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A Revolution in State Taxation of Commerce

William B. Lockhart

A Revolution in State Taxation of Commerce?*

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I. INTRODUCTION

To those who might have expected that I would discuss constitutional philosophy or the latest constitutional developments concerning obscenity, I assure you that recent developments in state taxation of interstate commerce are of far greater importance. Recent changes in the United States Supreme Court's treatment of state taxation of interstate commerce suggest that a potentially revolutionary shift is now underway in the court-created limits on such taxation. This constitutional development has far-ranging implications for both large and small businesses and their lawyers.

In addition to its current significance, this topic seems particularly appropriate for this tapering-off-a-career reflection because it relates to the article that opened my academic career, forty-three years ago.[1] One object of that article was to nudge the Supreme Court into limiting or departing from what I shall call the Formal Rule,[2] long held even then, that a state may not impose a tax on any activity or process viewed by the Court as a part of interstate commerce, even though the tax threatens no discriminatory burden on commerce.[3] At the time I had little success in that objective,[4] and turned to more malleable subjects like obscenity.[5] But now, nearly half a century later,

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1. Lockhart, *The Sales Tax in Interstate Commerce*, 52 HARV. L. REV. 617 (1939).
2. *See* notes 12-61 *infra* and accompanying text.
3. Lockhart, *supra* note 1, at 618-19, 629, 642-44.
4. *See* McLeod v. J.E. Dilworth Co., 322 U.S. 327, 330 (1944); Freeman v. Hewit, 329 U.S. 249, 256 (1946); Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602, 610 (1951). *But see* McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 58 (1940) (a temporary success when the Court evaded the Formal Rule).
5. *See* Lockhart & McClure, *Literature, the Law of Obscenity, and the Constitution*, 38 MINN. L. REV. 295 (1954); Lockhart & McClure, *Censorship of Ob-*

the Court has explicitly and unanimously repudiated one common application of the Formal Rule in two recent cases. I claim no credit for this belated turnaround, but I eagerly return to discuss the implications of these decisions that shook the foundations underlying much of the current law.

The Supreme Court shook the foundations for the first time in 1977 with *Complete Auto Transit, Inc. v. Brady*.[6] Justice Blackmun's unanimous opinion upheld a Mississippi tax on the "privilege of doing business" in the state,[7] as applied to a motor carrier engaged there exclusively in interstate commerce. In doing so, the Court expressly overruled *Spector Motor Service, Inc. v. O'Connor*.[8] The foundations shook again the next year when another unanimous Blackmun opinion in *Department of Revenue v. Association of Washington Stevedoring Cos.*[9] upheld a similar state privilege tax, as applied to a stevedoring company engaged exclusively in interstate and foreign commerce in Washington. Both cases explicitly repudiated the long-established rule that a state may not tax the privilege or business[10] of engaging exclusively in interstate commerce—the *Spector* rule.[11]

The potential significance of these recent decisions lies not in their rejection of *Spector* and its predecessors, though this has independent importance, but in their implication for the Formal Rule, the more sweeping rule of decision from which the *Spector* rule was derived.[12] The Formal Rule has had far more extensive application than the *Spector* rule. It has been the basis over the past century for invalidating many different types of state taxes on varying aspects of interstate commerce.[13] Hence, the effect of *Complete Auto* and *Stevedoring*

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scenity: The Developing Constitutional Standards, 45 MINN. L. REV. 5 (1960); Lockhart, *Escape from the Chill of Uncertainty: Explicit Sex and the First Amendment*, 9 GA. L. REV. 533 (1975).

6. 430 U.S. 274 (1977).

7. *Id.* at 289.

8. 340 U.S. 602 (1951).

9. 435 U.S. 734 (1978).

10. While the taxes invalidated under this rule were usually "privilege" taxes, the rule applied equally to taxes on occupations or "doing business." *See* text accompanying notes 113-16 *infra*.

11. Following *Complete Auto*'s lead in overruling *Spector*, *Stevedoring* overruled two *Spector* predecessors: Joseph v. Carter & Weekes Stevedoring Co., 330 U.S. 422 (1947); Puget Sound Stevedoring Co. v. State Tax Comm'n, 302 U.S. 90 (1937). *See* 435 U.S. at 750.

12. For evolution of this Formal Rule, see text accompanying notes 14-30 *infra*.

13. For illustrations, see notes 35, 121-22, 147, 159-60, 173-74 *infra* and accompanying text.

on the Formal Rule and its other applications is vitally important to the states' power to tax interstate business.

This Article, then, explores the potential impact of *Complete Auto* and *Stevedoring* on the law relating to state taxation of interstate commerce. Such an exploration raises several questions. To the extent that the Formal Rule has been the basis for invalidating state taxes, is that basis for decision still available in its applications outside a *Spector*-type tax? This question requires consideration of the origins and rationale of the Formal Rule and the reasons advanced in *Complete Auto* and *Stevedoring* for overruling its application to taxes on the privilege of engaging in interstate business. Do those origins and reasons, coupled with the unanimous rejection of the privilege tax application of the Formal Rule, suggest its probable rejection in its other applications as well? If so, to what extent may the present limitations on state taxation that are attributable in whole or in part to the Formal Rule nonetheless remain the law because supportable for independent reasons?

II. THE FORMAL RULE

A. The Origin of the Formal Rule

Nearly a century ago, two decades of decisions firmly established the Formal Rule: a state tax on any activity or process of interstate commerce was an invalid "regulation of commerce." Repeatedly cited in support of that rule were two 1872 companion cases bearing the same name[14] but distinguished in the reports as *Case of the State Freight Tax*[15] and *State Tax on Railway Gross Receipts*.[16] In *State Freight Tax* the Supreme Court made the actual ruling that held invalid, as applied to interstate cargo, a tax on freight carried within the state. It viewed the tax as "in effect a regulation of interstate commerce"[17] on a subject exclusively within the power of Congress under the need-for-uniformity criterion established in *Cooley v. Board of Wardens*.[18] The Court thought interstate transportation of passengers or merchandise required "one reg-

14. Reading R.R. v. Pennsylvania, 82 U.S. (15 Wall.) 232, 284 (1872). Little noted was a laconic opinion six years earlier invalidating a state tax on ships entering the harbor as a "regulation of commerce" within the power of Congress. Southern S.S. Co. v. Portwardens, 73 U.S. (6 Wall.) 31, 34 (1867). *See also* Woodruff v. Parham, 75 U.S. (8 Wall.) 123, 139 (1868).

15. 82 U.S. (15 Wall.) 232 (1872).

16. *Id.* at 284.

17. *Id.* at 279.

18. 53 U.S. (12 How.) 299, 319 (1851).

ulating power" to guard against destruction of "commercial intercourse between States remote from each other," which might be "crushed under the load of many" similar state taxes.[19] On the same day, the Court summarized this *State Freight Tax* ruling in oft-quoted dicta in *Railway Gross Receipts*: a state "tax upon interstate transportation" is invalid because it is "a regulation of interstate commerce, which Congress only can make."[20]

Within the next fifteen years the Court advanced the same Formal Rule rationale in nine different cases as the basis for invalidating state taxes on various aspects of interstate transportation,[21] communication,[22] and trade.[23] Some were taxes on the activity itself,[24] some on gross receipts therefrom,[25] and some were license taxes on engaging in the activity.[26] In each case the underlying reason the Court gave was the same: the tax was a regulation of interstate or foreign commerce, exclusively within the power of Congress.

Toward the end of this formative era, two 1887 cases clearly

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19. 82 U.S. (15 Wall.) at 280.

20. *Id.* at 292-93. *Railway Gross Receipts* actually upheld a tax on gross receipts from interstate transportation, but this holding was overruled by Philadelphia S.S. Co. v. Pennsylvania, 122 U.S. 326, 343 (1887). *See* text accompanying notes 49-50 *infra*.

21. Fargo v. Michigan, 121 U.S. 230, 247 (1887) (tax on those providing cars to run on another's railroad, measured by gross receipts, invalid as applied to steamship company engaged in interstate and foreign commerce); Pickard v. Pullman S. Car Co., 117 U.S. 34, 49 (1886) ("privilege" tax on running and using sleeping cars on railroads in state, at $50 per car, invalid as applied to those used exclusively in interstate commerce); Gloucester Ferry Co. v. Pennsylvania, 114 U.S. 196, 211 (1885) (tax on "doing business," measured by capital stock, invalid as applied to interstate ferry company); Moran v. New Orleans, 112 U.S. 69, 73 (1884) (license tax on towboats engaged in interstate and foreign commerce invalid). *See also* Railroad Co. v. Maryland, 88 U.S. (21 Wall.) 456, 472 (1874).

22. Leloup v. Port of Mobile, 127 U.S. 640, 645 (1888) (flat rate license tax on doing business, invalid as to telegraph company engaged in interstate and intrastate commerce); Telegraph Co. v. Texas, 105 U.S. 460, 466 (1881) (tax on doing business as telegraph company, measured by number of messages, invalid as to interstate messages). *But see* Osborne v. Florida, 164 U.S. 650, 655 (1897) (license tax valid when construed to apply only to express company's intrastate business). *See also* Pacific Tel. & Tel. Co. v. Tax Comm'n, 297 U.S. 403, 415-16 (1936).

23. Robbins v. Shelby Taxing Dist., 120 U.S. 489, 498 (1887) (county flat rate license tax on drummers, invalid as applied to one soliciting orders for goods to be shipped into state from outside).

24. *See* cases cited in notes 21-23 *supra* , except those also cited in note 26 *infra*.

