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An Analytical Approach to State Tax Discrimination Under the Commerce Clause

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I. INTRODUCTION

The commerce clause as an instrument of federalism facilitates a system of government that places a national government over fifty sovereign states. Federalism requires a balancing of the interest in a unified national approach to government with the competing interest in state sovereignty. As Justice Brennan explained:

> [O]ur Constitution is an instrument of federalism. The Constitution furnishes the structure for the operation of the States with respect to the National Government and with respect to each other. . . . Because there are 49 States and much of the Nation's commercial activity is carried on by enterprises having contacts with more States than one, a common and continuing problem of constitutional interpretation has been that of adjusting the demands of individual States to regulate and tax these enterprises in light of the multistate nature of our federation.[1]

The commerce clause provides: "The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."[2] The commerce clause has been interpreted not only as conferring power on the national government to regulate commerce, but also as limiting the states' power to interfere with commerce. This restriction on state power often is referred to as the "negative implication of the

1. Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 532 (1959) (Brennan, J., concurring).
2. U.S. CONST. art. I. § 8, cl. 3.

commerce clause" or as the "dormant commerce clause" principle.[3] Under the authority of the commerce clause, the United States Supreme Court has struck down as unconstitutional a variety of state regulatory and taxation measures as unduly burdening commerce.[4]

The primary purpose of the commerce clause is to foster free trade and prevent commercial wars among the states.[5] According to the Court in *H.P. Hood & Sons, Inc. v. Du Mond*:[6]

> Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any.[7]

Although the states have legitimate interests in raising revenues through taxes and in regulating commercial activity within their boundaries, the states' taxing and police powers may not be used

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3. *See* Wardair Canada, Inc. v. Department of Revenue, 106 S. Ct. 2369 (1986) (in holding that a Florida aviation fuel tax did not violate the commerce clause, the Court points out that dormant commerce clause principles do not apply in this case because the federal government has acted affirmatively in the area and therefore it is not the responsibility of the judiciary to determine whether state action threatens commerce clause values); *see also* L. TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-2 (1978); Blnmstein, *Some Intersections of the Negative Commerce Clause and the New Federalism: The Case of Discriminatory State Income Tax Treatment of Out-of-State Tax Exempt Bonds*, 31 VAND. L. REV. 473 (1978); Case Note, *The Constitutional Dilemma of State Tax Exemptions:* Sears, Roebuck and Co. v. County of Los Angeles, 13 LAW & POL'Y IN INT'L BUS. 811, 818 (1981).

4. *See, e.g.*, Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) (holding that state excise tax on alcoholic beverages, which exempted certain locally produced beverages, was unconstitutional under the commerce clause); Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977) (holding that New York transfer tax on securities transactions was unconstitutional under the commerce clause because transactions involving an out-of-state sale were taxed more heavily than most transactions involving a sale within the state); Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366 (1976) (holding that Mississippi regulation providing that out-of-state milk could be sold in Mississippi only if the producing state would accept Mississippi milk on a reciprocal basis was unconstitutional under the commerce clause); Pike v. Bruce Church, Inc., 397 U.S. 137 (1970) (holding that state regulatory order prohibiting taxpayer from shipping cantaloupes outside the state unless they were packed in containers approved by the state was an unconstitutional burden on interstate commerce).

5. *See* McLeod v. J. E. Dilworth Co., 322 U.S. 327, 330 (1944) (holding a state cannot impose sales tax on sales to residents made out-of-state). According to the Court in *McLeod*, "The very purpose of the Commerce Clause was to create an area of free trade among the several States." *Id. See also* H.P. Hood and Sons, Inc. v. Du Mond, 366 U.S. 525, 539 (1949) (holding that New York could not deny a license to an out-of-state milk distributor to expand its facilities within the state); *c.f.* Bosten Steck Exch. v. State Tax Comm'n, 429 U.S. 318, 328 (1977) (citing with approval cases stating that the purpose of the commerce clause is to encourage free trade among the states).

6. 366 U.S. 525 (1949).

7. *Id.* at 539.

to erect barriers to interstate commerce.[8] Barriers to interstate commerce may result in states enacting retaliatory taxes, taxpayers fractionalizing out-of-state operations into multiple local units, and taxpayers being pressured into moving business operations into the taxing state.[9] Because state governments are prone to favor local interests and because out-of-state taxpayers have little access to the taxing state's political process, the commerce clause is needed to protect interstate commerce and avoid these deleterious effects.[10] According to the Court in *McGoldrick v. Berwind-White Coal Mining Co.*,[11] commerce clause analysis must recognize the danger that "to the extent that the burden falls on economic interests without the state, it is not likely to be alleviated by those political restraints which are normally exerted on legislation where it affects adversely interests within the state."[12]

Under the contemporary approach to the commerce clause,[13] the Supreme Court has balanced the interests of the national government and the states by imposing four requirements on state taxes. The Court first enunciated these requirements in 1977 in *Complete Auto Transit, Inc. v. Brady*,[14] and the substantive analysis often is referred to as the four-prong *Complete Auto Transit* test. Accordingly, to protect the national interest, the commerce clause has been interpreted as requiring that a state tax will be valid only if "the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State."[15]

The prohibition of taxes that discriminate against interstate

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8. *See* Maltz, *The Burger Court, The Commerce Clause, and the Problem of Differential Treatment*, 54 IND. L.J. 165, 175 (1979); Case Note, *supra* note 3, at 818-19.

9. *See* P. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION § 2.19, at 34-35 (Supp. 1985) [hereinafter cited as P. HARTMAN, 1985 SUPPLEMENT].

10. *See* McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 45-46 n.2 (1940) (holding that destination state could impose sales tax on interstate sales without violating the commerce clause); 1 J. HELLERSTEIN, STATE TAXATION ¶ 4.12 (1983); L. TRIBE, *supra* note 3, § 6-5; Barrett, *Constitutional Limitations on Discriminatory State Tax Laws*, 2 N.Y.U. INST. ON STATE AND LOCAL TAX'N AND CONF. ON PROPERTY TAX'N 1-7 (1983); Maltz, *supra* note 8, at 175.

11. 309 U.S. 33 (1940).

12. *Id.* at 46 n.2.

13. For a discussion of historical approaches to the commerce clause, see *infra* notes 70-77 and accompanying text.

14. 430 U.S. 274 (1977) (holding that state tax on the privilege of doing business in the state did not violate the commerce clause when applied to an interstate activity).

15. *Id.* at 279. For a discussion of additional requirements applied when foreign commerce is involved, see *infra* notes 42, 61-67 and accompanying text.

commerce is perhaps the most crucial element of the commerce clause as applied to state taxation. In contrast to the antidiscrimination requirement, which is not qualified, the remaining restrictions on state taxation (substantial nexus, fair apportionment, and fair relation to services provided by the state) grant the state some leeway in designing taxing provisions.[16] Moreover, the substantial nexus, fair apportionment, and fairly related to services requirements are to some extent independently incorporated by the due process clause.[17] As Professor Tribe has pointed out, "The Supreme Court has traditionally recognized that a large part of the rationale for granting Congress control over interstate commerce 'was to insure . . . against discriminating State legislation.' "[18]

State taxes frequently are challenged as discriminating against interstate or foreign commerce, and recently the United States Supreme Court has shown a willingness to strike down state taxes as being discriminatory.[19] In the past, however, the Court often up-

16. *See* J. HELLERSTEIN, *supra* note 10, ¶ 4.8, at 123. A tax will not be beld unconstitutional under tbese three prongs of *Complete Auto Transit* if the nexus is deemed substantial, the apportionment is deemed fair, and the tax is fairly related to the services provided by the state.

It is unclear whether the Court will ever deem it necessary to likewise qualify the prohibition against discrimination so as to allow taxation designed to promote legitimate state goals which has an inadvertent discriminatory effect. For instance, a state tax intended to promote environmental concerns could have the unintended result of taxing interstate commerce more heavily than intrastate commerce. Arguably, the legitimate state interest in protecting its environment may outweigh the negative effects on interstate commerce so that the tax should be allowed to stand. Such a halancing of competing state and national interests is the approach used by the Supreme Court in analyzing regulatory cases under the commerce clause. *See, e.g.*, Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366 (1976); Pike v. Bruce Church, Inc., 397 U.S. 137 (1970). Although the Court does not generally use such a balancing approach in analyzing state tax discrimination under the commerce clause, it is possible that a legitimate state interest in imposing a tax other than the typical purpose of collecting revenue may warrant upholding a state tax with an inadvertent discriminatory effect on interstate commerce. The Court suggested that such a result could be possible in stating that discriminatory effects caused by a state tax statute "could be ignored only after a showing of adequate justification." Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 71 (1963) (holding that Louisiana use tax discriminated against interstate commerce because the use tax base included the cost of labor and shop overhead, whereas the sales tax on intrastate transactions was not imposed on these items).

17. *See* P. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION § 2:3 (1981); J. HELLERSTEIN, *supra* note 10, ¶ 4.8, at 123.

18. L. TRIBE, *supra* note 3, § 6-16, at 354 (*quoting* Welton v. Missouri, 91 U.S. 275, 280 (1876)).

19. *See, e.g.*, Westinghouse Elec. Corp. v. Tully, 466 U.S. 388 (1984) (holding that New York tax credit against DISC accumulated income for gross receipts attributable to export shipments made from New York unconstitutionally discriminated against interstate commerce); Armco v. Hardesty, 467 U.S. 638 (1984) (holding that West Virginia wholesale gross receipts tax unconstitutionally discriminated against interstate commerce by exempting lo-

held state levies when challenged on discrimination grounds.[20] In evaluating the case law, it sometimes is difficult to distinguish a tax that legitimately "encourage[s] the growth and development of intrastate commerce and industry"[21] from a tax that unconstitutionally discriminates against interstate commerce. As Professor Hartman has stated, " 'Discrimination' is not a self-defining term. It can be a delusively simple term, and once the question goes beyond the tax that is patently discriminatory on its face, much room for controversy about hidden discrimination exists."[22]

An analytical approach for determining when a state tax discriminates against interstate or foreign commerce is needed. Such an approach would help state legislators draft tax statutes consistent with the mandates of the commerce clause. An analytical approach also would aid tax advisors, litigators, and adjudicators in determining whether a particular state tax is subject to invalidation as being discriminatory against interstate or foreign commerce. Other possible methods of studying state tax discrimination under the commerce clause that do not rely on an analytical approach have less potential as a predictive tool for evaluating when a state tax may be deemed unconstitutional. For example, studying state tax discrimination cases by reviewing the taxing mechanism employed is of little use in predicting constitutionality since any mechanism (direct tax, exemption, credits, etc.) can be used to discriminate. Nor does categorizing the subject of discrimination as interstate goods, taxpayers, or transactions help in making the determination because state discrimination may weigh against any of these categories. Finally, a case-by-case analysis of how courts have defined discrimination for state tax purposes is helpful in ob-

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cal manufacturers from tax); Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984); Maryland v. Louisiana, 451 U.S. 725 (1981) (holding that Louisiana's first-use tax on natural gas brought into Louisiana unconstitutionally discriminated against interstate commerce because various exemptions and credits operated to burden only the gas moving out of the state).

20. *See, e.g.,* Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981) (holding that Montana severance tax on coal did not discriminate against interstate commerce even though most of the coal was shipped outside the state); Alaska v. Arctic Maid, 366 U.S. 199 (1961) (holding that Alaska tax on the business of operating freezer ships did not unconstitutionally burden interstate commerce even though the freezer ships transported salmon out-of-state); Henneford v. Silas Mason Co., 300 U.S. 577 (1937) (holding that use tax on goods purchased outside the state but brought into the state for use did not discriminate against interstate commerce).

21. Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336 (1977).

22. P. HARTMAN, *supra* note 17, § 2:19, at 122-23 (1981); *see also* J. HELLERSTEIN, *supra* note 10, ¶ 4.12[5], at 147.

taining a general understanding of the issue, but fails to provide a method for predicting when a particular tax will be deemed discriminatory.

This Article develops an analytical approach to state tax discrimination under the commerce clause. The approach can be used in determining whether a particular state tax discriminates against interstate or foreign commerce. The approach sets forth six questions that must be answered consecutively to determine whether a state tax is unconstitutionally discriminatory under the commerce clause. These six questions are:

(1) Is the state tax subject to commerce clause scrutiny?

(2) Is there disparate tax treatment?

(3) Is the inequality being challenged caused by the state tax statute?

(4) Does the unequal treatment weigh against a protected class of commerce?

(5) Does the unequal treatment weigh in favor of local commerce?

(6) Can any other law alter the commerce clause result?

This Article examines these questions and explores the ways in which they may be answered.

This analytical approach relates only to discrimination. Other commerce clause requirements (substantial nexus, fair apportionment, and fair relation to services provided) are not examined. Furthermore, the focus of this Article is on state tax discrimination under the commerce clause and not on other constitutional or statutory provisions. This Article will consider, however, whether any other law can override the commerce clause. This Article also will examine how the commerce clause prohibition against state tax discrimination compares to other constitutional or statutory limits on discrimination in state taxation.

II. The Scope of Commerce Clause Scrutiny

In considering whether a state tax unconstitutionally discriminates against interstate or foreign commerce, a court first must determine whether the tax is subject to commerce clause scrutiny. If the tax is not subject to judicial scrutiny under the commerce clause, then no further inquiry under this constitutional provision is warranted. To subject a state tax to commerce clause scrutiny, two conditions must be met. First, the state tax must affect commerce. Second, this commerce may have to be related to interstate or foreign business.

A. The Scope of Commerce

For constitutional purposes "commerce" is defined very broadly. As Chief Justice Marshall stated in *Gibbons v. Ogden*, "Commerce, undoubtedly, is traffic, but it is something more: it is intercourse. It describes the commercial intercourse between nations, and parts of nations, in all its branches."[23] Accordingly, most economic activity is considered commerce.[24] Professional sports, theatrical productions, legal services, and the operations of a public utility holding company all constitute commerce.[25] Although insurance originally was held not to constitute commerce,[26] this view later was repudiated.[27] Nevertheless, Congress subsequently has removed the commerce clause barrier to state regulation of the insurance business.[28] Thus, in determining whether a state tax is subject to commerce clause scrutiny, the first condition, that commerce must be involved, almost always is satisfied.

B. Connection with Interstate or Foreign Commerce

As stated above, for a tax on commerce to be subject to judicial review under the commerce clause, not only must the taxpayer be engaged in commerce, but that commerce also may be required to have some connection with interstate or foreign business. Over the years the law has evolved to diminish the significance of the required connection between the state tax and interstate or foreign commerce. Arguably, the contemporary commerce clause analysis under *Complete Auto Transit* renders this requirement obsolete. Some relationship with interstate or foreign business, however, always has been and may still remain part of commerce clause analysis by the courts.

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23. Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 189-90 (1824) (New York law granting monopoly position in steam navigation of its waters to two individuals held invalid under the commerce clause).

24. *See* J. HELLERSTEIN, *supra* note 10, ¶ 4.1, at 85-86.

25. *Id.* at 85-86.

26. *See* Paul v. Virginia, 75 U.S. (8 Wall.) 168, 183 (1868) (holding that state licensing statute for out-of-state insurance companies was not invalid under the commerce clause because the insurance business did not constitute commerce).

27. *See* United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944) (holding that a fire insurance company that conducted a substantial part of its business transactions across state lines was engaged in interstate commerce and subject to regulation by Congress under the commerce clause).

28. *See* McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015 (1982). For a discussion of congressional consent to state interference with interstate commerce, see *infra* notes 303-07 and accompanying text.

1. Historical Approach

Historically, the connection between a state tax and interstate commerce was all-important for commerce clause analysis because the privilege of engaging in interstate commerce was immune from state taxation.[29] The connection between the tax and interstate commerce was the beginning and also the end of commerce clause inquiry for state tax purposes. In the past, any direct tax on interstate commerce was unconstitutional under the commerce clause.[30] Hence, states could not tax goods in transit in interstate commerce;[31] it therefore was crucial to determine when goods were in interstate commerce. Interstate commerce was deemed to have commenced when goods started transportation in a continuous route or journey to another state.[32] Interruption of the journey across state lines would take the goods out of interstate commerce if the interruption served the business purposes of the owner rather than being necessitated by the exigencies of travel.[33]

Interstate commerce formerly was viewed as having a beginning and an end, and any business preceding the interstate commerce or occurring after its conclusion was susceptible to state taxation.[34] Activities such as manufacturing, mining, and publishing were held to be local business subject to tax even though the goods produced were largely intended for sale outside the state.[35] The distinction drawn between purely local business and interstate commerce was pivotal in determining taxability under the commerce clause.

These old approaches to commerce clause analysis have been criticized as depending on illusory distinctions.[36] One commentator remarked: "The 'principles' formerly applied by the Court made rational analysis of tax statutes almost impossible. At times, it

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29. *See* Spector Motor Serv. v. O'Connor, 340 U.S. 602 (1951) (holding that franchise tax on privilege of doing business within the state was invalid as applied to exclusively interstate business).

30. *See* P. HARTMAN, *supra* note 17, § 2:13.

31. *See* Coe v. Errol, 116 U.S. 517 (1886) (holding that the state could impose property tax on logs cut in-state waiting to be shipped out-of-state because the logs had not yet been started in the course of interstate transportation but state could not impose property tax on those logs cut out-of-state because these logs had been started on a journey in interstate commerce); P. HARTMAN, *supra* note 17, § 2:18.

32. *See* Coe v. Errol, 116 U.S. at 528.

33. J. HELLERSTEIN, *supra* note 10, ¶ 4.3.

34. *Id.* ¶ 4.4[1].

35. *Id.*

36. *See, e.g.,* P. HARTMAN, *supra* note 17, § 2:16; J. HELLERSTEIN, *supra* note 10, ¶ 4.4[1]; L. TRIBE, *supra* note 3, § 6-14; Barrett, *supra* note 10, § 1.03[1][d].

seemed that constitutional questions—some obviously of major financial importance to the states and affected parties—were decided literally on the basis of labels."[37] In particular, Professor Hartman has ridiculed the distinction between the tax imposed on the net income of an interstate business that the Court upheld in *Northwestern States Portland Cement Co. v. Minnesota*[38] and the tax on the privilege of engaging in interstate commerce measured by net income that the Court held unconstitutional in *Spector Motor Service, Inc. v. O'Connor.*[39] As Professor Hartman colorfully explained:

> A nondiscriminatory privilege tax 'measured by' apportioned net income from interstate commerce would seem to present, in practical consequence, no more danger of suppressing or hampering that commerce than a tax imposed *directly* upon that *same* income. Both taxes would yield the *same* amount of revenue. Thus, a great principle of constitutional law hinged on a judicially hatched distinction that has as much economic substance as soup made from the shadow of an emaciated sparrow on a cloudy day.[40]

2. Current Approach

Currently, interstate and foreign commerce can be taxed if certain requirements are met. In regard to interstate commerce, a state tax will be held valid only if the following four prongs of *Complete Auto Transit* are satisfied: the tax must be applied to an activity having a substantial nexus with the taxing state; the tax must be fairly apportioned; the tax must not discriminate against interstate commerce; and the tax must be fairly related to the services provided by the state.[41] A state tax affecting foreign commerce must satisfy two additional requirements: the tax must not create a substantial risk of multiple international taxation, and the tax must not prevent the federal government from "speaking with one voice" when regulating commercial relations with foreign governments.[42]

As opposed to historical approaches to commerce clause analysis, under the current approach taxability generally is not dependent on whether the levy falls upon interstate commerce. Clearly, a

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37. Barrett, *supra* note 10, § 1.03[1][d], at 1-11.

38. 358 U.S. 450 (1959) (holding that net income from the exclusively interstate operations of a foreign corporation may be subjected to state taxation).

39. 340 U.S. 602 (1951).

40. P. HARTMAN, *supra* note 17, § 2:16, at 86 (emphasis in original).

41. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

42. Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 451-52 (1979) (holding that California ad valorem property tax as applied to cargo containers of Japanese shipping companies unconstitutionally burdened foreign commerce).

state tax imposed directly on the privilege of engaging in interstate commerce is no longer a per se violation of the commerce clause.[43] Nonetheless, it is unclear under the current approach whether a state can impose a property tax on goods in transit in interstate commerce.[44] If such a tax is prohibited, then taxability still may turn on whether goods are in transit in interstate commerce. As Professor Jerome Hellerstein suggests, however, the logic behind prohibiting such a state tax should not simply be that the goods are in interstate commerce; rather, because the goods are in interstate commerce, one prong of the *Complete Auto Transit* requirements has not been satisfied.[45]

Although commerce clause analysis no longer turns on whether a tax is imposed on interstate or foreign commerce, an element of interstate or foreign business may be necessary before commerce clause protection even can be invoked. In determining whether the requisite interstate or foreign connection is present, it is helpful to categorize the commerce involved. These categories are useful in assessing the necessary connection between the tax and interstate or foreign commerce. Interstate commerce should be divided between commerce originating outside the taxing state and commerce originating inside the taxing state. Likewise, foreign commerce should be divided between commerce originating outside the United States and commerce originating inside the United States.

3. Interstate Commerce Originating from Outside the Taxing State

Taxation of commerce originating from outside the taxing state clearly is subject to interstate commerce clause scrutiny. Hence, business that originates out-of-state but crosses into the state may be taxed only if the tax statute satisfies the four-part *Complete Auto Transit* test, including the requirement that the tax not discriminate against interstate commerce. Specifically, in regard to out-of-state business crossing into the state, the Supreme Court will scrutinize the taxation of various types of subjects under the commerce clause. The Court has analyzed the taxation of im-

43. *See Complete Auto Transit*, 430 U.S. at 288-89.

44. *See* P. HARTMAN, *supra* note 17, § 2:18; J. HELLERSTEIN, *supra* note 10, ¶ 4.11.

45. *See* J. HELLERSTEIN, *supra* note 10, ¶ 4.11. Assuming that the tax on goods in transit is fairly apportioned to the mileage or ton-miles of freight in the state, there still may be a problem with satisfying the requirements of adequate nexus and fair relation of the tax to the services provided.

ported goods,[46] taxation of transactions,[47] and taxation of nonresidents.[48] Taxation of out-of-state business over which the state has taxing jurisdiction also is subject to commerce clause scrutiny. Thus, a state may not impose a greater tax burden on transactions taking place outside the state than on similar transactions conducted within the state.[49] Nor may a state tax the income associated with out-of-state activity more heavily than the income associated with in-state activity.[50]

4. Interstate Commerce Originating from Inside the Taxing State

Taxation of commerce originating from inside the taxing state may be subject to judicial scrutiny under the commerce clause only if the taxation has a substantial effect on interstate commerce. Under the so-called affectation doctrine, "all local activities which have an adverse bearing or effect upon the interstate commerce" are subject to commerce clause scrutiny.[51] According to the Supreme Court in *Commonwealth Edison Co. v. Montana*,[52] "State taxes levied on a 'local' activity preceding entry of the goods into interstate commerce may substantially affect interstate commerce, and this effect is the proper focus of Commerce Clause inquiry."[53]

In *Commonwealth Edison* the Court addressed a commerce clause challenge to a state severance tax imposed on goods prior to their entry into the stream of interstate commerce.[54] The Court concluded that although mining was a local activity, the practical effect of the tax on interstate commerce necessitated judicial review under the *Complete Auto Transit* test.[55] A logical inference from *Commonwealth Edison* is that certain local taxation that does not substantially affect interstate commerce will not be sub-

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46. *See* Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) (holding that a state may not impose a greater tax burden on imported goods than on locally produced goods).

