959, after the Court had handed down "some three hundred full dress opinions"[892] dealing with the power of the states to tax interstate commerce that Congress enacted a general statute regulating state taxation of interstate commerce, Public Law 86-272.[893] Congress had earlier adopted legislation to eliminate the doubt that had arisen as to the power of the states to tax national insurance companies,[894] and it had also authorized the states to impose taxes or fees as a condition of transportation of intoxicating liquors into the state.[895] When unemployment insurance was adopted, Congress lifted all Commerce Clause barriers to state unemployment insurance taxation of foreign corporations engaged exclusively in interstate commerce.[896] But Public Law 86-272, which Congress enacted in response to the Court's decision in *Northwestern*,[897] was Congress's first effort to enact general legislation restricting the states' power to tax interstate commerce.

In Public Law 86-272, Congress forbade the states from taxing income derived from the sale of tangible personal property in interstate commerce unless the out-of-state vendor's activities in the taxing state exceeded "solicita-

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[891] Moorman Mfg. Co. v. Bair, 437 US 267, 279–280, 98 S. Ct. 2340 (1978).

[892] Northwestern States Portland Cement Co. v. Minnesota, 358 US 450, 457–458, 79 S. Ct. 357 (1959).

[893] Pub. L. No. 86-272, 73 Stat. 55, codified at 15 USC § 381. The statute is discussed in detail at ¶¶ 6.16–6.27.

[894] See the McCarran Act, 59 Stat. 33, codified at 15 USC § 1011, discussed at ¶ 3.05[3].

[895] See the Webb-Kenyon Act, 37 Stat. 699, codified at 27 USC §§ 122 et seq., which prohibits the transportation of liquor into any state in violation of its laws.

[896] IRC § 3305(a). See International Shoe Co. v. Washington, 326 US 310, 66 S. Ct. 154 (1945) (construing this provision).

[897] Northwestern States Portland Cement Co. v. Minnesota, 358 US 450, 79 S. Ct. 357 (1959). The *Northwestern* case is discussed supra ¶ 4.10[1].

tion."[898] Louisiana challenged the constitutionality of Public Law 86-272 in *International Shoe Co. v. Cocreham*,[899] on the ground that "the imposition of a tax measured on net income derived from sources within a . . . state does not constitute a regulation of interstate commerce, and, hence, Congress is without power to forbid it."[900] The state's position misconceived the Court's position in *Northwestern*, namely, that a fairly apportioned net income tax on an exclusively interstate business did not burden interstate commerce and therefore that it lies within the states' taxing powers in the absence of congressional legislation to the contrary.

The state also attacked the federal legislation on the ground that, while Congress has the power under the Commerce Clause to broaden the scope of state taxation, it is not vested with the power to restrict state taxing powers. The Louisiana Supreme Court disagreed, saying:

> Of the many matters presented to the Supreme Court concerning the unconstitutionality of state taxation of activities in interstate commerce, there is none in which the court has ever suggested that Congress has not retained plenary power to regulate the activity by prohibiting the imposition of a state tax when it determines such tax to unduly burden the free flow of such commerce.[901]

The U.S. Supreme Court denied certiorari in the Louisiana case.[902] The Supreme Courts of Missouri and Oregon also rejected tax administrators' challenges to the constitutionality of Public Law 86-272.[903]

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[898] 15 USC § 381.

[899] International Shoe Co. v. Cocreham, 246 La. 244, 164 So. 2d 314 (1964), cert. denied sub nom. Mouton v. International Shoe Co., 379 US 902, 85 S. Ct. 193 (1964) .

[900] *International Shoe Co.*, 246 La. 244, 164 So. 2d 314, 318 (1964), cert. denied, sub nom. Mouton v. International Shoe Co., 379 US 902, 85 S. Ct. 193 (1964).

[901] *International Shoe Co.*, 246 La. 244, 164 So. 2d 314, 319 (1964), cert. denied, sub nom. Mouton v. International Shoe Co., 379 US 902, 85 S. Ct. 193 (1964).

[902] Mouton v. International Shoe Co., 379 US 902, 85 S. Ct. 193 (1964). The case is noted in 14 Am. UL Rev. 88 (1964); 14 De Paul L. Rev. 195 (1964); 39 NYU L. Rev. 1130 (1964); 18 Vand. L. Rev. 313 (1964). See also R. Roland, "Public Law 86-272: Regulation or Raid," 46 Va. L. Rev. 1172 (1960).

[903] State ex rel. Ciba Pharmaceutical Prods., Inc. v. State Tax Comm'n, 382 SW2d 645 (Mo. 1964); Smith Kline & French Lab., Inc. v. State Tax Comm'n, 241 Or. 50, 403 P2d 375 (1965).

For analyses concluding that the congressional action taken under Public Law 86-272 is valid and that Congress has ample power to restrict state taxation of businesses engaged to any extent in interstate commerce, including local manufacturing that is followed by sale and shipment of goods across state lines, see J. Hellerstein, "An Academician's View of State Taxation of Interstate Commerce," 16 Tax L. Rev. 159 (1961); J. Hellerstein, "The Power of Congress to Restrict State Taxation of Interstate Income," 12 J. Tax'n 302 (1960); P. Mickey & G. Mickum, "Congressional Regulation of State Taxation of Interstate Income," 38 NC L. Rev. 119 (1960); but see A. Parnell, "Constitutional Considera-

¶ 4.24 FEDERAL PREEMPTION OF STATE TAXATION UNDER THE COMMERCE CLAUSE

Under the Supremacy Clause of the Constitution, a valid exercise of congressional power preempts any conflicting state legislation.[904] Consequently, state taxes on interstate or foreign commerce that conflict with federal legislation, enacted pursuant to Congress's power to regulate commerce, are invalid. For example, state income taxes imposed on foreign corporations whose in-state activities do not exceed the minimum activities protected by Public Law 86-272 are unconstitutional.[905] Historically there has been relatively little federal legislation restricting state taxing power,[906] at least by comparison to the vast body of federal legislation restricting state regulatory power. Consequently, there have been relatively few cases raising issues of federal preemption of

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tions of Federal Control Over the Sovereign Taxing Authority of the States," 28 Cath. UL Rev. 227, 244–245 (1979). On congressional legislation in the state tax field generally, see J. Hellerstein & E. Hennefeld, "State Taxation in a National Economy," 54 Harv. L. Rev. 949 (1941); E. Ribble, "National and State Cooperation Under the Commerce Clause," 37 Colum. L. Rev. 43 (1937); F. Rodell, "A Primer on Interstate Taxation," 44 Yale LJ 1166, 1182–1184 (1935).

[904] U.S. Const. art. VI provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land.

[905] See supra ¶ 4.23 for the cases sustaining the constitutionality of Public Law 86-272.

