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STATE TAXATION OF INTERSTATE COMMERCE

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"The Congress shall have the Power . . . to regulate Commerce . . . among the several States."[1]

That sentence certainly seems simple enough. However, that little sentence has probably caused more difficulty for the United States Supreme Court than any other group of words in the whole Constitution. Some judges and lawyers have considered it to be an exclusive grant to Congress to regulate interstate commerce, i. e., it is also a restriction on state power. John Marshall in 1824 in *Gibbons* v. *Ogden* enunciated the idea that the Federal Commerce power is plenary, and "that a state may regulate commerce . . . among the states, cannot be admitted."

Since *Gibbons* v. *Ogden,* the commerce clause has developed not only to afford Congress more and more power under the commerce clause, but also to limit and qualify state regulation of interstate commerce. These seemingly paradoxical developments have as their common basis the desire on the part of the court to curtail its own power of judicial review in favor of the political agencies of the government in the country.[2]

However, it is just a development and nothing more. The states, in the exercise of their own powers, notably the taxing power, have constantly run into the maxim that they shall not regulate commerce. Since the states need more subjects of taxation to defray the increased costs of government, the trend has been to allow the states more and more freedom in the exercise of their taxing power. This is more understandable since the first purpose of the commerce clause, the creation of a unified nation, has long since been achieved.[3] Thus instead of a hard dividing line limiting a state's power to tax in the light of Congress' oft stated plenary control[4] of interstate commerce, there has been a steadily shifting line, which has varied with the historical situation, and allowed the states more freedom in the exercise of their taxing power affecting commerce. This does not mean that all the barriers are down. The purpose of this article is to determine just what are the present limits of a state's power to tax interstate commerce.

The Supreme Court has used and discarded many tests in determining whether to uphold or to strike down a state tax. The court has been criticized

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[1]Article I, section 8, U. S. Constitution.

[2]Corwin: The Constitution and What It Means Today, page 44.

[3]35 Georg. L. J. 517.

[4]"The power of Congress over interstate commerce is complete in itself, may be exercised to its utmost extent, and acknowledges no limitations other than are prescribed by the Constitution." Gibbons v. Ogden, 9 Wheat. 1.

"That power can neither be enlarged nor diminished by the exercise or non-exercise of state power." Kentucky Whip & Collar Co. v. Illinois Central R.R., 299 U. S. 334.

by many writers[5] for using legalistic theory or formulae as the basis for its decisions, rather than using a pragmatic test based on whether the tax actually does interpose a real trade barrier between the states or does place an economic burden on interstate commerce. The pragmatist would look to the *ultimate effect* of the test rather than to the *manner* in which the tax is imposed or to the legalistic form in which it is cast. The court has continued to use legalistic formulae, with various members of the court backing their own particular favorites, so it is incumbent on us to examine their various tests.

Tests, Formulae, and Criteria

DIRECTNESS OF BURDEN—Traditionally, state taxes which burden interstate commerce directly have been held invalid,[6] and those which have only an "indirect" effect on interstate commerce have been upheld.[7] This doctrine is founded on the "plenary" interstate commerce power vested in Congress, i. e.:

> "the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States. In short, the Commerce Clause, even without implementing legislation by Congress is a limitation upon the power of the States."[8]

A legalistic anomaly has appeared in the application of this rule, however. It has been consistently held since 1872 that any state tax on gross receipts derived from interstate commerce was an undue burden on that commerce and thus forbidden by the Constitution.[9] If the tax is levied *on* some other subject matter and is merely *measured by* gross receipts derived from interstate commerce, the tax is valid.[10] In spite of pronouncements like those of Justice Holmes that "The distinction between a tax equal to one per cent of gross receipts and a tax of one per cent of the same, seems to us nothing,"[11] the court has continued to rely on this presumed distinction and to hold taxes *measured by* gross receipts valid, while it nullifies taxes *on* gross receipts from interstate commerce. The state legislatures simply have to shout the magic words, "Open, Sesame!" (only in this case "measured by") and

[5]Brown: State Taxation of Interstate Commerce—What Now? 48 Mich. L. R. 899; 33 Va. L. R. 351; 46 Mich. L. R. 50.

[6]New Jersey Tel. Co. v. State Board of Taxes (1930), 280 U. S. 338.

[7]American Mfg. Co. v. St. Louis (1919), 220 U. S. 459.

[8]See Freeman v. Hewitt (1946), 329 U. S. 249, where Justice Frankfurter in his decision expresses almost the same thoughts that Justice Marshall had in Gibbons v. Ogden on Congress' plenary power over interstate commerce. However, it is highly doubtful whether Justices Marshall and Frankfurter would see eye to eye on just what is the size of "the area of trade" that should be free from interference by the states.

[9]Rule of the State Tax, 15 Wall 232.

[10]U. S. Express Co. v. Minn. (1912), 223 U. S. 335.

[11]210 U. S. 217 (1908).

they open to themselves the treasurehouse of gross receipts from interstate commerce.[12]

There is probably a great deal of validity to the direct burden criterion, if not applied too rigidly, since a direct burden is more likely to be injurious and objectionable than an indirect burden.[13] A tax *on* gross receipts derived from interstate commerce is presumptively bad (ignoring for the moment the distinction between "*on*" and "*measured by*"), since a business has to pay the tax even if it runs at a loss. There is far more chance of its constituting an actual burden than a tax on *net income* derived from interstate commerce, which the courts have upheld.[14]

The difficulty with the direct burden test is that the line between direct and indirect is not a very definite one and, in truth, is just a matter of degree. However, if the line is capable of being drawn, a small direct tax may be in fact a greater burden than a heavy tax which only indirectly impinges on interstate commerce.[15]

LOCAL INCIDENT—It has been argued that if a state is allowed to tax a local incident of interstate commerce such as delivery,[16] or manufacturing,[17] or use,[18] there can be no discrimination against, or multiple burden upon interstate commerce. Obviously no other state can tax delivery but the state in which delivery is made; no state can tax manufacturing but the state in which the manufacturing takes place; no state can tax use but the state in which an article is used. If another state did attempt to levy such taxes, it would run afoul of the due process clause in trying to tax an operation outside its territorial boundaries.

This theory has been behind the imposition of use taxes by the state of the buyer of goods moving in interstate commerce. The state of the seller has usually not been allowed to tax an interstate sale, but in order to compensate for the taxes on intrastate sales, states are allowed to impose taxes on the local use of articles of interstate commerce. Otherwise local producers would be at a competitive disadvantage.[19]

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[12]See Pullman Co. v. Richardson (1923), 261 U. S. 330, where a tax on "property," or American Mfg. Co. v. St. Louis (1919), 250 U. S. 459, where a tax on "manufacturing" *measured by* gross receipts, were only considered to have a remote or indirect effect on interstate commerce.

[13]48 Mich. L. R. 899.

[14]Memphis Gas Co. v. Beeler (1942), 315 U. S. 649. Of course the net income tax must be apportioned so as not to burden activities outside the taxing state, but this is a due process consideration rather than a commerce clause restriction. See Hans Rees' Sons v. N. Carolina (1931), 283 U. S. 123.

[15]Indiana Warehouses Inc. v. Schiele, 331 U. S. 70.

[16]McGoldrick v. Berwind-White Coal Mining Co. (1940), 309 U. S. 22.

[17]American Mfg. Co. v. St. Louis (1919), 250 U. S. 459.

[18]Henneford v. Silas Mason Co. (1937), 300 U. S. 577.

[19]*Ibid.*, at page 581.

The difficulty with this theory is that interstate commerce is composed of a great many separate incidents, as was pointed out by Justice Rutledge in *Nippert* v. *Richmond,*[20] and the cumulative effect of taxes on each incident might be very great.

A few of these local incident cases have been explained on the ground that the "local incident" is actually not part of commerce at all. Chief Justice Hughes, in his dissent in the Berwind-White case in which the court upheld a New York state tax on the delivery of coal produced in Pennsylvania, but delivered in New York, stated:

> "Mr. Justice Cardozo in speaking for the Court in the Henneford case was most careful to show that the use tax was upheld because it was imposed *after* interstate commerce had come to an end."

In the same case he also said:

> "It is urged that there is a taxable event within the state. That event is said to be the delivery of the coal. But how can that event be deemed to be taxable by the State? The delivery is but the necessary performance of the contract of the sale. Like the shipment from the mines, it is an integral part of the interstate transaction."[21]

Although Hughes' point of view had been discarded for some time, *Freeman* v. *Hewitt,*[22] decided in 1946, made its reappearance a distinct possibility. *Freeman* v. *Hewitt,* itself, was decided on the direct burden criteria, however.

DISCRIMINATION—A tax that discriminates against interstate commerce is invalid.[23] A discriminatory tax is one falling only on interstate commerce but not in *intrastate* commerce. Thus in *Best* v. *Maxwell*[24] a North Carolina tax on the use of hotel rooms for display of goods was held invalid since it was only imposed on out-of-state merchants and specifically exempted resident retail merchants. The court considered this a flagrant discrimination against such out-of-state salesmen and the goods which they carried into the state through interstate commerce channels. Undoubtedly a substantial trade barrier between states would be raised if discriminatory taxes were ever allowed. Everyone would buy goods which were produced locally because they would be cheaper than goods which came into a state through interstate channels, with a tax added to their sales price.

Justice Black has consistently pointed out this danger.[25] He feels that

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[20] 327 U. S. 416 (1947).

[21] 309 U. S. 33 (1940).

[22] 329 U. S. 249 (1946).

[23] Darnell & Son v. Memphis (1908), 208 U. S. 113; see Pacific Co. v. Johnson (1932), 285 U. S. 480.

[24] 311 U. S. 454 (1940).

[25] Dissent—J. D. Adams Mfg. Co. v. Storen (1938), 304 U. S. 307.

the court should not invalidate any state tax, no matter how extreme and burdensome

> "unless it *actually* discriminates against interstate commerce, or conflicts with a regulation enacted by Congress. Congress alone must determine how far interstate commerce . . . shall be free and untrammelled, how far it shall be burdened by duties and imposts, and how far it shall be prohibited."[26]

Note that not only does Justice Black use discrimination as the sole criterion for the validity of a state tax on interstate commerce, but also that he means *actual* discrimination and not merely threatened or potential discrimination. It was for that reason in *Gwin, White & Prince* v. *Henneford* that he dissented from the majority opinion which held unconstitutional a Washington tax on those desiring to do business in the fruit industry, such a tax being a tax on the gross income of the total business. Justice Black felt that since no other state had imposed a similar tax on this particular appellant, the appellant had sustained no injury which would justify overcoming the presumption of constitutionality of the Washington tax statute.

Whether or not there has been discrimination has been considered too narrow a test by other judges, and it has been held that the mere lack of actual discrimination against interstate commerce will not lend validity to an unduly burdensome tax.[27]

MULTIPLE OR CUMULATIVE BURDEN—Justice Stone in 1938 in *Western Livestock Co.* v. *Bureau of Revenue*,[28] announced a rule permitting state taxes on gross receipts from interstate commerce if they were either (1) apportioned, or (2) incapable of being duplicated by any other state. His rule was that the threat of exposure to a cumulative tax burden because of a tax on the same subject by other states rendered a gross receipts tax imposed by the seller's state invalid.[29] This gives recognition to the idea that "even interstate business must pay its own way by bearing its share of local tax burdens,"[30] but it need not bear cumulative tax burdens that would place it at a competitive disadvantage with intrastate commerce.

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[26]Dissent—Gwin, White & Prince v. Henneford (1939), 305 U. S. 434.

[27]Puget Sound Stevedoring Co. v. State Tax Commission (1937), 302 U. S. 90; Freeman v. Hewitt (1946), 329 U. S. 249.

[28]303 U. S. 250.

[29]Justice Black maintains his position that discrimination should be the sole criterion for the courts, and opposes a rule of self apportionment:

"It has been suggested that Indiana might by law apportion to itself that part of a tax on gross receipts from interstate commerce to which it is entitled. Such an apportionment by Indiana would fix the portion of such a tax for the other forty-seven states, which appellant interstate business might touch. Indiana has no authority to determine what, how, when, or to what extent other states may tax within their respective boundaries. If such power of apportionment or allocation exists at all, it must be true that the only repository of a power touching complex and national aspects of interstate commerce is not Indiana, not the Judiciary, but the National Congress." Adams Mfg. Co. v. Storen (1938), 304 U. S. 377.

[30]Postal Telegraph Co. v. Richmond, 249 U. S. 252, 259.

In *Gwin, White & Prince* v. *Henneford*,[31] decided in 1939, Justice Stone expressed his views in this manner:

> "Under the commerce clause, in the absence of Congressional action, state taxation, whatever its form, is precluded if it discriminates against interstate commerce or undertakes to lay a privilege tax measured by gross receipts derived from activities in such commerce which extend beyond the territorial limits of the taxing state.[32] Such a tax at least when not apportioned to the activities carried on within the state . . . burdens the commerce in the same manner and to the same extent as if the exaction were for the privilege of engaging in interstate commerce and would, if sustained, expose it to multiple tax burdens, each measured by the entire amount of the commerce to which local commerce is not subject. . . . Such a multiplication of state taxes, each measured by the volume of the commerce, would reestablish the barriers to interstate trade which it was the object of the commerce clause to remove."

This test seems to have the closest identification with a pragmatic test, i. e., whether there is an actual burden on interstate commerce. Indeed, in a footnote in the Berwind-White case, Justice Stone admits:

> "Despite mechanical or artificial distinctions sometimes taken between the taxes deemed permissible and those condemned, the 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."

There was a certain difficulty though in applying the cumulative burden test to tax cases involving interstate sales. A sales tax on an interstate sale is in effect a gross receipts tax on interstate commerce. But, while the state of the seller can administer an apportioned gross receipts tax without great difficulty, it is virtually impossible to apportion a sales tax. To require the buyer's state to apportion a sales tax almost amounts to a prohibition of any tax since the seller may not maintain a place of business within the taxing state, and the buyer's state would then have no means of collecting the tax. In that case it would give a competitive advantage to interstate commerce. On the other hand, to allow a sales tax on the full proceeds of an interstate sale would appear to permit multiple taxation, at least to the extent that the other states touched by the commerce attempt to exact any type of levy, apportioned or unapportioned.[33] The use tax has been developed to avoid legal objections to a sales tax. It is imposed on the state of the user and has been upheld as being imposed on a local incident of commerce. However, as Mr. Justice Frankfurter pointed out in *McCleod* v. *Dilworth*,[34] "The economic effect of a use tax and a sales tax on interstate commerce is exactly the same."

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[31] 305 U. S. 434.

[32] Note that there would be infringement of due process here also.

[33] 56 Yale L. J. 898.

[34] 322 U. S. 327 (1944).

OTHER CONSIDERATIONS—State taxation of interstate commerce must pass the scrutiny of the court to determine if it imposes a prohibitive burden on interstate commerce. In this connection, it should be noted that state taxation is scrutinized much more closely than state regulation of interstate commerce. Justice Frankfurter, in *Freeman* v. *Hewitt,* stated:

> "A police regulation of local aspects of interstate commerce is a power often essential to a state in safeguarding vital local interests. . . . State taxation falling on interstate commerce, on the other hand, can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys. But revenue serves as well no matter what its source. To deny to a state a particular source of income because it taxes the very process of interstate commerce does not impose a crippling limitation on a state's ability to carry on its local function.
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> "Moreover, the burden on interstate commerce involved in a direct tax upon it is inherently greater, certainly less uncertain in its consequences, than results from the usual police regulations. The power to tax is a dominant power over commerce. Because the greater or more threatening burden of a direct tax on commerce is coupled with the lesser need to a state of a particular source of revenue, attempts at such taxation have always been more carefully scrutinized and more consistently resisted than police power regulations of aspects of such commerce."

Obviously the application of a state gross receipts tax to those businesses which are wholly engaged in interstate commerce, such as railroads, is more likely to be held an invalid interference with such commerce.[35] However, it is easier to apportion taxes on such businesses, basing the apportionment on the total mileage within the state as compared to the mileage without. In the case of a nontransportation business, apportionment of the tax is difficult and often impossible.[36]

Recent Cases

From 1938 to 1946 the Supreme Court appeared to use Justice's Stone's cumulative burden test wherever possible. Indeed, it seemed as if the Supreme Court were approaching the stage where it would eliminate legalistic formulae and use a pragmatic test on which to base its decisions.

However, in 1946 the case of *Freeman* v. *Hewitt* was decided. In that case an Indiana gross receipts tax was held invalid as applied to the sale of stock by an Indiana resident on the New York Stock Exchange. Justice Frankfurter, in his majority opinion, went back to 1925 and resurrected the direct burden test. This was not done by oversight as the following excerpt clearly shows:

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[35] Fargo v. Mich. (1887), 121 U. S. 230.

[36] Lockhart: Gross Receipts Taxes on Interstate Commerce (1943), 57 H. L. R. 40.

> "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 hadly 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. Courts are not possessed of instruments of determination so delicate as to enable them to weigh the various factors in a complicated economic setting which, as to an isolated application of a state tax, might mitigate the obvious burden generally created by a direct tax on commerce. Nor is there any warrant in the constitutional principles heretofore applied by this Court to support the notion that a state may be allowed one single-tax-worth of direct interference with the free flow of commerce. An exaction by a state from interstate commerce falls not because of a proven increase in the cost of the product. What makes the tax invalid is the fact that there is interference by a state with the freedom of interstate commerce."

This quotation, by inference, discards all the tests developed by preceding cases for determining the validity of a state tax on interstate commerce. It discards apportionment, local incident, multiple burden, and discrimination, and resurrects the direct burden formula.

In 1947, an excise tax levied by the City of New York on the gross receipts of a stevedoring company engaged wholly within the territorial limits of the city in loading and unloading vessels moving in interstate and foreign commerce was held invalid in *Joseph* v. *Carter & Weekes Stevedoring Co.*[37] Here it was expressly noted there was no danger of multiple taxation but still the Court declared the tax invalid because, "Stevedoring . . . is essentially a part of interstate commerce itself . . . and therefore a tax on its gross receipts is involved." Probably the consideration that the taxpayer was an agency of interstate transportation was determinative.

In 1948 the Supreme Court, in *Central Greyhound Lines* v. *Mealey,* which involved a New York gross receipts tax, held "Interstate Commerce is unconstitutionally burdened by a state tax upon carriers' gross receipts from such transportation; but the state may constitutionally tax such part of the receipts as is proportioned to the mileage traversed within the state." Here the taxpayer was engaged in the transportation of passengers between two cities in New York, but over 40 per cent of the mileage of the route was out of the state. By this decision, New York could only tax that percentage of the gross receipts which the mileage traveled in the state bore to the total mileage traveled.

Also in 1948, in *Memphis Gas Co.* v. *Stone*[38] the Supreme Court allowed Mississippi to impose a property tax on the amount of pipe line and the compressors within the state boundaries even though the petitioner's business was

[37]330 U. S. 422.
[38]335 U. S. 80.

exclusively interstate, transporting gas from Louisiana to Tennessee. The court said:

> "This is a tax on activities for which the State, not the United States, gives protection and the State is entitled to reasonable compensation when its tax cannot be said to be an unreasonable burden or a toll on the interstate business."

Conclusions

On the basis of these recent cases, what conclusions can be drawn as to the constitutionality of a state tax or interstate commerce?

1. Where there is an actual cumulative tax burden, a state tax on gross receipts derived from interstate commerce will be held invalid. Such a tax would be invalid under the direct burden test as well as all the other tests and would impose a discriminatory economic burden on interstate commerce.

2. If the court does not choose to rely on the possibility of double taxation, then the old test of direct or indirect burden may be used (as it was in *Freeman* v. *Hewitt, supra*).

3. In the case of carriers and transportation businesses, an apportioned gross receipts tax will be upheld. (*Central Greyhound, Memphis Gas Co., supra.*) An unapportioned gross receipts tax on an agency of interstate transportation will evidently fall even though duplication is impossible. (*Joseph* v. *Carter & Weekes Stevedoring Co., supra.*)

4. Gross receipt taxes in the form of sales taxes or use taxes imposed by the state of a buyer will be considered valid, even though they are levied on articles which have moved in interstate commerce. Otherwise, producers for interstate commerce would be given an advantage over local producers.

5. An unapportioned gross receipts tax imposed by a seller state is considered invalid as applied to receipts from interstate commerce. In most situations it is extremely difficult, if not impossible, for the seller's state to apportion a tax on gross receipts of sales in interstate commerce.

6. Even though there is no discrimination, *e. g.*, a tax is imposed on intrastate as well as interstate commerce, that is not sufficient to save the tax if it is considered to impose a direct burden on interstate commerce.