47. *See* Armco, Inc. v. Hardesty, 467 U.S. 638 (1984) (holding that a state cannot impose a tax on the wholesaling of goods produced out-of-state when the wholesaling of goods produced in-state was exempt from taxation). According to the Court, "[A] state may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the state." *Id.* at 642.

48. *See Complete Auto Transit*, 430 U.S. at 274 (tax imposed on foreign corporation for the privilege of doing business in the state subject to commerce clause scrutiny but held valid under the four-prong test).

49. Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977).

50. Westinghouse Elec. Corp. v. Tully, 466 U.S. 388 (1984).

51. M. Forkosch, Constitutional Law § 220, at 234 (2nd ed. 1969).

52. 453 U.S. 609 (1981).

53. *Id.* at 616.

54. *Id.* at 617.

55. *Id.* at 615-17.

ject to commerce clause review. There is a legitimate need for states to raise revenues, and hence, certain taxation of local activity must be allowed even though this taxation somehow affects interstate commerce. Consequently, courts may scrutinize only those taxes imposing substantial effects on interstate commerce. Arguably, the clearest example of state taxation that should not be subject to commerce clause review is ad valorem real property taxation. If local real property taxes affect interstate commerce at all, the effect truly may be inconsequential.

Of course, most state taxation is not as far removed from interstate commerce as the taxation of real property. Under this approach, one problem in determining the applicability of the *Complete Auto Transit* analysis is distinguishing local commerce that substantially affects interstate commerce from local commerce that does not have this substantial effect. Moreover, it may be unwise for the judiciary even to attempt to make this distinction. Arguably, the distinction between a state tax that substantially affects interstate commerce and a state tax that does not is just as artificial and impractical as the former judicial distinction between a tax on interstate commerce and a tax on intrastate commerce. Perhaps evolving jurisprudence calls for complete abandonment of a requirement that the tax somehow be connected with interstate or foreigu commerce. Under this approach, taxes on purely local commerce would be subject to the requirements of the *Complete Auto Transit* test, but most such taxes would have little difficulty in passing the test.

Although the analysis is very different, the results are frequently the same under the historical commerce clause approach, which allowed taxation of local activity, and the contemporary approach, which would subject taxation of local activity substantially affecting interstate commerce to the *Complete Auto Transit* test. Thus, it is interesting to compare *Oliver Iron Mining Co. v. Lord*,[56] which the Supreme Court decided in 1923, with *Commonwealth Edison Co. v. Montana*,[57] decided in 1981. In *Oliver Iron Mining* the Court held that an occupation tax on the value of ore mined in the taxing state but sold in other states did not violate the commerce clause because mining was a local business, not interstate commerce. Similarly, in *Commonwealth Edison* the Court held that a severance tax on coal mined in the taxing state but sold in other states did not violate the commerce clause because the *Com-*

56. 262 U.S. 172 (1923).
57. 453 U.S. 609 (1981).

plete Auto Transit test was satisfied.

In both *Oliver Iron Mining* and *Commonwealth Edison* the taxpayers contended that the tax unconstitutionally burdened interstate commerce because the vast majority of the natural resource subject to tax was transported to markets out-of-state.[58] This argument, however, did not sway the Court either in 1923 or in 1981. According to the Court in *Oliver Iron Mining*, "Mining is not interstate commerce, but, like manufacturing, is a local business subject to local regulation and taxation."[59] In *Commonwealth Edison* the Court concluded that there was no commerce clause violation because the Montana tax "comports with the requirements of the *Complete Auto Transit* test."[60] In short, classification as a tax on local activity no longer assures commerce clause immunity, but the tax still may be valid either because it does not substantially affect interstate commerce or because it passes the *Complete Auto Transit* test.

5. Foreign Commerce

In regard to foreign commerce clause protection, distinguishing between commerce originating from outside the United States and commerce originating from inside the United States may be useful. When commerce originates from outside the United States, commerce clause scrutiny clearly is warranted, and state taxation of such commerce should be subjected to the *Complete Auto Transit* requirements. In addition, the state taxation also may be subject to the two additional requirements enunciated in *Japan Line, Ltd. v. County of Los Angeles*:[61] the tax (1) must not create a substantial risk of international multiple taxation and (2) must not prevent the federal government from "speaking with one voice when regulating commercial relations with foreign governments."[62] Although *Japan Line* involved commerce originating in Japan,[63] the case was decided on narrow grounds; the Court pointed out that the case involved instrumentalities of commerce owned, based, and registered abroad that were used exclusively in international commerce.[64] Thus, it is unclear whether all foreign com-

58. *See Commonwealth Edison*, 453 U.S. at 617-18; *Oliver Iron Mining*, 262 U.S. at 177.

59. 262 U.S. at 178.

60. 453 U.S. at 629.

61. 441 U.S. 434 (1979).

62. *Id.* at 452.

63. *Id.* at 436.

64. *Id.* at 444. *See also* Wardair Canada, Inc. v. Department of Revenue, 106 S. Ct.

merce originating from outside the United States will be granted the added protection from state taxation provided to the *Japan Line* taxpayers.[65]

When commerce originates inside the United States, foreign commerce clause scrutiny presumably may be warranted only when the local taxation has a substantial effect on foreign commerce. Although the Supreme Court has not as yet applied the substantial effects test to taxation of foreign commerce originating in the taxing state,[66] it may be logical to extend the test to this type of foreign commerce. It appears a fortiori that forms of state taxation so inherently local in nature that they affect interstate commerce inconsequentially also probably affect foreign commerce inconsequentially. Accordingly, assuming that the *Commonwealth Edison* analysis applies to foreign commerce, it may be necessary for the taxpayer to show that the state tax has a substantial effect on foreign commerce originating in the state before commerce

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2369 (1986) (holding that Florida fuel tax on the sale of aviation fuel used by foreign airlines does not violate the commerce clause). The two additional prongs set forth in *Japan Line* were considered by the Court in *Wardair* because the case involved foreign-owned instrumentalities of commerce engaged in foreign commerce.

65. In an amicus curiae brief recently filed with a federal district court, the United States Attorney General suggested that the two additional prongs of *Japan Line* should have a broad application. Amicus Curiae Brief for United States at 17, Alcan Aluminum, Ltd. v. Franchise Tax Bd., Civil Action No. 84-C-6932 (N.D. Ill. July 30, 1986). Imperial Chemical Indus. v. Franchise Tax Bd., Civil Action No. 84-C-8906 (N.D. Ill. July 30, 1986). These cases involve challenges to California's worldwide unitary business principle as applied to multinational enterprises with a foreign parent corporation. According to the Attorney General, the California worldwide unitary method of apportionment should be held unconstitutional as applied in these cases since this method enbances a risk of multiple taxation and impairs federal uniformity in foreign policy. Thus, the Attorney General would extend the two additional prongs of *Japan Line*.

It is interesting to note, however, that due to an apparent misunderstanding of the term "instrumentality of commerce," the Attorney General fails to see how the application of the two additional prongs in these cases would constitute an extension of *Japan Line*. Instrumentalities of commerce generally are equated with vehicles such as the shipping companies' vessels and cargo containers involved in *Japan Line*. The Attorney General, however, refers to corporations engaged in foreign commerce as "instrumentalities of foreign commerce." *See* Amicus Curiae Brief of United States at 17 *Alcan Aluminum*.

66. *But see* Department of Revenue v. Association of Washington Stevedoring Co's., 435 U.S. 734 (1978). In this case, the Court held that Washington's business and occupation tax as applied to the activity of stevedoring within the state was constitutional. Although the stevedoring activity involved, in part, the loading of imports and exports, the Court did not analyze the case in terms of foreign commerce. Instead, the case was considered under the interstate commerce clause and the import-export clause. As a result, the Court did not clarify the scope of foreign commerce clause protection. No distinction between local taxation substantially affecting foreign commerce and local taxation not substantially affecting foreign commerce was made. Moreover, the Court did not address the issue of additional protection afforded to foreign commerce until the following year in *Japan Line*.

clause scrutiny even is warranted. Again, it is questionable whether the "substantial effect" distinction is advisable. Subjecting all state taxation to commerce clause review may be preferable.

Assuming the taxpayer has established that the state tax on commerce originating in the United States is subject to commerce clause scrutiny, it is unclear what requirements the tax must satisfy to survive this scrutiny. Clearly, the four-prong *Complete Auto Transit* test must be satisfied. These four requirements have been universally applied in all contemporary commerce clause cases. The applicability of the additional two prongs set forth in *Japan Line*, however, is uncertain. *Japan Line* did not involve foreign commerce originating in the United States, and the Court itself limited its decision by explicitly avoiding questions of the taxability "of domestically owned instrumentalities engaged in foreign commerce."[67] Moreover, it may be difficult to distinguish between interstate and foreign commerce in cases involving the taxation of commerce originating in one state, traveling interstate, and then leaving the country. In these cases it is unclear whether the tax imposed by the state in which the commerce originates should be subject to only the *Complete Auto Transit* requirements or also the additional requirements of *Japan Line*. Perhaps, the substantial effects test is needed to distinguish between interstate commerce clause protection and foreign commerce clause protection. In other words, only those state taxes substantially affecting foreign commerce would have to satisfy the additional two prongs of *Japan Line*.

III. Disparate Tax Treatment

Under contemporary commerce clause analysis, it is crucial to determine what constitutes discrimination for state tax purposes. A state tax invalidated solely on commerce clause grounds is likely to be found to discriminate against interstate commerce. The significance of the antidiscrimination provision of the commerce clause results in part because of the "illusory" nature of the remaining three *Complete Auto Transit* restrictions on state taxation.[68] Moreover, the antidiscrimination requirement, unlike some of the other *Complete Auto Transit* requirements, is not reiterated by the due process clause.[69] In light of its significance and unique-

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67. *Japan Line*, 441 U.S. at 444 n.7. The Court also did not reach questions concerning the taxability of foreign owned instrumentalities engaged in interstate commerce.

68. *See* J. Hellerstein, *supra* note 10, ¶ 4.8, at 123.

69. *See* P. Hartman, *supra* note 17.

ness, this Article analyzes the requirement that a state tax not discriminate against interstate commerce. This Article will not dwell on the other requirements that the commerce clause imposes on state taxation.

A. *Evolution of Commerce Clause Adjudication*

Under earlier approaches to the commerce clause, the validity of state tax measures did not turn on whether the tax discriminated against interstate commerce.[70] Originally, the commerce clause was viewed as prohibiting virtually all state taxation of interstate commerce.[71] By the midpart of the last century, it was believed that the commerce clause prohibited some, but not all, state taxation of interstate commerce and that a distinction could be made between areas of interstate commerce in which there was need for national tax uniformity and areas in which local taxation was permissible.[72] In the 1890s new terminology was introduced so that "direct" taxes on interstate commerce were invalid, whereas "indirect" taxes on interstate commerce were valid.[73]

Beginning in 1938 state taxes were invalidated under the commerce clause if they threatened interstate commerce with cumulative burdens not imposed on local commerce.[74] *Freeman v. Hewit*,[75] decided in 1946, marked a temporary reversion to the formalistic distinction between direct and indirect taxes on interstate commerce. Not long after *Freeman*, however, the Supreme Court abandoned the direct/indirect burdens test and adopted an approach that focused on multiple burdens.[76] According to Professor

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70. *See id.* §§ 2.10-2.16.

71. *See* Brown v. Maryland, 25 U.S. 419 (1827) (state license provision applied to importers of foreign goods held unconstitutional).

72. *See* Cooley v. Board of Wardens, 54 U.S. 299, 319 (1851) (holding that state law requiring vessel to pay fee if it did not use a pilot was constitutional because the subject of regulation demanded local diversity, not national uniformity).

73. *See* Adams Express Co. v. Ohio, 165 U.S. 194 (1897) (property tax on instrumentalities of interstate commerce held valid under the commerce clause because it was not considered to be a direct tax on interstate commerce).

74. *See* Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938) (privilege tax on the business of publishing magazines measured by the gross receipts from the sale of advertising beld constitutional because there was no danger of this type of tax resulting in cumulative burdens on interstate commerce).

75. 329 U.S. 249 (1946) (holding that Indiana could not tax gross receipts from sale of securities by Indiana resident on New York Stock Exchange because the tax was considered to be a direct tax on interstate commerce).

76. *See* Northwestorn States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959) (holding that a state could impose an apportioned income tax on a foreign corporation engaged in interstate commerce in part because there was no showing that such taxation

Hartman, this new version of the multiple burdens test required the taxpayer to show actual multiple taxation rather than just the mere risk of multiple taxation.[77]

The 1977 *Complete Auto Transit* decision marked a breakthrough in state tax adjudication under the commerce clause.[78] The Court enunciated an approach grounded in economic reality rather than in formalistic distinctions.[79] *Complete Auto Transit* provides an analytical framework heretofore lacking in the Court's approach to state taxation under the commerce clause. Generally, more state taxes will be held valid under the commerce clause when using the *Complete Auto Transit* test than under the old approaches.[80] Nonetheless, commentators agree that the logic and predictability of the *Complete Auto Transit* test are preferable to the arbitrary and capricious nature of the old approaches.[81] Although the *Complete Auto Transit* test is more logical and predictable, it provides only the bare frame of a complete analytical approach to state tax discrimination. Even with *Complete Auto Transit*, there is considerable uncertainty in determining when a state tax is valid under the commerce clause. A major element of this uncertainty derives from the difficulty in determining what constitutes discrimination. Discussed below are factors that must be considered when scrutinizing a state tax provision for discrimination against interstate or foreign commerce.

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would subject interstate commerce to multiple taxation).

77. P. HARTMAN, *supra* note 17, § 2:16. Whether the multiple burden test still stands and, if so, whether the mere risk or the actuality of multiple taxation of interstate commerce is necessary to invalidate a state tax will be considered below. *See infra* notes 187-214 and accompanying text.

78. *See* Barrett, *supra* note 10, § 1.03[2].

79. *Id.* at 1-15. According to Barrett, *Complete Auto Transit* is a "hellweather decision marking a shift away from adjudicating the constitutionality of tax measures by labels and to the use of practically oriented economic analysis." *Id. See also* P. HARTMAN, *supra* note 17, § 2:17 at 91; L. TRIBE, *supra* note 3, § 6-14, at 345.

80. Barrett, *supra* note 10, § 1.03[2]. According to Barrett, the tendency for the old approaches to favor taxpayer challenges to state taxes under the commerce clause is illustrated by the result in *Complete Auto Transit.* "The case upheld a tax that had been found unconstitutional less than three decades earlier. Thus, the new doctrine may well be more hospitable than the old verbal formulas to the broad range of taxes that can meet its requirements." *Id.* at 1-15.

81. *See, e.g., id.* § 1.03[2]; P. HARTMAN, *supra* note 17, § 2:17; L. TRIBE, *supra* note 3, § 6-14.

B. *The Supreme Court's Formulations of State Tax Discrimination*

The Supreme Court has developed various formulations of what constitutes state tax discrimination. Basically, the Court relies on an analysis of relative tax burdens. State tax discrimination is, then, in part, inequality resulting from a state imposing greater state tax burdens on certain taxpayers than on others. According to the Court in *Armco, Inc. v. Hardesty*, "[A] State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State."[82] Moreover, as described in *Commonwealth Edison*, state tax discrimination is "differential tax treatment of interstate and intrastate commerce."[83] Hence, the Court has "struck down state tax statutes that encouraged the development of local industry by means of taxing measures that imposed greater burdens on economic activities taking place outside the State than were placed on similar activities within the State."[84] In short, a state tax statute cannot provide "a direct commercial advantage to local business."[85]

On another level, the Court focuses on the state tax's effect on economic decisionmaking. Under this analysis, state tax discrimination is viewed as an interference with independent decisionmaking in a free market economy. Thus, discrimination is seen as, among other things, tending "to neutralize [economic] advantages belonging to the place of origin."[86] According to this approach, the use tax is permissible even though it was designed to keep domestic purchasers from avoiding the local sales tax by purchasing goods out-of-state. In such a situation, the use tax is not viewed as neutralizing an advantage belonging to the place of origin of goods because the advantage nonresident sellers possess is deemed attributable to the sales tax of the taxing state.[87] Thus, taken together, the complementary sales and use taxes of the state do not affect a taxpayer's decision regarding in which state to purchase an item.[88] Instead, this decision is left to the taxpayer's assessment of

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82. 467 U.S. 638, 642.

83. 453 U.S. at 618.

84. *Westinghouse Elec. Corp.*, 466 U.S. at 403-04.

85. *Northwestern States Portland Cement Co.*, 358 U.S. at 457.

86. Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 527 (1935) (holding that a state could not insulate in-state milk producers from out-of-state competition by establishing a minimum price that in-state retailers had to pay their suppliers, wherever situated).

87. *See* Varat, *State "Citizenship" and Interstate Equality*, 48 U. CHI. L. REV. 487, 544-46 (1981).

88. For a discussion of the complementary tax doctrine, see *infra* notes 137-85 and

the market devoid of any consideration of state taxes.

State tax discrimination is seen as an interference with the businessman's decision regarding where he should locate his business. This discrimination "encourages an out-of-state operator to become a resident in order to compete on equal terms."[89] Thus, in *Maryland v. Louisiana*[90] the Supreme Court held that the Louisiana first use tax paid on the first use of outer continental shelf (OCS) natural gas brought into the state was unconstitutional under the commerce clause because the tax was allowed as a credit against other state taxes. Consequently, the first use tax generally did not burden in-state consumers of the OCS gas. According to the Court, "The obvious economic effect of this Severance Tax Credit is to encourage natural gas owners involved in the production of OCS gas to invest in mineral exploration and development within Louisiana rather than to invest in further OCS development or in production in other States."[91] In short, as stated in *Boston Stock Exchange v. State Tax Commission*,[92] a discriminatory tax statute "forecloses tax-neutral decisions."[93]

C. *Burden of Proving Disparate Tax Treatment*

It is important to note that a taxpayer who is challenging a state tax statute under the commerce clause carries the burden of proving that discrimination exists. The Supreme Court pointed out in *Norton Co. v. Department of Revenue*,[94] "[A] taxpayer claiming immunity from a tax has the burden of establishing his exemption."[95]

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accompanying text.

89. Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 72 (1963).

90. 451 U.S. 725 (1981).

91. *Id.* at 757.

92. 429 U.S. 318 (1977).

93. *Id.* at 331.

94. 340 U.S. 534 (1951) (holding that gross receipts tax on sales to residents by out-of-state corporation with office in-state was valid unless taxpayer could show that particular sales were disassociated from the local business).

95. *Id.* at 537. The Court explains this burden of proof by stating that it cannot be met as follows:

> by sbowing a fair difference of opinion which as an original matter might be decided differently. This corporation, by submitting itself to the taxing power [of the state], likewise submitted itself to its judicial power to construe and apply its taxing statute insofar as it keeps within constitutional bounds. Of course, in constitutional cases, we have power to examine the whole record to arrive at an independent judgment as to wbether constitutional rights have been invaded, but that does not mean that we will re-examine, as a court of first instance, findings of fact supported by substantial evidence.

Although the taxpayer carries the burden of proving that tax discrimination exists, the taxpayer need not show the extent of disparate tax treatment or demonstrate a minimal level of discriminatory effect. Hence, in *Maryland v. Louisiana* the Supreme Court stated:

> It may be true that further hearings would be required to provide a precise determination of the extent of the discrimination in this case, but this is an insufficient reason for not now declaring the Tax unconstitutional and eliminating the discrimination. We need not know how unequal the Tax is before concluding that it unconstitutionally discriminates.[96]

Moreover, in *Bacchus Imports* a tax statute that discriminated against out-of-state alcoholic beverage distributors could not be saved merely because the in-state alcoholic beverage distributors exempted from the tax did not pose a "competitive threat."[97]

To sustain the burden of proof, it should be sufficient for the taxpayer to show the risk, as opposed to the actuality, of disparate tax treatment. Language in Supreme Court opinions suggesting that actual discrimination is necessary to render a statute unconstitutional relates to the fair apportionment requirement, not the antidiscrimination requirement of *Complete Auto Transit*.[98] When the challenge involves a claim of discrimination rather than a claim of multiple taxation,[99] the interstate taxpayer should not be re-

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Id. at 537-38.

The taxpayer challenging the tax must show, then, that the tax violated one or more of the four parts of the *Complete Auto Transit* test. *See Washington Rev. Dep't. v. Stevedoring Ass'n*, 435 U.S. 734, 750 (Washington business and occupation tax as applied to stevedoring held not to violate the commerce clause since taxpayers had "proved no facts" to show failure of the *Complete Auto Transit* test). Thus, the taxpayer challenging a state tax provision on this ground must prove that the tax discriminates against interstate commerce. According to the Court in *Gregg Dyeing Co. v. Query*, appellants had the burden of showing an injurious discrimination against them. 286 U.S. 472, 481 (1932) (held that a state may tax gasoline bought and imported from another state which is stored by the purchasers for future use in their local business).

96. 451 U.S. at 759-60.

97. 468 U.S. at 269.

98. *See, e.g.*, Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) (Vermont's apportioned corporate income tax as it related to dividends from foreign subsidiaries upheld in part because actual multiple taxation not shown); Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 228 (1980) (Wisconsin apportionment scheme upheld with the Court noting that "actual multiple taxation has not been shown"). *But see* J. HELLERSTEIN, *supra* note 10, ¶ 4.7, at 120. Professor Hellerstein views *Mobil Oil Corp.* as a case reaffirming the risk test of multiple taxation. However, this view appears to ignore language in the *Mobil Oil Corp.* case and also language in *Exxon Corp.* suggesting that *Mobil Oil Corp.* required that actual multiple burdens be shown. *Exxon Corp.*, 447 U.S. at 228.

99. For a discussion of why the multiple taxation doctrine best fits into the requirement of fair apportionment rather than the antidiscrimination requirement, see *infra* notes 187-214 and accompanying text.

quired to prove that it actually paid more in taxes than its local competitors. As the Court explained in *Armco*, "Appellee suggests that we should require Armco to prove actual discriminatory impact on it by pointing to a state that imposes a manufacturing tax that results in a total burden higher than that imposed on Armco's competitors in West Virginia. This is not the test."[100]

Because proof of actual competitive injury is not necessary to hold a statute invalid, the Court has been able to separate the two issues of constitutionality and remedy. In *Bacchus Imports* the Court held that the Hawaiian excise tax on liquors unconstitutionally discriminated against interstate commerce, but withheld opinion on the remedies available to appellant liquor wholesalers.[101] The Court did not find it necessary to hold that the appellant taxpayers were entitled to a refund in order to hold that the tax unconstitutionally discriminated against interstate commerce.[102]

D. *Identifying Discriminatory State Tax Statutes*

1. Facially Discriminatory Statutes

For the taxpayer to meet his burden of proving state tax discrimination, he must show unequal treatment of different groups of taxpayers. Disparate tax treatment can arise either on the face

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100. 467 U.S. at 64.

101. There has been controversy surrounding available remedies to a taxpayer who proves that a state taxing statute unconstitutionally discriminates against interstate commerce. Such a sbowing may not entitle the taxpayer to a refund of the taxes paid. On the one hand, it has been argued that only the parties bearing the "economic incidence" of the tax are constitutionally entitled to a refund of an illegal tax. Thus, if a taxpayer passes a tax on to its customers, it could not collect a refund. On the other hand, it has been contended that the commerce clause requires that taxes illegally collected from a taxpayer must be refunded. *See Bacchus Imports*, 468 U.S. at 274. In fact, taxpayers frequently have been unsuccessful in obtaining refunds after a state tax has been declared unconstitutionally discriminatory. *See, e.g.*, American Trucking Ass'ns, Inc. v. Conway, No. 85-452 (Vt. Feb. 21, 1986), *petition for cert. filled*, No. 86-89 (July 21, 1986) (holding that although user license fees burdening interstate motor carriers were unconstitutionally discriminatory, no refunds would be granted); Private Truck Council, Inc. v. Secretary of State, No. Ken-85-278 (Me. Jan. 3, 1986), *cert. denied*, 106 S. Ct. 1997 (1986) (holding that reciprocal tax on trucks coming into Maine that are registered in states that levy certain taxes on Maine-registered trucks was unconstitutionally discriminatory under the commerce clause, but also holding that taxpayers were not entitled to a refund of taxes paid prior to establishment of a court-ordered escrow account); Saloria v. Glaser, 93 N.J. 447, 461 A.2d 1100 (1983) (holding that the New Jersey Emergency Transportation Tax was unconstitutionally discriminatory under the privileges and immunities clause, but that only prospective relief would be granted); Metropolitan Life Ins. Co. v. Commissioner of the Dep't of Ins., 373 N.W.2d 399 (N.D. 1985) (holding that domestic preference tax on insurance premiums was unconstitutional, but that only prospective relief would be granted).

102. *See Bacchus Imports*, 468 U.S. at 273.

of the tax statute or from the impact of a facially neutral statute. Legislators with the avowed, or at least intended, purpose of providing special tax treatment for local business sometimes will enact a facially discriminatory statute. In these cases, it is not difficult for the taxpayer to meet its burden of proof. Examples of facially discriminatory tax provisions are abundant in commerce clause case law. For instance, *Welton v. Missouri*[103] involved a license tax imposed only on itinerant salesmen who sold goods produced outside the state. In *Boston Stock Exchange v. State Tax Commission*[104] the challenged provisions taxed the in-state sale of stock at a lower rate than the out-of-state sale of stock. And *Halliburton Oil Well Cementing Co. v. Reily*[105] involved a tax statute that imposed higher taxes on out-of-state manufacturer-users than on in-state manufacturer-users.[106] These cases were resolved fairly easily since the enacting state clearly had ignored the commerce clause premise that no state shall discriminate against interstate commerce.[107]

2. Facially Neutral Statutes with Discriminatory Effects

The more difficult cases involve facially neutral statutes that nonetheless have a discriminatory effect on interstate commerce. Professor Hartman describes these statutes as follows:

> While purporting to treat local commerce and interstate commerce alike, if the practical operation of the tax gives local business a competitive advantage over interstate business, it will be branded as unconstitutionally discriminatory. In short, a tax may be nondiscriminatory on the face, but the effect may be discriminatory. The Court has frequently found it necessary to probe beneath the face of the statute to expose its discriminatory nature and effect.[108]

A series of cases involving itinerant salesmen demonstrates how a facially neutral statute can be discriminatory. In *Robbins v. Shelby County Taxing District*[109] a drummers license tax imposed on all salesmen selling by sample who did not have a licensed place of business in the taxing district was held invalid. Even though the language of the statute applied equally to domestic and foreign

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103. 91 U.S. 275 (1876).
104. 429 U.S. 318 (1977).
105. 373 U.S. 64 (1963).
106. *See also Bacchus Imports,* 468 U.S. 263 (excise tax imposed on sales of liquor at wholesale exempted locally produced beverages); *Armco,* 467 U.S. 638 (gross receipts tax on businesses selling tangible property at wholesale exempted local producers).
107. *See* Tushnet, *Rethinking the Dormant Commerce Clause,* 1979 WIS. L. REV. 125, 131.
108. P. HARTMAN, *supra* note 17, § 2:19, at 123.
109. 120 U.S. 489 (1877).

drummers, the Court recognized that the practical effect of the statute would be to burden foreign merchandisers more heavily because domestic merchandisers generally have an established place of business in the state.[110] Likewise, in *Best Co. v. Maxwell*[111] the Court invalidated an annual privilege tax of 250 dollars on salesmen displaying samples who were not regular retail merchants in the state. Nominally, the statute taxed all itinerant salesmen whether resident or nonresident. The practical effect of the statute, however, was to discriminate against foreign salesmen who normally would not be considered regular retail merchants in the state. According to the Court, "[T]he commerce clause forbids discrimination, whether forthright or ingenious. In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce."[112] In *Nippert v. Richmond*,[113] moreover, an annual license tax imposed on all persons "engaged in business as solicitors" was held unconstitutional. Analyzing the practical effect of the tax, the Court concluded that it would more heavily burden foreign solicitors in part because of the risk of multiple taxation by various localities in which the itinerant salesman offered his goods for sale. According to the Court,

> It is no answer . . . that the tax is neither prohibitive nor discriminatory on the face of the ordinance; or that it applies to all local distributors doing business as appellant has done. Not the tax in a vacuum of words, but its practical consequences for the doing of interstate commerce in applications to concrete facts are our concern. To ignore the variations in effect which follow from application of the tax, uniform on the face of the ordinance, to highly different fact situations is only to ignore those practical consequences.[114]

3. Legislative History

A facially neutral statute may be revealed as discriminatory through examination of its legislative history. Statements in the legislative history of a statute relating to its purpose may indicate that a facially neutral statute was enacted to benefit local commerce. For example, in *Westinghouse Electric Corp. v. Tully*[115] the legislative history showed that the DISC export credit was intended to be a "tax advantage" that "would increase as the sales

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110. *Id.* at 498.
111. 311 U.S. 454 (1940).
112. *Id.* at 455-56 (footnote omitted).
113. 327 U.S. 416 (1946).
114. *Id.* at 431 (footnote omitted).
115. 466 U.S. 388 (1984).

. . . of products from New York sources increases—a situation that provides an incentive to remain and possibly expand business in this state."[116]

The legislative history also may contain less obvious indicators of a discriminatory purpose than outright statements of an intent to benefit local business. For example, Colorado originally enacted a five cent reduction in its gasoline tax for gasohol manufactured in-state.[117] After the Minnesota Supreme Court held that a similar Minnesota statute violated the commerce clause,[118] Colorado altered its gasoline tax reduction provision.[119] Under the new provision the reduction was granted to gasohol "produced from no more than three million gallons of alcohol annually from each facility having a design production capacity of seventeen million gallons or less per year of such alcohol."[120] The effect of this new provision was the same as the old provision since only out-of-state gasohol producers were large enough to be adversely affected by the newly enacted production capacity limitation. It would appear, then, that the Colorado legislature simply found a clever way to retain the tax reduction for in-state producers.[121] The new statute was challenged on equal protection and commerce clause grounds, but was held valid by the Colorado Supreme Court.[122] It appears, however, that the statute does discriminate against interstate commerce. Although the new statute is facially neutral, its effect is discriminatory, and its legislative history suggests that it was enacted for discriminatory purposes.[123]

Although a legislative statement of discriminatory purpose is somewhat superfluous when a statute is facially discriminatory, the courts often cite legislative history when holding these statutes unconstitutional. For example, in *Boston Stock Exchange* the Court

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116. New York State Department of Commerce, Memorandum Recommending Approval of Assembly Bill A-12108-A (May 24, 1972), *reprinted in* Bill Jacket of 1982 N.Y. Laws ch 778, at 9.11.

117. 1978 Colo. Sess. Laws 516, *quoted in* Archer Daniels Midland Co. v. State, 690 P.2d 177 (Colo. 1984). For a description of the chain of events leading to Colorado's gasoline tax reduction, see J. HELLERSTEIN & W. HELLERSTEIN, STATE TAXATION ¶ 4.12[4A][c], at S28 (1985 Supp.) [hereinafter cited as J. HELLERSTEIN, 1985 SUPPLEMENT].

118. *See* Archer Daniels Midland Co. v. State, 315 N.W.2d 597 (Minn. 1982).

119. *See* J. HELLERSTEIN, 1985 SUPPLEMENT, *supra* note 117, ¶ 4.12[4A][c], at S28.

120. COLO. REV. STAT. § 39-27-102(1)(a)(III) (1982).

121. *See* J. HELLERSTEIN, 1985 SUPPLEMENT, *supra* note 117, ¶ 4.12[4A][c], at S28.

122. *See* Archer Daniels Midland Co. v. State, 690 P.2d 177 (Colo. 1984).

123. *See* J. HELLERSTEIN, 1985 SUPPLEMENT, *supra* note 117, ¶ 4.12[4A][c], at S29. Moreover, Professor Hellerstein indicates that the statute is inconsistent with the recent Supreme Court decision in *Bacchus Imports,* in which the Court held that a state cannot prefer its own products over out-of-state goods. *Id.* at S30.

made a point of stating that the legislative history of the challenged New York statute indicated that its purpose was " 'to encourage the effecting by nonresidents of the state of New York of their sales within the State of New York and the retention within the state of New York of sales involving large blocks of stock.' "[124] Similarly, in *Bacchus Imports* the Court noted that the legislative history of the Hawaiian excise tax indicated that the tax was designed " 'to help' in stimulating 'the local fruit wine industry.' "[125]

If a statute is discriminatory either on its face or in its effect, a statement in the legislative history that the statute was intended for nondiscriminatory purposes should not save the statute from being found unconstitutional. Thus, in *City of Philadelphia v. New Jersey*[126] a New Jersey statute prohibiting the importation of waste material into the state was held unconstitutionally discriminatory even though the legislature cited environmental protection as the statute's purpose. As the Court explained:

> [T]he evil of protectionism can reside in legislative means as well as legislative ends. . . . [W]hatever New Jersey's ultimate purpose, it may not be accomplished by discriminating against articles of commerce coming from outside the State unless there is some reason, apart from their origin, to treat them differently. Both on its face and in its plain effect, [the statute] violates this principle of nondiscrimination.[127]

E. Statutory Mechanisms Used to Create Disparate Tax Treatment

Disparate tax treatment in which one group of taxpayers is subjected to a heavier tax burden than another group can be effected through various statutory mechanisms. One of the more obvious methods of discriminating is to tax one group of individuals or enterprises and not another. To discriminate in this manner, a tax can be narrowly aimed at one group of taxpayers. For example, in *Welton v. Missouri*[128] the Court struck down as discriminatory a license tax imposed only on itinerant salesmen who sold goods produced outside the state. Alternatively, a tax statute can be focused broadly, but provide exemptions for certain taxpayers. *Bacchus Imports* involved an excise tax that was imposed on sales of liquor

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124. 429 U.S. at 318 (quoting 1968 N.Y. Laws 827, § 1).

125. 468 U.S. at 270-71 (quoting *In re* Bacchus Imports, Ltd., 65 Hawaii 566, 574, 656 P.2d 724, 730 (1982)).

126. 437 U.S. 617 (1978).

127. *Id.* at 626-27.

128. 91 U.S. 275 (1876).

at wholesale, but that exempted from the tax sales of certain locally produced beverages.[129] Similarly, in *Armco v. Hardesty* the Court found discriminatory a gross receipts tax on businesses selling tangible property at wholesale that exempted local manufacturers.[130]

States also can create disparate tax treatment between groups by differentiating various elements used to compute the groups' tax liabilities. Accordingly, the tax rates applied to different groups can be varied. *Boston Stock Exchange*, for instance, involved tax provisions that reduced by fifty percent the rate of transfer tax on securities transactions when a nonresident conducted the transaction within the state.[131] Disparity also can be created in the taxpayers' tax bases. In *Halliburton* the Court held that a use tax was discriminatory because the tax base included the cost of labor and shop overhead only when equipment was assembled out-of-state.[132]

Tax discrimination also can be effected through use of credits, limitations, or special deductions for the favored group. For instance, in *Maryland v. Louisiana* the Court held discriminatory a tax imposed on the first use of outer continental shelf natural gas brought into Louisiana because the tax was allowed as a credit against other Louisiana taxes so that in-state consumers of the outer continental shelf gas generally were not burdened by the tax.[133] In *Boston Stock Exchange* the Court found that disparate tax treatment resulted from a special limitation favoring intrastate commerce. In that case the total transfer tax on securities transactions involving an in-state sale was limited to 350 dollars for a single transaction, whereas no such limitation was provided for out-of-state transactions.[134] In *Westinghouse Electric Corp. v. Tully*[135] the Court found unconstitutional discrimination when a franchise tax credit was based on gross receipts from products shipped from a regular place of business within the state. The Court pointed out that discrimination is unconstitutional regardless of the kind of taxing mechanism used to create the disparate treatment. According to the *Westinghouse* Court, it is not "relevant that New York discriminates against business carried on outside the State by disallowing a tax credit rather than by imposing a higher tax. The

129. 468 U.S. at 263.
130. 467 U.S. at 638.
131. 429 U.S. at 318.
132. 373 U.S. at 63.
133. 451 U.S. at 725 (1981).
134. 429 U.S. at 318.
135. 466 U.S. 388 (1984).

discriminatory economic effect of these two measures would be identical."[136]

F. *Complementary Taxes*

1. The Concept of Complementary Taxes

Although a tax statute results in disparate tax treatment of different groups of taxpayers, the statute still may not be considered discriminatory if other related taxes equalize the tax burdens. The concept of compensating or complementary taxes that can save a particular tax statute from being deemed unconstitutional is embedded firmly in commerce clause theory.[137] In 1928 the Supreme Court held in *Interstate Bus Corp. v. Blodgett*[138] that a mileage tax imposed on buses used in interstate commerce was not repugnant to the commerce clause, in part because buses used in intrastate commerce were subjected to a gross receipts tax. The Court explained the complementary tax doctrine as follows:

> The two statutes are complementary in the sense that while both levy a tax on those engaged in carrying passengers for hire over state highways in motor vehicles, to be expended for highway maintenance, one affects only interstate and the other only intrastate commerce. Appellant plainly does not establish discrimination by showing merely that the two statutes are different

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136. *Id.* at 389-90.

137. Concepts analogous to the commerce clause doctrine of complementary taxes also are applied in analysis of other constitutional provisions prohibiting discrimination such as the equal protection clause, the privileges and immunities clause, the first amendment, and the supremacy clause. Often the courts will consider the effect of other tax provisions in determining whether a particular tax statute is unconstitutionally discriminatory. *See, e.g.*, Williams v. Vermont, 105 S. Ct. 2465 (1985) (in holding that a Vermont statute imposing a use tax on cars registered in Vermont may be unconstitutionally discriminatory under the equal protection clause, the Court noted that the use tax in this instance did not complement the state's sales tax); Minneapolis Star & Tribune Co. v. Commissioner of Revenue, 460 U.S. 575 (1983) (in holding that a use tax imposed on paper and ink products used by certain newspapers imposed an unfair burden on interests protected by the first amendment, the Court pointed out that there was no constitutionally valid reason for substituting the use tax for the generally applicable sales tax); Washington v. United States, 460 U.S. 536 (1983) (in holding that a sales tax imposed on contractors involved in construction projects on federally owned land, but not imposed on contractors for nonfederal projects, did not violate the nondiscrimination principle of the supremacy clause, the Court explained that due to a sales tax imposed on the landowners of nonfederal projects, there was no discriminatory economic burden on the United States); Austin v. New Hampshire, 420 U.S. 656 (1975) (in holding that a New Hampshire commuters income tax imposed on nonresidents' New Hampshire-derived income violated the privileges and immunities clause, the Court refused to agree with the state's contention that there was no discrimination against nonresidents due to offsetting tax credits allowed by neighboring states). For a discussion of these other restraints on state tax discrimination, see *infra* notes 319-54, 371-92 and accompanying text.

138. 276 U.S. 245 (1928).

in form or adopt a different measure or method of assessment, or that it is subject to three kinds of taxes while intrastate carriers are subject only to two or to one.[139]

Similarly, in *Gregg Dyeing Co. v. Query*[140] a state statute imposing a tax on gasoline imported into the state and stored for future use or consumption withstood commerce clause attack because the state enacted complementary tax statutes imposing equivalent excise taxes on the sale and use of gasoline in the state. Responding to the contention that the constitutionality of a statute must be determined "within its four corners," the Court stated:

> The question of constitutional validity is not to be determined by artificial standards. What is required is that state action, whether through one agency or another, or through one enactment or more than one, shall be consistent with the restrictions of the Federal Constitution. There is no demand in the Constitution that the State shall put its requirements in any one statute. It may distribute them as it sees fit, if the result, taken in its totality, is within the State's constitutional power.[141]

The classic case of compensating taxes involves the interrelationship of retail sales and use taxes. Use taxes specifically are designed to prevent sales tax avoidance by taxpayers buying property outside the state.[142] A use tax imposed on the privilege of using property within the state prevents sales tax avoidance because the taxpayer buying outside the state is taxed when the property is brought into the state for use. In *Henneford v. Silas Mason Co.*[143] the Supreme Court upheld the validity of a use tax against commerce clause challenge. The taxpayer argued that the use tax was discriminatory because it effectively applied only to goods purchased outside the state since in-state purchases were subjected to sales tax and thus were exempted from use tax. Viewing the interaction of the state's use tax with its sales tax, however, the Court found no discrimination. According to the Court,

> When the account is made up, the stranger from afar is subject to no greater burdens as a consequence of ownership than the dweller within the gates. The one pays upon one activity or incident, and the other upon an-

139. *Id.* at 251. *See also* American Trucking Ass'ns, Inc. v. Scheiner, No. 11 M.D. 1985 (Pa. May 6, 1986) (holding that marker fee and axle tax burdening only foreign registered trucks were not discriminatory due to the compensating registration fee imposed on domestic registered trucks). *But see* American Trucking Ass'ns., Inc. v. Conway, No. 85-452 (Vt. Feb. 21, 1986) (holding user fees burdening foreign registered trucks discriminatory despite existence of higher registration fees for domestically registered trucks).

140. 286 U.S. 472 (1932).

141. *Id.* at 479-80.

142. *See* W. Hellerstein, *State Taxation in the Federal System: Perspectives on Louisiana's First Use Tax on Natural Gas*, 55 Tul. L. Rev. 601, 621 (1981).

143. 300 U.S. 577 (1937).

> other, but the sum is the same when the reckoning is closed. Equality exists when the chattel subjected to the use tax is bought in another state and then carried into [the state]. It exists when the imported chattel is shipped from the state of origin under an order received directly from the state of destination. In each situation the burden borne by the owner is balanced by an equal burden where the sale is strictly local.[144]

2. The Court's Method of Recognizing Complementary Taxes

Although it is firmly established that designation as a compensating tax can prevent a state tax statute from being deemed discriminatory under the commerce clause, the definition of "compensating tax" is not clearly established. As Professor Hartman has pointed out, "[A] 'bright-line' test is not easily discernible from a number of decisions where the Court inquired whether the alleged compensating tax did properly serve as a balm of Gilead to heal an otherwise discriminatorily ill tax."[145]

Some of the older Supreme Court decisions appear to go further afield in search of compensating taxes than more recent decisions. Older decisions considered different types of taxes on unrelated activities to be complementary. In *Interstate Bus Corp. v. Blodgett*[146] a gross receipts tax and a mileage tax were viewed as complementary; in *Hinson v. Lott*[147] a tax on bringing liquor into the state for sale and a tax on manufacturing liquor were held to be complementary.[148] In more recent decisions the Court has demonstrated a reluctance to consider taxes on unrelated activities to be complementary. For example, in *Maryland v. Louisiana* a tax on the first use of natural gas brought into the state and not previously taxed by another jurisdiction was not considered to be a compensating tax for the state's severance tax on natural gas;[149] in *Armco, Inc. v. Hardesty* a wholesale gross receipts tax was not considered a compensating tax for a manufacturing tax.[150]

It is difficult to understand just how the Court identifies complementary taxes. For instance, in *Alaska v. Arctic Maid*[151] the Court upheld a tax on freezer ships obtaining fish for freezing, in

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144. *Id.* at 584.

145. P. HARTMAN, 1985 SUPPLEMENT, *supra* note 9, § 2:19, at 23.

146. 276 U.S. at 245.

147. 75 U.S. (8 Wall.) 148 (1868).

148. *See also* General Am. Tank Car Corp. v. Day, 270 U.S. 367 (1926) (special tax on rolling stock of nonresidents in lieu of general property tax on residents held nondiscriminatory).

149. 451 U.S. at 725.

150. 467 U.S. at 638.

151. 366 U.S. 199 (1961).

part because local canners were subjected to even higher taxes. The Court focused on identifying the competitors of the freezer ships, which were deemed to be the Alaskan canners and not those who freeze fish for the local retail market. Local fish processors selling to the consumer market were subjected to a lower tax than the freezer ships, but the canners were subjected to a higher tax than the freezer ships.[152]

The *Arctic Maid* rationale suggests that it is crucial to assess competitive effects in determining whether two taxes are complementary. More recently, however, the Court has not focused on identifying competitors. Instead, in its most recent pronouncements on the subject, the Court indicated that taxes must be levied on "substantially equivalent events" for them to be considered complementary.[153] In *Armco* the Court concluded, "[M]anufacturing and wholesaling are not 'substantially equivalent events' such that the heavy tax on in-state manufacturers can be said to compensate for the admittedly lighter burden placed on wholesalers from out of state."[154] Elaborating on this conclusion, the Court focused on the mechanics of the manufacturing tax, pointing out that the tax did not operate as "a proxy" for the gross receipts tax imposed on out-of-state wholesalers. As the Court explained, the taxes were not equivalent since the manufacturing tax was not reduced when an in-state manufacturer sold its goods out-of-state, but was reduced when part of the manufacturing took place out-of-state.[155] Moreover, the Court suggested that the taxes were not compensatory because they were not "internally consistent."[156] Hence, if another state had imposed a manufacturer's gross receipts tax, no provision was made to reduce the West Virginia liability.

Likewise, in *Maryland v. Louisiana* the Louisiana first use tax could not be justified as compensating for the effect of the state's severance tax on local production since the two events were not considered to be substantially equivalent.[157] According to the Court, "[T]he common thread running through the cases upholding compensatory taxes is the equality of treatment between local and interstate commerce."[158] In an attempt further to illuminate

152. *Id.* at 204.
153. *See Armco,* 467 U.S. at 640; *Maryland v. Louisiana,* 451 U.S. at 758-59.
154. 468 U.S. at 642.
155. *Id.* at 642.
156. *Id.* at 642-43.
157. 451 U.S. at 758-59.
158. *Id.* at 759.

the compensatory tax issue, the Court pointed out, "[T]he concept of a compensatory tax first requires identification of the burden for which the State is attempting to compensate."[159] The severance tax was viewed as compensating the state for the depletion of its natural resources. The first use tax, however, was not designed for the same purpose since it was levied on natural gas taken from the outer continental shelf, and the state had no right to be compensated for these federally owned resources.[160] Again, as in *Armco*, the Court in *Maryland v. Louisiana* considered the operation and interaction of the two taxes, noting that "the pattern of credits and exemptions allowed under the Louisiana statute undeniably violate [the] principle of equality."[161]

Unfortunately, the "substantially equivalent events" test sheds very little light on the problem of identifying compensatory taxes. As Professor Hartman has pointed out, "[T]he phrase 'substantially equivalent events' used by *Armco* as the touchstone for determining the complementary nature of two or more taxes appears to he something of an accordion term that can be expanded or contracted as the Court thinks the situation warrants."[162] In fact, analysis of the *Armco* and *Maryland v. Louisiana* cases suggests that the Court's enunciation of a test based solely on comparison of events is misleading. The Court in these two cases appears to have focused not only on the equivalence of events, but also on other factors relating to the operation and interaction of the two taxes. Thus, it is unclear just how the Court now decides whether two taxes are complementary.

The confusion remaining in the area of complementary taxes is perhaps best exemplified by a recent decision of the Supreme Court of Washington. In *National Can Corp. v. Washington*[163] the Washington Supreme Court held that the state's business and occupation tax provision, which exempts from the manufacturing tax local wholesalers who are taxed under the wholesaling provisions, does not discriminate against interstate commerce. Despite the Court's *Armco* holding that manufacturing and wholesaling are not substantially equivalent events, the Washington Supreme Court held that the Washington wholesaling and manufacturing tax provisions were complementary:[164]

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159. *Id.* at 758.
160. *Id.* at 759.
161. *Id.*
162. P. HARTMAN, 1985 SUPPLEMENT, *supra* note 9, § 2:19, at 30.
163. 105 Wash. 2d 327, 715 P.2d 128, *cert. granted* (U.S. Oct. 6, 1986)(No. 85-2006).
164. *Id.* at 328, 715 P.2d at 131. The court distinguished the West Virginia provisions

> The incongruities between Taxpayers' reading of *Armco* and earlier, well-established commerce clause cases makes us reluctant to extend *Armco* as Taxpayers urge. There is a disturbing formalism in their argument that manufacturing and wholesaling are never "substantially equivalent events." To read *Armco* thusly would foreclose analyzing a taxpayer's burden in light of both the structure of the relevant tax system and its effect on a single economic unit.[165]

There is, then, a need for the Court to clarify what factors it will consider in determining whether two taxes are complementary. State legislators need to know the scope of the compensating tax doctrine to fashion complementary taxes that do not violate the commerce clause. Taxpayers and their advisors also need to know when courts will consider taxes to be complementary to determine whether a tax should be challenged under the commerce clause. Uncertainty deters taxpayers from challenging the constitutionality of taxes. To the extent unfairness in the taxing system is perceived, voluntary compliance suffers.

3. Principles for Determining Whether Taxes Are Complementary

Two principles generally are agreed upon by those attempting to delineate the scope of the complementary tax doctrine. First, only one state's tax laws should be considered in determining the existence of a compensatory tax.[166] Thus, courts will not look to more than one state's taxes when weighing the relative tax burdens of the intrastate and interstate taxpayers. Second, to be complementary the two taxes should impose roughly equivalent economic burdens[167] or at least not impose a greater burden on interstate

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held unconstitutional in *Armco*, in part, by emphasizing that the West Virginia rates on manufacturing and wholesaling were substantially different, whereas the Washington rates on the two activities were "substantially identical." *Id.* at 330, 715 P.2d at 133. This distinction appears unwarranted since the disparity in the West Virginia tax rates in fact weighed in favor of the out-of-state interests. Thus, the rates in *Armco* would appear to be irrelevant to the determination that the two tax provisions were not complementary.

165. *Id.* at 331-32, 715 P.2d at 134 (citations omitted).

166. *Cf.* Austin v. New Hampshire, 420 U.S. 656 (1975) (holding that income tax on nonresidents violated the privileges and immunities clause because residents were not taxed on out-of-state income and tax credits of neighboring states could not cure the disparate tax treatment); Travis v. Yale & Towne Mfg. Co., 252 U.S. 60 (1920) (holding that privileges and immunities clause prohibited disparate income taxation of residents and nonresidents in the taxing state despite argument that similar taxing schemes enacted by neighboring states would remove the disparate tax treatment).

167. Although generally equivalence of economic burdens means dollars equivalence of disparate taxes, in certain instances dollar equivalence of disparate taxes may not result in the same economic burden or there may be equivalence of economic burdens without dollar equivalence. *See* W. Hellerstein, *Complementary Taxes as a Defense to Unconstitutional*

taxpayers.[168] Sales and use taxes, for example, are considered complementary only if they do not result in higher taxes on the out-of-state purchase than on the in-state purchase.[169]

Beyond these two general principles, further limitations on the scope of the complementary tax doctrine are needed, but are difficult to construct. Professor Jerome Hellerstein advocates clarifying the scope of compensatory taxes by use of a single-factor test that focuses on the transactions being taxed. Professor Hellerstein would require that for taxes to be compensatory, they must be levied on the same transaction.[170] Professor Hellerstein points out that Congress enacted such a limitation in 1976 legislation prohibiting state tax discrimination against out-of-state manufacturers, producers, wholesalers, retailers, or consumers of electricity.[171] The applicable state taxes were limited to those "on or with respect to the generation or transmission of electricity."[172] According to Professor Hellerstein, a transaction based limitation is needed because "[i]mplementation of a rule of law that a tax is nondiscriminatory because other taxes of at least the same magnitude are imposed by the taxing State on other taxpayers engaging in different transactions would plunge the Court into the morass of weighing comparative tax burdens."[173]

At least from a superficial viewpoint, the "same transaction" test would seem to be not so far removed from the Court's "substantially equivalent events" langnage. It would appear at first glance that determining whether taxes are imposed on "substantially equivalent events" or on the "same transaction" would both require merely a pinpointing of the subjects of taxation. The same transaction test simply would require closer identity between the subjects of taxation. There is, however, a problem with relying exclusively on the identity of transactions subject to tax to define

State Tax Discrimination, 39 TAX LAW. 405, 435-36, 463 (1986).

168. As Professor Walter Hellerstein has remarked, however, the Court on several occasions has paid only "lip service" to the concept that taxes imposed on interstate transportation and communication businesses in lieu of property taxes must be the equivalent of the local property taxes in order to be constitutional. *Id.* The Court has sustained taxes that are greater than the property taxes that could have been imposed on the taxpayer. *See* Railway Express Agency, Inc. v. Virginia, 358 U.S. 434 (1958).

169. *See, e.g.*, Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64 (1963) (sales and use taxes held not complementary because use tax base larger than sales tax base).

170. *See* J. HELLERSTEIN, *supra* note 10, ¶ 4.12[5], at 150-51. *See also* W. Hellerstein, *supra* note 167, at 460 (complementary tax doctrine should not be extended to taxes on different business activities or transaction).

171. *Id.*

172. Tax Reform Act of 1976, 15 U.S.C. § 391 (1982).

173. J. HELLERSTEIN, *supra* note 10, ¶ 4.12[5], at 150.

complementary taxes. It is universally agreed that sales and use taxes are complementary to each other. Yet, under Professor Hellerstein's "same transaction" test it is difficult to reach this conclusion. The sales tax is imposed on the retail transaction, whereas the use tax is imposed on the use of property. As the Court pointed out in *McLeod v. Dilworth Co.*,[174] sales and use taxes "are assessments upon different transactions."[175] Professor Hellerstein contends, "The Court can readily take into account the interrelations of such levies as sales and use taxes growing out of the same purchase and sale."[176] Professor Hellerstein, however, provides no explanation of when such interrelations are to be taken into account. In particular, it is difficult under the "same transaction" test to distinguish a complementary sales and use tax statute from the severance tax and first use tax at issue in *Maryland v. Louisiana*. Focusing on the transactions being taxed, severance and first use could appear to be related in the same manner as sales and use.[177]

Perhaps sales and use taxes should be considered complementary not because they are imposed on the same transaction, but rather because they both are designed as taxes on consumption. Instead of requiring that the transactions subject to tax be identical, a finding of compensatory taxes should depend on whether both statutes target the same economic activity for the burden of taxation. As the Court stated in *Maryland v. Louisiana*, "The concept of a compensatory tax first requires identification of the burden for which the state is attempting to compensate."[178] The typical sales and use taxing statutes thus would be deemed compensatory because both taxes are aimed at taxing consumption. The fact that a taxpayer generally is given a credit against his use tax liability for any sales taxes paid in other states underlines the focus on taxing all consumption equally.

On the other hand, the severance and first use taxes in *Maryland v. Louisiana* did not burden a common economic process. Un-

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174. 322 U.S. 327 (1944).

175. *Id.* at 330.

176. J. HELLERSTEIN, *supra* note 10, ¶ 4.12[5], at 150.

177. *See* W. Hellerstein, *supra* note 142, at 620-24. Professor Walter Hellerstein has suggested that the "surface discrimination" embodied in Louisiana's first use tax may disappear when it is read in conjunction with the severance tax in a manner analogous to sales and use taxes. Professor Hellerstein argues, however, that the manner in which the severance tax and first use tax operate and interact reveals underlying discriminatory features in the Louisiana taxing scheme. *Id.*

178. 451 U.S. at 758.

like the typical sales and use taxes' focus on consumption, depletion of natural resources does not appear to be the shared target of the two taxes. Under the Louisiana scheme a credit was given against the severance tax for first use taxes paid.[179] This credit mechanism undermines a scheme of equally taxing depletion of natural resources and instead provides a tax benefit for certain depletion of these resources within the state. According to one commentator, "[T]he grant of a severance tax credit for First Use Taxes paid effectively removes the burden of the First Use Tax from gas extracted offshore to the extent of severance tax liability. . . .[Hence,] an incentive is provided for First Use Taxpayers to undertake mineral extraction activities in Louisiana so as to minimize their effective First Use Tax burden."[180] Moreover, other provisions of the first use tax exempted from taxation outer continental shelf gas consumed in Louisiana for certain purposes.[181] Clearly, the two taxes did not have the common objective of taxing the consumption of natural resources. In fact, the interaction of the two taxes runs against a shared goal of taxing the consumption of natural resources. Ratber than subjecting the same economic activity (depletion of natural resources) to the same burden of taxation, Louisiana rewarded taxpayers for depleting in-state natural resources to the extent they paid first use tax on the depletion of outer continental shelf resources. Consequently, it seems quite clear that the two taxing statutes, when read together, were not aimed at taxing the same economic process, namely, the depletion of natural resources.

Focusing on the underlying economic activity that the taxing statutes are designed to burden is preferable to focusing on the particular transaction that triggers the tax. Although a test that looks to the identity of transactions being taxed has the advantage of ease of administration and predictability, it is not based on the relevant criteria and hence may be unfair. Frequently, the selection of a transaction or event on which to levy a tax is merely a matter of administrative convenience. For example, the retail transaction on which a sales tax is levied merely represents a convenient point to measure consumption.

To maintain fairness along with some degree of predictability and ease of administration in the complementary tax doctrine, several factors should be considered in determining whether two taxes

179. *See id.* at 756.

180. W. Hellerstein, *supra* note 142, at 623-24.

181. *See Maryland v. Louisiana,* 451 U.S. at 756.

burden the same economic activity. First, and perbaps foremost, the taxes should be imposed on related events, for example, the same stage in the economic process. Although taxation of the same transaction may not be necessary, there must be an underlying connection between the transactions subject to tax so that imposition of a tax on them represents a burden on the same economic activity. In this regard, the Court's "substantially equivalent event" test could be given real meaning. Events would be substantially equivalent only if they represented taxation of the same economic activity. For instance, taxes on manufacturing and wholesaling generally would not be considered compensatory because they are not imposed on related events.[182]

The equivalence of events being taxed, however, should not end the analysis of whether taxes are compensatory. Other factors may demonstrate that two taxes burden the same economic activity in such a manner as to be compensatory. For instance, the operation and interaction of the two taxes should be considered. In particular, any offsetting credits must be analyzed to determine whether the two taxes operate in conjunction with each other to burden the same economic activity. Thus, in *Maryland v. Louisiana* it was the credit provisions that revealed that the two taxes were not in fact compensatory.[183] Likewise, in *Armco* the Court suggested that certain reductions in the manufacturing tax would have indicated that it was a "proxy" for the gross receipts tax.[184]

The consequences of all states' enacting provisions similar to those of the taxing state should also be considered in determining whether the taxing provisions are complementary. As the Court pointed out in *Armco*, complementary taxes should be internally consistent. If the two taxes are designed to burden the same economic activity equally, whether the activity is conducted within or without the taxing state, then equal burdens on intrastate and interstate commerce should result when all states enact the same taxing scheme.[185]

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182. Unless the state enacted certain credits or deductions which resulted in a tax on wholesaling being equivalent to a tax on manufacturing, taxes on these two activities would not appear to be complementary. Thus, under this analysis, the recent decision of the Washington Supreme Court in National Can Corp. v. Washington, 105 Wash. 2d 327, 715 P.2d 128, *cert. granted* (U.S. Oct. 6, 1986)(No. 85-2006), which held that the Washington manufacturing and wholesaling tax provisions were complementary, would appear to be incorrect.

183. *See* 451 U.S. at 759.

184. 467 U.S. at 643.

185. *Id.* at 644. *But see National Can Corp.*, 105 Wash. 2d at 327, 715 P.2d at 128. According to the Washington Supreme Court, *Armco* does not require that the internal consistency requirement be applied to determine discrimination.

Legislative intent may be relevant in determining whether taxes are complementary. If the legislature expressly designs two taxes to burden the same economic activity, it may be easier for the court to reach the conclusion that in fact the two taxes are compensatory. In this regard, statements in the statute's legislative history sometimes reveal legislative intent. Even without an express statement of intent, however, it may be possible to surmise why a particular statute was enacted as formulated. For instance, constitutional limitations influence the manner in which the state legislature imposes burdens on interstate commerce. Because a state cannot constitutionally tax out-of-state sales, to equalize the tax burdens of residents buying tangible personal property in-state and those buying out-of-state, the state complements its sales tax with a use tax.

IV. The Cause of the Inequality

Once a court determines that disparate tax treatment exists, it must determine that the inequality is a result of the state tax statute being challenged. Generally, a statute will not be invalidated unless it is shown to be the cause of a prohibited result.[186] This section examines the causation element of a discrimination claim and discusses whether multiple tax burdens are unconstitutionally discriminatory. In addition, this section reviews to what extent, if any, the nondiscriminatory prong of the *Complete Auto Transit* test should apply when a state's apportionment formula is challenged on commerce clause grounds.

A. *Multiple Burden of Taxation Doctrine and State Tax Discrimination*

It is unclear whether a state tax statute that imposes a possibility or risk of multiple taxation on interstate commerce is unconstitutionally discriminatory. Traditionally, under the multiple burden of taxation doctrine, a statute that threatened interstate commerce with cumulative tax burdens not borne by local business was unconstitutional under the commerce clause. Nearly fifty years ago, in developing the multiple burden of taxation doctrine, Justice

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186. *See* L. Tribe, *supra* note 3, § 3-21, at 92. Professor Tribe explains causation as a corollary to the injury in fact requirement, which must be shown for a litigant to have standing to challenge a statute. *Id.* As Professor Tribe explains, it is necessary that "a litigant show that the challenged government action caused the litigant's injury." *Id.* Thus, the challenged state tax statute must be responsible for the disparate tax treatment in order for a court to find it unconstitutional as discriminating against interstate commerce.

Stone stated:

> The vice characteristic of those [taxes] which have been held invalid is that they have placed on the commerce burdens of such a nature as to be capable, in point of substance of being imposed or added to with equal right by every state which the commerce touches, merely because interstate commerce is being done, so that without the protection of the commerce clause it would bear cumulative burdens not imposed on local commerce.[187]

A number of taxes subsequently were invalidated under the multiple burden of taxation doctrine.[188] The Supreme Court temporarily abandoned the multiple burdens doctrine, but then revived it in the late 1950s.[189]

Although the contemporary approach to commerce clause analysis enunciated in *Complete Auto Transit* does not explicitly refer to multiple burdens of taxation, the four-prong test implicitly may incorporate the multiple burden doctrine. Clearly, the requirement that a state tax be fairly apportioned to the taxpayer's activity within the state prevents a certain degree of multiple taxation.[190] Arguably, the requirement that state taxes not discriminate against interstate commerce also prohibits certain multiple burdens. There is disparate tax treatment when commerce crossing state lines is subjected to multiple taxation that is not imposed on purely local business. According to Professor Jerome Hellerstein,

> The multiple taxation doctrine . . . is designed to prevent interstate commerce from being put in a disadvantageous position vis-a-vis intrastate commerce, because of the power of the States, aside from the Commerce Clause, to subject interstate enterprises to cumulative tax burdens not borne by local business. Hence, like taxes that on their face discriminate against interstate businesses, taxes that subject interstate business to a risk of multiple taxation to which intrastate business is not subjected, may be subsumed under

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187. Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 255-56 (1938) (citations omitted).

188. *See, e.g.*, Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434 (1939) (state tax imposed on total gross receipts of marketing agency making sales in-state and out-of-state held invalid since other states could impose a tax similarly measured on the taxpayer's gross receipts); Adams Mfg. Co. v. Storen, 304 U.S. 307, 311 (1938) (Indiana gross receipts tax imposed directly on an in-state manufacturer shipping orders out of state held invalid since "the exaction is of such a character that if lawful it may in substance he laid to the fullest extent by States in which the goods are sold as well as those in which they are manufactured").

189. Freeman v. Hewit, 329 U.S. 249 (1946), marked a temporary reversion to the direct versus indirect burden test of constitutionality under the commerce clause. This backward step in commerce clause adjudication was renounced when the Court revived the multiple burden doctrine. *See* Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 463 (1959) (holding that income tax imposed on out-of-state corporation's income apportioned to business activities within the taxing state did not violate the commerce clause in part because there was "nothing to show that multiple taxation is present").

190. *See* Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 442-47 (1979).

the prohibition of taxes that discriminate against interstate commerce.[191]

Intuitively, there is some logic in equating the multiple burden test with the prohibition against discriminatory state taxes. Prior to *Complete Auto Transit,* the chief role of the commerce clause in state taxation was to prohibit multiple tax burdens. After this landmark decision, the prohibition against discrimination is viewed as the primary contribution of the commerce clause to the state tax field.[192] Moreover, the Supreme Court has made a passing reference that multiple burdens are discriminatory. In *Northwestern States Portland Cement Co. v. Minnesota*[193] the Court asserted: "Nor may a State impose a tax which discriminates against interstate commerce either by providing a direct commercial advantage to local business, or by subjecting commerce to the burden of 'multiple taxation.' "[194]

Incorporating the multiple burden doctrine into the prohibition against discriminatory state taxation is difficult, however, because the disparate tax treatment flowing from multiple burdens results from several states' taxing statutes rather than those of a single state. Hence, with multiple taxation a court could not justify invalidating a challenged taxing statute on discrimination grounds because it is impossible to attribute sole culpability for discrimination to that state's statute.[195] As Professor Jerome Hellerstein has pointed out, the architects of the multiple burdens test, Justices Rutledge and Stone, "may possibly have been reluctant to categorize as discriminatory a State tax which, considered without reference to the taxing powers of other States, appeared to treat intrastate and interstate taxpayers equally."[196] The Supreme Court later echoed this reluctance in *Moorman Manufacturing Co. v.*

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191. J. HELLERSTEIN, *supra* note 10, ¶ 4.8, at 125-26 (footnote omitted); *see also,* J. Hellerstein, *State Tax Discrimination Against Out-of-Staters,* 30 NAT'L TAX J. 113, 120-21 (1977).

192. *See* J. HELLERSTEIN, *supra* note 10, ¶ 4.8, at 122-23. According to Professor Hellerstein, "If the multiple taxation doctrine is being interred . . . the question arises as to what, if anything, remains of the long-standing principle that State taxes may be struck down as repugnant to the unexercised power of Congress to regnlate the commerce?" *Id.* at 123.

193. 358 U.S. 450 (1959).

194. *Id.* at 458 (citations omitted); *see also* Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 443-44 (1980) (Court addressed the multiple burdens question as an element of discrimination); Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434 (1938) (holding that gross receipts tax imposed by origin state violated the antidiscrimination requirement of the commerce clause hecause it imposed the risk of multiple taxation).

195. *See* P. HARTMAN, 1985 SUPPLEMENT, supra note 9, § 2:19.

196. J. Hellerstein, *supra* note 191, at 121.

Bair,[197] in which the Court refused to hold that Iowa's single-factor apportionment formula discriminated against interstate commerce. Although the Court conceded that the interaction of the apportionment formulas of Iowa and Illinois might result in duplicative taxation, it contended that "whatever disparity [that] may have existed is not attributable to the Iowa statute. . . . [T]he alleged disparity can only be the consequence of the combined effect of the Iowa *and* Illinois statutes, and Iowa is not responsible for the latter."[198] Moreover, in *Container Corp. of America v. Franchise Tax Board*[199] the Court remarked that the antidiscrimination principle had *not* been construed "to require that a state apportionment formula not differ so substantially from methods of allocation used by other jurisdictions in which the taxpayer is subject to taxation so as to produce double taxation of the same income and a resultant tax burden higher than the taxpayer would incur if its business were limited to any one jurisdiction."[200] In short, the multiple burdens doctrine does not fit easily into the antidiscrimination requirement because the multiple burdens doctrine refers to the taxation of a single taxpayer by more than one state, and discrimination implies disparate taxation of different taxpayers by a single state.[201]

In examining the taxation of foreign commerce, the Supreme Court explicitly has incorporated the multiple burdens test. The Court has held that a tax on foreign commerce must meet two requirements in addition to the four prongs of *Complete Auto Transit*.[202] One of these additional requirements is that the tax must not create a substantial risk of international tax multiplication.[203] Separate incorporation of the multiple burdens doctrine in foreign commerce jurisprudence suggests that the Court may not view this doctrine as implicit in the prohibition against discrimination.

Evolving jurisprudence reveals that the Court increasingly is reluctant to hold a state tax unconstitutionally discriminatory on

197. 437 U.S. 267 (1978).

198. *Id.* at 277 n.12.

199. 463 U.S. 159 (1983).

200. *Id.* at 170-71.

201. *See* Case Note, *State Taxation of Interstate Commerce: An Analysis of Current Standards Promulgated by the United States Supreme Court*—Department of Revenue v. Association of Washington Stevedoring Companies, 28 DE PAUL L. REV. 205, 223 (1978).

202. For a discussion of the foreign commerce clause, see *supra* notes 61-67 and accompanying text.

203. *See* Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 446-48 (1979).

the ground that it threatens interstate commerce with multiple burdens of taxation.[204] In the past, this reluctance has been reflected in an insistence that the taxpayer prove actual multiple burdens to invalidate the state tax.[205] Relying on its opinion in *Mobil Oil Corp. v. Commissioner of Taxes*,[206] the Court in *Exxon Corp. v. Department of Revenue*[207] stated: "[I]t is the *risk* of multiple taxation that is being asserted; actual multiple taxation has not been shown. While of course 'the constitutionality of a [Wisconsin] tax should not depend on the vagaries of [another State's] tax policy,' nonetheless 'the absence of any existing duplicative tax does alter the nature of appellant's claim.' "[208] Similarly, in *General Motors Corp. v. Washington*[209] the Court emphasized that the taxpayer "has not demonstrated what definite burden, in a constitutional sense, the St. Louis tax places on the identical interstate shipments by which Washington measures its tax."[210]

More recently the Court has steered away from framing state tax discrimination issues in the guise of the multiple burdens doctrine. Cases such as *Armco, Inc. v. Hardesty* make no mention of multiple burdens.[211] Arguably, then, the Court is heading toward the conclusion that the multiple burdens doctrine should not be subsumed under the prohibition against discrimination.

Although multiple burdens of taxation may not be attributable to a single state's taxing scheme, it still may be possible to challenge a state tax as discriminatory by hypothesizing situations in which one state's taxing scheme clearly causes disparate tax

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204. *See* L. TRIBE, *supra* note 3, § 6-17, at 360-61. Professor Tribe notes that the Court has made the rule against cumulative burdens "so difficult to invoke with success." *Id.* He suggests that there should be a "re-evaluation of rigid rules bearing on cumulative burdens." *Id.*

205. *See, e.g.*, Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) (holding that Vermont could include dividends from foreign subsidiaries and affiliates in the apportionment base of its income tax even though New York, the state of commercial domicile, had the power to tax dividend income without apportionment); Exxon Corp. v. Department of Revenue, 447 U.S. 207 (1980) (holding that income derived from oil production outside the state was apportionable by Wisconsin despite taxpayer's separate functional accounting system and the fact that the state of production had the right to tax such income); General Motors Corp. v. Washington, 377 U.S. 436 (1964) (holding that Washington tax on the privilege of doing business in the state measured by gross receipts was constitutional even though other jurisdictions could impose taxes measured by the same gross receipts).

206. 445 U.S. 425 (1980).

207. 447 U.S. 207 (1980).

208. *Id.* at 228-29 (quoting *Mobil Oil Corp.*, 445 U.S. at 444).

209. 377 U.S. 436 (1964).

210. *Id.* at 449.

211. *See* Armco, Inc. v. Hardesty, 467 U.S. 638 (1984); *see also* Maryland v. Louisiana, 451 U.S. 725 (1981).

treatment. In *Armco* the Court found that a West Virginia gross receipts tax that exempted local manufacturers was unconstitutionally discriminatory after determining that it was not internally consistent.[212] As Professor Hartman has pointed out, the taxpayer circumvented the causation problem by avoiding the multiple taxation accusation and by claiming instead that the West Virginia tax was intrinsically flawed.[213] The taxpayer demonstrated the intrinsic flaw by hypothesizing that if all states employed the West Virginia taxation method, then an interstate seller would be subjected to greater taxation than a purely intrastate seller.[214]

B. *Formulary Apportionment and State Tax Discrimination*

In contrast to the situation in *Armco*, it may be difficult to challenge a state's income tax apportionment formula as lacking in internal consistency. In *Moorman Manufacturing Co. v. Bair*[215] the Court upheld Iowa's single-factor gross receipts formula for apportioning net income. The Court reasoned that the taxpayer's objection to the formula was based not on any intrinsic flaw in the formula itself, but rather on its variance from the standard three-factor formula used in most states. The commerce clause does not require, the Court held, a nationally uniform apportionment formula.[216]

Despite a finding of internal consistency, however, it may be possible to demonstrate that a single state's apportionment method risks disparate tax treatment between certain taxpayers. For instance, it may be possible to hypothesize a situation in which formulary apportionment subjects an interstate taxpayer to more tax liability than a purely intrastate taxpayer conducting exactly the same activities within the state. For example, assume that two taxpayers both manufacture and sell widgets. Further suppose that both of these taxpayers have the exact same property, payroll, and sales within the taxing state. Assume also that one of these taxpayers also conducts business outside the taxing state that does not contribute to or depend on the in-state operations in any material way and that the other taxpayer has no operations outside the

212. 467 U.S. at 644-46.

213. P. HARTMAN, 1985 SUPPLEMENT, *supra* note 9, § 2:19, at 31.

214. *See Armco*, 467 U.S. at 644. The dissent argued that the internal consistency test should be restricted to net income taxes and not applied to transactional taxes. *Id.* at 648 (Rehnquist, J., dissenting).

215. 437 U.S. 267 (1978).

216. *Id.* at 276-81.

state. The tax base of the purely intrastate taxpayer will be the taxpayer's total income. The tax base of the interstate taxpayer, on the other hand, will be determined by applying the state's apportionment formula to the taxpayer's total income. Even assuming that the taxing state uses the standard three-factor apportionment formula based on property, payroll, and sales, there is no guarantee that this formula will result in a tax base identical to that of the purely intrastate taxpayer. It is possible that the interstate taxpayer's tax base may be larger than that of the intrastate taxpayer.[217] Opponents of separate accounting would argue that it is impossible to prove that the interstate taxpayer's operations in the taxing state are exactly the same as the intrastate taxpayer's operations. It is, however, possible to hypothesize such a situation.

The interstate taxpayer in the above example may wish to challenge the apportionment formula on commerce clause grounds under the fair apportionment and nondiscrimination prongs of *Complete Auto Transit*. There is considerable (but not complete) overlap between these two prongs of the *Complete Auto Transit* test. Traditionally, in cases involving operational (*e.g.*, net income) taxes, as opposed to transactional (*e.g.*, sales and use) taxes, commerce clause validity turns on the state's apportionment method, and the second and third prongs of *Complete Auto Transit* are then collapsed together.[218] In *Container Corp. v. Franchise Tax Board* the Court remarked, "[T]he anti-discrimination principle has not in practice required much in addition to the requirement of fair apportionment."[219] Assuming that the state's apportionment method would be deemed fair, the interstate taxpayer in our example may have difficulty in proving a violation of the commerce clause.[220]

Apportionment methods that are deemed to be within the realm of fairness, however, still could be found to cause unequal tax treatment between certain individual taxpayers. As the Court

217. Of course, it also is possible that the interstate taxpayer's tax base may be smaller than that of the intrastate taxpayer.

218. *See* Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 171 (1983); *see also* Michael, *The Constitutionality of Minnesota's Business Tax Credits After* Westinghouse Electric Corp., 4 J. STATE TAX'N 163, 166 (1985). According to Michael, "In almost all net income tax cases the Court has treated the apportionment and discrimination tests as equivalent. If the tax is fairly apportioned, it is also nondiscriminatory." *Id.*

219. 463 U.S. at 171.

220. *But see Westinghouse Electric Corp.*, 466 U.S. at 398-99. *Westinghouse* suggests that it may not be sufficient analysis of the nondiscriminatory requirement to find that a tax is fairly apportioned. According to the Court, " 'Fairly apportioned' and 'nondiscriminatory' are not synonymous terms." *Id.* at 399.

has pointed out, even the standard three-factor apportionment formula used by many states and advocated in the Uniform Division of Income for Tax Purposes Act (UDITPA)[221] is imperfect in attributing income to a state.[222] Moreover, the Court has sustained a single-factor apportionment formula over objections to its fairness. Such a formula generally is viewed as even less successful in attributing income to the state in which it was earned than the three-factor approach.[223]

The results of challenging a state's apportionment formula on fairness grounds should be contrasted with the results of challenging the apportionment formula on discrimination grounds.[224] Assume a taxpayer argues that an apportionment formula causes disparate tax treatment between an intrastate taxpayer not subject to formulary apportionment and itself, an interstate taxpayer subject to formulary apportionment who conducts the exact same activities within the taxing state as the intrastate taxpayer. This theory raises a potential conflict between the commerce clause principles that an apportionment formula need only be fair and that no state tax may be discriminatory. This conflict arises because formulary apportionment, although it is deemed fair, can be viewed in certain cases as causing disparate tax treatment between specific intrastate and interstate taxpayers.

The conflict between the commerce clause requirements of no discrimination and fair apportionment can be analyzed on several different levels. Arguably, a taxpayer cannot show disparate tax treatment because it generally is impossible, via separate accounting, geographically to isolate the interstate taxpayer's in-state activities. This approach, however, overlooks the fact that the discrimination theory does not rely on the actual accuracy of separate geographical accounting, but rather depends on a hypothetical disparity between the tax bases attributable to interstate and intrastate taxpayers in the state's taxing system. It clearly is possible to hypothesize situations that all would agree constitute unequal tax

221. The UDITPA is a model act adopted by the National Conference of Commissioners on Uniform State Laws at its annual conference meeting in 1957. For a detailed discussion of UDITPA, see Tatarowicz, *Problems in Allocating and Apportioning Income—an Overview and Critique of Recent State Court Decisions*, 3 N.Y.U. INST. ON STATE AND LOCAL TAX'N AND CONF. ON PROPERTY TAX'N § 3.00 (1985).

222. *See Container Corp.*, 463 U.S. at 183 & n.20.

223. *See Moorman Mfg. Co.*, 437 U.S. at 267.

224. *See* J. HELLERSTEIN, *supra* note 191. According to Professor Jerome Hellerstein, "There may . . . be a basis for invalidating some apportionment methods currently in use on the ground that they discriminate against interstate commerce." *Id.* at 120.

treatment between certain taxpayers. This hypothetical disparity should be sufficient and there should be no need actually to prove the disparity.

One also might argue that the analysis of a state's apportionment formula should end with a conclusion that it is fair according to the standards set forth in the second prong of the *Complete Auto Transit* test. This conclusion, however, ignores the recognized overlap between the second and third prongs of *Complete Auto Transit.* Alternatively, one might concede that formulary apportionment does result in discrimination, but that discrimination is not always per se invalid under the commerce clause. But, this approach is a dangerous resolution of the conflict because it opens up the door for the Court to permit other types of state tax discrimination. Perhaps the best resolution of the conflict is to conclude that a state's formulary apportionment scheme may cause disparate tax treatment, but that the discrimination weighs only against certain individuals engaged in commerce and not against a protected class of commerce.[225] The antidiscrimination provision, then, is viewed as promoting equal treatment of interstate and foreign commerce and not identical treatment of all taxpayers engaged in such commerce.

V. Negative Effects on Protected Commerce

After a court determines that a state tax statute causes disparate tax treatment, it next must determine whether the inequality weighs against protected commerce. This determination requires a two-part analysis: first, the protected commerce that the tax statute affects must be identified;[226] and second, it must be determined whether the effect of the tax statute on protected commerce is beneficial, burdensome, or neutral.

The commerce clause protects interstate and foreign commerce, not intrastate commerce. Moreover, the commerce clause protects only commerce and not individual taxpayers engaged in commerce.[227] Only state tax statutes imposing burdens on protected commerce generally are unconstitutional under the com-

225. *See infra* notes 233-37 and accompanying text.

226. To invoke commerce clause scrutiny in the first place, the taxpayer must show that the challenged statute has an effect on protected commerce. Hence, if there is no effect on protected commerce, no commerce clause analysis is warranted.

227. *See* Metropolitan Life Ins. Co. v. Ward, 105 S. Ct. 1676, 1683 (1985) (in holding that an Alabama gross premiums tax may violate the equal protection clause, the Court pointed out that the commerce clause protects interstate commerce, whereas tbe equal protection clause protects persons.).

merce clause. Accordingly, it may be constitutional for a tax statute to benefit intrastate commerce if the resulting effect on interstate commerce is neutral rather than negative. As discussed below,[228] however, it is unclear whether a statute is unconstitutional if it benefits certain protected commerce, but burdens other protected commerce.

A. *Identifying Protected Commerce*

1. Interstate and Foreign Commerce Protected

The commerce clause protects interstate and foreign commerce, not local commerce, against discrimination. Both the commerce clause language and its underlying policies identify interstate and foreign commerce as protected commerce. The commerce clause gives Congress the power to regulate commerce "with foreign Nations and among the several States."[229] The commerce clause is designed to promote free trade among the states, assure national uniformity in foreign commerce, and circumvent parochial biases of state legislators.[230]

The commerce clause is not designed to protect local commerce. Theoretically, local interests are represented in the state's political processes and do not need the protection afforded by the commerce clause. Moreover, the commerce clause is designed to facilitate free trade across sovereign jurisdictions and is not concerned with free trade within a single jurisdiction. As the Court has pointed out, "[T]he fundamental purpose of the Clause is to assure that there be free trade among the several states. This free trade purpose is not confined to the freedom to trade with only one State; it is a freedom to trade with any State, to engage in commerce across all state boundaries."[231] Hence, a state taxing scheme is not invalid under the commerce clause because local taxpayers are taxed at a higher rate than out-of-state taxpayers.[232]

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228. *See infra* notes 279-90 and accompanying text.

229. U.S. CONST. art. 1, § 8, cl. 3.

230. *See* Barrett *supra* note 10, § 1.02(2); Case Note, *supra* note 3, at 840-41.

231. *Boston Stock Exch.*, 429 U.S. at 335.

232. *Cf.* Alaska v. Arctic Maid, 366 U.S. 199 (1961). (although the Court did not directly address the issue of preferring interstate commerce over local commerce, it held that an Alaska tax on freezer fishing ships taking salmon from Alaskan territorial waters for interstate commerce was valid under the commerce clause even though a higher tax was imposed on similar freezer ships engaged in intrastate commerce).

2. Commerce and Not Taxpayers Protected

The commerce clause protects commerce and not the individual taxpayers engaging in commerce. Again, the commerce clause language and its purposes reveal a focus on interstate and foreign trade rather than on out-of-state taxpayers. It is this focus on commerce instead of taxpayers that makes it possible for courts to find a tax on commerce originating from inside the taxing state in violation of the commerce clause.[233]

In addition, this focus on commerce as opposed to taxpayers may best reconcile the conflict discussed earlier[234] that exists between the commerce clause principles that a state tax need only be fairly apportioned, but cannot discriminate to any extent against interstate commerce.[235] Even though one may be able to show that formulary apportionment disadvantages an interstate taxpayer as compared to a purely domestic taxpayer conducting the same activities within the taxing state, this showing does not prove discrimination against interstate commerce. Although formulary apportionment may disadvantage certain interstate taxpayers as compared to their wholly intrastate competitors, it also may result in less tax for other interstate taxpayers as compared to in-state taxpayers conducting the same activities within the taxing state. In other words, formulary apportionment does not discriminate against interstate commerce because it does not consistently burden interstate commerce; it only may disadvantage particular interstate taxpayers.

Although the commerce clause does not address individual taxpayers, other constitutional provisions provide protection to individuals against state tax discrimination. Under the equal protection clause, no state may discriminate against a class of taxpayers unless the classification is rationally related to a legitimate state purpose.[236] Moreover, a tax statute cannot so narrowly single out a group of taxpayers for adverse treatment that it constitutes a bill of attainder.[237]

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233. *See Commonwealth Edison,* 453 U.S. at 616 ("State taxes levied on a 'local' activity preceding entry of the goods into interstate commerce may substantially affect interstate commerce, and this effect is the proper focus of Commerce Clause inquiry.").

234. *See supra* notes 215-25 and accompanying text.

235. Thus, the fair apportionment requirement appears to be a standard that allows for reasonable compliance, whereas the antidiscrimination requirement is an absolute prohibition.

236. See *infra* notes 320-39 and accompanying text for a discussion of state tax discrimination under the equal protection clause.

237. *See* Barrett, *supra* note 10, § 1.05[5].

B. *Classifying Effects as Burdensome*

Generally, disparate tax treatment that burdens protected commerce is unconstitutional under the commerce clause. Clearly, a taxing scheme imposing greater tax liabilities on interstate business than on intrastate business burdens interstate commerce.[238] As the Supreme Court stated in *Armco*, "[A] State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State."[239] Moreover, it is unconstitutionally burdensome for a state to impose a greater tax on nonresidents doing business in other states than on nonresidents doing business in the taxing state.[240] According to the Court in *Boston Stock Exchange*,

> A State may no more use discriminatory taxes to assure that nonresidents direct their commerce to businesses within the State than to assure that residents trade only in intrastate commerce. As we stated at the outset, the fundamental purpose of the Clause is to assure that there be free trade among the several States. This free trade purpose is not confined to the freedom to trade with only one State; it is a freedom to trade with any State, to engage in commerce across all state boundaries.[241]

1. Legitimate State Tax Incentives vs. Unconstitutional State Tax Discrimination

A tax incentive rewarding in-state activities without similarly rewarding the same out-of-state activities clearly ties a taxpayer's effective tax rate to the choice of whether to conduct an activity within the state. Although such an incentive introduces a distinction in the state tax code between in-state and out-of-state activities, this distinction probably should not be considered unconstitutional discrimination against protected commerce.

The concern over the constitutionality of such tax incentives has its roots in several Supreme Court decisions[242] that may be read as drawing into question any state tax incentive offered exclusively with respect to in-state activities. On closer examination, however, it appears that a state tax incentive that focuses exclusively on a taxpayer's in-state activities does not have the sort of negative impact on interstate commerce with which the commerce

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238. *See, e.g., Armco*, 467 U.S. at 642; *see also Halliburton Oil Well Cementing Co.*, 373 U.S. at 72.

239. 467 U.S. at 642.

240. Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977).

241. *Id.* at 334-35.

242. *See Westinghouse Elec. Corp.*, 466 U.S. at 388; *Boston Stock Exch.*, 429 U.S. at 318.

clause is concerned. Rather, the key to finding a tax incentive unconstitutionally discriminatory appears to be a reliance by the state tax provision on both a taxpayer's in-state and out-of-state activities in determining the taxpayer's effective tax rate. Such a provision clearly has a negative impact on interstate commerce. A provision that relies exclusively on a taxpayer's in-state activities in determining an effective tax rate, however, arguably does not have a negative effect on interstate commerce. First and foremost, then, it is necessary to examine the principle that a tax incentive will not be found in violation of the commerce clause unless it has a negative impact on protected commerce. In addition, it is possible that a tax incentive challenged as discriminatory can be sustained on another ground. For instance, it may be difficult for a taxpayer challenging a particular tax incentive to establish that the tax incentive in question is, in fact, the source of the discrimination.

One case that may be helpful in identifying which tax incentives discriminate against protected commerce is *Boston Stock Exchange v. State Tax Commission*.[243] In that case appellant-stock exchanges challenged two amendments to New York's transfer tax on securities,[244] which provided for a fifty percent reduction in the tax rate for transactions by nonresidents involving New York sales and a maximum tax liability of any taxpayer (resident or nonresident) of 350 dollars for a single transaction if it involved a New York sale. The exchanges alleged, consistently with statements in the legislative history of the challenged amendments,[245] that these

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243. 429 U.S. 318 (1977).

244. Act of June 16, 1968, ch. 827, 1968 N.Y. Laws 2530 (codified at N.Y. TAX LAW § 270.1 (McKinney 1966)).

245. The legislature's intent to divert sales to New York exchanges appeared clearly within the amendment's legislative history:

> The securities industry, and particularly the stock exchanges located within the state have contributed importantly to the economy of the state and its recognition as the financial center of the world. The growth of exchanges in other regions of the country and the diversion of business to those exchanges of individuals who are nonresidents of the state of New York, requires recognition that the tax on transfers of stock imposed by article twelve of the tax law, is an important contributing element to the diversion of sales to other areas to the detriment of the economy of the state. Furthermore, in the case of transactions involving large blocks of stock, recognition must be given to the ease of completion of such sales outside the state of New York without the payment of any tax. In order to encourage the effecting by nonresidents of the state of New York of their sales within the state of New York and the retention within the state of New York of sales involving large blocks of stock, a separate classification of the tax on sales by nonresidents of the state of New York and a maximum tax for certain large block sales are desirable.

Id. at 2530-31, *quoted in Boston Stock Exch.*, 429 U.S. at 326-27. Furthermore, Governor provisions diverted transactions from out-of-state exchanges to New York exchanges. The Court unanimously held that these provisions discriminated against interstate commerce in violation of the commerce clause.[246]

In striking down these amendments, the Court emphasized that the commerce clause prohibits states from enacting "laws that favor local enterprises at the expense of out-of-state businesses."[247] Thus the Court indicated that there must be a negative impact on interstate commerce before an unconstitutional burden on interstate commerce will be found. Under this approach, the New York amendments were unconstitutional because they "create[d] both an advantage for the exchanges in New York and a discriminatory burden on commerce to its sister States."[248] The amendments tied the effective rate of tax not only to the New York activity with which the state identified the taxable moment, but also to whether another activity (*i.e.*, sale on an exchange) took place in New York or in another state. A lower effective rate resulted if the sale on an exchange occurred in New York.

In addition, the Court in *Boston Stock Exchange* carefully emphasized that tax incentives without negative effects on interstate commerce could withstand commerce clause scrutiny:

> Our decision today does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry. Nor do we hold that a State may not compete with other States for a share of interstate commerce; such competition lies at the heart of a free trade policy. We hold only that in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State.[249]

Before New York amended its transfer tax, the choice of an exchange "was not influenced by the transfer tax."[250] In contrast, because of the amendments, "the choice of exchange by all nonresidents and by residents engaging in large transactions [was] not

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Nelson Rockefeller's memorandum of approval of the transfer tax amendment explained: "The bill recognizes the changing character of the securities industry and the importance of its continued presence and strength for the future economic prosperity of the State and will provide long-term relief from some of the competitive pressures from outside the State." PUBLIC PAPERS OF GOVERNOR NELSON A. ROCKEFELLER 553 (1968), *quoted in Boston Stock Exch.*, 429 U.S. at 327 n.10; PUBLIC PAPERS OF GOVERNOR NELSON A. ROCKEFELLER 552-54 (1968); 1968 McKinneys Session Laws of New York, Vol. 2, p. 2384.

246. 429 U.S. at 318.

247. *Id.* at 329.

248. *Id.* at 331.

249. *Id.* at 336-37.

250. *Id.* at 330.

made solely on the basis of nontax criteria."[251]

The Court contrasted the amendments' effect on interstate commerce in *Boston Stock Exchange* with decisions sustaining compensating use taxes, such as *Henneford v. Silas Mason Co.*[252] and *General Trading Co. v. State Tax Commission.*[253] In those decisions the Court held that compensating use taxes merely balanced the sales tax burden on in-state sales. By enacting compensating use taxes, a state again rendered the decision whether to purchase goods in interstate commerce neutral so that "an individual faced with the choice of an in-state or out-of-state purchase could make that choice without regard to the tax consequences."[254] Thus, a true compensating use tax does not tie the effective tax on a purchase to the choice of a market. In contrast, the New York provisions made taxes an important consideration in the choice of a stock exchange.

Although promotion of tax neutrality may be a useful starting point in evaluating a state's tax incentives, the Court's emphasis on the foreclosure of tax neutral decisions in *Boston Stock Exchange* creates complex problems. Many state statutes granting tax incentives—including job credits,[255] investment credits,[256] and

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251. *Id.* at 331.

252. 300 U.S. 577 (1937).

253. 322 U.S. 335 (1944).

254. *See Boston Stock Exch.*, 429 U.S. at 332.

255. *See, e.g.*, ALASKA STAT. §§ 43.20.021(d), 43.20.042 (Supp. 1985); CAL. REV. & TAX CODE §§ 17053.7, 24330 (West Supp. 1986); DEL. CODE ANN. tit. 30, § 2011 (1985); IDAHO CODE § 63-3029F (Supp. 1985); KY. REV. STAT. § 141.065 (Supp. 1984); LA. REV. STAT. ANN. § 47:34 (West Supp. 1986); MASS. GEN. LAWS ANN. ch. 63, § 31C (West Supp. 1986); MONT. CODE ANN. §§ 15-31-124 to -126 (1985); N.D. CENT. CODE § 57-38-30.1 (1983); — PA. TAX REFORM CODE § 1701-A.

Additionally, some states not only restrict their jobs-type credits to in-state investments, but further limit them to specified locations, such as enterprise zones. *See, e.g.*, CAL. REV. & TAX CODE § 17053.8 (West Supp. 1986); CONN. GEN. STAT. ANN. § 12-217e (West 1983 & Supp. 1985); DEL. CODE ANN. tit. 30, § 2011 (1985); Illinois Income Tax Act § 201(h), ILL. ANN. STAT. ch. 120, § 2-201(h) (Smith-Hurd Supp. 1985); IND. CODE § 6-3-3-10 (1984); KAN. STAT. ANN. § 79-32, 153 (1984); LA. REV. STAT. ANN. § 51:1787 (West Supp. 1986); MD. ANN. CODE art. 81, § 291-A (Supp. 1985); MASS. GEN. LAWS ANN. ch. 63, § 38E (West Supp. 1986); MINN. STAT. ANN. § 273.1314 (West Supp. 1986); MISS. CODE ANN. § 27-7-22 (Supp. 1985); MO. ANN. STAT. § 135.225 (Vernon Supp. 1986); N.J. STAT. ANN. § 52:27H-78 (West 1986); OHIO REV. CODE ANN. § 5709.65 (Page Supp. 1984); OKLA. STAT. ANN. tit. 62, § 690.4 (West Supp. 1985); S.C. CODE ANN. § 12-7-616 (Law. Co-op. Supp. 1985).

Some states condition their credits on a certain level of investment in property in addition to a job-creation requirement, or grant a credit based on both new investments and new jobs. *See, e.g.*, COLO. REV. STAT. § 39-22-508.3 (19XX); ILL. ANN. STAT. ch. 120, § 2-201(g) (Smith-Hurd Supp. 1985); ME. REV. STAT. ANN. tit. 36, § 5215 (Supp. 1985); MO. ANN. STAT. § 135.110.1 (Vernon Supp. 1986); N.M. STAT. ANN. §§ 7-9A-3 to -9 (1983); N.Y. TAX LAW § 210.11 (McKinney Supp. 1986); OKLA. STAT. ANN. tit. 68, §§ 2357.4, .5 (West Supp. 1985); W.

research credits[257]—explicitly are limited to in-state activities. Furthermore, it may be presumed that many of these statutes were enacted in attempts to foreclose tax neutral decisions and that the limitations of the incentives to in-state activities would not be severable from the remainder of the statutes.[258] If these incentives are constitutional, the Court must distinguish permissible and impermissible attempts to foreclose tax neutrality. Perhaps the Court's tax neutrality requirement may be limited best by recognizing that the constitutional infirmity in *Boston Stock Exchange* was that the decision of which stock exchange to use, which previously had been made without state tax consequences, systematically was biased by the challenged amendments against other states' exchanges and in favor of New York exchanges.

Likewise, in *Halliburton Oil Well Cementing Co. v. Reily*[259] a negative effect on interstate commerce was created because Louisiana's use tax base included labor and overhead, but these items were excluded from the sales tax base. Accordingly, a provision relating to the determination of Louisiana's use tax base was struck down because its effect would have been to encourage taxpayers to move existing assembly operations into the state and/or to encourage them to fractionalize assembly operations. The Court again carefully distinguished discrimination in the tax base from constitutional compensatory use taxes. In contrast to the disparities between the Louisiana sales and use tax bases before the Court, a compensating use tax imposed on the same base as the sales tax presumably would have had little or no impact on the

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VA. CODE §§ 11-13C1 to -13 (Supp. 1985).

256. *See, e.g.*, ALASKA STAT. § 43.20.036(b) (1983); COLO. REV. STAT. § 39-22-507.5 (1979); IDAHO CODE § 63-3029B (Supp. 1985); KAN. STAT. ANN. § 79-32.153 (Supp. 1981); N.Y. TAX LAW § 210.11 (McKinney Supp. 1986); OHIO REV. CODE ANN. § 5733.061 (Page Supp. 1984); R.I. GEN. LAWS § 44-31-1 (1980); TENN. CODE ANN. § 67-4-808(3) (Supp. 1985).

As noted *supra* note 255, some states condition their credits on a combination of new jobs as well as increased investment in the state. Other states limit their credits to investments in enterprise zones. *See, e.g.*, Act of Nov. 29, 1967, No. 292, 1967 Pa. Laws 636.

257. *See, e.g.*, IND. CODE ANN. § 6-3.1-4-1 to -6 (Burns Supp. 1985); IOWA CODE ANN. § 422.33 (West Supp. 1985); MINN. STAT. ANN. § 290.068(1), (6) (West Supp. 1986); N.Y. TAX LAW § 606(h) (McKinney Supp. 1986); WIS. STAT. ANN. § 71.09(12r) (West Supp. 1985).

258. *See, e.g.*, LA. REV. STAT. ANN. § 34A (West Supp. 1986) ("The intent of this Section is solely to reward the generation of new full-time and part-time jobs in the state of Louisiana."). MONT. CODE ANN. § 15-31-126 (1985) ("This credit is available only to those new and expanding corporations that provide jobs within the state of Montana."); *c.f.* Act of June 16, 1968, ch. 827, 1968 N.Y. Laws 2530, 2530-31 (codified at N.Y. TAX LAW § 270.1 (McKinney 1966), *quoted in Boston Stock Exch.*, 429 U.S. at 326-27 (legislative bistory of provisions struck down in *Boston Stock Exch.*,). For the relevant text of the legislative history, see note 245.

259. 373 U.S. 64 (1963).

number or location of Halliburton's plants.[260]

The discrimination against protected commerce in *Boston Stock Exchange* and in *Halliburton* existed because a taxpayer's effective tax rates were dependent, not only on the activities the taxpayer performed in the state, but also on the activities performed in other states.[261] Thus, the tax provisions and the effective tax rates were not tied exclusively to in-state activities. There is no indication, however, that these cases require a state to offer incentives regardless of the state in which the desired activities occur; the cases indicate only that the effective tax rates must not be tied to out-of-state activities. Furthermore, the suggestion that a tax incentive may be offered only for activities within the state is not confined to transaction taxes. Rather, this analysis is further borne out by a recent case dealing with an income tax incentive, *Westinghouse Electric Corp. v. Tully*.[262]

In *Westinghouse* the Court struck down New York's DISC credit, which had been apportioned using two factors: (1) the taxpayer's New York allocation percentage, and (2) the ratio of gross receipts from New York shipments to total export-related gross receipts ("the gross receipts factor").[263] The commerce clause problem with the credit arose from the gross receipts factor.[264] As the Court observed, one effect of this factor was that as total DISC gross receipts increased, the New York credit actually would decrease if the gross receipts related to New York shipments increased at a slower rate than the overall increase in the taxpayer's export shipments.[265]

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260. *Id.* at 70 (citing Henneford v. Silas Mason Co., 300 U.S. 577 (1937)).

261. Another way of analyzing the negative effects on interstate commerce, and thus limiting the principle that state tax laws cannot impair neutral economic decision making, is to focus on the effect that the tax law has on the distribution of a limited amount of activity. Both *Boston Stock Exchange* and *Halliburton* involved situations in which the state attempted to redistribute a limited amount of activity from out-of-state into the taxing state. Thus, it can be concluded that the number of security transactions occurring on the Boston Stock Exchange and the number of oil well servicing vehicles customized by Halliburton were determined by factors other than state tax considerations. Consequently, state tax provisions can serve only to redistribute the fixed amount of these activities.

In contrast, the typical investment credit, jobs credit, or research credit may not have been enacted with the primary intent of diverting activity from other states. Instead, many tax incentives appear to have been enacted to encourage a higher level of the desired activity (investment or jobs or research) within the state through the creation of more of the activity. There may be no (or little) diversion of the activity from other states and hence no negative effects on interstate commerce.

262. 466 U.S. 388 (1984).

263. N.Y. TAX LAW § 210.13(a)(2)-(5) (McKinney Supp. 1986).

264. *See id.* § 210.13(a).

265. 466 U.S. at 402 n.9 (Table C).

The New York DISC credit not only encouraged activities in New York, but its gross receipts factor actually penalized activities outside the state.[266] According to the Court,

> This adjustment has the effect of allowing a parent a greater tax credit on its accumulated DISC income as its subsidiary's DISC moves a greater percentage of its shipping activities into the State of New York. Conversely, the adjustment decreases the tax credit allowed to the parent for a given amount of its DISC's shipping activity conducted from New York as the DISC increases its shipping activities in other States. Thus, not only does the New York tax scheme 'provide a positive incentive for increased business activity in New York State,' but also it penalizes increases in the DISC's shipping activities in other States.[267]

Westinghouse, then, suggests that valid tax incentives may be distinguished from unconstitutional discrimination by determining whether interstate commerce is negatively affected. A tax incentive that does not penalize out-of-state activity presumably could withstand scrutiny under the commerce clause after *Westinghouse*. The Court indicated that a constitutional DISC credit could be drafted: "[I]t is not the provision of the credit that offends the Commerce Clause, but the fact that it is allowed on an impermissible basis, *i.e.*, the percentage of a specific segment of the corporation's business that is conducted in New York."[268] The Court further suggested that if the gross receipts factor were severed, the statute would be constitutional; the New York Court of Appeals adopted this remedy on remand.[269] There is, however, a problem with defining the breadth of the *Westinghouse* holding. Although severing the gross receipts factor saved the New York credit from being completely invalidated, this remedy raises an interesting issue regarding the constitutionality of tax incentives in general. The New York court's remedy left a DISC credit effectively granted without reference to New York activities. The United States Supreme Court did not indicate that New York's use of its more gen-

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266. *Id.* at 400-01.

267. *Id.* (quoting New York State Division of the Budget, Report on A.12108-A and S.10544 (May 23, 1972), *reprinted in* Bill Jacket of 1972 N.Y. Law, Ch. 778, at p. 18).

268. *Id.* at 406 n.12. *See also* Comptroller of the Treasury v. Armco, Inc., No. 85326007/C1-42988 (Md. Cir. Ct., April 29, 1986) (holding that Maryland's exemption of DISC dividends, when at least 50 percent of the net income of the DISC is subject to Maryland taxation, unconstitutionally discriminates against interstate commerce).

269. *See* Westinghouse Elec. Corp. v. Tully, 63 N.Y.2d 191, 470 N.E.2d 853, 481 N.Y.S.2d 55 (1984). *See also* Comptroller of the Treasury v. Armco, Inc., No. 85326007/C1-42988 (Md. Cir. Ct., April 29, 1986) (holding that principles of severability require that the unconstitutional flaw in the DISC exemption be eliminated so that dividends received from any DISC are exempt from Maryland tax, regardless of the amount of income of that DISC which is subject to Maryland taxation).

eral income allocation percentage created any constitutional problems, even though a taxpayer's New York DISC activities might incidentally affect this percentage. Other than this incidental effect, however, a taxpayer could obtain the same New York credit regardless of whether its DISC activities were related to New York.

If *Westinghouse* mandates the sort of neutrality whereby a tax incentive is permissible only if offered without reference to the taxpayer's in-state activities, many current state tax credits violate the commerce clause.[270] In rejecting New York's argument that its credit fostered export activities consistent with federal policies behind the DISC provisions and the commerce clause, the Court used language that suggested a very broad scope might be given to the concept of tax neutrality:

> Whether the discriminatory tax diverts new business into the State or merely prevents current business from being diverted elsewhere, it is still a discriminatory tax that "forecloses tax-neutral decisions and . . . creates . . . an advantage" for firms operating in New York by placing "a discriminatory burden on commerce to its sister States."[271]

Carried to its extreme, this line of analysis would invalidate any state tax incentive granted only with reference to in-state activities. In our survey of state tax incentives, most incentives clearly and explicitly were limited to in-state activities.[272] Moreover, in contrast to the finding of the New York Court of Appeals on remand in *Westinghouse*,[273] it would seem unlikely that many of the limitations on tax incentives to in-state activities would be found to be severable.[274]

Some commentators have suggested that the Court's reading of the commerce clause in *Westinghouse* signals a substantial limitation on the states' powers to offer tax incentives. For example, Professors Seago and Schell have suggested that after *Westinghouse* the Court may find that a state tax credit discriminates against interstate commerce "[i]f the induced or rewarded behavior relates to the conduct of business in the state."[275] Similarly, another commentator has concluded that the langnage of the

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270. *See supra* notes 255-58.

271. 466 U.S. at 406 (quoting *Boston Stock Exch.*, 429 U.S. at 331).

272. *See supra* notes 255-58.

273. Westinghouse Elec. Corp. v. Tully, 63 N.Y.2d 191, 470 N.E.2d 853, 481 N.Y.S.2d 55 (1984).

274. See *supra* note 258 for several examples of state tax statutes in which it would appear to be impossible to sever the in-state limitation from tbe remainder of the credit.

275. Seago & Scbell, *Tax Credits and the Commerce Clause After* Westinghouse Electric Corporation, 3 J. STATE TAX'N 101, 111 (1984).

Westinghouse opinion implies that an incentive is unconstitutional if it imposes higher taxes on out-of-state activities than on similar in-state activities. In other words, if the incentive results in higher effective tax rates on out-of-state investments or activities, the incentive is unconstitutional.[276] This interpretation of *Westinghouse* certainly is plausible in light of the Court's language and the remedy adopted by the New York appellate court on remand, the severance of the credit from any direct reference to New York activities.

Assuming, however, that the Court did not intend to invalidate the vast majority of state tax incentives, the DISC credit in *Westinghouse* must be distinguished from other tax incentives. A logical way to distinguish *Westinghouse* may be to focus on the negative effects of the New York DISC credit provision on interstate commerce. As explained earlier, the New York credit not only rewarded in-state activity, but also penalized out-of-state activity.[277] In contrast to New York's DISC credit, which the taxpayer's out-of-state activities negatively affected, a tax incentive could be designed without reference to out-of-state activities. For example, if an out-of-state business investing one million dollars in a state is entitled to the same investment credit that an in-state business would receive if it likewise decided to invest one million dollars in the state, and no reduction in the credit results from out-of-state investment, then the credit does not have a negative discriminatory impact on protected commerce.

The infirmity of the New York DISC credit was that once the taxpayer's tax base was determined, thereby arriving at an amount of income New York clearly had jurisdiction to tax, the state again looked outside the state through the gross receipts factor in determining the tax paid by the corporation. This resulted in penalties for out-of-state activities. In contrast, if the taxpayer's effective tax rate is determined solely with reference to in-state activities, there appear to be no negative effects on interstate commerce.

In addition to the absence of negative effects on interstate

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276. Michael, *supra* note 218, at 172.

277. *See supra* note 266 and accompanying text. Michael has suggested a similar analysis:

> If the U.S. Supreme Court does not wish to invalidate literally hundreds of state income tax credits, the distinction between a credit that *rewards* increases in in-state activity with lower effective tax rates and a credit that *penalizes* relative increases in out-of-state activity may provide a convenient basis for refusing to extend *Westinghouse*.

Michael, *supra* note 218, (emphasis in original).

commerce, there is another reason why it is difficult to find that a tax incentive focusing exclusively on a taxpayer's in-state activities discriminates against interstate commerce. Such an incentive provides the identical tax benefits for two taxpayers conducting the same activities in the state when one taxpayer also conducts interstate business. The taxpayer facing a higher effective tax rate in the state because it conducts the incentive-related activities outside the state is the one with a possible claim that it is being "discriminated" against because it is engaging in the creditable activity in another state. This taxpayer, however, will face significant obstacles in mounting a successful challenge to the incentive. First, this multistate taxpayer, in essence, is arguing that it has to pay a higher effective tax rate because the state's tax incentives do not apply to activities conducted outside the state. A taxpayer claiming that it faces a higher tax burden because it chooses to perform its activities outside the state must show that the source of the alleged multiple burdens is the state offering the incentive. This showing may be difficult. If the incentive is internally consistent so that no discrimination would exist if all the states offered the same incentive, then it may be impossible to show that the disparity created by the nonuniformity among the states' tax laws is caused by the state offering the credit rather than the state not offering the credit.[278]

2. Interstate Commerce vs. Foreign Commerce

Assessing the constitutionality of a statute that affects two types of protected commerce in different manners may be difficult. For instance, a tax statute could differentiate between interstate commerce and foreign commerce. The courts addressed this issue in the context of an old California ad valorem property tax statute that was repealed in 1981. The California statute exempted from property taxes two classes of goods: property produced outside the United States and brought into California for transshipment out of the state for sale, and goods brought into California from other states for transshipment outside the United States.[279] No exemption was allowed for goods produced in California to be shipped to other states or for goods brought into California from other states for shipment within the United States. Hence, the statute weighs against certain interstate commerce in favor of foreign commerce

278. *See supra* notes 195-201 and accompanying text.

279. *See* CAL. REV. & TAX CODE § 225 (West 1970) (repealed 1981). CAL. REV. & TAX CODE § 219 now exempts all business inventory from taxation.

and other interstate commerce.

The California statute has been challenged on commerce clause grounds several times in the past decade. The courts, however, have had difficulty in resolving the issue whether a state tax statute can prefer foreign commerce over interstate commerce.[280] In holding the exemption unconstitutional, the California Court of Appeals in 1978 reasoned that the commerce clause prohibits not only discrimination in favor of local commerce and against interstate or foreign commerce, hut also "discriminatory tax burdens which favor one class of commerce, subject to the control of Congress over another such class."[281]

Although one court of appeals had declared the exemption unconstitutional, the exemption remained in the California law, and only taxpayers in Los Angeles County were denied the benefit of the exemption.[282] In 1984 a taxpayer challenged the county's right to deny the benefit of the exemption.[283] Although the trial court held that the exemption was unconstitutional, the California Court of Appeals reversed and held that the exemption did not violate the commerce clause. In disposing of the discrimination issue, the court focused on the effect of the provisions on out-of-state taxpayers rather than on interstate commerce and avoided the issue of preferring foreign commerce over interstate commerce.[284] Thus, the court appears to have equated equal treatment of California and non-California taxpayers as equivalent to nondiscrimination against interstate commerce. According to the court, "It is essential to note that the ineligibility [for the property tax exemption] applies equally to California and non-California business entities."[285] Moreover, the court made no analysis of the comparative effects of the statute on interstate and foreign commerce. The

280. *See* Sears Roebuck & Co. v. County of Los Angeles, 85 Cal. App. 3d 763, 149 Cal. Rptr. 750 (Cal. Ct. App. 1978) (reversing decision of trial court and holding tax statute unconstitutionally discriminatory under the commerce clause); Sears Roebuck & Co. v. County of Los Angeles, 449 U.S. 1119 (1981) (The Supreme Court was equally divided with Justice Stewart not participating so that the decision of the California Court of Appeals invalidating the statute was summarily affirmed.); Star-Kist Foods, Inc. v. County of Los Angeles, 152 Cal. App. 3d 258, 199 Cal. Rptr. 440 (Cal. Ct. App. 1984) (The same district of the California Court of Appeals that decided *Sears Roebuck* reversed its decision and held that the statute was constitutional under the commerce clause.); Star-Kist Foods, Inc. v. Los Angeles, 42 Cal. 3d 1, 719 P.2d 897, 227 Cal. Rptr. 391 (1986) (Supreme Court of California held that the statute does violate the commerce clause).

281. *Sears Roebuck*, 85 Cal. App. 3d at 775, 149 Cal. Rptr. at 758.

282. *See Star-Kist Foods*, 152 Cal. App. 3d at 260 n.1, 199 Cal. Rptr. at 441.

283. *Id.*

284. *See id.* at 262, 199 Cal. Rptr. at 444.

285. *Id.*

court simply concluded that the provision "provides no advantage to local business; thus, we do not find the discriminatory effect which would constitute a violation of the commerce clause."[286]

The Supreme Court of California, however, recently has decided that the exemption from taxation provided under the California law does violate the commerce clause.[287] First, the court pointed out that the additional protection from state taxation afforded foreign commerce did not mandate such an exemption. The court then proceeded to identify the discrimination the exemption created. According to the court, the provision was unconstitutional because it discriminated against "a distinct class of interstate commerce" by exempting domestic corporations importing goods into the United States while taxing those domestic corporations operating exclusively within the United States.[288] The court thereby implied that foreign commerce cannot be favored over interstate commerce.

The courts' vacillation in determining whether a state tax may favor foreign commerce over interstate commerce reveals the complexity of this issue. On the one hand, it could be argued that the California exemption is constitutional under the commerce clause for the same reason that certain state tax incentive provisions are valid. In other words, it is possible to view the statute as providing a benefit to foreign commerce without burdening interstate commerce. As one commentator has pointed out, it is not clear that the statute actually burdens interstate commerce so as to have an impact on the flow or cost of goods remaining within interstate commerce.[289] Nevertheless, as the California Supreme Court opinion reveals, it is possible to view the statute as burdening interstate commerce. By virtue of the exemption, the price of foreign goods may be reduced below the price of comparable interstate goods, thereby discouraging the transshipment of interstate goods.[290] If this is the case, then it would appear impossible to avoid the issue whether the commerce clause prohibits preferential treatment of foreign commerce over interstate commerce or only prohibits preferential treatment of local commerce over either interstate or foreign commerce.[291]

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286. *Id.*

287. Star-Kist Foods, Inc. v. Los Angeles. 42 Cal. 3d 1, 719 P.2d 897, 227 Cal. Rptr. 391 (1986).

288. *Id.* at ______, 719 P.2d at ______, 227 Cal. Rptr. at 400.

289. *See* Case Note, *supra* note 3, at 836-40.

290. *Id.* at 837.

291. For a discussion of this issue, *see infra* notes 296-302 and accompanying text.

VI. Positive Effects on Local Commerce

Once a court determines that a state tax subject to commerce clause scrutiny causes disparate tax treatment that weighs against a protected class of commerce, it then must determine whether the tax statute benefits local commerce. Generally, when local commerce is involved, a negative effect on interstate or foreign commerce results in a benefit to competing local commerce. When the disparity involves a distinction between interstate and foreign commerce, however, then positive effects on intrastate commerce will not necessarily exist. In such cases it may be unclear whether the disparate tax treatment is unconstitutional.

A. *Protected Commerce vs. Local Commerce*

When disparate tax treatment burdens interstate and/or foreign commerce on the one hand and benefits intrastate commerce on the other hand, then clearly there is unconstitutional discrimination under the commerce clause. Burdens on interstate or foreign commerce and benefits to local commerce often are flip sides of the same coin. According to the Court in *Bacchus Imports, Ltd. v. Dias*,

> Virtually every discriminatory statute allocates benefits or burdens unequally; each can be viewed as conferring a benefit on one party and a detriment on the other, in either an absolute or relative sense. The determination of constitutionality does not depend upon whether one focuses upon the benefited or the burdened party. A discrimination claim, by its nature, requires a comparison of the two classifications, and it could always be said that there was no intent to impose a burden on one party, but rather the intent was to confer a benefit on the other.[292]

Frequently, then, the Court describes unconstitutional discrimination as a burden on interstate commerce with a resulting benefit to intrastate commerce. In *Northwestern States Portland Cement Co. v. Minnesota*[293] the Court stated that no state may "impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business."[294] Likewise, the Court in *Boston Stock Exchange* explained that the New York transfer tax was invalid because it "creates both an advantage for the exchanges in New York and a discriminatory burden on commerce to its sister States."[295] In short, dis-

292. Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 273 (1984).
293. 358 U.S. 450 (1959).
294. *Id.* at 458.
295. 429 U.S. at 331; *see also Westinghouse Elec. Corp.*, 466 U.S. at 399-401.

crimination against interstate or foreign commerce in favor of intrastate commerce clearly is the inequity that the commerce clause was designed to prevent.

B. Interstate Commerce vs. Foreign Commerce

It is unclear whether the commerce clause prohibits disparate tax treatment between interstate and foreign commerce. Clearly, foreign commerce is granted additional commerce clause protection.[296] The question remains, however, whether this additional protection afforded foreign commerce justifies a state tax, such as the California ad valorem property statute discussed above,[297] that benefits foreign commerce at the expense of interstate commerce.[298]

On the one hand, it can be contended that a state should be allowed to discriminate against interstate commerce in favor of foreign commerce. Arguably, disparity between interstate and foreign commerce is not the evil that the commerce clause generally is supposed to prevent. The commerce clause may be viewed as a protection from local biases against either interstate or foreign commerce. Thus, it can be concluded that not only negative effects on protected commerce, but also positive effects on local commerce are necessary to find a statute unconstitutional under the commerce clause.[299] Moreover, it can be said that the import-export clause demonstrates a constitutional preference for foreign commerce over domestic commerce.[300] Argnably, the *Japan Line* Court implicitly approved such a preference. By holding that the California ad valorem property tax was unconstitutional only as applied to instrumentalities of foreign commerce, *Japan Line* resulted in disparate tax treatment between interstate and foreign com-

296. *See* Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979).

297. *See supra* notes 279-288 and accompanying text.

298. It is also unclear whether a state tax provision can favor interstate commerce over foreign commerce. The additional protection afforded foreign commerce renders it unlikely that such a provision would be held constitutional.

299. *See* P. HARTMAN, 1985 SUPPLEMENT, *supra* note 9, at 20. According to Professor Hartman, "A tax is generally said by the Court to be discriminatory when the taxing State provides a commercial advantage to local business at the expense of out-of-state business." *Id.*; *see also* Brief for the United States as Amicus Curiae at 8, Sears Roebuck and Co. v. County of Los Angeles, 449 U.S. 1119 (1981).

300. *See* Brief for the United States, *supra* note 299, at 12. According to the Solicitor General, "[T]he decisions of this Court involving imports, exports and foreign commerce uniformly empbasize that one of the principal purposes of the Constitution was to assure that the states did not impede or obstruct importation, exportation, or foreign commerce." *Id.*

merce.[301] Under this analysis, it can be concluded that the other California ad valorem property tax statute discussed above which provided an exemption in favor of foreign commerce over interstate commerce is constitutional because the statute did not provide benefits to local commerce.[302]

On the other hand, it can be argued that a state tax statute that burdens interstate commerce should be held unconstitutional regardless of the fact that it benefits foreign commerce instead of local commerce. The prohibition of discrimination against interstate commerce always has been unqualified. Intuitively, the antidiscrimination principle operates as a check on state legislators' actions rather than as an inducement to action. Hence, the fact that a statute benefits foreign commerce should not obscure the fact that the statute burdens interstate commerce. Principle policy concerns served by the commerce clause are the promotion of a free trade unit among the states and noninterference by the states with the foreign policy of the nation. Allowing the states to prefer foreign commerce over interstate commerce conceivably could interfere with both of these aims.

VII. Effects of Other Laws

If a state tax statute subject to commerce clause scrutiny causes disparate tax treatment that burdens protected commerce and benefits local commerce, then the statute violates the commerce clause. This conclusion, however, may not necessitate invalidation of the state tax. It is possible that a federal statute may alter the commerce clause result. Also, the twenty-first amendment may override the commerce clause.

A. *Congressional Consent to State Tax Discrimination*

A conclusion that a state tax discriminates against interstate commerce may not invalidate the statute if Congress legitimizes the state action. The power of Congress over interstate commerce includes the authority to consent to state taxes affecting such commerce.[303] Congressional consent to state taxes that otherwise would

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301. *See id.* at 9. Of course the disparity between interstate and foreign commerce was not addressed by the Court in *Japan Line.*

302. For a discussion of this statute, *see supra* notes 279-288 and accompanying text.

303. *See* International Shoe Co. v. Washington, 326 U.S. 310 (1945) (holding that state unemployment tax applied to employers engaged in interstate commerce was valid because Congress had provided that the employer should not be relieved of such taxes on the ground that he is engaged in interstate commerce). According to the *International Shoe* Court, "It

be unconstitutional under the commerce clause is most prominent in the insurance tax field. In 1945 Congress enacted the McCarren-Ferguson Act, which provides, "The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business."[304] In *Prudential Insurance Co. v. Benjamin*[305] the Supreme Court held that a South Carolina statute that imposed a three percent tax on the premiums of insurance policies written by foreign insurance companies but that did not tax domestic insurance companies was not unconstitutional under the commerce clause because of congressional consent to such taxation in the McCarren-Ferguson Act. The McCarren-Ferguson Act also has been interpreted as allowing state retaliatory taxes on the insurance business that the commerce clause otherwise would prohibit.[306] Discriminatory state taxes on the insurance industry, however, may be susceptible to challenge on equal protection grounds.[307]

B. The Interplay Between the Commerce Clause and the Twenty-First Amendment

The twenty-first amendment grants the states the power to enact laws regulating commerce involving intoxicating liquors. According to section two of the amendment, "The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."[308] By granting the states power to regulate interstate commerce in intoxicating liquors while granting Congress the power to regulate interstate commerce in general, the Constitution creates a potential conflict.

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is no longer debatable tbat Congress, in the exercise of the commerce power, may authorize tbe states, in specified ways, to regulate interstate commerce or impose burdens upon it." *Id.* at 315.

304. 15 U.S.C. § 1012(a) (1982).

305. 328 U.S. 408 (1946).

306. Western & Southern Life Ins. Co. v. State Bd. of Equalization, 451 U.S. 648 (1981) (holding that retaliatory insurance taxes do not violate the commerce clause).

307. *See* Metropolitan Life Ins. Co. v. Ward, 105 S. Ct. 1676 (1985) (holding that domestic preference taxes on insurance premiums may violate the equal protection clause). For a discussion of this case, see *infra* notes 333-38 and accompanying text. *See also* Metropolitan Life Ins. Co. v. Commissioner of Dep't of Ins., 373 N.W.2d 399 (N.D. 1985) (holding that North Dakota domestic preference tax on insurance premiums violated the equal protection clauses of the federal and state constitutions); State v. American Bankers Ins. Co., 374 N.W.2d 609 (S.D. 1985) (holding that South Dakota tax provisions requiring unlicensed and unauthorized out-of-state insurers to pay a higher premium tax than domestic insurers violated equal protection clause).

308. U.S. CONST., amend. XXI, § 2.

The Supreme Court has faced the conflict between the twenty-first amendment and the commerce clause with varying results.[309] In *State Board of Equalization v. Young's Market Co.*[310] the Court found the twenty-first amendment to be controlling and upheld a California statute that imposed a license fee on the privilege of importing beer to any place in California. The Court noted that the fee would have been unconstitutional under the commerce clause prior to enactment of the twenty-first amendment.[311] Likewise, in *Hostetter v. Idlewild Bon Voyage Liquor Corp.*[312] the Court held that New York could not prevent the sale of liquor at in-state airports for delivery to international airline travelers because the liquor was not destined for use in New York. According to the Court, "[A] State is totally unconfined by traditional Commerce Clause limitations when it restricts the importation of intoxicants destined for use, distribution, or consumption within its borders."[313]

Despite these cases, the Supreme Court recently has stated that the twenty-first amendment "did not entirely remove state regulation of alcoholic beverages from the ambit of the Commerce Clause."[314] In *Bacchus Imports* the Court held that a Hawaii excise tax imposed on sales of liquor at wholesale that exempted certain locally produced beverages was unconstitutional. The Court reasoned that the Hawaiian statute violated the fundamental tenet of the commerce clause (promoting free trade among the states), but did not further the primary purpose of the twenty-first amendment (promoting temperance).[315] According to the Court, "State laws that constitute mere economic protectionism are therefore not entitled to the same deference as laws enacted to combat the perceived evils of an unrestricted traffic in liquor."[316]

Under *Bacchus Imports* it would appear unlikely that the twenty-first amendment could be used to alter the result of finding a state tax statute unconstitutional under the commerce clause. Generally, any state tax statute that discriminates against inter-

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309. *See* P. HARTMAN, 1985 SUPPLEMENT, *supra* note 9, § 2.19, at 43-58.

310. 299 U.S. 59 (1936).

311. *Id.* at 62.

312. 377 U.S. 324 (1964).

313. *Id.* at 330; *see also* Heublein, Inc. v. South Carolina Tax Comm'n, 409 U.S. 275 (1972) (holding that South Carolina regulation requiring out-of-state liquor manufacturers to do more than solicit sales in the state so as to render them susceptible to the state income tax does not violate the commerce clause).

314. *Bacchus Imports,* 468 U.S. at 275.

315. *Id.* at 275-76.

316. *Id.* at 276.

state commerce "constitute[s] mere economic protectionism" so that the Supreme Court would not view the twenty-first amendment controlling. The *Bacchus Imports* decision has been criticized, however. A vigorous dissent pointed out that the decision flies in the face of the Court's previous decisions involving the twenty-first amendment. According to the dissent, the majority's approach of looking at central purposes of the constitutional provisions was not only novel, but inapposite.[317] In addition, Professor Hartman has pointed out that the majority opinion is inconsistent with previous decisions. He suggests that *Bacchus* may have "sapped the objective vitality of the Twenty-First Amendment."[318]

VIII. Comparison of Other Restraints Against State Tax Discrimination

Although the commerce clause may be viewed as the most significant protection against discriminatory state taxes, other sources of protection may prove to be at least as important in certain cases. In addition to other federal constitutional provisions, various federal statutory and state constitutional provisions commonly are invoked as restraints against state tax discrimination. The discussion below briefly describes the salient features of these alternative protections and compares their application to that of the commerce clause.

A. *Federal Constitutional Provisions*

Apart from the commerce clause, the equal protection clause and the privileges and immunities clause are the most common federal constitutional provisions that taxpayers invoke to challenge allegedly discriminatory state taxes.[319] The potential application of other provisions, however, should not be overlooked. Indeed, these other provisions may be particularly useful in certain situations.

1. Equal Protection Clause

The equal protection clause provides that no state "shall deny to any person within its jurisdiction the equal protection of the laws."[320] Initially, it is interesting to compare the scope of pro-

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317. *Id.* at 278-87 (Stevens, J., dissenting).

318. P. Hartman, 1985 Supplement, *supra* note 9, § 2.19, at 57.

319. *See* Western & Southern Life Ins. Co. v. State Bd. of Equalization, 451 U.S. 648, 655-56 (1981) (insurance company without commerce clause or privileges and immunities clause protection challenged California "retaliatory" tax under equal protection clause).

320. U.S. Const., amend. XIV, § 1.

tected taxpayers under the commerce clause and the equal protection clause. Both provisions may generally be invoked to challenge corporate taxes. It is well settled that a corporation is considered a "person" within the meaning of the fourteenth amendment.[321] The equal protection clause, however, may be the strongest constitutional barrier to discriminatory entrance fees, because the commerce clause affords little protection to foreign corporations seeking to enter a state to conduct an intrastate business.[322]

Although the equal protection clause and the commerce clause both protect against discriminatory state taxation, there are some fundamental differences between these protections. Challenges to state tax discrimination under the commerce clause usually are more successful than challenges under the equal protection clause. The commerce clause unconditionally forbids state tax discrimination against interstate or foreign commerce. In contrast, the validity of a state tax statute under the equal protection clause generally will be determined under the same standard of rationality traditionally applied in evaluating other forms of state economic and commercial regulations. Under this rational basis test, a statute will be sustained if the state legislature reasonably could have concluded that the challenged classification would promote a legitimate state purpose.[323] If the purpose of a particular state tax is legitimate, an equal protection challenge will not prevail as long as the rational relationship question is at least debatable.[324]

In structuring internal taxation schemes, "the States have large leeway in making classifications and drawing lines which in

321. *Western & Southern Life Ins.*, 451 U.S. at 660-61 (holding a corporation to be a "person" entitled to equal protection); Southern Ry. v. Greene, 216 U.S. 400, 412 (1910) (holding that foreign corporation doing business in the state is a "person" entitled to equal protection of the laws).

322. *See* Atlantic Refining Co. v. Virginia, 302 U.S. 22 (1937) (holding that the commerce clause does not protect a foreign corporation from entrance fees); *see also* J. HELLERSTEIN, *supra* note 191, at 125. For a discussion of the constitutionality of entrance fees, see P. HARTMAN, *supra* note 17, § 11.3.

323. Exxon Corp. v. Eagerton, 462 U.S. 176, 195-96 (1983) (holding Alabama severance tax prohibiting tax pass-through and exempting royalty owners valid). State taxes that adversely affect a fundamental interest or contain a classification based on a suspect criterion may be subject to stricter judicial scrutiny.

324. *Western & Southern Life Ins.*, 451 U.S. at 674 (tax valid if legislature "rationally could have believed" tax would serve its objective); *see also* Regan v. Taxation with Representation of Washington, 461 U.S. 540, 547-48 (1983) (noting legislature's "especially broad latitude" in creating tax classifications); San Antonio Indep. School Dist. v. Rodriguez, 411 U.S. 1, 40-41 (1973) (requiring only "some rational relationship to legitimate state purposes").

their judgment produce reasonable systems of taxation."[325] Thus, when the public interest is served, a state may tax one business but not another in order to promote the one or to restrict or suppress the other.[326] Furthermore, a state "may impose different specific taxes upon different trades and professions and may vary the rate of excise upon various products."[327] A state need not "resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition, use or value."[328]

Although state tax statutes are not often invalidated on equal protection grounds, statutes that seek to benefit domestic industry by discriminating against foreign competitors have been struck down.[329] In this regard there may be some overlap between commerce clause and equal protection clause protection. The focuses of these two constitutional provisions, however, are different. The commerce clause is designed to protect commerce and to promote free trade among the states; it is not concerned with the treatment of individual taxpayers. The equal protection clause, on the other hand, protects individual taxpayer groups. Thus, statutes that discriminate against nonresidents are especially vulnerable to invalidation under the equal protection clause rather than the commerce clause. In a recent decision, *Hooper v. Bernalillo County Assessor*,[330] the Court invalidated a state property tax exemption limited to Vietnam veterans who had resided in the state prior to a certain date. The Court reasoned that the residency requirement bore no rational relationship to the state's asserted objectives.

The Court has indicated that it will examine the state's purpose in enacting a statute that is challenged under the equal protection clause as discriminating against out-of-state interests.

325. Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 359 (1973) (Illinois property tax classifying corporations differently from individuals held reasonable).

326. Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 512 (1937) (upholding Alabama act exempting particular classes of employers).

327. Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 527 (1959) (upholding Ohio's property tax exemption for nonresidents' goods held in Ohio warehouses).

328. *Id.*

329. *See, e.g.*, WHYY, Inc. v. Glassboro, 393 U.S. 117, 119 (1968) ("[W]hile a State may impose conditions on the entry of foreign corporations to do business in the State, once it has permitted them to enter, the adopted corporations are entitled to equal protection with the state's own corporate progeny."); Wheeling Steel Corp. v. Glander, 337 U.S. 562, 571-72 (1949) ("[A]s to taxation of intangibles . . . the federal right of a nonresident is the right to equal treatment."); Hanover Fire Ins. Co. v. Harding, 272 U.S. 494, 511 (1926) ("[T]he foreign corporation stands equal, and is to be classified with domestic corporations of the same kind."); Southern Ry. v. Greene, 216 U.S. 400, 417 (1910) (franchise tax not imposed upon domestic corporations).

330. 105 S. Ct. 2862 (1985).

Under equal protection analysis, as opposed to commerce clause analysis, a legitimate state purpose for the disparate tax treatment may save the statute. For example, in *Western & Southern Life Insurance Co. v. State Board of Equalization*[331] the Court sustained California's retaliatory insurance tax that discriminated against out-of-state insurers whose home states imposed higher premium taxes than California. The Court reasoned that California's legitimate purpose of promoting the interstate business of its domestic insurers by deterring other states from enacting excessive taxes satisfied equal protection requirements.[332]

In a more recent decision, *Metropolitan Life Insurance Co. v. Ward*,[333] the Court held that certain state goals did not justify Alabama's higher gross premiums tax on foreign insurers. The *Metropolitan Life* Court distinguished *Western & Southern Life Insurance Co.* on the ground that the Alabama statute was designed only to promote domestic insurance industry at the expense of out-of-state insurers, whereas California's purpose was to influence the taxing policies of other states.[334] The Court's holding indicates that under the equal protection clause, states may not discriminate in their taxing schemes against foreign corporations solely because they are nonresidents.

The Alabama statute's discrimination against out-of-state businesses clearly violates the commerce clause. The McCarren-Ferguson Act, however, removed the commerce clause barrier to state taxation of the insurance industry.[335] In rejecting the argument that this statute also immunized the Alabama tax from an equal protection clause challenge, the Court reasoned that "[t]he two constitutional provisions perform different functions in the analysis of the permissible scope of a State's power—one protects interstate commerce, and the other protects persons from unconstitutional discrimination by the States."[336] The Court determined that "[e]qual protection restraints are applicable even though the effect of the discrimination in this case is similar to the type of burden with which the Commerce Clause also would be concerned."[337] The Court's reasoning highlights the fundamental dif-

331. 451 U.S. 648 (1981).
332. *Id.* at 674.
333. 105 S. Ct. 1676 (1985).
334. *Id.* at 1681.
335. 15 U.S.C. §§ 1011-1015 (1982); *see Western & Southern Life Ins. Co.*, 451 U.S. at 655.
336. *Metropolitan Life Ins. Co.*, 105 S. Ct. at 1683.
337. *Id.*

ference between the two constitutional provisions:

> The Commerce Clause, unlike the Equal Protection Clause, is integrally concerned with whether a state purpose implicates local or national interests. The Equal Protection Clause, in contrast, is concerned with whether a state purpose is impermissibly discriminatory; whether the discrimination involves local or other interests is not central to the inquiry to be made. Thus, the fact that promotion of local industry is a legitimate state interest in the Commerce Clause context says nothing about its validity under equal protection analysis.[338]

The Court may be more lenient with respect to taxes that discriminate against residents. In these cases the commerce clause affords no protection, and the equal protection clause affords only limited protection. *Allied Stores of Ohio, Inc. v. Bowers*[339] involved a statute designed to encourage foreign companies to build warehouses in Ohio. The Court upheld the statute against a challenge by a domestic merchandiser on equal protection grounds. The discriminatory tax involved did not favor residents by burdening outsiders, but granted the nonresident an exemption that residents did not share. Further, because the foreign and domestic companies involved were not competing to provide warehousing services, granting the former an exemption did not adversely affect the domestic companies subject to tax.

2. Privileges and Immunities Clause

The privileges and immunities clause provides: "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States."[340] As opposed to the commerce clause, which provides protection to both individuals and corporations, corporations are not "citizens" protected by the privileges and immunities clause.[341] For purposes of analyzing a taxing scheme under the privileges and immunities clause, the terms "citizen" and "resident" are essentially interchangeable.[342] Thus, "a general taxing scheme . . . if it discriminates against all non-residents, has the necessary effect of including in the discrimination

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338. *Id.* at 1681 n.6.

339. 358 U.S. 522 (1959).

340. U.S. CONST. art. IV, § 2, cl. 1. The Fourteenth Amendment also contains a clause protecting the privileges and immunities of citizens. U.S. CONST. amend. XIV, § 1. This provision, however, does not provide any protection against discriminatory state and local taxation. *See* P. HARTMAN, *supra* note 17, § 4.1.

341. Hemphill v. Orloff, 277 U.S. 537, 548-550 (1928) (corporations not protected by privileges and immunities clause).

342. Austin v. New Hampshire, 420 U.S. 656, 662 n.8 (1975) (New Hampshire's income tax on nonresidents' in-state income held invalid).

those who are citizens of other States."[343]

Whereas the commerce clause primarily protects businesses operating in more than one state, the central concern of the privileges and immunities clause is to assure fair treatment of citizens of other states.[344] In *Toomer v. Witsell*[345] the Court invalidated a statute that required nonresident shrimp fishermen to pay an annual license fee of twenty-five hundred dollars per boat to fish in South Carolina's coastal waters, because residents were required to pay only twenty-five dollars per boat. In a concurring opinion Justice Frankfurter[346] argued that the South Carolina tax scheme did not violate the privileges and immunities clause because the state could reserve the shrimp for capture and consumption by its own citizens. Rather, because the state sought to reserve for its own residents the business of exporting shrimp in interstate commerce, Justice Frankfurter believed that the South Carolina statute violated the commerce clause. The significance of the majority's decision to rest the decision on the privileges and immunities clause, then, was that the state was required to treat nonresident fishermen equally with South Carolina fishermen, whether they operated in interstate commerce or restricted their business activity to catching and selling shrimp entirely within South Carolina's borders.

The privileges and immunities clause also protects a commuter who engages in intrastate commerce in a neighboring state from that state's discrimination in favor of its own residents.[347] In *Austin v. New Hampshire*[348] the Supreme Court held that a New Hampshire commuters income tax, which did not apply to residents, violated the privileges and immunities of Maine residents who worked in New Hampshire. The Court rejected New Hampshire's argument that because of the credit granted under Maine income tax law for income taxes paid to other states, there was no actual discrimination.

The *Toomer* Court observed that the privileges and immunities clause, like many other constitutional provisions, is not an ab-

343. Travis v. Yale & Towne Mfg. Co., 252 U.S. 60, 79 (1920) (New York income tax favoring residents over nonresidents held invalid).

344. Varat, *supra* note 87, at 499.

345. 334 U.S. 385 (1948); *see also* Mullaney v. Anderson, 342 U.S. 415 (1952) (higher license fee on nonresident than on resident fisherman held to violate the privileges and immunities clause).

346. *Toomer*, 334 U.S. at 408-09 (Frankfurter, J., concurring).

347. Varat, *supra* note 87, at 500-01.

348. 420 U.S. 656 (1975).

solute bar to differential treatment of residents and nonresidents. The privileges and immunities clause requires only that the state treat residents and nonresidents without unnecessary distinctions when a nonresident seeks to engage in an essential activity or exercise a basic right. It bars discrimination against citizens of other states only when there is no substantial reason for the discrimination beyond the fact that the taxpayers are citizens of other states.[349] Thus, the inquiry in each case is whether valid reasons exist for disparate tax treatment and whether the degree of discrimination bears a close relation to the justifications. In making this inquiry, courts are inclined to respect the principle that "[s]tates should have considerable leeway in analyzing local evils and in prescribing appropriate cures."[350]

In *Baldwin v. Fish & Game Commission of Montana*[351] the Court held that the privileges and immunities clause did not prevent Montana from imposing on nonresidents a hunting license fee at least 7.5 times as great as the fee charged residents because recreational elk hunting was not a fundamental right.[352] The Court, in thus limiting the applicability of the privileges and immunities clause, reasoned that the affected right did not bear "upon the vitality of the Nation as a single entity."[353] Thus, the state was merely required to justify the discrimination under the minimum rationality standard of review of the equal protection clause. In the view of one Supreme Court Justice, this standard allows a state to draw any distinction based on residence that is not totally arbitrary.[354]

3. Due Process Clause

The due process clause provides: "No State shall . . . deprive any person of life, liberty, or property, without due process of law . . . . "[355] A taxpayer typically will not raise a due process challenge to an allegedly discriminatory state tax because the principal

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349. Even a discriminatory statute will be upheld if the nonresidents "constitute a peculiar source of the evil at which the statute is aimed" and there is a "reasonable relationship" between that evil and the statutery discrimination against nonresidents. Hicklin v. Orbeck, 437 U.S. 518, 525-526 (1978) (holding Alaskan statute absolutely preferring residents over nonresidents for certain jobs to violate the privileges and immunities clause).

350. *See Toomer*, 334 U.S. at 396.

351. 436 U.S. 371 (1978).

352. *Id.* at 388.

353. *Id.* at 383.

354. *See id.* at 402-05 (Brennan, J., dissenting).

355. U.S. CONST. amend. XIV, § 1.

focus of the due process clause is jurisdiction to tax rather than fairness. Although due process challenges to state apportionment formulas might be viewed as involving claims of "discrimination," this Article rejects this view. Instead, we view discrimination as involving disparate tax treatment by one state between two taxpayers, whereas apportionment issues involve the taxation of one taxpayer by two or more states.[356] Moreover, the significance of the due process clause in regard to state tax issues other than the jurisdiction to tax is diminished because many due process challenges to a tax will be subsumed under other constitutional arguments.[357]

The due process clause places two restrictions on the power of states to tax income: first, there must be some "minimal connection" or definite link between the income generating activities and the taxing state; second, the income sought to be taxed must be reasonably related to the activities in the state.[358] These requirements of the due process clause overlap the commerce clause requirements of substantial nexus, fair apportionment, and fair relation to the services provided by the state.[359] The nexus requirement necessitates a showing that the taxpayer conducted activities in the state that gave rise to the taxable income.[360] The requirement of a reasonable relationship between the income sought to be taxed and the taxpayer's activities in the taxing state is essentially a measurement problem.[361]

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356. *See supra* notes 215-25 and accompanying text.

357. *See, e.g.,* Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 470 n.12 (1981) (validity of statute under equal protection clause precludes due process challenge); *Western & Southern Life Ins. Co.,* 451 U.S. at 656 n.7 (1980) (any due process argument is subsumed in the equal protection issue).

358. Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425, 436-37 (1980) (upholding income taxation of dividends from unitary foreign subsidiaries).

359. J. HELLERSTEIN, *supra* note 10, ¶ 4.8.

360. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959) (maintenance in a state of sales office that supports salesmen who solicit orders in the state, subject to acceptance and processing outside the state, is sufficient contact).

Apportionment of income that is not part of a unitary business carried on in a state is invalid under the due process clause. ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) (apportioning intangible income of subsidiary not connected with taxpayer's in-state operations held invalid); F.W. Woolworth Co. v. Taxation & Revenue Dep't, 458 U.S. 354 (1982) (same); Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980).

Federal law also limits the states' power to tax multijurisdictional corporations. 15 U.S.C. § 381 (1982).

361. Norfolk & Western Ry. v. Missouri State Tax Comm'n, 390 U.S. 317 (1968) (due process violation found in the application of single-factor apportionment formula to a particular taxpayer, but only when record contained calculations showing 300% overapportion-

4. Import-Export Clause

The import-export clause provides: "No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws . . . ."[362] The import-export clause thus contains an explicit limitation on the taxing powers of the states, in contrast to the commerce clause, which is a grant to Congress of the power to regulate commerce. The commerce clause restrictions on the states' taxing power are derived from the implication of congressional silence. Thus, Congress may remove all commerce clause restrictions by acquiescing to state taxing schemes,[363] but no comparable power is granted to Congress under the import-export clause. Congress must consent to particular state duties on imports or exports (except for those that may be absolutely necessary for executing the state's inspection laws), and the net produce of such duties and imposts must be for the use of the United States Treasury.[364]

Michelin Tire Corp. v. Wages[365] changed the focus of attention of the import-export clause cases from the nature of the taxed goods to the nature of the tax at issue. Prior to *Michelin Tire* the basic legal principle used to determine whether state exactions on imported goods were constitutionally permissible was the "original package" doctrine.[366] The *Michelin Tire* Court held that a state's

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ment); Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931) (there may be a constitutional problem with a State's apportionment formula when 15% of income had source in state but 83% taxed). *But see* Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978) (single-factor formulas upheld when taxpayer merely relied on general claims of burden and possible double taxation).

362. U.S. CONST. art. I, § 10, cl. 2.

363. *See supra* notes 303-07 and accompanying text.

364. J. HELLERSTEIN, *supra* note 10, ¶ 5.1.

365. 423 U.S. 276 (1976) (Georgia's assessment of a nondiscriminatory ad valorem property tax against imported goods that were no longer in import transit did not violate import-export clause, regardless of whether the goods had lost their status as imports by being mingled with other goods of importer).

366. Low v. Austin, 80 U.S. (13 Wall.) 29 (1871) (states prohibited by import-export clause from imposing a nondiscriminatory ad valorem property tax on imported goods until they have lost their character as imports and have become incorporated into the mass of property in the state). The *Austin* decision was based on the language of Chief Justice Marshall in *Brown v. Maryland*, 25 U.S. (12 Wheat.) 419, 441-42 (1827):

> It is sufficient for the present to say, generally, that when the importer has so acted upon the thing imported, that it has become incorporated and mixed up with the mass of property in the country, it has, perhaps, lost its distinctive character as an import, and has become subject to the taxing power of the State; but while remaining the property of the importer, in his warehouse, in the original form or package in which it was imported, a tax upon it is too plainly a duty on imports to escape the prohibition in the

nondiscriminatory ad valorem personal property tax was not the type of exaction that the framers of the Constitution considered as being an "impost" or "duty" and that such a tax was therefore not within the prohibition of the import-export clause. Instead, the import-export clause was designed to prohibit "discriminatory state taxation against imported goods as imports" and "transit fees on the privilege of moving [imports] through a state."[367]

In the wake of its *Michelin Tire* decision, the Court in *Department of Revenue of Washington v. Association of Washington Stevedoring Cos.*[368] upheld the State of Washington's business activities tax, measured by gross receipts, as applied to stevedoring that included the handling of goods destined for foreign commerce. Moreover, in *Limbach v. Hooven & Allison Co.*[369] the Court reiterated its abandonment of the "original package" doctrine, expressly overruling its 1945 decision involving the same parties.[370]

5. Supremacy Clause

The supremacy clause provides: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land . . . any Thing in the Constitution or laws of any State to the Contrary notwithstanding."[371] Under the supremacy clause a state tax statute that conflicts with a federal statute is unconstitutional.[372] Federal law may restrict state taxation of various aspects of interstate or foreign commerce. Thus, a state statute may be struck down under the supremacy clause as imposing undue burdens on interstate or foreign commerce. In *Aloha Airlines, Inc. v. Director of Taxation of Hawaii*[373] the Court invalidated a Hawaii gross receipts tax imposed on airlines, finding it preempted by the Airport Development Acceleration Act of 1973.[374] The Court rea-

constitution.

367. *Michelin Tire*, 423 U.S. at 286, 290.

368. 435 U.S. 734 (1978).

369. 466 U.S. 353 (1984).

370. The 1945 decision, *Hoover & Allison Co. v. Evatt*, 324 U.S. 652 (1945), held that the import-export clause barred Ohio's nondiscriminatory ad valorem property tax on imported goods stored in their original packages awaiting use in manufacturing.

371. U.S. CONST. art. VI, § 2, cl. 2.

372. Examples of cases involving overriding federal law are discussed *infra* notes 394-97 and accompanying text.

373. 464 U.S. 7 (1983).

374. 49 U.S.C. § 1513(a) (1976) (legislation prior to 1982 amendment that added § 1513(d)). For cases construing § 1513(d) of the Airport Development Acceleration Act, see

soned: "[W]hen a federal statute unambiguously forbids the States to impose a particular kind of tax on an industry affecting interstate commerce, courts need not look beyond the plain language of the federal statute to determine whether a state statute that imposes such a tax is preempted."[375]

Moreover, the supremacy clause extends beyond taxes that Congress has expressly prohibited or that are in direct conflict with federal law. State action that frustrates the purposes and objectives of federal law likewise violates the supremacy clause.[376] For example, in *McGoldrick v. Gulf Oil Corp.*[377] the Court held that a New York City sales tax imposed on sales of fuel oil to vessels engaged in foreign commerce was an infringement of congressional regulation of foreign commerce. In the recent case of *Wardair Canada, Inc. v. Florida Department of Revenue*,[378] however, the Court held that Florida's tax on aviation fuel used by foreign airlines in foreign air commerce did not violate the supremacy clause because there was no indication that Congress in enacting the Federal Aviation Act intended to preclude state sales taxation of airline fuel.[379]

Some state and local taxes have been held to be preempted by the federal ERISA statute.[380] Moreover, in *Exxon Corp. v. Hunt*[381] the Supreme Court held that federal Superfund legislation[382] preempted portions of New Jersey's spill fund tax.[383]

Under the supremacy clause states may not impose taxes whose legal incidence falls on the federal government, regardless of

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infra note 397.

375. 464 U.S. at 13.

376. J. HELLERSTEIN, 1985 SUPPLEMENT, *supra* note 117, ¶ 4.13[B], at S40; *see* Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947).

377. 309 U.S. 414 (1940).

378. 106 S. Ct. 2369 (1986).

379. *Id.*

380. 29 U.S.C. §§ 1001-104 to -106 (1982); *see, e.g.*, Northwest Airlines, Inc. v. Roemer, 603 F. Supp. 7 (D. Minn. 1984) (tax lien against monthly pension payments); General Motors Corp. v. California State Bd. of Equalization, 600 F. Supp. 76 (C.D. Cal. 1984) (insurance franchise tax using benefit plan payments as a means for measuring taxable insurance premiums); National Carriers' Conference Comm. v. Heffernan, 454 F. Supp. 914 (D. Conn. 1978) (Connecticut tax against benefits paid from ERISA-covered plan). *But see* Firestone Tire and Rubber Co. v. Bodle, (N.D. Ohio Aug. 1, 1985) (municipal income tax on employees income may include amounts contributed to ERISA-covered plan).

381. 106 S. Ct. 1103 (1986).

382. 42 U.S.C. § 9614 (1984), part of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) Pub. L. 96-510, 94 Stat. 2795.

383. New Jersey Spill Compensation and Control Act, N.J. STAT. ANN. §§ 58:10-23.11 to 58:10-23.11z (West 1982 & Supp. 1985).

whether the tax discriminates against the federal government.[384] States, however, may impose taxes whose economic burden falls on the federal government.[385] Nevertheless, states may not impose taxes that discriminate against the federal government or its instrumentalities, nor may states discriminate against those who deal with the federal government or its instrumentalities.[386]

In *Washington v. United States*[387] the Court held that because Washington's sales tax rate for federal and nonfederal contracts was the same and because the tax base was computed in a manner favorable to federal contractors, the tax did not discriminate against federal contractors. The test of discrimination as formulated in *Washington v. United States* is the economic burden of the tax and not the legal incidence. Thus, if the economic burden of the tax is no greater on transactions with the federal government than it is on comparable transactions in the private sector, the tax does not violate federal government immunity even though the legal incidence of the tax may fall differently on those who do business with the government and those who engage in private transactions.[388] One commentator has observed that the allegedly discriminatory tax on federal contractors in *Washington v. United States* was saved by the "complementary" exaction on private contractors.[389]

6. First Amendment

The first amendment provides: "Congress shall make no law . . . abridging the freedom of speech, or of the press."[390] The first amendment prohibition encompasses discrimination against the press in the form of state taxes.[391] Furthermore, state income tax

384. Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1954) (Arkansas gross receipts tax unconstitutional as applied against contractor acting as purchasing agent for federal government).

385. United States v. New Mexico, 455 U.S. 720 (1982) (holding that contractors as independent tax entities were not protected from state taxes by the supremacy clause); Alabama v. King & Boozer, 314 U.S. 1 (1941) (upholding application of state sales tax applied against contractor performing cost-plus building contract for federal government).

386. *See, e.g.*, Phillips Chem. Co. v. Dumas Indep. School Dist., 361 U.S. 376 (1960) (lessees of federally owned property taxed more heavily than lessees of state owned property).

387. 460 U.S. 536 (1983).

388. Warren, *Federal Immunity from State Sales Taxes*, in NYU SECOND ANNUAL INSTITUTE STATE & LOCAL TAXATION at 9-12 (1984).

389. W. HELLERSTEIN, *supra* note 167, at 423-25.

390. U.S. CONST. amend. I. The first amendment has been held applicable to the states by reason of the fourteenth amendment.

391. *See* Minneapolis Star and Tribune Co. v. Minnesota Comm'r of Revenue, 460

laws that grant tax benefits to parents of children attending parochial schools have come under attack as violating the first amendment establishment clause.[392]

B. *Federal Statutory Restrictions Against State Tax Discrimination*

Unlike commerce clause protection, which generally protects all forms of interstate commerce, federal statutory restrictions against state tax discrimination usually have been aimed at protecting taxpayers engaged in specified businesses. A number of state tax statutes have been found to violate the provisions of the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act),[393] which prohibits state tax discrimination against railroads. Many of the cases construing these provisions have involved disputes over the showing required of the railroad company to prove a statutory violation (for example, that its property has been assessed at a higher ratio to its true market value than other com-

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U.S. 575 (1983) (use tax imposed on paper and ink products used by certain newspapers was discriminatory against such publications); Grosjean v. American Press Co., 297 U.S. 233 (1936) (thirteen large metropolitan newspapers were subject to a two percent license tax on gross receipts derived from advertising; at least 124 Louisiana newspapers paid no such tax because the tax applied only if a newspaper's weekly circulation exceeded 20,000). *But see* Chicago Tribune Co. v. Johnson, 119 Ill. App. 3d 270, 456 N.E.2d 356 (1983), *aff'd*, 106 Ill. 2d 63, 477 N.E.2d 482, *appeal dismissed*, 106 S. Ct. 241 (1985) (rejecting claim that practice of granting manufacturers, but not the newspaper publisher, an exemption from a state use tax on machinery violated first amendment).

392. *But see* Mueller v. Allen, 463 U.S. 388 (1983) (sustaining Minnesota income tax provision that allowed a deduction for the costs of dependent students attending public or private elementary or secondary schools).

393. The operative provision of the 4-R Act, 49 U.S.C. § 11503 (1982), provides:

> The following acts unreasonably burden and discriminate against interstate commerce, and a State, subdivision of a State, or authority acting for a State or subdivision of a State may not do any of them:
>
> (1) assess rail transportation property at a value that has a higher ratio to the true market value of the rail transportation property than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction has to the true market value of the other commercial and industrial property.
>
> (2) levy or collect a tax on an assessment that may not be made under clause (1) of this subsection.
>
> (3) levy or collect an ad valorem property tax on rail transportation property at a tax rate that exceeds the tax rate applicable to commercial and industrial property in the same assessment jurisdiction.
>
> (4) impose another tax that discriminates against a rail carrier providing transportation subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title.

49 U.S.C. § 11503(b). *See generally* Benshoof, *Trial of a Tax Discrimination Case Under the 4-R Act*, NYU SECOND ANNUAL INSTITUTE STATE & LOCAL TAXATION § 20 (1984).

mercial and industrial property in the jurisdiction).[394] Other cases in federal and state courts have focused on the scope of a separate prohibition against nonproperty taxes that discriminate against railroads.[395]

Federal statutes patterned after the 4-R Act protect motor[396] and air[397] carriers against discriminatory state property taxes. Moreover, legislation now pending in Congress[398] similarly would limit the power of states to impose ad valorem taxes on interstate natural gas transmission property. Additional federal statutes prohibit discrimination against other types of taxpayers.[399]

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394. *See, e.g.,* Burlington N.R.R. v. Bair, 766 F.2d 1222 (8th Cir. 1985) (higher property tax rate applied to railroad property); Clinchfield R.R. Co. v. Lynch, 700 F.2d 126 (4th Cir. 1983) (railroad property value reassessed more frequently than other real property); Trailer Train v. State Bd. of Equalization, 697 F.2d 860 (9th Cir.) (higher property tax rate applied to railroad property), *cert. denied,* 464 U.S. 846, (1983); Arizona v. Atchison, T. & S. F. Ry., (9th Cir. 1983) (unreported), *cert. denied,* 465 U.S. 1084 (1984); Burlington N.R.R. v. Lennen, 715 F.2d 494 (10th Cir. 1983) (no statutory remedy for challenge of valuation method), *cert. denied,* 467 U.S. 1230, (1984); Burlington N.R.R. v. Department of Revenue of Wisconsin, 604 F. Supp. 1575 (W.D. Wis. 1985) (railroad property assessed at higher rate than other property).

395. *See, e.g.,* Richmond, F. & P. R.R. v. Department of Tax'n, 762 F.2d 375, 379 (4th Cir. 1985) (statute, "on its face, clearly and unambiguously prohibits all forms of discriminatory taxation of railroads"); Trailer Train v. Bair, 765 F.2d 744 (8th Cir. 1985), *cert. denied,* 106 S. Ct. 572 (1985) (Iowa railroad mileage tax on loaded train cars traveling through the state); Alabama Great S. R.R. v. Eagerton, 663 F.2d 1036 (11th Cir. 1981) (Alabama franchise tax on railroads measured by gross receipts from intrastate business); Kansas City S. Ry. v. McNamara, 563 F. Supp. 199 (M.D. La. 1983) (Louisiana gross receipts tax levied upon public utilities, including railroads); Atchison, T. & S. F. Ry. v. Bair, 338 N.W.2d 338 (Iowa 1983), *cert. denied,* 465 U.S. 1071 (1984) (Iowa special excise tax on railroads measured by amount of fuel consumption in state).

396. 49 U.S.C. § 11503a (1982) (prohibiting property tax discrimination against motor carriers). *See* Arkansas-Best Freight System, Inc. v. Lynch, 723 F.2d 365 (4th Cir. 1983) (requiring equal treatment of motor carrier and other property); Arkansas-Best Freight System, Inc. v. Cochran, 546 F. Supp. 915 (M.D. Tenn. 1982) (prohibiting discrimination against motor carriers in valuation methods).

397. 49 U.S.C. § 1513(d) (1982) (prohibiting property tax discrimination against air carriers). *See* Northwest Airlines, Inc. v. State, 358 N.W.2d 515 (N.D. 1984) (holding state's airline flight property tax preempted by § 1513(d)); Western Air Lines, Inc. v. Hughes County, S.D., 372 N.W.2d 106 (S.D. 1985), *prob. juris. noted,* 106 S. Ct. 1180 (1986) (state tax upheld); *see generally* Note, *Discriminatory Demands and Divided Decisions: State and Local Taxation of Rail, Motor, and Air Carrier Property,* 39 VAND. L. REV. 1107 (1986).

398. H.R. REP. No. 99-121, Part III, 99th Cong., 1st Sess. (1985).

399. 15 U.S.C. § 391 (1982) (discrimination against out-of-state purchases of electricity); 12 U.S.C. § 548 (1982) (discrimination against national banks); 12 U.S.C. § 1464(h) (1982) (discrimination against federal savings and loan associations).

C. State Constitutional Provisions

Provisions of the constitution of every state except Connecticut and New York require taxes to be uniform and/or equal.[400] Some "[s]tate constitutions require taxes to be both 'equal' and 'uniform,' or 'proportional' and 'uniform,' while others require only 'uniformity.'"[401] Other states require uniformity only within the classes of persons or property taxed.[402] These state uniformity provisions can be used to challenge disparate tax treatment by a state.

Unlike the commerce clause, state uniformity provisions do not focus on discrimination against interstate commerce. Instead, these provisions often are applied using the same standard applied under the equal protection clause.[403] Alternatively, some state courts have developed other standards.[404] Some uniformity requirements have been held not to apply to all types of state or local taxes. Generally, uniformity requirements are applicable to ad valorem property taxes. Hence, the uniformity provisions may provide protection against state tax discrimination that the commerce clause, which does not apply to ad valorem property taxes, generally does not reach.[405]

IX. Conclusion

This Article presents an analytical approach to state tax discrimination under the commerce clause. Under this approach one

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400. J. Hellerstein, *supra* note 10, ¶ 2.1; W. Newhouse, Constitutional Uniformity and Equality in State Taxation (2d ed. 1984).

401. J. