1964

# Constitutional Law - Interstate Commerce: Out-of-State Manufacturer Subject to State Tax on gross Receipts Attributable Local Activities

Minn. L. Rev. Editorial Board

## Constitutional Law—Interstate Commerce: Out-of-State Manufacturer Subject to State Tax on Gross Receipts Attributable to Local Activities

A Washington statute[1] levied a tax on the privilege of engaging within the State in the business of making sales at wholesale, measured by the gross proceeds of such sales. General Motors, an out-of-State automobile manufacturer, sold motor vehicles, parts, and equipment to Washington retail dealers of the Chevrolet, Pontiac and Oldsmobile Divisions[2] of the corporation. District managers in Washington conferred with the dealers and assisted in the preparation of projected orders, which were filed monthly. These were purchase orders, in effect, although individual orders specifying optional features later were sent to zone offices in Portland, Oregon, approved there or at the factories, and filled by shipments *f.o.b.* the factories. The district managers operated from their homes in Washington, maintaining close contact with dealers in their areas and acting "in a supervisory or advisory capacity to see that they have the proper sales organization and to acquaint them with the Divisional sales policies and promotional and training plans to improve the selling ability of the sales organization."[3] Service representatives also worked with the dealers, checking the adequacy of their service facilities and the appearance of their places of business, assisting them with customer complaints, and conducting clinics for the dealers and their service personnel. The Portland zone managers and their assistants supervised the work of the district managers and service representatives, and also made personal visits to the dealers. The Chevrolet Division maintained a one-man branch office in Seattle to expedite orders through its Portland zone office for dealers in the northern counties of Washington. Since 1954 Chevrolet Division also has maintained a zone office in Seattle and has paid without dispute the tax on sales

1. WASH. REV. CODE § 82.04.270(1) (1961).

2. These divisions, although not separately incorporated, are "operated as substantially independent entities." General Motors Corp. v. Washington, 377 U.S. 436, 452 (1964) (dissenting opinion).

3. Record, vol. 2, p. 246, General Motors Corp. v. Washington, 377 U.S. 436 (1964). Although the dealers were independent merchants owning their own facilities, they were required to conform to the specifications and conditions of a "Dealer's Selling Agreement," the terms of which are discussed in General Motors Corp. v. State, 60 Wash. 2d 862, 868–69, 376 P.2d 843, 846–47 (1962).

connected with this office. A fourth division, General Motors Parts, maintained warehouses in Seattle and Portland, each of which received orders from and sold directly to Washington dealers. The tax on sales from the Seattle warehouse was paid without protest. The Supreme Court of Washington held the receipts from all transactions of these divisions involving delivery to Washington dealers subject to the privilege tax.[4] On appeal to the United States Supreme Court, this judgment was affirmed. The Court *held*, four Justices dissenting, that the tax was levied upon the incidents of a substantial local business within the taxing State and was constitutionally valid. *General Motors Corp. v. Washington*, 377 U.S. 436 (1964).

Mr. Justice Clark, writing for the majority, concluded that the in-State activities of appellant's employees provided a sufficient basis for the imposition of the tax; that the receipts from sales attributable to such activities were a fair measure for the tax; and that appellant had failed to establish a multiple burden resulting from the tax. The first conclusion seems adequately supported by authority and practical considerations. Due process, as a jurisdictional requirement, has been held to demand only "'some minimum connection'" or sufficient "'nexus between such a tax and transactions within a state for which the tax is an exaction.'"[5] Clearly this requirement was satisfied by the presence of the corporation's personnel and business establishments within the State.

Mr. Justice Goldberg, writing for three of the dissenting Justices, asserted that the local activity of solicitation never has been held sufficient to constitute a basis for imposing a tax on interstate sales.[6] He argued further that *Norton Co. v. Department of Revenue*,[7] relied upon by the majority, provided no authority for taxing interstate sales except to the extent that they might be attributed to a local esablishment making intrastate sales.[8] This situation concededly did not exist in the instant case. The willingness of the majority to go beyond the facts of *Norton* may have removed a standard which was regarded as affording some certainty to state taxing officials and interstate

4. General Motors Corp. v. State, 60 Wash. 2d 862, 376 P.2d 843 (1962).

5. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 464–65 (1959), quoting Miller Bros. v. Maryland, 347 U.S. 340, 344–45 (1954), and Wisconsin v. J. C. Penney Co., 311 U.S. 435, 445 (1940).

6. 377 U.S. at 456.

7. 340 U.S. 534 (1951).

8. 377 U.S. at 454–56.

businesses.[9] However, the recognition that the attempt to make interstate commerce pay its fair share of state tax burdens cannot be restricted by so artificial a standard as the presence of an intrastate sales office is a laudable holding. As the majority rightly pointed out, the privilege of conducting an interstate business with certain tax immunities does not mean that a corporation may "channel its operations through . . . a maze of local connections . . . and take advantage of its gain on domesticity, and still maintain that same degree of immunity."[10]

The fear of the dissenting Justices that the decision in the instant case will permit taxation of interstate sales whenever a company enters a state through solicitors or traveling salesmen, leaving only mail-order houses immune,[11] appears ill-founded. General Motors' Washington activities were certainly more substantial than those traditionally considered mere solicitation.[12] This case, therefore, may be read as approving a tax on receipts from interstate sales only where the company maintains a substantial permanent base in the state of destination.

The majority's reference to the incidents of a "substantial local business"[13] admittedly leaves undefined the limits of state power to tax interstate sales. But it is unlikely that an extension of that power would be approved which reached activities as insubstantial as the solicitation by nonresidents of orders to be approved and filled from without the state — a prohibited subject for an apportioned net income tax.[14] Such an extension would

9. See BEAMAN, PAYING TAXES TO OTHER STATES 12-13 to -17 (1963). Beaman states that following the *Norton* case, the Illinois Department of Revenue promulgated a regulation dealing with the question "whether or not a person who is 'engaged in the business of selling tangible personal property at retail' is engaged in such business in this State, and with the question of the relation of such business to interstate commerce." Ill. Retailer's Occupation Tax Reg. art. 5, pt. 1 (1962). Separate paragraphs are devoted to sales (1) made by or through an Illinois place of business at which the seller sometimes makes intrastate retail sales, (2) made by or through an Illinois place of business at which the seller makes no intrastate retail sales, and (3) made by or through a place of business outside Illinois. BEAMAN, *op. cit. supra*.

10. 377 U.S. at 448.

11. 377 U.S. at 462 *passim*.

12. See, *e.g.*, Nippert v. City of Richmond, 327 U.S. 416 (1946); McLeod v. J. E. Dilworth Co., 322 U.S. 327 (1944); Real Silk Hosiery Mills v. City of Portland, 268 U.S. 325 (1925); Robbins v. Shelby County Taxing Dist., 120 U.S. 489 (1887).

13. 377 U.S. at 439.

14. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959), probably represents the extent of state power to tax interstate sales transactions. In that case orders for interstate sales were solicited by salesmen working out of sales offices maintained within the State by the taxpayers.

also test the Court's resolve to stand by the proposition that a state may not lay a tax on the "privilege" of engaging in interstate commerce.[15] For if the local activity upon which the tax is based is not substantial, or if the state has not "exerted its power in proper proportion to . . . [the taxpayer's] activities within the State and to . . . [his] consequent enjoyment of the opportunities and protections which the State has afforded,"[16] then presumably the state in substance is taxing the privilege of engaging in interstate commerce.[17]

The dissenting opinion of Mr. Justice Brennan was concerned primarily with the second conclusion of the majority — that receipts from sales to Washington dealers provided a fair measure of the tax. He argued that it was not sales but commercial activity which gave Washington a right to tax General Motors, and that the tax should therefore be apportioned by a formula based upon the volume of commercial activity involved.[18] No doubt it would be possible to select factors preferable to sales volume for apportioning a firm's gross receipts among taxing authorities. It seems clear, however, that the Court would have no basis for requiring a state to select one or more of these factors in the absence of a showing that the formula being utilized did not provide a fair measure of that portion of the firm's gross receipts "earned" in the taxing state. If the majority's conclusion that receipts from sales to Washington dealers were attributable to local activities be correct, then its acceptance of the Washington formula as a fair apportionment is justified.

---

Following the decision, Congress enacted Public Law 86–272, which was designed to prevent the states from extending their taxing power beyond the facts of *Northwestern States*. It provides in essence that the states may not tax the net income of nonresidents if their business activities within the taxing state amount to nothing more than solicitation of orders for the sale of tangible personal property and the orders are approved and filled from without the state. 73 Stat. 555 (1959), as amended, 15 U.S.C. §§ 381–84 (Supp. V, 1964). The statute is discussed in Comment, 44 MINN. L. REV. 999 (1960); Note, 46 VA. L. REV. 297 (1960); 108 U. PA. L. REV. 1077 (1960).

15. See Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602, 609 (1951); 377 U.S. at 446 (dictum); Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959) (dictum).

16. 377 U.S. at 441.

17. However, it has been suggested that no state tax will be struck down as a levy on the privilege of engaging in interstate commerce, so long as the state does not assert the right to exclude out-of-state firms for nonpayment of the tax and resorts only to ordinary collection devices to enforce payment. See Hartman, *State Taxation of Corporate Income From a Multistate Business*, 13 VAND. L. REV. 21, 27, 40 (1959).

18. 377 U.S. at 450–51.

It has been suggested that a state is more competent than the Supreme Court to determine the relation between local activities and local sales receipts,[19] and that the Supreme Court is unlikely to invalidate an apportioned tax in the absence of a finding by the state court that the apportionment is unreasonable.[20] In the instant case the majority quotes language from the *Norton* opinion hinting at a "substantial evidence" type of review of the state court determination.[21] Putting aside factors making a state court better able to apply state tax laws, to entrust state courts with responsibility for making fairly conclusive determinations of the constitutionality of a tax affecting commerce might give sectional interests a leverage inconsistent with the policy underlying the commerce clause.

In refusing to pass on the taxpayer's claim of potential multiple taxation,[22] the Court left open the possibility that Washington's tax could be approved despite a demonstrated multiple burden. This possibility is not remote, since a long series of cases suggests that taxes on interstate sales by the destination state are less carefully scrutinized than those imposed by other states having some contact with the sales.[23] At the very least, however, the instant case indicates that the validity of a tax on commerce will not be tested by the mere possibility of multiple taxation,

19. See *The Supreme Court, 1963 Term,* 78 HARV. L. REV. 143, 243 (1964).

20. See *Developments in the Law — Federal Limitations on State Taxation of Interstate Business,* 75 HARV. L. REV. 953, 1015 (1962).

21. 377 U.S. at 441–42.

22. 377 U.S. at 449. Compare Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 462–63 (1959); Southern Pac. Co. v. Gallagher, 306 U.S. 167, 172 (1939); Henneford v. Silas Mason Co., 300 U.S. 577, 587 (1937).

23. *Compare* Norton Co. v. Department of Revenue, 340 U.S. 534 (1951), *and* International Harvester Co. v. Department of Treasury, 322 U.S. 340 (1944), *and* General Trading Co. v. State Tax Comm'n, 322 U.S. 335 (1944), *and* McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940), *and* Field Enterprises, Inc. v. Washington, 47 Wash. 2d 852, 289 P.2d 1010 (1955), *aff'd per curiam,* 352 U.S. 806 (1956), *with* Freeman v. Hewit, 329 U.S. 249 (1946), *and* Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434 (1939), *and* J. D. Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938). It was once suggested that the combined effect of the decisions in *J. D. Adams Mfg. Co. v. Storen* and *McGoldrick v. Berwind-White Coal Mining Co.,* was "to permit the state of the market to tax the interstate transaction, but to deny this power to the forwarding state, unless by credit or otherwise it should make provision for apportionment." Freeman v. Hewit, *supra* at 281–82 (Rutledge, J., concurring). See generally Lockhart, *The Sales Tax in Interstate Commerce,* 52 HARV. L. REV. 617 (1939); Powell, *New Light on Gross Receipts Taxes,* 53 HARV. L. REV. 909 (1940).

whereas a demonstrated multiple burden may or may not invalidate the same tax.

It is not clear just what must be shown in order to satisfy the requirement of actual multiple taxation. Apparently the Court does not object to double taxation of receipts, so long as each state's tax is nominally imposed on a different and separable "local incident."[24] In the instant case the corporation apparently would have had to demonstrate that its Washington activities were the basis for a tax by another state on receipts from sales to Washington dealers. This would have amounted to a showing that two states taxed the same activity and measured their taxes by the same receipts. A tax burden of similar proportions would arise, however, if two or more states taxed the same activity in different fashions. For example, another state might claim a portion of the receipts from Washington sales by apportioning to itself that share of the firm's total net income attributable to the sales themselves or to activities related to the sales. Nevertheless, under prevailing standards, it is not clear that such a tax would have any effect on the validity of Washington's tax. Duplicative taxation of corporate net income, resulting from two states placing the same transactions in the numerators of their apportionment formulas, is not objectionable if each apportionment considered by itself is found to be reasonable.[25] Since the Washington tax was found to be a "fair demand" when considered alone, it is difficult to see how it could be invalidated if in combination with another state's tax it subjected a taxpayer to a multiple burden. A consequence of making the validity of a state tax dependent upon the exercise of taxing power by other states[26] would be to make taxes valid one year and invalid the next; state officials and business managers would be unable to forecast accurately revenues and expenses for coming years.

In an earlier case the Court disposed of an argument in favor of a tax, based on the fact that only one state was taxing a particular transaction, by saying:

> The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of

24. *Compare* International Harvester Co. v. Department of Treasury, 322 U.S. 340 (1944), *with* American Mfg. Co. v. St. Louis, 250 U.S. 459 (1919).

25. See Commonwealth v. South Philadelphia Terminal, Inc., 404 Pa. 293, 171 A.2d 758 (1961).

26. See, *Developments in the Law — Federal Limitations on State Taxation of Interstate Business*, 75 HARV. L. REV. 953, 1018–19 (1962).

> the various States at a particular moment. Courts are not possessed of instruments of determination so delicate as to enable them to weigh the various factors in a complicated economic setting which, as to an isolated application of a State tax, might mitigate the obvious burden generally created by a direct tax on commerce.[27]

The Court is equally incapable of weighing the factors which *create* a burden on commerce. Therefore, the likelihood of proving actual multiple taxation to the satisfaction of the Court is extremely remote. Unless another state's tax is identical to Washington's, the Court will probably find itself unable to determine the extent to which it is levied on the taxpayer's "activity bearing on Washington sales."[28]

The Court's reluctance to base constitutional adjudication upon complex economic determinations may prove to be the wisest approach if current congressional studies result in comprehensive legislation.[29] During the interim period the Court might approach state taxation the same way it has approached state regulation of commerce under the police power, by recognizing that competing interests must be balanced and by exercising a limited review of the reasonableness of state action in order to keep the states within broad discretionary limits.[30] Determining whether gross receipts are fairly related to local activities would prevent completely unwarranted extensions of state taxing power, and continuing to look for actual multiple taxation would at least prevent the most obvious and onerous burdens on interstate commerce.

If Congress fails to establish guidelines, however, the Court may be compelled to take a more active role. It must then choose one of two courses. Either it must take cognizance of the burdens to which interstate firms are exposed by diverse local taxes, short of that which it has previously indicated it will accept as a showing of multiple taxation; or it must devise more objective and concrete tests of the reasonableness of the relations between taxes and the activities for which they are an exaction.

---

27. Freeman v. Hewit, 329 U.S. 249, 256 (1946).

28. 377 U.S. at 449.

29. Section 201 of Public Law 86–272, as amended, 75 Stat. 41 (1961), provides for studies by House and Senate committees of all matters pertaining to the taxation of interstate commerce by the states.

30. See, *e.g.*, Southern Pac. Co. v. Arizona, 325 U.S. 761, 770–71, 783–84 (1945).