[906] Apart from Public Law 86-272, which is by far the most significant piece of federal legislation restricting state tax power, see ¶ 6.16 et seq., Congress has restricted state power (other than its power to tax the federal government or its instrumentalities) only in highly specific circumstances. For example, in adopting the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94–210, 90 Stat. 54, 49 USC § 11501, Congress prohibited the states from taxing railroad property more heavily than other commercial and industrial property. Congress subsequently extended similar protection to motor carriers, 49 USC § 14502, and to air carriers. 49 USC § 40116. See infra ¶ 4.24[1][b][iii]. In amending the securities acts in 1975, Congress imposed limitations on the power of states to levy stock transfer taxes. See Pub. L. No. 94-29, 89 Stat. 97, 15 USC § 78bb(d). Federal legislation also prohibits the states from imposing user charges in connection with the carriage of persons in air commerce, 49 USC § 40116(b) (see infra ¶ 4.24[1][a]); it "supersede[s] any and all State taxes insofar as they now or hereafter relate to any employee benefit plan" instituted pursuant to the Employee Retirement Income Security Act (ERISA), 29 USC § 1144(a) (see infra ¶ 4.24[1][c]); it prohibits the states from imposing electrical energy taxes discriminating against out-of-state purchasers, 15 USC § 391 (see infra ¶ 4.24[1][d]); it prohibits localities from taxing providers of direct-to-home satellite services, Pub. L. No. 104-104 (1996), 47 USC §§ 251 et seq.; it prohibits state and local governments from taxing flights of commercial aircraft or any activity or service aboard such aircraft unless the aircraft takes off or lands in the taxing jurisdiction, 49 USC § 40116(c), discussed supra ¶ 4.12[2][d]; and it prohibits states from taxing interstate passenger transportation by motor carriers, 49 USC § 14505.

state taxation. Nevertheless, in recent years, the Court on a number of occasions has had to address taxpayers' claims that a state tax was preempted by federal legislation.

[1] Congressional Legislation Explicitly Preempting State Taxes

[a] Taxes on Air Travel or Transportation

In 1970, Congress enacted legislation designed to assist states and localities in improving the nation's air transportation system (including the imposition of several federal aviation taxes to fund local airport expansion and improvement).[907] In 1972, the U.S. Supreme Court held that neither this legislation nor the Commerce Clause prevented states or localities from imposing charges designed to recoup the costs of airport construction and maintenance.[908] Congress responded to this decision by enacting a statute providing that "[n]o State . . . shall levy or collect a tax, fee, head charge, or other charge, directly or indirectly, on persons traveling in air commerce or on the carriage of persons in air commerce or on the sale of air transportation or the gross receipts derived therefrom."[909]

In *Aloha Airlines, Inc. v. Director of Taxation*,[910] the Court considered whether the congressional legislation prohibited a Hawaii tax on airlines measured by 4 percent of their gross income from the airline business. The statute declared that the "tax . . . is a means of taxing the personal property of the airline . . . tangible and intangible, including going concern value, and is in lieu of the [general excise] tax imposed by Chapter 237."[911] Airlines that carried both passengers and freight contested the tax as violating the federal statute.

The Hawaii Supreme Court upheld the levy.[912] The court conceded that, "[r]ead literally, the subsection decrees a federal preemption of the entire field of commercial aviation taxes."[913] The court nevertheless concluded that Congress "could not have intended so broad a preemptive sweep since the statute

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[907] See Aloha Airlines, Inc. v. Director of Tax'n, 464 US 7, 8–9, 104 S. Ct. 291 (1983).

[908] Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines, 405 US 707, 92 S. Ct. 1349 (1972).

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

[910] *Aloha Airlines*, 464 US 7, 104 S. Ct. 291 (1983).

[911] *Aloha Airlines*, 464 US 7, 10–11, 104 S. Ct. 291 (1983) (quoting the statute).

[912] In re Tax Appeal of Aloha Airlines, Inc., 65 Haw. 1, 647 P2d 263 (1982).

[913] In re Tax Appeal of Aloha Airlines, Inc., 65 Haw. 1, 647 P2d 263, 270 (1982).

explicitly allows property, net income, franchise and sales or use taxes."[914] It found that the purpose of the federal statute was to prohibit "taxes on passengers and shippers," and particularly state airport head taxes.[915] The court concluded that the Hawaii tax was imposed not on passengers or freight shippers, but on airlines.

The U.S. Supreme Court made short shrift of the Hawaii court's reasons for "construing" the tax out of the "plain language" of the federal prohibition. In a brief opinion, a unanimous Court rejected the state court's resort to congressional purpose in determining the meaning of the federal statute. The Court declared:

> [W]hen a federal statute unambiguously forbids the States to impose a particular kind of tax on an industry affecting interstate commerce, courts need not look beyond the plain language of the federal statute to determine whether a state statute that imposes such a tax is preempted. Thus, the Hawaii Supreme Court erred in failing to give effect to the plain meaning of § 1513(a).[916]

[i] Freight versus passenger transportation. There remains some question whether the statute at issue in the Hawaii case applies to gross receipts from freight as well as from passenger transportation. Although there is nothing in the language of the federal statute limiting its scope to receipts from passenger transportation, the Court in its opinion did refer, without apparent disapproval, to an Arizona decision holding that "49 USC § 1513a preempts state gross receipts taxes on the carriage of passengers, but not freight, in air commerce."[917] The New York courts, however, have held that the statute

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[914] In re Tax Appeal of Aloha Airlines, Inc., 65 Haw. 1, 647 P2d 263, 270 (1982). The statute provides that

> [n]othing in this section shall prohibit a State . . . from the levy or collection of taxes other than those enumerated in subsection (a) of this section, including property taxes, net income taxes, franchise taxes, and sales or use taxes on the sale of goods or services.

49 USC § 1513(b).

[915] In re Tax Appeal of Aloha Airlines, Inc., 65 Haw. 1, 647 P2d 263, 274 (1982).

[916] *Aloha Airlines*, 464 US 7, 12, 104 S. Ct. 291 (1983) (footnotes omitted). See also Republic Airlines, Inc. v. State Dep't of Treasury, 169 Mich. App. 674, 427 NW2d 182 (1988) (invalidating single business tax "minimum tax" on air carriers measured by gross receipts); but see United Air Lines v. County of San Diego, 1 Cal. App. 4th 418, 2 Cal. Rptr. 2d 212 (4th Dist. 1991) (sustaining possessory interest tax over objection that levy violated 49 USC § 1513); Burlington Air Express, Inc. v. Michigan Dep't of Treasury, 1988 WL 125466 (single business tax does not generally constitute a tax on gross receipts, so that the application of the tax to an air-freight company did not violate 49 USC § 1513(a)).

[917] *Aloha Airlines*, 464 US 7, 14 n.11, 104 S. Ct. 291 (1983) (citing State ex rel. Arizona Dep't of Revenue Cochise Airlines, 128 Ariz. App. 432, 626 P2d 596 (1980)).

preempts all state gross receipts taxes on air transportation, without distinguishing between passenger and freight transportation.[918]

[ii] Reasonable rental charges, land fees, and other charges. In *Northwest Airlines, Inc. v. County of Kent*,[919] the Supreme Court rebuffed commercial airlines' challenge to airport user fees on the ground that they conflicted with the federal statute barring taxes on persons traveling in air commerce. The statute explicitly permits states and their political subdivisions to impose "reasonable rental charges, landing fees, and other service charges from aircraft operators for using airport facilities of an airport owned or operated by that State or subdivision."[920] The airlines contended, however, that the user charges at issue were unreasonable because they allegedly allocated a disproportionate share of the airport's cost to the commercial airlines while allocating an insufficient share of such costs to "general" (noncommercial) aviation and airport concessionaires. Analyzing the airlines' claims under the standards it had employed under the Commerce Clause to determine the reasonableness of user charges,[921] the Court declared that "a levy is reasonable . . . if it (1) is based on some fair approximation of use of the facilities, (2) is not excessive in relation to the benefits conferred, and (3) does not discriminate against interstate commerce."[922]

The Court concluded that the user charges at issue met these tests. Even though certain airport costs were not allocated to the concessions, which would have reduced the costs allocated to the airlines, the Court found that this failed to establish that the airlines were charged fees excessive in comparison to the benefits conferred. Nor did the fact that the fees generated surpluses for the airport prove that they were excessive, since the surplus was attributed largely to fees charged the concessions. Finally, the Court rejected the claim that the fees discriminated against interstate commerce by charging general aviation less than a fair share of the airport costs because the airlines had not established that general aviation engaged only in intrastate commerce.[923]

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[918] Airborne Freight Corp. v. New York State Dep't of Tax'n & Fin., 137 AD2d 30, 527 NYS2d 107 (3d Dep't 1988); Air Transp. Ass'n of Am. v. New York State Dep't of Tax'n & Fin., 91 AD2d 169, 458 NYS2d 709 (3d Dep't 1983), aff'd, 59 NY2d 917, 453 NE2d 548, 466 NYS2d 319 (1983), cert. denied, 464 US 960, 104 S. Ct. 392 (1983).

[919] Northwest Airlines, Inc. v. County of Kent, 510 US 355, 114 S. Ct. 855 (1994).

[920] 49 USC § 40116(e).

[921] See Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines, 405 US 707, 92 S. Ct. 1349 (1972); see also American Trucking Ass'ns, Inc. v. Scheiner, 483 US 266, 107 S. Ct. 2829 (1987), discussed supra ¶ 4.13[2][g]; cf. Massachusetts v. United States, 435 US 444, 98 S. Ct. 1153 (1978) (applying *Evansville* test to determine constitutionality of tax under intergovernmental immunities doctrine).

[922] *Northwest Airlines*, 510 US 355, 364, 114 S. Ct. 855 (1994).

[923] In pre–*Northwest Airlines* cases, courts disagreed over the question whether airport concession revenues must be taken into account in determining the reasonableness of

[b] Congressional Legislation Prohibiting Discriminatory Taxation of Rail, Motor Carrier, and Air Transportation Property

In 1976, Congress adopted a special statute prohibiting the states from taxing rail transportation property at a higher ratio to its true market value than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction bore to the true market value of such other commercial and industrial property.[924] The statute also prohibits ad valorem property taxation of rail transportation property at a higher rate than that applicable to other commercial and industrial property.[925] The statute provides for federal court jurisdiction over these issues, and the federal courts have become forums for a considerable amount of litigation over the statute's construction.[926]

One of the principal interpretive issues raised by the federal statute involves the question of what showing a railroad must make in order to demonstrate that its property has been assessed at a higher ratio to its true market value than other commercial and industrial property in the jurisdiction.[927] In *Burlington Northern Railroad Co. v. Oklahoma Tax Commission*,[928] the Supreme Court held that federal courts may consider overvaluation of railroad

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fees imposed on aircraft operators. Compare Indianapolis Airport Auth. v. American Airlines, 733 F2d 1262 (7th Cir. 1984) (concession fees must be considered) with City & County of Denver v. Continental Air Lines, Inc., 712 F. Supp. 834 (D. Colo. 1989) (concession fees need not be considered). The *Continental* case also held that the act forbade an airport owner from using landing fees at an existing airport to fund a new airport and they were permissible only insofar as they were used for airport maintenance. These decisions must now be read in light of the U.S. Supreme Court's decision in *Northwest Airlines*.

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

[925] 49 USC § 11501(b).

[926] 49 USC § 11501(c). In Seminole Tribe of Fla. v. Florida, 517 US 44, 116 S. Ct. 1114 (1996), however, the U.S. Supreme Court held that the Eleventh Amendment prevents Congress from exercising its power under the Commerce Clause to authorize suits against states in federal court. Some courts have read *Seminole* as barring federal court jurisdiction over the states under the federal statute prohibiting discriminatory taxation of railroads. See, e.g., Union Pac. RR v. Burton, 949 F. Supp. 1546 (D. Wyo. 1996). Others, however, have held that such jurisdiction is authorized bacause Congress exercised its power under Section 5 of the Fourteenth Amendment when it provided for federal jurisdiction under the 4-R Act. See, e.g., Oregon Short Line RR v. Department of Revenue, 139 F3d 1259 (9th Cir. 1998).

[927] See, e.g., Burlington N. RR v. Lennen, 715 F2d 494 (10th Cir. 1983), cert. denied, 467 US 1230, 104 S. Ct. 2690 (1984); Trailer Train v. State Bd. of Equalization, 697 F2d 860 (9th Cir. 1983), cert. denied, 464 US 846, 104 S. Ct. 149 (1983); Arizona v. Atchison, Topeka & Santa Fe Ry. (9th Cir. 1983) (unreported), cert. denied, 465 US 1084, 104 S. Ct. 1455 (1984).

[928] Burlington N. RR Co. v. Oklahoma Tax Comm'n, 481 US 454, 107 S. Ct. 1855 (1987).

property in determining whether a state tax is discriminatory and that the railroads need not make a preliminary showing of intentional discrimination before federal courts may review claims of discrimination based on overvaluation.

[i] Prohibition against "another tax that discriminates against a rail carrier." A number of cases have focused on the meaning of another provision of the statute that denies to the states authority to "impose another tax that discriminates against a rail carrier."[929] In *Department of Revenue v. ACF Industries, Inc.*,[930] the Supreme Court considered the question of whether the quoted language prevented a state from subjecting railroads to property taxation when other classes of commercial and industrial property are exempt from such taxation. The U.S. Court of Appeals for the Ninth Circuit, agreeing with most other courts that had considered the issue, had held that the language forbade "*any* exemption given to other taxpayers but not to railroads" with possible room for "a *de minimis* level of exemption[s]."[931] Because 25 percent of nonrailroad commercial property was exempted, far exceeding any de minimis exemption, the court held that the taxation of railroad property violated the statute and that the taxpayers "were entitled to the same total exemption preferred property owners enjoyed."[932]

The Supreme Court reversed, observing that for purposes of determining whether a property tax was imposed on railroads at a higher assessment level or rate than other commercial and industrial property, the statute defined "commercial and industrial property" as "property . . . devoted to a commercial and industrial use *and subject to a property tax levy.*"[933] Because exempt property was excluded from the comparison with railroad property for purposes of implementing the specific statutory bar against property tax rate and assess-

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[929] 49 USC § 11501(b)(4). See, e.g., Department of Revenue v. ACF Indus., Inc., 510 US 332, 114 S. Ct. 843 (1994); ACF Indus., Inc. v. Department of Revenue, 946 F2d 1414 (9th Cir. 1991); Burlington N. RR v. City of Superior, 932 F2d 1185 (7th Cir. 1991); Union Pac. RR v. Public Util. Comm'n, 899 F2d 854 (9th Cir. 1990); Trailer Train Co. v. Leuenberger, 885 F2d 415 (8th Cir. 1988), cert. denied, sub nom. Boehm v. Trailer Train Co., 490 US 1066, 109 S. Ct. 2065 (1989); Kansas City S. Ry. v. McNamara, 817 F2d 368 (5th Cir. 1987); Alabama Great S. RR v. Eagerton, 663 F2d 1036 (11th Cir. 1981), on remand, 541 F. Supp. 1084 (MD Ala. 1982); Ogilvie v. State Bd. of Equalization, 657 F2d 204 (8th Cir. 1981); Burlington N. RR v. Bair, 837 F. Supp. 298 (SD Iowa 1993); Burlington N. RR v. Bair, 815 F. Supp. 1223 (SD Iowa 1993); Atchison, Topeka & Santa Fe Ry. v. Bair, 338 NW2d 338 (Iowa 1983), cert. denied, 465 US 1071, 104 S. Ct. 1427 (1984); Burlington N. RR v. Commissioner of Revenue, 509 NW2d 551 (Minn. 1993).

[930] Department of Revenue v. ACF Indus., Inc., 510 US 332, 114 S. Ct. 843 (1994).

[931] ACF Indus., Inc. v. Department of Revenue, 961 F2d 813, 822 (9th Cir. 1992) (emphasis in original).

[932] *ACF Indus.*, 961 F2d 813, 823 (9th Cir. 1992).

[933] 49 USC § 11501(a)(4) (emphasis supplied).

ment discrimination, the Court reasoned that it should likewise be excluded from the comparison for purposes of determining whether railroads are subject to "another tax that discriminates against railroads."

The Court was careful to limit its holding, however, to "generally applicable" ad valorem property taxes. It noted that the case was not one "in which the railroads—either alone or as part of some isolated and targeted group—are the only commercial entities subject to an ad valorem property tax."[934] If such a case were to arise, the Court suggested it would be incorrect to characterize such treatment as an "exemption" of the untaxed property. "Rather, one could say that the State had singled out the railroad property for discriminatory treatment."[935] Thus, the Court concluded that the statute "does not limit the States' discretion to exempt nonrailroad property, but not railroad property, from ad valorem property taxes *of general application.*"[936]

Following *ACF*, courts have struggled with the question whether a property tax is "generally applicable" within the meaning of *ACF*, although it is clear from the case itself that exemption of 25 percent of nonrailroad property poses no problem in this regard. For example, one federal appeals court held that Wisconsin's exemption of 80 percent of nonrailroad commercial and industrial property from a generally applicable ad valorem property tax does not violate the statute,[937] whereas another federal appeals court held that Iowa's exemption of most of the personal property of the majority of commercial and industrial enterprises in the state singles out property of railroads for discriminatory taxation in violation of the statute.[938] Similarly, a federal district court held that North Dakota's system of exempting all property, except centrally assessed property (which includes railroad property) "falls squarely within" *ACF*'s exception for property taxes that are not "generally applicable."[939] And a federal appeals court has held that a state may not subject the value of a railroad's computer software to ad valorem property taxation because intangible property was generally exempt.[940] The railroads were an "isolated and targeted" group subjected to discriminatory treatment.

A federal appeals court held that Arizona's imposition of a transaction privilege tax on a railroad's sale of services is not "another tax that discriminates against railroads" under the statute, because the transaction privilege tax

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[934] *ACF*, 510 US 332, 346, 114 S. Ct. 843 (1994).

[935] *ACF*, 510 US 332, 347, 114 S. Ct. 843 (1994).

[936] *ACF*, 510 US 332, 347–348, 114 S. Ct. 843 (1994) (emphasis supplied).

[937] Burlington N. RR v. Wisconsin Dep't of Revenue, 59 F3d 55 (7th Cir. 1995).

[938] Burlington N. RR v. Bair, 60 F3d 410 (8th Cir. 1995), cert. denied, 516 US 1113, 116 S. Ct. 914 (1996).

[939] Ogilvie v. State Bd. of Equalization, 893 F. Supp. 882, 886 (DND 1995).

[940] Burlington N. RR v. Huddleston, 94 F3d 1413 (10th Cir. 1996).

applies to a broad class of taxpayers, even though it exempts motor carriers.[941] The court found that the proper comparison class for purposes of discrimination analysis is all other commercial and industrial taxpayers subject to tax, not just the railroads' competitors. Courts have also concluded that the existence of property that escapes taxation, through no fault of the assessor, does not constitute discrimination within the meaning of the statute.[942]

[ii] Other issues. Other cases have involved such questions as whether federal district court abstention is appropriate in suits brought under the statute;[943] whether the statute authorizes federal district courts to order tax refunds;[944] whether particular statistical methods may be employed to demonstrate discrimination;[945] whether particular assessment methodologies may be challenged under the statute;[946] and whether the protection of the statute extends to a company that is not a railroad but leases rolling stock to railroads.[947]

[iii] Extension of antidiscrimination provisions to motor carriers and air carriers. In 1980, Congress extended to motor carriers protection against discriminatory state property taxes that is similar to protection it had previously enacted for railroads.[948] The principal difference between the statutes is that the motor carrier statute does not contain any provision prohibiting the

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[941] Atchison, Topeka & Santa Fe Ry. v. Arizona, 78 F3d 438 (9th Cir. 1996).

[942] American Airlines v. San Mateo County, 12 Cal. 4th 1110, 912 P2d 1198, 51 Cal. Rptr. 2d 251 (Cal. 1996) (discrimination under airline antidiscrimination statute is not demonstrated merely by the existence, through no fault of the assessor, of escaped commercial and industrial property, but must result from a practice or policy on assessor's part that is either targeted to disadvantage of or has an unacceptable disparate effect on the airlines); Northwest Airlines, Inc. v. Department of Revenue, 325 Or. 530, 943 P2d 175 (1997) (same).

[943] Union Pac. RR v. Department of Revenue, 920 F2d 581 (9th Cir. 1990).

[944] Atchison, Topeka & Santa Fe Ry. v. Lennen, 732 F2d 1495, 1506–1507 (10th Cir. 1984) (yes); Burlington N. RR v. Bair, 584 F. Supp. 1229, 1231–1232 (SD Iowa 1984) (no).

[945] CSX Transp., Inc. v. Board of Pub. Works, 95 F3d 318 (4th Cir. 1996) (median ratio of assessed value tomarket value rather than ratio of aggregates method must be used to determine state's average assessment level); Clinchfield RR v. Lynch, 700 F2d 126, 130 (4th Cir. 1983).

[946] Chesapeake W. Ry. v. Forst, 938 F2d 528 (4th Cir. 1991), cert. denied, 503 US 966, 112 S. Ct. 1577 (1992); Union Pac. RR v. State Tax Comm'n, 716 F. Supp. 543 (D. Utah 1988).

[947] General Am. Transp. Co. v. Louisiana Tax Comm'n, 680 F2d 400, 403 (5th Cir. 1982). See generally J. Gossett, "Assessment Law Notes: The Continuing Battle Over the 4-R Act and Its Progeny," 1 Prop. Tax J. 245 (1982).

[948] 49 USC § 14502. See ABF Freight Sys., Inc. v. Tax Div., 787 F2d 292 (8th Cir. 1986); Arkansas-Best Freight Sys., Inc. v. Lynch, 723 F2d 365 (4th Cir. 1983); Arkansas-Best Freight Sys., Inc. v. Cochran, 546 F. Supp. 904 (MD Tenn. 1981).

states from imposing nonproperty taxes that discriminate against motor carriers. In 1982, Congress extended to air carriers protection similar to that which it had provided for motor carriers, except for federal court jurisdiction.[949]

The North and South Dakota Supreme Courts reached conflicting conclusions as to whether the air carrier provision precludes a state from imposing a personal property tax on air carrier transportation property while exempting other personal property from taxation. Although the federal statute prohibits the states from assessing air carrier transportation property at a higher ratio to market value or at a higher rate than that applied to other commercial and industrial property, the term "commercial and industrial property" is defined by the statute as "property . . . devoted to a commercial or industrial use *and subject to a property tax levy.* "[950] The South Dakota Supreme Court reasoned that exempt commercial and industrial property, which was not "subject to a property tax," fell outside the class of commercial and industrial property that was to be considered in determining whether air transportation property was taxed more heavily than other commercial industrial property in the state.[951] The North Dakota Supreme Court, however, rejected this analysis. It observed that such a construction of the statute "would allow discriminatory taxation of air carrier transportation property as long as a state imposed no tax at all on other commercial and industrial property."[952]

The U.S. Supreme Court affirmed the South Dakota court's decision on a narrow ground that left the question of the interpretation of "commercial and industrial property" unresolved.[953] It held the federal statute inapplicable to the South Dakota tax under the provision making it inapplicable to "any in lieu tax which is wholly utilized for airport and aeronautical purposes."[954] The Court's subsequent decision in the *ACF* case,[955] however, supports the South Dakota court's reasoning, at least in cases in which airlines are subject to a generally applicable ad valorem property.

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[949] 49 USC § 40116. For a comprehensive analysis of all three statutes and the litigation they have spawned, see Note, "Discriminatory Demands and Divided Decisions; State and Local Taxation of Rail, Motor, and Air Carriers Property," 39 Vand. L. Rev. 1107 (1986); see also M. Egr, "Litigation Under Section 306 of the Railroad Revitalization and Regulatory Reform Act of 1976: A Review and Critique," 1991 Multistate Tax Commission Rev. 1 (Mar. 1991).

[950] 49 USC § 40116(d)(1)(D) (emphasis added).

[951] Western Air Lines, Inc. v. Hughes County, 372 NW2d 106 (SD 1985).

[952] Northwest Airlines, Inc. v. State, 358 NW2d 515 (ND 1984).

[953] Western Air Lines, Inc. v. Board of Equalization, 480 US 123, 107 S. Ct. 1038 (1987).

[954] 49 USC § 40116(d)(2)(A)(iv). The language of the current codified version of the statute varies slightly from the language quoted in the text.

[955] See supra ¶ 4.24[1][b][i].

[c] The Employee Retirement Income Security Act

The Employee Retirement Income Security Act (ERISA),[956] which "supersede[s] any and all State laws insofar as they may now or hereafter relate to any employee benefit plan,"[957] preempts state taxes affecting employee benefit plans.[958] In *De Buono v. NYSA-ILA Medical & Clinical Services Fund*,[959] the Court held that ERISA's "opaque language"[960] preempting state laws insofar as they "relate to" any employee benefit plan did not bar New York from imposing a gross receipts tax on the income of medical centers operated by ERISA funds. The Court observed that its prior attempts to construe the "relate to" language had not provided much useful guidance. Hence, the Court had to "go beyond the unhelpful text . . . and look instead to the objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive."[961] On this basis, the Court concluded that New York's tax was not the type of law that Congress intended ERISA to supersede, because it was not directed to specific pension plan issues. Rather it was simply one of "'myriad state laws' of general applicability that impose some burden on the administration of ERISA plans but nevertheless do not 'relate to' them within the meaning of the governing statute."[962]

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[956] 29 USC §§ 1001 et seq.

[957] 29 USC § 1144(a).

[958] See, e.g., E-Systems, Inc. v. Pogue, 935 F2d 1293 (5th Cir. 1991), cert. denied, 502 US 981, 112 S. Ct. 585 (1991) (invalidating Texas tax on administration of ERISA plans); General Motors Corp. v. California Bd. of Equalization, 815 F2d 1305 (9th Cir. 1987), cert. denied, 485 US 941, 18 S. Ct. 1122 (1988) (invalidating California premiums tax assessed against insurer and calculated with reference to benefits paid by ERISA plan); Northwest Airlines v. Roemer, 603 F. Supp. 7 (D. Minn. 1984) (invalidating Minnesota law permitting officials to levy on ERISA plan to satisfy state income tax liability of plan participant); Morgan Guar. Trust Co. v. Tax Appeals Tribunal, 80 NY2d 44, 599 NE2d 656, 587 NYS2d 252 (1992) (invalidating New York real property gains tax as applied to transactions affected by ERISA plan); Petition of Smith, 1992 WL 14115 (NY Div. of Tax Appeals) (invalidating New York law requiring add back of excess contributions to ERISA plan, insofar as such contributions were necessary to satisfy ERISA's minimum funding requirements). See generally Note, "ERISA's Preemption of State Tax Laws," 41 Fordham L. Rev. 401 (1992).

[959] De Buono v. NYSA-ILA Med. & Clinical Servs. Fund, __ US __, 117 S. Ct. 1747 (1997).

[960] *De Buono*, __ US __, 117 S. Ct. 1747, 1749 (1997).

[961] *De Buono*, __ US __, 117 S. Ct. 1747, 1751 (1997) (citation omitted).

[962] *De Buono*, __ US __, 117 S. Ct. 1747, 1752 (1997). See also Thiokol Corp. v. Roberts, 76 F3d 751 (6th Cir. 1996), cert. denied, __ US __, 117 S. Ct. 2448 (1997) (Michigan single business tax, which includes contributions to employee benefit plans in tax base, not preempted by ERISA, because tax on plans is too remote).

[d] State Energy Taxes Discriminating Against Interstate Commerce

In 1976, Congress enacted legislation prohibiting the states from imposing taxes on or with respect to the generation or transmission of electricity that discriminate against out-of-state manufacturers, producers, wholesalers, retailers, or consumers of electricity.[963] Construing this legislation, the Court struck down a facially nondiscriminatory New Mexico tax on the generation of electricity within its borders, as applied to electricity generated for sale to out-of-state consumers, because the tax was offset by a credit against the state's tax on in-state sales of electricity.[964] The tax-credit provisions assured that locally consumed electricity was not burdened by the electricity generation tax whereas the bulk of electricity generated in New Mexico for out-of-state sale was subject to the tax, because there was no offsetting credit, as in the case of local sales of electricity.

The Court rejected the New Mexico court's view that the aggregate burden of state taxes on the in-state sales, including the gross receipts tax, should be taken into account in determining whether the particular tax at issue was discriminatory. Instead, the Court held that Congress had directed its prohibition "specifically at a state tax 'on or with respect to the generation or transmission of electricity,' not to the entire tax structure of the State."[965] The Court's decision construing the statute forbidding state tax discrimination is consistent with its more recent decisions involving the application of the complementary tax doctrine to allegedly discriminatory taxes under the Commerce Clause.[966]

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[963] Tax Reform Act of 1976 § 2121(a), 90 Stat. 1914 (1976), codified at 15 USC § 391.

[964] Arizona Pub. Serv. Co. v. Snead, 441 US 141, 99 S. Ct. 1629 (1979).

[965] *Arizona Pub. Serv. Co.*, 441 US 141, 149, 99 S. Ct. 1629 (1979). The statutory provision and the case are analyzed in a thoughtful commentary in Note, "Supreme Court Decisions on Taxation: 1978 Term," 33 Tax Law. 505, 515 (1980). As the note points out, the federal statute appears to require the invalidation of the Washington tax sustained in Public Util. Dist. v. Washington, 82 Wash. 2d 232, 510 P2d 206 (1973), appeal dismissed, 414 US 1106, 94 S. Ct. 833 (1973). See also State v. City of Burbank, 100 Nev. 598, 691 P2d 845 (1984) (applying the federal antidiscrimination statute to invalidate state law taxing recipients of electric power from exempt property that discriminated against out-of-state political subdivisions).

[966] See generally supra ¶ 4.13[2][c] (dealing generally with complementary taxes) and W. Hellerstein, "Complementary Taxes as a Defense to Unconstitutional State Tax Discrimination," 39 Tax Law. 405 (1986). In Duquesne Light Co. v. State Tax Dep't, 174 W. Va. 506, 327 SE2d 683 (1984), cert. denied, 471 US 1029, 105 S. Ct. 2040 (1985), the court sustained a provision of West Virginia's former business and occupation tax that appeared to discriminate against the generation of electric power transmitted out of the state. Because another provision of the same act imposed an identical tax burden on the generation of electricity for in-state use, the court held that the tax was nondiscriminatory. Reliance on other provisions of the same taxing statute is proper in applying the federal

[e] Federal Legislation Barring Application of State Tax Laws to Outer Continental Shelf

The Outer Continental Shelf Lands Act (OCSLA)[967] provides that "State taxation laws shall not apply to the Outer Continental Shelf."[968] In *Shell Oil Co. v. Iowa Department of Revenue*,[969] the Supreme Court considered the question whether the OCSLA prevented Iowa from including in Shell's apportionable tax base income derived from oil and gas it extracted from the OCS. It was clear as a matter of constitutional law that Iowa could include in Shell's apportionable tax base income derived from its unitary petroleum business carried on in part on the OCS.[970] Shell argued, however, that the OCSLA deprived a state of any power to tax income arising from sales of OCS gas and oil.

The Court took a less sweeping view of the statute. In the Court's judgment:

> [T]he language, background, and history of the OCSLA leave no doubt that Congress was exclusively concerned with preventing adjacent States from asserting, on the basis of territorial claims, jurisdiction to assess direct taxes on the OCS. We believe that Congress primarily intended to prohibit those direct taxes commonly imposed by States adjacent to offshore production sites: for example, severance and production taxes.[971]

In light of this understanding, the Court was unwilling to find that Congress had intended to "prohibit a State from including income from OCS-derived oil and gas in a constitutionally permissible apportionment scheme."[972]

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antidiscrimination statute, since it is not unusual to have offsetting compensating provisions to a tax or an exemption in different portions of a statute. See Hellerstein, supra, and ¶ 4.13[2][c]. In a sequel to the federal statutory challenge, the court upheld the same provision over a Commerce Clause challenge for largely the same reasons: the allegedly discriminatory levy was complemented by an equivalent levy on intrastate generation of electric power. Duquesne Light Co. v. State Tax Dep't, 177 W. Va. 126, 350 SE2d 754 (1986), appeal dismissed, 481 US 1044, 107 S. Ct. 2172 (1987).

[967] 43 USC §§ 1331 et seq.

[968] 43 USC § 1333(a)(2).

[969] Shell Oil Co. v. Iowa Dep't of Revenue, 488 US 19, 109 S. Ct. 278 (1988).

[970] Exxon Corp. v. Wisconsin Dep't of Revenue, 447 US 207, 100 S. Ct. 2109 (1980).

[971] *Shell Oil*, 488 US 19, 29–30, 109 S. Ct. 278 (1988).

[972] *Shell Oil*, 488 US 19, 30, 109 S. Ct. 278 (1988). In so holding, the Court rejected Shell's claim that including OCS-derived income in Shell's apportionable tax base amounted to a direct tax on OCS production, observing that a state does not tax income merely by including it in a taxpayer's apportionable tax base. See also Shell Oil Co. v. Department of Revenue, 496 So. 2d 789 (Fla. 1986), vacated and remanded for reconsideration in light of Shell Oil Co. v. Iowa Dep't of Revenue, reinstated on remand, 540 So. 2d 107 (Fla. 1989) (sustaining Florida's inclusion of income derived from the sale in the

[f] Federal "Superfund" Legislation

In *Exxon Corp. v. Hunt*,[973] the U.S. Supreme Court held that the express language of Section 114(c) of the Federal Comprehensive Environmental Response, Compensation, and Liability Act,[974] the so-called Superfund legislation, preempted in part a New Jersey tax that was designed to fund the state's Spill Compensation and Control Act. The congressional statute explicitly preempted state taxes whose "purpose" was to provide "compensation for claims for any costs of response or damages or claims which may be compensated under this [Act]."[975] The Court found that some of the purposes for which expenditures could be made from the state spill act were preempted and that others were not. It therefore held that the state tax was preempted "[t]o the extent that" the state act could support preempted purposes.[976]

[2] State Taxes That Frustrate Purposes and Objectives of Federal Legislation

The Supremacy Clause extends beyond state legislation that is expressly prohibited by Congress or is in direct conflict with congressional legislation. State action that frustrates the purposes and objectives of federal legislation likewise violates the Supremacy Clause. As the Supreme Court has stated: "Our primary function is to determine whether . . . [the State] law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[977]

United States of oil extracted from the OCS). See also In re Superior Oil Co. & Canadian Superior Oil (US), Ltd., Decision No. 83-30 (Alaska Dep't of Revenue Sept. 7, 1983) (OCSLA does not prevent Alaska from including the value of OCS leases in the property factor of its corporate income tax apportionment formula). But see Amerada Hess Corp. v. State Dep't of Revenue, Alaska Super. Ct., 3d Jud. Dist. Dec. 12, 1986 (inclusion of value of property permanently located on OCS lands in the state's property factor numerator would violate the Supremacy Clause) (dictum).

[973] Exxon Corp. v. Hunt, 475 US 355, 106 S. Ct. 1103 (1986).

[974] 42 USC § 9614(c).

[975] 42 USC § 9614(c).

[976] *Exxon*, 475 US 355, 376, 106 S. Ct. 1103 (1986). On remand, the New Jersey Supreme Court held that the non-preempted portions of the tax were severable from the preempted portions and that the taxpayers were entitled to a refund only if the legislature did not reimburse the state spill fund for the preempted expenditures. Exxon Corp. v. Hunt, 109 NJ 110, 534 A2d 1 (1987).

[977] Hines v. Davidowitz, 312 US 52, 67, 61 S. Ct. 399 (1941). For a general treatment of the cases dealing with federal preemption of an area of state legislation, see L. Tribe, American Constitutional Law § 6-25 (2d ed. 1988).

[a] Alleged Frustration of National Energy Policy

The Court has, in a number of instances, rejected claims by taxpayers that a state tax frustrates the policy or objectives of congressional legislation. For example, in *Commonwealth Edison Co. v. Montana*,[978] the taxpayers claimed that Montana's 30 percent severance tax on coal frustrated national energy policy as reflected in a welter of federal statutes that were allegedly intended to foster the use and production of coal and, particularly, low-sulphur coal like that found in Montana. While agreeing with the taxpayers that many federal enactments did indeed encourage the use of coal, the Court refused to accept the taxpayers' "implicit suggestion that these general statements demonstrate a congressional attempt to preempt all state legislation that may have an adverse impact on the use of coal."[979]

[b] Alleged Frustration of Federal Tax Policy

The mere fact that Congress has adopted a particular policy towards taxation of income at the federal level—even in the sensitive area of taxation of foreign source income—does not require the states to adopt similar policies for state income tax purposes. For example, the U.S. Supreme Court rejected a taxpayer's challenge to the inclusion of foreign source dividends in its apportionable tax base on the theory that such inclusion was barred by federal tax policy.[980] As the Court declared:

> Concurrent federal and state taxation of income, of course, is a well-established norm. Absent some explicit directive from Congress, we cannot infer that treatment of foreign income at the federal level mandates identical treatment by the states.[981]

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[978] Commonwealth Edison Co. v. Montana, 453 US 609, 101 S. Ct. 2946 (1981), discussed supra ¶ 4.17.

[979] *Commonwealth Edison*, 453 US 609, 633, 101 S. Ct. 2946 (1981).

[980] Mobil Oil Corp. v. Commissioner of Taxes of Vt., 445 US 425, 100 S. Ct. 1223 (1980), discussed in ¶ 8.08[2][a]. Generally speaking, the apportionment method is not employed for federal income tax purposes in separating U.S. income from foreign source income. Instead, double taxation is avoided by taxing the entire income of a U.S. corporation, but allowing a credit (within stated limitations) for foreign income taxes. The avoidance of double taxation at the national level is thus a major feature of the federal tax system, as is the deferral of taxation of income earned by foreign subsidiaries, until the income is repatriated in the form of dividends. Taxpayers have therefore contended that the taxation of foreign source income and the use of worldwide apportionment on a combined basis, as applied to unitary businesses, are inconsistent with, and frustrate, federal policy as embodied in the federal treatment of foreign source income.

[981] *Mobil Oil*, 445 US 425, 448, 100 S. Ct. 1223 (1980). See also Barclays Bank PLC v. Franchise Tax Bd., 512 US 298, 114 S. Ct. 2268 (1994) (sustaining state's requirement of worldwide combined reporting despite federal tax policy to the contrary);

[c] State Taxation of Goods Stored Free of Federal Tax in Customs-Bonded Warehouses

A number of preemption controversies have arisen over state efforts to tax goods stored free of federal tax in federal customs-bonded warehouses. In *McGoldrick v. Gulf Oil Corp.*,[982] the taxpayer attacked a New York City sales tax imposed on sales of fuel oil made by the company to the owners of vessels engaged in foreign commerce. Gulf imported crude oil from Venezuela and entered it with the U.S. Customs Service under bond. The federal statute authorized the importation of crude oil duty free, if the oil was placed under bond in the importer's warehouse for export or for manufacture of fuel oil by the importer and its sale as ships' stores to vessels engaged in foreign commerce.

Gulf had manufactured the fuel oil in controversy in New York City. Because Gulf had complied with the statutory exemption procedures, no federal duty was payable. Gulf challenged the New York City sales tax on sales of fuel oil to oceangoing vessels as frustrating the federal policy underlying the federal tax exemption statute. The Court agreed, and invalidated the application of the tax, saying:

> As we have seen, the exemption and drawback provisions were designed, among other purposes, to relieve the importer of the import tax so that he might meet foreign competition in the sale of fuel as ships' stores. . . . It is evident that the purpose of the Congressional regulation of the commerce would fail if the state were free at any stage of the transaction to impose a tax which would lessen the competitive advantage conferred on the importer by Congress, and which might equal or exceed the remitted import duty. . . . The Congressional regulation, read in the light of its purpose, is tantamount to a declaration that in order to accomplish constitutionality permissible ends, the imported merchandise shall not become a part of the common mass of taxable property within the state, pending its disposition as ships' stores and shall not become subject to the state tax-

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Container Corp. of Am. v. Franchise Tax Bd., 463 US 159, 193–197, 103 S. Ct. 2933 (1983) (same); Standard Mfg. Co. v. State Tax Comm'n, 114 AD2d 138, 498 NYS2d 724 (3d Dep't 1986), aff'd, 69 NY2d 635, 511 NYS2d 229, 503 NE2d 694 (1987), appeal dismissed, 481 US 1044, 107 S. Ct. 2172 (1987) (federal legislation providing tax credit for income received from conduct of business in U.S. possession does not preclude state from requiring that corporation and its Puerto Rican subsidiary file combined report); Westinghouse Elec. Corp. v. Tully, 55 NY2d 364, 434 NE2d 1044, 449 NYS2d 677 (1982) (federal legislation providing for preferential treatment of income of domestic international sales corporations under the Internal Revenue Code does not preempt different treatment of such income at state level), rev'd on other grounds, 466 US 388, 104 S. Ct. 1856 (1984); Cook Export Corp. v. King, 652 SW2d 896 (Tenn. 1983) (same).

[982] McGoldrick v. Gulf Oil Corp., 309 US 414, 60 S. Ct. 664 (1940).

ing power. . . . The state tax in the circumstances must fail as an infringement of the Congressional regulation of the commerce.[983]

In *Xerox Corp. v. Harris County*,[984] the Court applied the principles of the *Gulf Oil* case to invalidate a property tax on copying machines held in a bonded warehouse in Texas. The parts, which had been manufactured in Colorado and New York, were shipped to Mexico for assembly, and then to Texas, where they were stored pending shipment to Latin America. The taxpayer stored the copiers in Texas in a customs-bonded warehouse for periods of from a few days to three years. Harris County argued, inter alia, that the *Gulf Oil* case was inapplicable, because the fuel oil in *Gulf Oil* could be sold only as ships' stores, whereas Xerox had the option to pay the duty and withdraw the copiers from bond. Moreover, the county argued that, because *Gulf Oil* involved a sales tax, whereas the instant controversy involved a property tax, the *Gulf Oil* case did not apply. The Court dismissed these arguments as "distinctions without a legal difference."[985]

In *RJ Reynolds Co. v. Durham County*,[986] the Court upheld an ad valorem property tax on imported tobacco stored in a customs-bonded warehouse. The Court distinguished its earlier holding in *Xerox* on the ground that the imported tobacco at issue was destined for domestic rather than foreign consumption.[987] In *Itel Containers International Corp. v. Huddleston*,[988] the Court likewise found *Xerox* (as well as *Gulf Oil*) distinguishable in sustaining a Tennessee sales tax on cargo containers used exclusively in international commerce over the objection, among others, that the tax was preempted by international container conventions and frustrated the purposes of federal legislation. The Court found that, in contrast to the regulatory provisions at issue in those cases, there was no congressional intent to exempt the containers from all domestic taxation and the federal government had not occupied the field of container regulation and taxation.[989]

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[983] *McGoldrick*, 309 US 414, 428–429, 60 S. Ct. 664 (1940).

[984] Xerox Corp. v. Harris County, 459 US 145, 103 S. Ct. 523 (1982).

[985] *Xerox*, 459 US 145, 153, 103 S. Ct. 523 (1982). The case is noted in S. Weintraub & S. Balsam, "The *Xerox* Decision—The Last Word!?" 2 J. St. Tax'n 131 (1983).

[986] RJ Reynolds Co. v. Durham County, 479 US 130, 107 S. Ct. 499 (1986).

[987] Accord City of Los Angeles v. Marine Wholesale/Warehouse Co., 15 Cal. App. 4th 1834, 19 Cal. Rptr. 2d 664 (Ct. App. 1993) (sustaining gross receipts and payroll taxes upon taxpayer who sold imported beverages and tobacco stored in a customs-bonded warehouse for consumption on ships and aircraft outside the territorial limits of the United States). See generally K. Horwitz & J. McArthur, "Recent Developments Favor Use of Foreign Trade Zones as a Way to Avoid Local Taxes," 63 J. Tax'n 172 (1985).

[988] Itel Int'l Containers Corp. v. Huddleston, 507 US 60, 113 S. Ct. 1095 (1993).

[989] *Itel* is considered further supra ¶¶ 4.19[1], 4.19[2] and at ¶ 5.05.

In Houston Indep. Sch. Dist. v. Plexchem Int'l, Inc., Texas Ct. of Civ. App., Aug. 24, 1995 (unpublished), 1995 WL 505962, 1995 Tex. App. LEXIS 2016, reversed on pro-

[d] State Taxing Schemes That Frustrate Federal Price Regulation and Deregulation Policies

On two occasions, the U.S. Supreme Court has invalidated state taxing schemes that sought to control the manner in which the economic burden of a tax on natural gas was distributed. In *Maryland v. Louisiana*,[990] the Louisiana legislature had sought to ensure that the economic burden of the state's First-Use Tax on natural gas would fall on the "owners" of natural gas, or their customers, by providing that the "tax shall be deemed a cost associated with uses made by the owner in preparation of marketing of the natural gas."[991] Agreements to the contrary were declared to be against public policy.[992] In substance, the legislation prohibited the statutory "owners" of natural gas, who were generally the pipeline companies, from passing back the burden of the First-Use Tax to producers, and compelled the pipelines either to absorb the burden of the tax themselves or to pass it on to their customers, who would ordinarily be out-of-state consumers.

The Supreme Court held that the Federal Natural Gas Act preempted these provisions of the Louisiana First-Use Tax. That act was designed "to assure that consumers of natural gas receive a fair price and also to protect against the economic power of the interstate pipelines."[993] The Court concluded:

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cedural grounds, 922 SW2d 930 (Tex. 1996), the court sustained an ad valorem property tax on domestically manufactured goods stored in a customs-bonded warehouse. The court found the case controlled by *RJ Reynolds* rather than by *Xerox*. The case was unlike *Xerox*, in which the customs-bonded warehouse was used solely as an interim point in international shipping. Rather, the taxpayer was using the warehouse to store domestic product pending its shipment to a foreign market. The only policy favoring exemption of such products would be that fewer companies would use customs-bonded warehouses if the product was taxable. As the court declared:

> We do not see the decreased use of warehouses as a justification for holding the assessment unconstitutional. Congress' goal in setting up the customs-bonded warehouse was to encourage commerce in international trade. . . . The purpose of the Customs Bonded warehouse scheme is not to encourage the use of Customs Bonded . . . warehouses themselves, but to encourage the use of American ports and American industry in international trade. . . . Because it is selling a domestically manufactured product, Plexchem does not need the advantage of a tax free enclave.

Houston Indep. Sch. Dist., Texas Ct. of Civ. App., Aug. 24, 1995 (unpublished), 1995 WL 505962, 1995 Tex. App. LEXIS 2016, at *20–*21, reversed on procedural grounds, 922 SW2d 930 (Tex. 1996).

[990] Maryland v. Louisiana, 451 US 725, 101 S. Ct. 2114 (1981). The negative Commerce Clause aspects of the case are considered supra ¶¶ 4.13[2][c][i], 4.13[2][d].

[991] Former La. Rev. Stat. Ann. § 47:1303(C) (West Supp. 1980).

[992] Former La. Rev. Stat. Ann. § 47:1303(C) (West Supp. 1980).

[993] *Maryland*, 451 US 725, 747–748, 101 S. Ct. 2114 (1981).

> The effect of [these provisions] is to interfere with the FERC's [Federal Energy Regulatory Commission's] authority to regulate the determination of the proper allocation of costs associated with the sale of natural gas to consumers. . . . By specifying that the First-Use Tax is a processing cost to be either borne by the pipeline or other owner without compensation, an unlikely event in light of the large sums involved, or passed on to purchasers, Louisiana has attempted a substantial usurpation of the authority of the FERC by dictating to the pipelines the allocation of processing costs for the interstate shipment of natural gas.[994]

Two years later, the Supreme Court struck down a provision of the Alabama oil and gas severance tax on similar grounds.[995] Alabama had increased the rate of the tax imposed on oil and gas producers and, at the same time, had prohibited the producers from passing the tax increase through to consumers. Tracking the reasoning of its opinion in *Maryland v. Louisiana*, the Court concluded with respect to sales in interstate commerce:

> The Alabama pass-through prohibition trespassed upon FERC's authority over wholesale sales of gas in interstate commerce, for it barred gas producers from increasing their prices to pass on a particular expense—the increase in the severance tax—to their purchasers. Whether or not producers should be permitted to recover this expense from their purchasers is a matter within the sphere of FERC's regulatory authority.[996]

Federal courts in New York and Connecticut similarly concluded that the anti-pass-through provisions of those states' gross receipts taxes on the oil industry were preempted by federal legislation relating to the pricing of petroleum products.[997]

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[994] *Maryland*, 451 US 725, 749–750, 101 S. Ct. 2114 (1981). See generally W. Hellerstein, "State Taxation in the Federal System: Perspectives on Louisiana's First Use Tax on Natural Gas," 55 Tul. L. Rev. 601 (1981).

[995] Exxon Corp. v. Eagerton, 462 US 176, 103 S. Ct. 2296 (1983).

[996] *Exxon*, 462 US 176, 185, 103 S. Ct. 2296 (1983).

[997] Mobil Oil Corp. v. Tully, 653 F2d 497 (Temp. Emer. Ct. App. 1981), vacated and remanded on other grounds, 455 US 245, 102 S. Ct. 1047 (1982); Mobil Oil Corp. v. Tully, 499 F. Supp. 888, 892 (NDNY 1980), dismissed in part and aff'd in part, 639 F2d 212 (2d Cir. 1981), cert. denied, 452 US 967, 101 S. Ct. 3122 (1981); Mobil Oil Corp. v. Dubno, 492 F. Supp. 1004, 1006 (D. Conn. 1980), dismissed in part and aff'd in part, 639 F2d 919 (2d Cir. 1981), cert. denied, 452 US 967, 101 S. Ct. 3122 (1981). But see Puerto Rico Dep't of Consumer Affairs v. Isla Petroleum Corp., 485 US 495, 108 S. Ct. 1350 (1988) (Congress's passage and subsequent repeal of comprehensive federal statutes providing for allocation and price controls on petroleum products did not manifest any congressional intent to preempt Puerto Rico's gasoline price regulation, including anti-pass-through provision of excise tax on oil refiners).