25. Philadelphia S.S. Co. v. Pennsylvania, 122 U.S. 326, 327 (1887).

26. Leloup v. Port of Mobile, 127 U.S. 640, 641 (1888); Robbins v. Shelby Taxing Dist., 120 U.S. 489, 491 (1887); Moran v. New Orleans, 112 U.S. 69, 69 (1884).

indicated that the Formal Rule was to be applied broadly and unequivocally. Invalidating a county license tax on drummers as applied to one soliciting orders for goods to be delivered from out of state, the Court in *Robbins v. Shelby Taxing District*[27] rejected the defense that the tax was not discriminatory by stating that "[i]nterstate commerce cannot be taxed at all, even though the same amount of tax should be laid on domestic commerce."[28] Even more sweeping was *Leloup v. Port of Mobile*,[29] in which the Court struck down a license tax on a telegraph company doing interstate business:

> [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 that 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.[30]

B. The Role of the Formal Rule Before 1977

The Formal Rule, thus created and expressed, played a major role in adjudicating the validity of state taxes affecting commerce for over one hundred years, from its origin in 1873 until *Complete Auto* in 1977. It was by no means the sole basis for striking down such state taxes. Other bases, quite independent of the Formal Rule, were discrimination against interstate or foreign commerce,[31] the risk of multiple taxation not borne by comparable local commerce,[32] unfair apportionment of property or income attributable to more than one state,[33] and the absence of due process jurisdiction to tax.[34] A great many taxes of widely varying types, however, were invalidated by invoking some form of the Formal Rule.[35]

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27. 120 U.S. 489 (1887).
28. *Id.* at 497.
29. 127 U.S. 640 (1888).
30. *Id.* at 648.
31. *See, e.g.*, Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 332 (1977); Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 72-73 (1963).
32. *See, e.g.*, Evco v. Jones, 409 U.S. 91, 94 (1972); J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307, 311 (1938).
33. *See, e.g.*, Norfolk & Western Ry. v. Tax Comm'n, 390 U.S. 317, 329 (1968) (property tax); Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931) (income tax).
34. *See, e.g.*, McLeod v. J.E. Dilworth Co., 322 U.S. 327, 330 (1944); Wisconsin v. J.C. Penny Co., 311 U.S. 435, 444 (1940).
35. *See, e.g.*, text accompanying notes 121-22, 134, 147, 159-61, 173-74 *infra*. Such cases include Freeman v. Hewit, 329 U.S. 249, 256 (1946), which invalidated a gross receipts tax imposed by the seller's state on an interstate sale because it was viewed as a "direct tax" on interstate commerce; McLeod v. J.E. Dilworth Co., 322 U.S. 327, 330 (1944), which held invalid a retail sales tax when

Because the Formal Rule condemned only taxes imposed on an activity or process viewed as a part of interstate commerce, the Court still managed to sustain a substantial variety of state taxes that required interstate business to pay a share of the costs of local government.[36] The more important of these included property taxes, fairly apportioned;[37] license, privilege, or occupation taxes if imposed on what the Court viewed as intrastate activities;[38] retail sales taxes, if a rationale to avoid the Formal Rule was available,[39] and compensatory use taxes on goods acquired through an interstate transaction but used in the taxing state;[40] net income taxes on that portion of net income fairly attributable to activities in the taxing state;[41] and, in later years, gross receipts taxes on receipts fairly attributable to activities in the taxing state.[42] Necessarily, the validity of such taxes depended upon whether the Court considered the taxed activity sufficiently remote from interstate commerce itself to escape the Formal Rule.[43] Whether we will be spared such tenuous distinctions in the future depends upon whether *Complete Auto* leads to the rejection of the Formal Rule in its other manifestations.[44]

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applied to interstate sales in the buyers' state because this is "to tax an interstate transaction"; Real Silk Hosiery Mills v. Portland, 268 U.S. 325, 327 (1925) (citing Robbins v. Shelby Taxing Dist., 120 U.S. 489, 497-98 (1887)), one of a long line of cases that voided taxes on taking orders for the sale of goods as applied to sellers of out-of-state goods; and of course the *Spector* decision, 340 U.S. 602, 610 (1951) (*see* text accompanying notes 8-13 *supra*), which struck down a tax on the privilege of engaging in business when applied to an exclusive interstate business because this taxed "the privilege of carrying on exclusively interstate commerce."

36. When consistent with the Formal Rule, the Court recognized the importance of interstate commerce paying its way. *See, e.g.*, McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 46 (1940); Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938).

37. *See, e.g.*, Brainiff Airways, Inc. v. Nebraska Bd. of Equalization & Assessment, 347 U.S. 590, 597-98 (1954).

38. *See, e.g.*, Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 258 (1938); Coverdale v. Arkansas-Louisiana Pipe Line Co., 303 U.S. 604, 610 (1938).

39. *See, e.g.*, McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 49-50 (1940).

40. *See, e.g.*, Henneford v. Silas Mason Co., 300 U.S. 577, 583 (1937).

41. *See, e.g.*, Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 219 (1980); Moorman Mfg. Co. v. Bair, 437 U.S. 267, 278 (1978).

42. *See, e.g.*, Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. 560, 564 (1975); General Motors Corp. v. Washington, 377 U.S. 436, 441 (1964); Canton R.R. v. Rogan, 340 U.S. 511, 515 (1951).

43. *Compare* Coverdale v. Pipe Line Co., 303 U.S. 604, 610 (1938) *with* Michigan-Wisconsin Pipe Line Co. v. Calvert, 347 U.S. 157, 166 (1954); *compare* McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 58 (1940) *with* McLeod v. J.E. Dilworth Co., 322 U.S. 327, 329 (1944).

44. For a discussion of this issue, see text accompanying note 117 *infra*.

C. The Rationale of the Formal Rule

The rationale underlying the Formal Rule is of critical importance in appraising whether the reasoning of *Complete Auto* foreshadows the total repudiation of the Formal Rule in all of its applications. *Complete Auto* and *Stevedoring* decided only that taxes on the privilege of engaging in interstate commerce were valid.[45] They did not decide whether the Formal Rule may continue to invalidate other types of taxes. To assist in answering this question we must first understand the reasoning that supports the Formal Rule and then examine the *Complete Auto* rationale and its impact on the Formal Rule.

A common rationale ran through the two decades of decisions that gave rise to the Formal Rule, as well as through its later applications. The Court classified as a "regulation of commerce" within the exclusive power of Congress under the *Cooley* test, and thus outside state power, any state tax on an activity viewed as a part of interstate commerce.[46] Although *State Freight Tax* also mentioned the danger that interstate commerce might be "crushed under the load" of similar taxes imposed by other states,[47] the later cases did not inquire into such factors in applying the *Cooley* need-for-uniformity test. They simply concluded that any state tax on what the Court viewed as interstate commerce was outside state power, because it was within the exclusive power of Congress.[48]

Although that was the doctrinal basis for the Formal Rule, underlying it appears to have been a judicial judgment that to permit the states to tax interstate commerce itself would threaten unmanageable burdens on commerce. The Court appears to have doubted its capacity to guard commerce from harmful state tax burdens by less drastic means. One of the opinions in the formative two decades, *Philadelphia Steamship Co. v. Pennsylvania*,[49] based its decision on the invalidity of a tax on interstate transportation, and commented on the "disastrous effects" of recognizing state power to tax interstate or foreign commerce. The Court warned, "[i]f the power exists . . . at all, it has no limit but the discretion of the state, and might

45. The cases overruled in these two cases involved only the privilege tax issue. *See* the discussion of *Spector*, text accompanying note 8 *supra*, and the cases cited in note 11 *supra*.

46. *See* text accompanying notes 14-30 *supra*.

47. *See* text accompanying note 19 *supra*.

48. *See, e.g.*, Fargo v. Michigan, 121 U.S. 230, 240 (1887).

49. 122 U.S. 326 (1887) (tax on gross receipts from interstate commerce held invalid under Formal Rule).

be exercised in such a manner as to drive away that commerce . . . seriously affecting the business and prosperity of other states . . . ."[50] This decision revealed two related concerns—the threat of excessive, burdensome taxes if any could be imposed on interstate commerce and judicial inability to control the amount if the power to tax were recognized.

In more modern times, Justice Frankfurter's opinions reflected the same doctrinal basis for the Formal Rule, as well as a similar practical concern over burdening commerce. In striking down a retail sales tax by the buyer's state on an interstate sale because it "tax[ed] an interstate transaction," Justice Frankfurter, in his majority opinion in *McLeod v. J.E. Dilworth Co.*,[51] characterized the tax as a "tax on the freedom of purchase."[52] The Court viewed a "tax on an interstate sale" as involving

> an assumption of power by a State which the Commerce Clause was meant to end. The very purpose of the Commerce Clause was to create an area of free trade among the several States. That clause vested the power of taxing a transaction forming an unbroken process of interstate commerce in the Congress, not in the States.[53]

The *McLeod* opinion thus reflects both the doctrine that Congress has the exclusive power to tax interstate commerce and the pragmatic fear that to recognize state taxing power in this situation would unduly interfere with the policy of "free trade" between the states.

Two years later and again speaking for the majority, Justice Frankfurter expanded upon this justification for the Formal Rule in *Freeman v. Hewit*.[54] In holding invalid a gross receipts tax by the seller's state on the proceeds from an interstate sale, he avoided the pragmatic reason asserted for such a result a few years earlier—the risk of a cumulative tax burden.[55] Instead, he reverted to the Formal Rule: the commerce clause "by its own force created an area of trade free from interference by the States."[56] He contrasted a "direct" tax on interstate commerce with several of the valid methods for making interstate commerce bear its share of the state tax load:[57]

> While these permitted taxes may, in an ultimate sense, come out of in-

50. *Id.* at 346.
51. 322 U.S. 327 (1944).
52. *Id.* at 330.
53. *Id.* at 330-31.
54. 329 U.S. 249 (1946).
55. *See* Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434, 439 (1939); J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307, 311 (1938).
56. 329 U.S. at 252.
57. *See* text accompanying notes 36-42 *supra*.

terstate commerce, they are not, as would be a tax on gross receipts, 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.

. . . 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. . . . Trade being a sensitive plant, a direct tax upon it to some extent at least deters trade even if its effect is not precisely calculable.[58]

The Court never explained why a tax "on" interstate commerce threatened commerce any more than a tax in the same amount, measured the same way, imposed on a taxable subject. Nor did it attempt to explain why the same pragmatic standards and other considerations used by the Court to protect interstate commerce from unfair burdens of taxes not subject to the Formal Rule could not also suffice to protect against unfair burdens from taxes "on" interstate commerce itself.

One further explanation was advanced for the view that a state cannot tax the privilege of engaging in interstate commerce. In *Interstate Oil Pipe Line Co. v. Stone*,[59] Justice Reed spoke for four members of a Court equally divided on the issue:

[T]he privilege of carrying on interstate commerce itself is immune from state taxation. This is because it is a privilege beyond the power of a state to grant. . . .

. . . .

. . . This is not because of the financial burden. Other taxes may equally burden the commerce. . . . It is because the commerce clause . . . does not leave to the states any power to permit or refuse the carrying on of interstate commerce.[60]

But the rule defended in *Interstate Oil* did not depend upon a magic word—"privilege." The Formal Rule equally invalidated a tax on engaging in business, or an occupation tax, imposed on one engaged exclusively in interstate commerce.[61] The justices were saying that because the state cannot forbid engaging in interstate business, a premise no one questions, it cannot tax engaging in such a business—a sheer non-sequitor.

58. 329 U.S. at 256-57.

59. 337 U.S. 662 (1949). Justice Burton took no position on this issue, viewing the application of the tax as limited to intrastate commerce, *id.* at 668-69 (Burton, J., concurring), but he wrote the majority opinion in *Spector* two years later.

60. *Id.* at 677, 680.

61. *See* text accompanying notes 113-16 *infra*. Even *Interstate Oil* itself noted: "[T]his Court has never interpreted the commerce clause to allow a state tax for the privilege of carrying on interstate commerce or one upon that commerce itself." 337 U.S. at 680.

The power to forbid an activity is not a prerequisite to the power to tax it.

We turn now to the *Complete Auto* and *Stevedoring* opinions and their relevance to the reasons underlying the Formal Rule.

III. THE IMPACT OF *COMPLETE AUTO* AND *STEVEDORING*

A. THE RATIONALE UNDERLYING *COMPLETE AUTO* AND *STEVEDORING*

Complete Auto and *Stevedoring* reflect three policy decisions. First, these cases reflect a decision to give broader sweep to the policy emphasized in 1938 in *Western Live Stock v. Bureau of Revenue*[62] not to "relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business."[63] A second policy reflected in these cases is a decision to base the validity of taxes on the act or privilege of engaging in interstate commerce upon their "practical effect" and "economic realities" rather than upon legal formalities that tend to create only a "trap for the unwary draftsman."[64] Finally, *Complete Auto* and *Stevedoring* reflect the Court's decision to apply to such taxes the same criteria already developed for determining the validity of "indirect" taxes not imposed on interstate commerce itself.[65]

By its ruling in *Complete Auto*, the Court made the *Western Live Stock* "just share" policy applicable to taxes on the privilege of engaging in interstate commerce, which it recognized had until then enjoyed "a sort of 'free trade' immunity" from such tax burdens.[66] Stating flatly that "the Court has rejected the proposition that interstate commerce is immune from state taxation,"[67] the Court quoted as authority a similar statement[68] from its 1975 decision in *Colonial Pipeline Co. v. Traigle*,[69]

62. 303 U.S. 250 (1938).

63. *Id.* at 254.

64. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 278-79 (1977). *See* text accompanying notes 72-78 *infra*.

65. *See* text accompanying notes 79-91 *infra*.

66. 430 U.S. at 278.

67. *Id.* at 288.

68. "'It is a truism that the mere act of carrying on business in interstate commerce does not exempt a corporation from state taxation.'" *Id.* (quoting Colonial Pipeline Co. v. Traigle, 421 U.S. 100, 108 (1975)).

69. 421 U.S. 100 (1975).

which had foreshadowed the end of *Spector* by upholding a tax equivalent to that in *Spector* and *Complete Auto* on the technicality that it was imposed on "doing business [within the state] 'in a corporate form.'"[70] A year later the *Stevedoring* opinion again invoked the "just share" concern in sustaining a *Spector*-like tax:

> *Complete Auto* recognized that a State has a significant interest in exacting from interstate commerce its fair share of the cost of state government. . . . The Commerce Clause balance tips against the tax only when it unfairly burdens commerce by exacting more than a just share from the interstate activity.[71]

Thus, *Complete Auto* and *Stevedoring* both emphatically stress that the policy of making interstate commerce pay its fair share of the cost of local government is now fully applicable to state taxes on the privilege or business of engaging in interstate commerce.

In *Complete Auto*, the Court also endorsed the need to judge the validity of taxes on the processes of interstate commerce by their "practical effect" on commerce. Referring approvingly to a series of cases that had "considered not the formal language of the tax statute but rather its practical effect,"[72] the Court noted that it had "applied this practical analysis in approving many types of taxes that avoided running afoul" of the *Spector* rule.[73] The Court indicated that it intended to apply the same analysis to cases like *Stevedoring* and *Complete Auto* by stressing in the opinions that the taxpayers had made no claim[74] or had not developed a factual record[75] under the practical criteria used for deciding the validity of taxes affecting interstate commerce.

The Court's disapproving comments about the *Spector* rule made the same point. In *Complete Auto* it commented that the rule "deems irrelevant any consideration of the practical effect of the tax,"[76] and "has no relationship to economic realities. Rather it stands only as a trap for the unwary draftsman."[77] In

70. *Id.* at 104.

71. 435 U.S. at 748 (citations omitted).

72. 430 U.S. at 279; *see id.* at n.8.

73. *Id.* at 279.

74. *See* Complete Auto Transit, Inc. v. Brady, 430 U.S. at 277-78, 287.

75. *See* Department of Revenue v. Association of Wash. Stevedoring Cos., 435 U.S. at 750-51.

76. 430 U.S. at 278.

77. *Id.* at 279. The opinion documented this statement by contrasting the differing results in Railway Express Agency, Inc. v. Virginia (*Railway Express I*), 347 U.S. 359, 364, 369 (1954) (invalid when tax measured by gross receipts was on "privilege of doing business") and Railway Express Agency, Inc. v. Vir-

the Court's view, the *Spector* rule results in "a focus on . . . formalism [that] merely obscures the question whether the tax produces a forbidden effect."[78]

These considerations, developed at some length in *Complete Auto*, were succinctly summarized in *Stevedoring*:

> With the distinction between direct and indirect taxation of interstate commerce thus discarded, the constitutionality under the Commerce Clause of the application of the Washington business and occupation tax to stevedoring depends upon the practical effect of the exaction. As was recognized in *Western Live Stock v. Bureau of Revenue*, . . . interstate commerce must bear its fair share of the state tax burden. The Court repeatedly has sustained taxes that are applied to activity with a substantial nexus with the State, that are fairly apportioned, that do not discriminate against interstate commerce, and that are fairly related to the services provided by the State.[79]

That last sentence succinctly restated the four criteria for validity that the Court in *Complete Auto* had twice summarized in substantially identical terms, once when describing what it called the "practical analysis" applied when the Court based the validity of taxes on their "practical effect,"[80] and once when the opinion upheld the tax by noting that "no claim is made" under any of the four criteria.[81] Both the *Complete Auto* and *Stevedoring* opinions thus equated these four criteria with judging the validity of a tax by its "practical effect" on interstate commerce. Although these criteria were developed in cases deciding the validity of taxes not subject to the Formal Rule, both opinions made explicit the Court's decision to apply them now to taxes previously struck down because imposed on the privilege of engaging in interstate commerce.[82] Indeed, in *Stevedoring* the Court devoted a paragraph to demonstrating briefly that the tax in question satisfied each of the criteria.[83]

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ginia (*Railway Express II*), 358 U.S. 434, 438, 440, 445 (1959) (valid when tax measured by gross receipts was labeled "franchise tax" on "intangible property" in form of "going concern value"); and the different results in taxes measured by fairly apportioned net income in *Spector*, 340 U.S. at 609-10 (invalid when on privilege of engaging in interstate commerce) and Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 464-65 (1959) (valid when imposed on net income, though taxpayer engaged exclusively in interstate commerce). *See* 430 U.S. at 284-85.

78. 430 U.S. at 288.

79. 435 U.S. at 750 (citation omitted).

80. 430 U.S. at 279.

81. *Id.* at 287.

82. *Id.*

83. 435 U.S. at 750-51. Two years later the Court, in Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980), upholding an apportioned net income tax, quoted and described the *Complete Auto* formulation of the four criteria as "an endeavor to establish a consistent and rational method of inquiry" by examining "the practical effect of a challenged tax." *Id.* at 443.

Each of the stated criteria is no more than a short-hand label for a complex set of considerations. Discrimination[84] and fair apportionment,[85] coupled with its corollary, the avoidance of multiple tax burdens on interstate commerce not borne by local commerce,[86] are familiar criteria, some of whose applications in recent years have produced critical appraisals and close divisions within the Court.[87] While "substantial nexus" is a familiar concept related to due process jurisdiction,[88] which is often not associated with practical effect concerns, a prime and "practical effect" consequence of the nexus requirement is to protect interstate commerce from cumulative taxation.[89] Less familiar and of less consequence is the criterion that a tax must be "fairly related to the services provided by the State."[90] This criterion does not mean what it seems to say, and appears satisfied if the tax is fairly related to activities, income, or property attributable to the taxing state.[91]

The Court's repeated listing of these four criteria raises a question: is the Court implying that its examination of the practical effect of a tax will be limited to these four criteria? Most practical effect claims will fall under one or more of them, but I cannot believe that the Court meant to exclude others. Such a restriction would be inconsistent with the thrust of *Complete Auto*'s repudiation of a requirement[92] that prevented

84. *See, e.g.*, Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977).

85. *See, e.g.*, Norfolk & W. Ry. v. Missouri State Tax Comm'n, 390 U.S. 317 (1968).

86. *See, e.g.*, J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938).

87. *See, e.g.*, Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978); General Motors Corp. v. Washington, 377 U.S. 436 (1964); Hellerstein, *State Taxation of Interstate Business and the Supreme Court, 1974 Term:* Standard Pressed Steel *and* Colonial Pipeline, 62 VA. L. REV. 149, 164-76 (1976).

88. *See, e.g.*, Brainiff Airways, Inc. v. Nebraska State Bd. of Equalization & Assessment, 347 U.S. 590 (1954); Wisconsin v. J.C. Penney, 311 U.S. 435 (1940).

89. *See* L. TRIBE, AMERICAN CONSTITUTIONAL LAW 367 (1978).

90. Department of Revenue v. Association of Wash. Stevedoring Cos., 435 U.S. at 750; Complete Auto Transit, Inc. v. Brady, 430 U.S. at 279; *see, e.g.*, Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. 560 (1975).

91. For example, in Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. 560 (1975), the Court found the "fair relation" criterion satisfied by a tax on doing business measured by gross receipts from all sales made in the state by an out-of-state manufacturer, who negotiated all sales from out of state and maintained within the state one engineer, helped every six weeks by three others, who kept the manufacturer informed of the buyer's needs and the names of its buying agents, and who arranged for testing of sample products and helped resolve problems of use after receipt of the products. *Id.* at 561, 564. It sufficed to satisfy the criterion that the engineer's "full time job within the state made possible the realization and continuance of valuable contractual relations between appellant and Boeing." *Id.* at 562.

92. This requirement was, of course, the Formal Rule.

consideration of the practical effect of a tax. In my view the Court should and will give consideration to any demonstrable, realistic claim that a state tax has a seriously harmful effect on interstate commerce, even though the tax satisfies the four stated criteria.

B. The Applicability of The *Complete Auto* Rationale to Other Types of Taxes

Do *Complete Auto* and *Stevedoring* sap the authority of the long line of decisions[93] that have invoked one form or another of the Formal Rule to strike down various types of state taxes other than the *Spector* "doing business" type? I think they do. In my judgment these recent decisions signal the end of the Formal Rule in all of its tax manifestations. The reasons given for overruling *Spector* apply with equal force to the other applications of the Formal Rule, which were all derived from the common rationale that *Complete Auto* unanimously rejected. That rationale, I remind you, was simply that a state tax imposed on an activity or process viewed as interstate commerce itself was an invalid "regulation of commerce" within the exclusive power of Congress, without regard for and with no need to consider the practical impact of the particular tax on commerce.[94]

The policy judgment in *Complete Auto*—that a state must be allowed to require interstate commerce to pay its fair share of the cost of state government—was not unique to a tax on the privilege of engaging in interstate commerce. The Court had earlier invoked the same policy in sustaining several different types of taxes that were not subject to the Formal Rule.[95] Now that the Court in *Complete Auto* has applied this policy to sustain one of the principal taxes within the Formal Rule, it would be difficult to justify disregarding the policy in deciding the validity of the other types of taxes that have been subject to the Formal Rule in the past. And there is no reason to expect the Court to do so.

93. *See* note 35 *supra*.

94. *See* text accompanying notes 14-30 *supra*.

95. *See, e.g.*, Northwestern States Port. Cement Co. v. Minnesota, 358 U.S. 450, 461-62 (1959) (state income tax on company engaged exclusively in interstate commerce); McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 49-50, 59 (1940) (sales tax by buyers' state on interstate sales viewed as tax on transfer of possession after end of interstate commerce); Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 258-61 (1938) (tax on publication of magazines measured by advertising gross receipts).

Similarly, the Court's emphasis in *Complete Auto* on the importance of a tax's "economic realities" rather than its "formal phrasing"[96] seems equally relevant to the validity of any type of tax that previously has been held invalid because imposed on some activity or process of interstate commerce without regard for the practical effect of the tax. The Court's policy conclusion that the validity of taxes on the privilege of engaging in interstate commerce should depend upon a "practical analysis" of their effect on interstate commerce[97] is equally persuasive when the issue is the validity of other types of taxes previously struck down under the Formal Rule. Such an analysis requires the application of criteria developed in cases involving taxes not subject to the Formal Rule. The problems of applying such a "practical analysis" to taxes on sales, or transportation, or some other aspect of interstate commerce should, however, be no greater than those associated with *Spector*-type taxes.

In *Complete Auto* the Court decided that, in protecting interstate commerce from harmful state taxes, it should no longer avoid the difficult problems concerning the effect of challenged taxes by resorting to a blanket rule against taxes on the privilege of engaging in interstate commerce. The opinion's footnote fifteen rejects the argument that such a tax could be "easily tailored to single out interstate businesses and subject them to effects forbidden by the Commerce Clause."[98] The Court responded that other kinds of taxes, such as property and income taxes (not subject to the *Spector* rule), could also be "tailored" to harm interstate commerce, so that a "tailored tax, however accomplished, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect on interstate commerce."[99] The Court could "perceive no reason" for viewing such a tax on the "privilege of doing business" as "creating a qualitatively different danger so as to require a *per se* rule of unconstitutionality."[100]

The Court thus unanimously rejected a per se rule designed to protect interstate commerce by means of a judicially created "free trade" zone that would obviate the need for careful judicial scrutiny concerning the effects of a tax. That this

96. 430 U.S. at 279-81; *see* text accompanying notes 72-78 *supra*, 107, 109 *infra*.

97. 430 U.S. at 279.

98. *Id.* at 288 n.15.

99. *Id.*

100. *Id.*

was the nature of the policy judgement is further indicated by the Court's answer in footnote fifteen to the argument that "a rule of absolute immunity for interstate commerce" would relieve the Court of such "difficult judgments":[101] "administrative convenience, in this instance, is insufficient justification for abandoning the principle that 'interstate commerce may be made to pay its way.'"[102] That policy judgment—to forego the easy resort to a per se rule and make the more difficult judgments concerning the effect of taxes on commerce so that states could require interstate commerce to pay its way—cannot logically be limited to a *Spector*-type tax. It appears equally applicable to all state taxes.

C. OTHER IMPLICATIONS OF *COMPLETE AUTO* AND *STEVEDORING*

Apart from the universal applicability of the reasons advanced for overruling *Spector*, at two points the *Complete Auto* and *Stevedoring* opinions went beyond a *Spector*-type tax to repudiate the Formal Rule more broadly.

The Court's comments in *Complete Auto* concerning *Freeman v. Hewit*,[103] which it called "the modern origin of the *Spector* rule,"[104] reflect its disapproval of the Formal Rule as applied to an entirely different type of tax—a gross receipts tax by the seller's state on the proceeds of an interstate sale. Before *Freeman* the same tax had been struck down on the "practical effects" ground that if the seller's state could tax the gross receipts, so could the buyer's, which would subject interstate commerce to "the risk of a double tax burden" not borne by local commerce.[105] The majority in *Freeman* disregarded this rationale in holding the tax invalid. Instead, the *Freeman* majority, according to Justice Blackmun in *Complete Auto*, "announced a blanket prohibition against any state taxation imposed directly on an interstate transaction," ruling that "a direct tax on interstate sales, even if fairly apportioned and nondiscriminatory, was . . . unconstitutional *per se*."[106]

Although *Freeman* was not an issue in *Complete Auto*, and hence not expressly overruled, the Court's comments on *Freeman* in *Complete Auto* indicate unanimous disapproval of *Freeman*'s application and endorsement of the Formal Rule as

101. *Id.*
102. *Id.*
103. 329 U.S. 249 (1946); *see* text accompanying notes 54-58 *supra*.
104. 430 U.S. at 279.
105. J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307, 311 (1938).
106. 430 U.S. at 280; *see* Freeman v. Hewit, 329 U.S. at 253-57.

applied to a tax on gross receipts from interstate sales. Justice Blackmun noted that Justice Rutledge's concurring opinion in *Freeman* had "argued that the tax should be judged by its economic effects rather than by its formal phrasing."[107] Justice Blackmun summarized the considerations that Rutledge would weigh in determining the validity of the tax, which were closely akin to the four criteria repeatedly stated in *Complete Auto*.[108] Finally, he invoked the criticism of *Freeman* by academic scholars who viewed the opinion "as a triumph of formalism over substance."[109]

Though the Court only restated in *Complete Auto*, and did not expressly endorse, the criticisms aimed at *Freeman*, the close parallel of those criticisms to the reasons given in *Complete Auto* for overruling *Spector* make clear the Court's approval of those criticisms and its rejection of Justice Frankfurter's *Freeman* rationale. Indeed, its incorporation of those criticisms into the *Complete Auto* opinion can fairly be viewed as an integral part of the Court's marshalling of reasons for overruling *Spector*. Further, by characterizing *Freeman* as the "modern origin of the *Spector* rule" in a case overruling *Spector*, the Court signaled its disapproval of the majority view in *Freeman*. Thus, we can reasonably conclude that since 1977 the Formal Rule has not been a viable basis for invalidating a tax on interstate sales, or on gross receipts therefrom.

This conclusion appears confirmed in one sentence of *Stevedoring*. After invoking *Complete Auto* as authority,[110] the majority stated: "With the distinction between direct and indirect taxation of interstate commerce thus discarded, the consti-

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107. 430 U.S. at 280.

108. "In [Justice Rutledge's] view, a state tax is unconstitutional only if the activity lacks the necessary connection with the taxing state to give 'jurisdiction to tax,' . . . or if the tax discriminates against interstate commerce, or if the activity is subject to multiple taxation." *Id.* at 280-81 (citation omitted). Compare these criteria with those repeatedly stressed in *Complete Auto:* (1) discrimination appears as a criterion in both; (2) "multiple taxation" is related to fair apportionment; (3) "necessary connection with the taxing state," is synonymous with "substantial nexus". 430 U.S. at 287. Only the *Complete Auto* criterion that a tax be "fairly related to the services provided by the state" was omitted, but this concept is related to the nexus requirement. *See* Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940). It did not emerge as a separate criterion until after *Freeman*. *See* Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. 560, 562 (1975); General Motors Corp. v. Washington, 377 U.S. 436, 440-41 (1964).

109. 430 U.S. at 281 (citing P. HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 200-04 (1953); Dunham, *Gross Recepits Taxes on Interstate Transactions*, 47 COLUM. L. REV. 211 (1947)).

110. 435 U.S. at 749-50.

tutionality [of the tax as applied] depends upon the practical effect of the exaction."[111] Should this sweeping statement be viewed as limited to the particular type of tax before the Court? I think not. *Complete Auto*'s criticism of making the validity of a tax depend upon whether it is imposed "directly on" some act of interstate commerce[112] was expressly aimed at an opinion (*Freeman*) that had applied that reasoning of the Formal Rule to a very different type of tax—one on gross receipts from interstate sales. The Court's broad statement in *Stevedoring* that *Complete Auto* had "discarded" the distinction between direct and indirect taxation in favor of applying criteria relevant to the tax's "practical effect" gave no weight to the particular type of tax before the Court.

D. THE BROAD SCOPE OF *COMPLETE AUTO*

In considering the impact of *Complete Auto* on other types of taxes previously subject to the Formal Rule, the broad scope of the *Complete Auto* ruling itself should not be overlooked. *Complete Auto* must be viewed as overruling the full line of cases represented by *Spector*, whether the tax was imposed on the privilege of engaging in business or simply on the business or occupation itself. *Spector* and most of its predecessors happened to involve privilege taxes, because this has been a common method of labeling taxes on doing business, but the Court has applied exactly the same rule to invalidate taxes that in form were imposed simply on doing business or engaging in business without any reference to taxing a "privilege."[113] The Court cited such "doing-business" tax cases as involving the same issue as those invalidating privilege taxes,[114] and on occasion expressly equated occupation or doing-business taxes ap-

111. *Id.* at 750.

112. 430 U.S. at 279-81.

113. *See* Alpha Portland Cement Co. v. Massachusetts, 268 U.S. 203, 207 (1925) (tax for "carrying on or doing of business . . . within the Commonwealth"); Cheney Bros. Co. v. Massachusetts, 246 U.S. 147, 154 (1918) ("essentially a tax on doing an interstate business and therefore repugnant to the commerce clause").

114. *See* Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 486 (1959) (Whittaker, J., dissenting) (citing *Cheney* and *Alpha Cement* with *Spector* and *Ozark Pipe Line*); Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602, 609 (1951) (citing *Alpha Cement* with several privilege tax cases); Atlantic Lumber Co. v. Commissioner of Corps. & Taxation, 298 U.S. 553, 555 (1936) (citing *Cheney* and *Alpha Cement* with *Ozark Pipe Line* (privilege tax) to support proposition that state tax on doing business is invalid if business is exclusively interstate); Ozark Pipe Line Corp. v. Monier, 266 U.S. 555, 565-66 (1925) (citing *Cheney* to support ruling invalidating tax on privilege).

plied to interstate business with privilege taxes on engaging in such business.[115]

There was good reason for this identity of treatment. The rationale underlying *Spector*—that such a tax was a "regulation of commerce" within the exclusive power of Congress—applied equally to every such business tax, whether or not called a "privilege tax." The taxes were invalid regardless of the label attached; they all threatened the "free trade" area of commerce the Court had been protecting against "direct" taxes by means of the Formal Rule. But when the Court in *Complete Auto* found that threat no longer sufficient to justify striking down such taxes, it advanced reasons for overruling *Spector* that apply with equal weight to all taxes on doing interstate business, whether designated an occupation, business, or "privilege" tax. Surely the Court that decided in *Complete Auto* to base the validity of the tax on its practical effect and economic realities would not interpret that ruling as based on some unstated significance derived from the word "privilege," when the economic realities and practical effect are the same with or without that word.[116]

IV. THE IMPACT OF THE PREDICTED END OF THE FORMAL RULE

A. THE GENERAL IMPACT

From the foregoing we can reasonably conclude that the Court is not likely to invoke again the Formal Rule to invalidate state taxes. This policy will have three general consequences. First, it will give the states greater latitude to formulate taxes without regard for the formalities that have been drafting hazards in the past. At the same time it should encourage the

115. *See* Interstate Oil Pipe Line Co. v. Stone, 337 U.S. 662, 681-82 (1949) (Reed, J., dissenting) ("So long as a tax on the privilege of doing interstate business or a tax on the doing of that business is prohibited, interstate commerce remains free from state exactions levied on that commerce."); Ozark Pipe Line Corp. v. Monier, 266 U.S. 555, 562 (1925) (invalidating "franchise" tax, said by Court to be "upon the privilege or right to do business;" Court invoked as "settled" the rule that "a State cannot lay a tax on interstate commerce in any form, whether on the transportation of subjects of commerce, the receipts derived therefrom, or the occupation or business of carrying it on.").

116. For example, see Justice Blackmun's remark in *Complete Auto*: "There is no economic consequence that follows necessarily from the use of the particular words, 'privilege of doing business,' and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect." 430 U.S. at 288.

drafters to weigh carefully foreseeable practical effect considerations.

In addition, this policy will eliminate the expensive and tantalizing game of counseling, and when needed, litigating whether a particular tax is imposed on a process, activity, or business that the Court is likely to view as an integral part of interstate commerce itself, and hence subject to the Formal Rule, or whether the tax is sufficiently removed from interstate commerce to be treated as a taxable local incident. Repeatedly this issue has been controlling,[117] however sterile it might be in terms of protecting interstate commerce from harmful taxation. Presumably, it will no longer be an issue.

Finally, this policy will change the focus of much of the litigation over state taxation of interstate commerce from formal to practical considerations concerning the effect of the tax. Certainly, the elimination of the Formal Rule will not mean that all taxes previously voided under the Formal Rule will now be valid. In both *Complete Auto* and *Stevedoring* the Court emphasized that the validity of taxes on interstate commerce should now be judged by their practical effect in light of the criteria developed in passing on taxes outside the Formal Rule. Some such decisions will be relatively easy, as was true in *Complete Auto* and *Stevedoring* where the taxes, which were upheld, were measured by gross receipts from interstate transportation confined to segments within the taxing state, and hence not subject to taxation by other states. In those cases there was no basis for harmful "practical effects" claims under the four criteria or otherwise. But on occasion the "practical effects" issues will require quite difficult judgments, as the Court acknowledged in *Complete Auto*,[118] and as demonstrated the next year when a divided Court encountered a difficult corporate income tax issue involving fair apportionment and a claim of potential multiple burden.[119]

117. *Compare* McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940) (valid—tax viewed as imposed on transfer after end of interstate transportation) *with* McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944) (invalid—tax viewed as "on an interstate transaction"); *compare* Ozark Pipe Line Corp. v. Monier, 266 U.S. 555 (1925) (invalid—tax viewed as on business of operating interstate pipeline) *with* Memphis Natural Gas Co. v. Stone, 335 U.S. 80 (1948) (valid—tax viewed as imposed on local maintenance and repair activities of pipeline company transporting natural gas exclusively interstate). For more detail, see P. HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 99-107 (1953).

118. 430 U.S. at 288 n.15.

119. Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978); *see* text accompanying notes 194-95 *infra*.

In the remaining sections of this Article, I will explore some of the issues likely to arise under the "practical effects" approach when taxes like those previously voided under the Formal Rule are challenged.

B. TAXES FORMERLY VOIDED UNDER THE FORMAL RULE: "PRACTICAL EFFECTS" ISSUES

1. *Property Taxes on Goods in Transit*

We have already noted that the Formal Rule originated with *State Freight Tax*,[120] which held invalid as applied to interstate cargo a tax on transportation companies measured by tons of cargo carried within the state. This ban on taxing cargo in interstate commerce was soon extended to ad valorem property taxes.[121] Goods considered in transit in interstate commerce were immune from state property taxation under the Formal Rule. The only real issue in such cases was whether the interstate transit had started or ended before the state's property tax date.[122]

If we assume the Formal Rule is now dead, would application of property taxes to goods in interstate transit raise "practical effect" issues that might still invalidate the tax? Though basing its decision on Formal Rule reasoning, the Court in *State Freight Tax* mentioned the danger that if one state may tax interstate transportation, "every other may," which would cause "commercial intercourse between States" to be "crushed under the load of many" such taxes.[123] This reasoning suggests the later multiple burden rationale with its "fair apportionment" requisite. Would property taxes on goods in transit threaten a multiple burden on interstate commerce not borne by local commerce because similar taxes might be imposed by other states through which the cargo passes?

Would not the validity of such a tax depend upon its terms? After the first decision invalidating such a tax,[124] no at-

120. *See* text accompanying notes 14-20 *supra*.

121. *See* Hughes Bros. Timber Co. v. Minnesota, 272 U.S. 469, 475-76 (1926); Champlain Realty Co. v. Brattleboro, 260 U.S. 366, 376-77 (1922); Kelley v. Rhoads, 188 U.S. 1, 7-8 (1903); Coe v. Errol, 116 U.S. 517, 527-28 (1886).

122. *See* Minnesota v. Blasius, 290 U.S. 1, 9 (1933); Coe v. Errol, 116 U.S. 517, 525 (1886). *See also* Hughes Bros. Timber Co. v. Minnesota, 272 U.S. 469, 473 (1926); Ferrell & Smith, *State Jurisdiction to Tax Tangible Personal Property*, 56 N.C.L. REV. 807, 817-24 (1978).

123. 82 U.S. (15 Wall.) at 280; *see* text accompanying notes 17-19 *supra*.

124. *See* Kelley v. Rhoads, 188 U.S. 1, 8-9 (1903) (tax apparently attempted here only because the sheep were being slowly moved across the state on foot, grazing en route.)

tempt appears to have been made to impose a property tax on goods actually in interstate transit.[125] But could a state, if it wished, impose fairly apportioned personal property taxes on interstate cargo in order to require commerce to help pay for the governmental services that protect cargo in transit along with other personal property in the state?

It would seem feasible to draft a valid statute to tax cargo in transit by use of an apportionment formula designed to ascertain the average daily value of cargo within the state in the possession of each carrier throughout the year, and to tax that value once yearly on the same basis as inventory and other personal property.[126] If we assume a "fair apportionment," such a tax would create no risk of a greater tax burden on interstate than on local commerce. If all other states traversed by the carrier were to impose a similar tax, an invalid multiple burden would not be threatened because each state would be able to tax only the average daily value of goods within that state throughout the year.[127] The total cargo thus taxed in all states would not exceed the total average daily value of the carrier's cargo.[128]

The Court has long upheld analogous methods of determining for tax purposes the value of railroad rolling stock within the state at all times.[129] I see no sound reason, with the Formal Rule discarded, to apply a different policy to taxation of cargo in transit.[130] True, in the rolling stock cases the railroads were

125. The other cases cited in note 121 *supra* involved the issue of whether goods taxed when not in actual transit were to be viewed as legally in transit.

126. I have seen no such tax proposed, and question its economic desirability in view of the availability of gross receipts and net income taxes, both of which are likely to be more productive. I have made no effort to draft the type of formula suggested. Presumably, it could ascertain the average daily value of cargo for the year and allocate a fraction of this to the taxing state by using factors relevant to the normal distribution of cargo throughout the carrier's routes.

127. The formula need produce only a fair approximation of the average daily value of cargo in the state. *Cf.* Moorman Mfg. Co. v. Bair, 437 U.S. 267, 273-74 (1978) (both Iowa and Illinois formulas are only "a rough approximation" of income attributable to the state, but "[s]tates have wide latitude in the selection of apportionment formulas" for income tax, so long as income attributed to the state is not "out of all appropriate proportions" to business done there).

128. *Cf.* Pullman's Palace Car Co. v. Pennsylvania, 141 U.S. 18, 26 (1891) (if a mileage allocation "were adopted by all the States through which these cars ran, the company would be assessed upon the whole value of its capital stock, and no more").

129. *See, e.g.*, Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169, 172-74 (1949); Pullman's Palace Car Co. v. Pennsylvania, 141 U.S. 18, 26 (1891).

130. Professor Hartman made a similar suggestion years ago. *See* P. HARTMAN, *supra* note 117, at 74.

taxed on their own property, whereas in the cases of carriers for hire an average daily value cargo would have to be imposed on the carriers, not the cargo owners. But the carriers would pass it on, like other costs, in the freight rates ultimately paid by the owners of all cargo shipped.[131] The effect would be to require those using transportation facilities within the state to pay their fair share of the cost of state government that protects their property when it is within the state, based on the property's approximate value. Such a tax is analogous to the property taxes paid by manufacturers, merchants, and others who keep an inventory within the state.

So far as the other criteria are concerned, such a property tax on the average daily value of cargo should satisfy the due process nexus criterion. The tax would be based on the approximate value of the cargo continuously within the state throughout the year, though in transit, just as in the case of railroad rolling stock. For similar reasons, such a tax should also satisfy the "fair relation" criterion; the tax would be based upon the value of property within the state and protected by its governmental services.

2. *Retail Sales Taxes*

When many states turned to consumers' retail sales taxes for revenue in the depression of the 1930s, it was generally assumed that the Formal Rule barred both the buyer's and the seller's states from taxing an interstate sale,[132] one in which the seller contracts to sell to the buyer in another state goods to be delivered from the seller's to the buyer's state. Through adroit analysis, the Court in 1940 avoided the Formal Rule in *McGoldrick v. Berwind-White Coal Mining Co.*[133] to sustain a retail tax by the buyer's state, but four years later in *McLeod v. J.E. Dilworth Co.*,[134] it applied the Formal Rule to invalidate such a tax. *McLeod* has never been overruled. There has been little need to question it since the compensatory use tax rulings permit the buyer's state to impose the equivalent of the sales

131. There should be no constitutional problem in making the carrier-possessor pay the tax, particularly when the carrier would redistribute it to the shippers through freight rates. *See, e.g.*, National Geographic v. California Equalization Bd., 430 U.S. 551, 558 (1977); Felt & Tarrant Mfg. Co. v. Gallagher, 306 U.S. 62, 67-68 (1939); Monomotor Oil Co. v. Johnson, 292 U.S. 86, 93 (1934).

132. *See* P. HARTMAN, *supra* note 117, at 149-51; Lockhart, *supra* note 1, at 618-19.

133. 309 U.S. 33 (1940).

134. 322 U.S. 327 (1944); *see* text accompanying notes 51-53 *supra*.

tax on the buyer for use of the product within the state[135] and to require out-of-state sellers subject to the buyer's state's jurisdiction to collect the tax for the state at the time of sale.[136] Though the validity of the sales tax on an interstate sale is itself thus not of earthshaking importance, it is worth brief discussion, both to facilitate simple drafting to omit the use tax circumlocution and to clarify tax doctrine because related questions may arise in connection with other types of sales taxes, such as those on manufacturers or wholesalers.

If we assume again the end of the Formal Rule, does a retail sales tax by the buyer's state on an interstate sale satisfy the four "practical effect" criteria for a valid tax? Such taxes are not "apportioned" in the narrow sense, for they are measured by a percentage of the total sales price. But with such taxes the Court has already informally alloted the full amount of the sales price exclusively to the buyer's state, and thereby eliminated the risk of multiple taxation at which the "fair apportionment" criterion is aimed. The Court in both *Berwind-White*, sustaining the buyer's state sales tax by avoiding the Formal Rule, and *Henneford v. Silas Mason Co.*,[137] sustaining the compensatory use tax, emphasized that "equality is its theme" since the buyer's state could collect from an interstate sale only the same tax burden borne by local sales.[138]

This would only be true, however, if the seller's state could not apply its retail sales tax to such sales. Although the Court did not explicitly say so in *Berwind-White*, the majority appears to have assumed the invalidity of such a tax by the seller's state.[139] At any rate, the issue was decided in 1972 in *Evco v. Jones*,[140] when the Court struck down a retail sales tax imposed by a seller's state on an interstate sale by invoking the risk of a multiple tax burden rationale.[141] So long as the

135. *See* Henneford v. Silas Mason Co., 300 U.S. 577, 582-83 (1937).

136. *See, e.g.*, National Geographic v. California Equalization Bd., 430 U.S. 551, 558 (1977); General Trading Co. v. State Tax Comm'n, 322 U.S. 335, 338 (1944); Nelson v. Sears Roebuck & Co., 312 U.S. 359, 364 (1941). *But see* National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 758 (1967) (no jurisdiction).

137. 300 U.S. 577 (1937).

138. McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 48-49 (1940); Henneford v. Silas Mason Co., 300 U.S. 577, 583-84 (1937).

139. *See* Powell, *New Light on Gross Receipts Taxes—The Berwind-White Case*, 53 HARV. L. REV. 909, 927 (1940).

140. 409 U.S. 91 (1972) (terms of tax same as typical sales and use tax though called "gross receipts tax").

141. *Id.* at 93-94 (quoting J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307, 311 (1938)).

seller's state is not permitted to impose a retail sales tax on an interstate sale,[142] there would appear to be no danger of discrimination, unfair apportionment, or a multiple tax burden when the buyer's state is permitted to collect a consumer tax measured by the full sales price, whether called a sales tax or a use tax.

A sales tax by the buyer's state on an interstate sale should also readily satisfy the substantial nexus criterion. Approximately half of the acts involved in such a sales transaction occur within the buyer's state. There the buyer acts to form the contract of sale, as the buyer accepts the offer to sell or makes a counter-offer; there the buyer makes payment for the goods, whether by mail or otherwise; there the buyer receives final delivery of the goods into his or her possession; and there the buyer finally uses or disposes of them. These acts provide ample basis for the buyer's state to impose a sales tax on the buyer.

The only real nexus problem is in finding jurisdiction to impose upon an out-of-state seller the obligation to collect the sales tax from the buyer at the time of sale, which is the effective way to collect the tax. That is actually what Arkansas sought in *McLeod*.[143] The Court gave as one reason for invalidating the tax that the sale occurred outside of Arkansas when the seller gave the goods to the carrier in Tennessee for delivery to the buyers in Arkansas: "[A]ccording to practical notions of what constitutes a sale . . . the sale—the transfer of ownership—was made in Tennessee. For Arkansas to impose a tax on such transactions would be to project its powers beyond its boundaries . . . ."[144]

In making this nexus ruling, the Court appeared to give no consideration to the factors noted above connecting the buyer's state with the sale, nor to the seller's presence there through salesmen taking orders in Arkansas. Yet on the same day as *McLeod*, and under similar facts, the Court in *General Trading Co. v. State Tax Commission*[145] recognized that Iowa had juris-

142. *Evco*, which so ruled, seems solidly based since it rested not on the Formal Rule but on the danger of a multiple tax burden if the seller's state could impose a retail sales tax on interstate sales. While not saying so, the Court must have had in mind that it had already given its blessing to the buyer's state's collection of an equivalent tax from interstate sales, both through use taxes and through retail sales taxes when they could escape the Formal Rule.

143. 322 U.S. 327 (1940).

144. *Id.* at 329-30.

145. 322 U.S. 335 (1944).

diction to require an out-of-state seller, whose salesmen took orders in Iowa, to collect and remit Iowa's use tax on interstate sales. This case differed from *McLeod* only in calling the tax one on "use" rather than on "sale." To thus make controlling the title transfer in Tennessee because of sales law doctrine unrelated to taxation while disregarding the transaction's substantial connections with the taxing state, and to invalidate a tax because it was called a sales tax instead of a use tax, is to engage in the same kind of formal reasoning unrelated to economic realities that the Court rejected in *Complete Auto*.[146] Now that the Court has rejected such formal reasoning concerning the commerce clause, will it not likewise reject such due process jurisdiction formal reasoning when, in fact, the taxed transaction has substantial connections with the taxing state and the practical effect of the tax is the same whether called a "use" or a "sales" tax?

There are thus good reasons to expect the Court to sustain retail sales taxes by the buyer's state on interstate sales whenever the transactions have substantial connections with that state, and to permit the buyer's state to require the seller from another state to collect a consumer tax, whatever called, whenever the seller has a substantial nexus with the buyer's state.

Can the seller avoid that collection burden by staying out of the buyer's state for all purposes? In 1967, the Court in *National Bellas Hess, Inc. v. Department of Revenue*[147] ruled that the seller could do so, holding that an out-of-state seller with no offices or agents in the buyer's state could not be required to collect the use tax on extensive sales made to buyers there only through catalogues and mail orders.[148] That case may, however, be vulnerable now.

National Bellas Hess rested on two grounds no longer available and on two that may yield to effective advocacy. The first two were the Formal Rule[149] and the "fair relation" test, stated somewhat differently,[150] which the Court in *National Ge-*

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146. Indeed, to justify invalidating the sales tax in *McLeod*, despite the admitted validity of a use tax with identical economic effects, the Court invoked Formal Rule "area of free trade" reasoning. *See* 322 U.S. at 330-31; text accompanying notes 51-53 *supra*.

147. 386 U.S. 753 (1967).

148. *Id.* at 758.

149. The Court noted that it is "difficult to conceive of commercial transactions more exclusively interstate in character." *Id.* at 759.

150. The Court wrote of "local jurisdictions with no legitimate claim to impose 'a fair share of the cost of the local government.'" *Id.* at 760.

ographic v. California Equalization Board[151] ruled in 1977 does not apply to a simple duty on a seller to collect and remit another's tax.[152]

The third ground was the lack of a due process nexus because the seller was absent from the state. The Court declined six to three "to repudiate totally the sharp distinction [previously] drawn between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business."[153] On that issue enterprising lawyers, taking their cue from the *National Bellas Hess* dissent,[154] might possibly persuade a majority of today's more practical-minded Court to find sufficient nexus to require mere collection of the tax in the seller's large-scale, continuous, and systematic exploitation of the consumers' market in a buyer's state, coupled with the seller's dependence on the state's legal system and its credit resources to service its large volume of credit sales.

The fourth ground in *National Bellas Hess* was the burden imposed on interstate commerce by the various recordkeeping requirements of many state and local taxing jurisdictions, which "could entangle National's interstate business in a virtual welter of complicated obligations."[155] Well-conceived evidence demonstrating the current availability of computer technology that could now satisfy the recordkeeping and reporting requirements of the different taxing jurisdictions without excessive costs might persuade the Court to reconsider and abandon this 1967 conclusion that a use tax collection duty on mail-order sellers would place too great a burden on commerce.

The sales or use tax itself must, of course, still satisfy the "fair relation" criterion, but since these are consumer taxes ultimately paid by buyers based in the taxing state where the goods are normally consumed or used, there is not only a "fair" but a close relation between the tax based on the value of the

151. 430 U.S. 551 (1977).

152. *Id.* at 560-62. Since the burden on the seller is only the "administrative one of collecting" the tax, *id.* at 558, the duty to collect and pay it need not relate to the seller's activities within the state, so long as there is "some definite link" between the seller and the state, found here in two offices soliciting national magazine advertising, wholly unrelated to the interstate mail order business in maps and books. *Id.* at 561.

153. 386 U.S. at 758.

154. *Id.* at 761-63 (Fortas, J., dissenting, joined by Black and Douglas, J.J.).

155. *Id.* at 759.

goods and their use and presence within the taxing state.[156]

I have limited this discussion on sales taxes to those on retail sales. Consideration of "practical effect" criteria requires such particularity. Other types of sales taxes, such as those on manufacturers or wholesalers, call for a different practical analysis directed to the terms and economic realities of the particular taxing statutes, but I leave that task for you.

3. *Gross Receipts Taxes*

During the formative period for the Formal Rule the Court held a tax on gross receipts from interstate transportation invalid as a tax on interstate transportation itself.[157] With minor deviations[158] thereafter the Court repeatedly invalidated gross receipts taxes on interstate commerce.[159] Even after Justice Stone in *Western Live Stock* sought to limit the rule to unapportioned gross receipts taxes threatening a multiple burden,[160] the Court in *Freeman* reasserted the gross receipts tax rule in 1946 without regard to any risk of a multiple tax burden.[161] But with disapproval in *Complete Auto* of *Freeman* and the Formal Rule reasoning, the rule against state taxes on or measured by gross receipts from interstate commerce passed into history. It now seems reasonable to conclude that no tax will be struck down simply because it taxes gross receipts from interstate commerce.

Of course, such a gross receipts tax is required to satisfy the "practical effect" criteria. In particular, such taxes raise "fair apportionment" problems to which the Court gave less than adequate consideration in *General Motors Corp. v. Washington*[162] in 1964 and *Standard Pressed Steel Co. v. Department of Revenue*[163] in 1975. Both cases upheld Washington state's "doing business" tax as applied to sellers, even though it was measured by total gross receipts from interstate sales to Washington commercial buyers by out-of-state manufacturers who

156. In addition, there are the many connections between the transaction and the buyers' state noted in this Article's nexus discussion. *See* text accompanying notes 142-43 *supra*.

157. Philadelphia S.S. Co. v. Pennsylvania, 122 U.S. 326 (1887).

158. *See, e.g.*, United States Express Co. v. Minnesota, 223 U.S. 335, 346-48 (1912) (upheld gross receipts tax in lieu of property tax on interstate railroad).

159. *See, e.g.*, Galveston, H. & S.A. Ry. v. Texas, 210 U.S. 217 (1908).

160. *See* 303 U.S. at 255-57. *See also* Lockhart, *Gross Receipts Taxes on Interstate Transportation and Communication*, 57 HARV. L. REV. 40, 71-78 (1943).

161. *See* text accompanying notes 54-58 *supra*.

162. 377 U.S. 436 (1964).

163. 419 U.S. 560 (1975).

had representatives within the state[164] but negotiated the sales from outside. Absent any showing of an actual "risk of a multiple tax burden,"[165] the Court in *Standard Pressed Steel* said that gross receipts were "apportioned exactly to the activities taxed" since Washington taxed only gross receipts from sales made to Washington buyers.[166] But if the out-of-state seller's state were to impose on the seller a "doing business" tax measured by gross receipts apportioned to include only that portion of the receipts from Washington sales fairly attributable to the manufacturer-seller's activities in its own state, the Court could hardly avoid sustaining such a tax, meeting as it would all the practical effect criteria. Would not the Court then have to recognize that a portion of the gross receipts it has allowed Washington to tax in *General Motors* and *Standard Steel* are no longer fairly attributable to Washington?

The Court could scarcely have overlooked such possibilities when deciding *General Motors* and *Standard Pressed Steel*. Could it really have intended to require an actual multiple burden before striking down a tax for unfair apportionment, so long as due process nexus and fair relation were satisfied? Such a policy would make the validity of applying a tax to a particular interstate transaction in the buyer's state depend upon whether the seller's state for the year in question imposed a comparable tax on the same transaction. This would produce both ad hoc unfairness in the individual applications of the tax, and substantial complications in tax administration.[167] The Court's 1972 decision in *Evco v. Jones*,[168] which invoked the risk of a multiple burden to strike down a sales tax in the seller's state without noting whether the buyer's state had a comparable tax, indicates that the Court did not intend such a sweeping rule.[169]

164. The due process nexus and "fair relation" criteria were satisfied in *Standard Pressed Steel* by one full-time employee in Washington, *see* 419 U.S. at 561, 563, and in *General Motors* by many, who advanced the interests of the seller in a variety of ways but did not themselves negotiate the interstate sales, *see* 377 U.S. at 443-48.

165. *See also* 419 U.S. at 563; General Motors Corp. v. Washington, 377 U.S. 436, 449 (1964).

166. 419 U.S. at 564. This "analytical nonsense . . . about a 'fairly apportioned' 'unapportioned' tax," Hellerstein, *supra* note 87, at 171, appears only in *Standard Pressed Steel*, which invoked the authority of *General Motors* but apparently sought in this manner to explain both rulings on the laconically-treated multiple burden-apportionment issue.

167. *See* Freeman v. Hewit, 329 U.S. 249, 278-90 (1946) (Rutledge, J., concurring).

168. 409 U.S. 91 (1972).

169. This indication finds support in the reasoning of Mobil Oil Co. v. Com-

Possibly in *General Motors* and *Standard Steel* the Court "analogized gross receipts taxes to retail sales and use taxes" permitted in the buyer's state but not in the seller's,[170] but it is hard to imagine the Court not then being aware of the strong claim that the manufacturer-seller's state would have to tax a fairly attributable portion of the gross receipts from products manufactured in the state and sold through interstate negotiations conducted from there by the seller. Or, while being aware of the problem, the Court may have concluded, as it did in a more recent net income tax case,[171] that working out an analytically sound apportionment scheme for interstate manufacturing and merchandising is more appropriately a legislative function that should be left to Congress,[172] so long as the Washington tax constituted no present practical threat to commerce and the out-of-state seller failed to show that other states sought to tax the same receipts.

Such issues, as yet unresolved, call for renewed and thoughtful analysis, both at the judicial and legislative levels, particularly now that *Complete Auto* has foreclosed resort to Formal Rule reasons and requires that we now resolve all such problems on the basis of economic realities.

4. *Taxes on Drummers*

As previously noted, an important case in development of the Formal Rule, *Robbins v. Shelby Taxing District*,[173] held invalid the application to an out-of-state drummer of a fixed-sum license tax on those taking orders for the sale of goods without a licensed place of business in the taxing district. Many times

missioner of Taxes, 445 U.S. 425, 442-44 (1980), a state income tax apportionment opinion, in which the Court keeps alive the possibility of holding a tax invalid because of its potential for a multiple burden without requiring proof of an actual burden. *See* Hellerstein, *State Income Taxation of Multijurisdictional Corporations: Reflections on Mobil, Exxon and H.R. 5076*, 79 MICH. L. REV. 113, 131-35 (1980).

170. *See* Hellerstein, *supra* note 87, at 171-72.

171. Moorman Mfg. Co. v. Bair, 437 U.S. 267, 280 (1978).

172. After extensive study aided by a distinguished advisory group, a House of Representatives Committee in 1965 proposed a method of allocating gross receipts taxes, net income taxes, and sales and use taxes applicable to all states. *See generally* H.R. REP. No. 952 (Vol. 4), 89th Cong., 1st Sess. (1965), H.R. REP. No. 565 (Vol. 3), 89th Cong., 1st Sess. (1965); H.R. REP. No. 1480 (Vols. 1, 2), 88th Cong., 2d Sess. (1964). Bills to enact the recommendations have been pending in Congress since 1966, and once passed the House. For a recent version, see H.R. 5, 96th Cong., 1st Sess. (1979). For recent, more focused efforts at congressional limits on state taxing power over commerce, see Hellerstein, *supra* note 169, at 113-15, 154-71.

173. 120 U.S. 489 (1887). *See* text accompanying notes 27-28 *supra*.

thereafter the Court invoked the Formal Rule to strike down state or local taxes on taking orders for the sale of goods, as applied to those representing out-of-state sellers.[174] Now that the Formal Rule is without force, may "practical effect" considerations alone justify the continuation of this long-standing ban on interstate drummers' taxes?

When such taxes are in a fixed amount without regard to the volume of business done, decisions of the 1940s suggest their continued invalidity on two grounds: (1) discrimination against interstate commerce, and (2) potential exclusionary effect of such taxes on the establishment of a market for out-of-state products. But in light of recent developments the Court may require in such cases that the record demonstrate that the actual operation of the tax does, in fact, cause such harms to commerce.

Both grounds for the continued invalidity of such a tax were suggested in *Robbins* itself, though the opinion rested on the Formal Rule concept. The Court noted that the tax on seeking orders was a "restriction" on "the very foundations of interstate trade"—the developments of a market for out-of-state products through order taking.[175] The majority also found discrimination favoring local, established retail merchants in their exemption from the license tax,[176] despite the dissenters' argument that such merchants already paid both a tax on their

[illegible]

than fifty years of voiding such taxes under the
n 1940 the Court reached the same result based
ion in *Best & Co. v. Maxwell*.[178] It viewed as dis-
rth Carolina's annual $250 tax on those not "reg-
erchants" within the state who temporarily
ples to secure orders, because the "only cor-
ed-sum license tax" on local merchants was a $1

Real Silk Hosiery Mills v. City of Portland, 268 U.S. 325, 335
. Morgan, 185 U.S. 27, 37 (1902). For other such cases, see
ote 1, at 618 n.10.
494.

)2 (Waite, C.J., dissenting). The majority's only response was
ble" that "merchants and manufacturers of other States" are
es where they reside." *Id.* at 498. But taxes on manufactur-
e-type distributors, wherever located, would equally be in-
of goods sold by the interstate seller and the local merchant.
uld have the costs and taxes—but also the advantages—that
il establishment.
4 (1940).

"doing business" tax.[179] The majority in *Best & Co.* made no reference to the other taxes on local merchants to which the North Carolina Supreme Court had referred in sustaining the tax.[180]

Finally, in *Nippert v. City of Richmond*,[181] the next case involving such a tax, and the last one to date, the Court struck down a $50 municipal license tax on solicitors, as applied to those selling out-of-state goods, again without resort to the Formal Rule, but with reasons similar to the practical ones advanced in *Robbins*. The Court reasoned that such flat rate taxes unrelated to the volume of business had both discriminatory and "potential excluding effects" for an "out-of-state itinerant" salesman who was subject to "the cumulative effect, practically speaking, of flat municipal taxes laid in succession upon [him] as he passes from town to town."[182] The Court viewed the tax as "prohibitive in an absolute sense, for many applications," and "discriminatory in favor of the local merchant as against the out-of-state one."[183] It concluded that the tax "inherently involve[d] too many probabilities, and we think actualities, for exclusion of or discrimination against interstate commerce, in favor of local competing business."[184]

As in *Best & Co.*, the Court in *Nippert* concluded that the tax had a discriminatory effect without recognizing the possibility that the tax on solicitors might be offset by different types of taxes on competing local distributors. But Justice Douglas, dissenting with Justice Murphy, protested making such a decision "without knowing what taxes the retail merchants in Richmond must pay. If the facts were known, it might appear that the tax . . . in fact resulted in parity of treatment between Nippert and her local competitors."[185]

The *Nippert* argument that the tax had a "potential excluding effect" on those seeking local markets for out-of-state products is significant as an illustration of a "practical effect" basis for challenging a tax on commerce outside of the four criteria enumerated in *Complete Auto*. With a supporting factual record this should be an appropriate basis for invalidating a tax even when no claim of discrimination could be made because

179. *Id.* at 456.
180. *See* 216 N.C. 114, 120, 3 S.E.2d 292, 297 (1939).
181. 327 U.S. 416 (1946).
182. *Id.* at 429-30.
183. *Id.* at 431.
184. *Id.* at 434.
185. *Id.* at 436-37 (Douglas, J., dissenting).

of the absence of competing products. But, as suggested below, in the future such a claim may have to be established by a more detailed, factual showing.

For three reasons I suggest that *Nippert* should not be considered as settling even for the short run the invalidity of all taxes on one seeking orders for sales of products to be shipped from another state. First, a tax proportionate to the volume of business might well be upheld. In both *Best & Co.* and *Nippert* the Court stressed that the substantial fixed rate taxes involved bore "no relation to actual or probable sales but [had to] be paid in advance no matter how small the sales turn[ed] out to be."[186] Under those circumstances when no such tax was imposed on the seller's true competitors, the local retail merchants, the discriminatory burden on interstate commerce could be severe. But if the tax on the solicitor varied with the volume or value of the business done within the taxing district, it would pose far less of a threat to interstate commerce. Its validity would appear assured if a similar, equal tax were imposed on local competing merchants.[187]

Second, in future interstate drummers' tax cases the Court may consider the possible equalizing effect of other types of taxes on local competing merchants. Since *Nippert*, the Court has twice deviated from the *Best & Co.-Nippert* silent disregard of different types of taxes on competing local activities. In both cases, the Court concluded that the tax on interstate activities was not discriminatory after comparing it with a different tax on competing local activities. In *Dunbar-Stanley Studios, Inc. v. Alabama*,[188] the Court found a $5 per week tax on out-of-state traveling photographers not discriminatory when compared to a $25 annual tax on local photographers with fixed locations.[189] In *Alaska v. Arctic Maid*,[190] it held Alaska's freezer ship tax of 4% of the value of fish frozen there (to be canned in other states) not discriminatory when compared with Alaska's tax of 6% of the value of fish canned in Alaskan canneries.[191]

I do not suggest that these cases foreshadow *Nippert*'s

186. Best & Co. v. Maxwell, 311 U.S. at 456. In *Nippert* the Court stated that "[t]he tax . . . bore no relation to the volume of business done or of returns from it." 327 U.S. at 427.

187. *Cf.* McGoldrick v. Berwind-White Coal Mining Co. 309 U.S. 33, 48-49 (1940) (sales tax upheld, avoiding Formal Rule); Henneford v. Silas Mason Co., 300 U.S. 577, 583-84 (1937) (compensatory use tax upheld).

188. 393 U.S. 537 (1969).

189. *Id.* at 542.

190. 366 U.S. 199 (1961).

191. *Id.* at 205.

overruling. *Dunbar-Stanley* and *Arctic Maid* involved different but comparable taxes on different but comparable local and interstate activities. The similarities of the taxes and activities made relatively simple a comparison for purposes of deciding whether the tax burden on interstate business was discriminatory.

Such an analysis in the case of a drummers' tax would be much more complex. The competing local merchants' methods of doing business are entirely different from the interstate drummers' methods, and they are normally subject to entirely different types of taxes. The difficulties of determining whether the tax burdens of incomparable taxes on incomparable methods of doing business discriminate against interstate commerce, particularly since part of the interstate sellers' burden may result from out-of-state taxes on out-of-state property and activities, may well have kept the Court from tackling such problems in *Best & Co.* and *Nippert* and may do so again. But the infeasibility of comparing incomparable tax burdens may not mandate continued invalidation of all flat rate taxes on drummers making interstate sales. The Court's recent inclination to require a showing of actual harm to commerce, noted next, may cause it to refuse to find a drummers' tax on interstate sales discriminatory when competing local merchants pay substantial other taxes, absent proof of an actual discriminatory burden.

Finally, the Court's emphasis in *Nippert* on the mere "potential" of a tax to discriminate or exclude, without factual proof of either, may no longer be an acceptable basis for invalidating state taxes. There are indications that the Court may now be moving from the "potential" burden rationale of *Nippert* and *J.D. Adams Manufacturing Co. v. Storch*,[192] toward the view Justice Douglas urged in his *Nippert* dissent when he invoked the Brandeis view that such cases should not be based on "speculation," but that absent facial discrimination one who claims discrimination against commerce "in its actual operation should be required to come forward with proof to sustain the charge."[193] Recent cases noted in my concluding remarks reveal a Court increasingly unpersuaded by speculative or potential harm to commerce, deduced in theory but not proved in

192. 304 U.S. 307, 311 (1938).

193. 327 U.S. at 437 (Douglas, J., dissenting). For Justice Black's similar view of "potential" multiple burdens, see J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307, 327-28 (1938) (Black, J., dissenting).

fact. It would not be surprising if the Court were to require in a future case like *Nippert* factual proof of an actual discriminatory tax burden on interstate transactions.

V. CONCLUSION

In conclusion, I invite you to think about the probable effect of these developments on the lawyers' role in state taxation of interstate commerce. Now that the practical economic effect of a tax is the controlling consideration, lawyers' tasks in this area should be more demanding and satisfying because more relevant to the real issues, whether the lawyer serves as counselor, advocate, or judge. The determination of the validity of taxes on interstate business will require, much more often than in the past, realistic, detailed analysis of the particular tax and others like it affecting both interstate and local commerce, and their practical effect on the taxpayer's business and its capacity to compete with local business. The lawyer will be responsible for painstaking data gathering and analysis, often with the aid of accountants and economists, and the development of effective methods for presenting the data and relating it to appropriate criteria.

I take time to state this conclusion because of the understandable inclination among lawyers, oriented by the past judicial decisions in this area, to think in legal-rule terms, to make logical, legalistic arguments rather than to develop and present particularized analyses of the relevant economic effects of the tax.

Moorman Manufacturing Co. v. Bair,[194] a 1978 decision, dramatizes this change in the Court's view of the type of record needed to invalidate a state tax because of its practical effects. Moorman manufactured animal feed in Illinois and sold 20% of it in Iowa, where it had elevators and salesmen. For income tax purposes, Iowa apportioned Moorman's total net income by the ratio its sales in Iowa bore to its total sales, while Illinois apportioned the same net income by the usual three-factor formula that weighed equally the ratio Moorman's property, payroll, and sales in Illinois bore to the total of each. Moorman argued that its Illinois operations, where it manufactured all its feeds, were responsible for part of the profits generated by the Iowa sales, and therefore, (1) Iowa was taxing some income not attributable to Iowa, thus violating due process, and

194. 437 U.S. 267 (1978).

(2) Iowa was taxing some income also taxed by Illinois, thus creating a multiple tax burden in violation of the commerce clause.[195] Rejecting both arguments, the Court termed "speculative" the "assumption" that Iowa was taxing income not attributable to Iowa.[196] It stressed that

> [t]he record does not contain any separate accounting analysis showing what portion of appellant's profits was attributable to sales, to manufacturing, or to any other phase of the company's operations. . . .
>
> . . . [A] separate accounting analysis might have revealed that losses in Illinois operations prevented . . . more income from exploitation of a highly favorable Iowa market.[197]

Although other considerations also influenced the *Moorman* decision, the Court's opinion underlines the importance of preparing and providing detailed factual support for claims made under today's "practical effects" criteria. It signals reluctance to invalidate a state tax based on rational probabilities when the Court believes supporting factual data should be available. Today a lawyer invoking broad "practical effects" criteria like fair apportionment or multiple burden cannot safely rely on making his or her case by logical deductions from underlying operative facts, such as the reasonable deduction by Moorman's counsel that some of its net profits from sales in Iowa must have been attributable to the manufacturing and management activities occurring in Illinois. Instead, the lesson from *Moorman* and other recent cases[198] is that counsel mak-

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195. *Id.* at 271-72.

196. *Id.* at 272, 276.

197. *Id.* at 272.

198. *See, e.g.*, Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 436, 442-43 (1980). In upholding Vermont's inclusion of income from dividends in calculating an apportioned net income tax on a petroleum company only marketing its products there, the Court stressed the taxpayer's failure to offer evidence on and "sustain its burden of proving" whether or not the many out-of-state and foreign corporations paying dividends to the taxpayer were engaged in activity that contributed to the taxpayer's integrated petroleum business. The Court doubted, but did not decide, the validity of including dividends from corporations not so contributing as part of apportionable net income. *See id.* at 443-45. (For the latest word on this issue, see Exxon Corp. v. Wisconsin Department of Revenue, 447 U.S. 207, 223-24 (1980)). For an excellent discussion of the principal issues raised in *Mobil* and *Exxon* relating to income taxation of unitary business, see Hellerstein, *supra* note 169.

In *Mobil Oil* the taxpayer had focused exclusively on legal arguments relating to constitutional power that, if successful, would have excluded all dividends from the tax; perhaps it sought to avoid inviting the Court by the factual record to sustain the tax as applied to dividends from contributing corporations. But the result when the legal arguments were rejected was to sustain the tax in its entirety because the factual evidence that might have invalidated a part of it was not provided. 445 U.S. at 442, 449.

General Motors Corp. v. Washington, 377 U.S. at 448-49, and Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. at 563-64, though laconic ing a "practical effect" attack on a state tax should be prepared to establish harm to commerce by detailed factual data.[199]

and ambiguous on the risk of multiple taxation issue (*see* Hellerstein, *supra* note 87, at 168-76), also demonstrate an inclination not to invalidate state taxes on the basis of a potential for harm to commerce, but to require some kind of factual showing.

199. The Court's downplaying in *Exxon, see* 447 U.S. at 220-21, 223, of its comments in *Moorman* concerning the absence of an accounting analysis of the profit or loss from the Illinois manufacturing, *see* 437 U.S. at 272, in no way undermines the *Moorman* Court's stress on the taxpayer's failure to establish its claim that Iowa sought to tax income attributable to Illinois. *Exxon* involved an entirely different issue for which separate accounting had entirely different relevance. *See* Hellerstein, *supra* note 169, at 146-47.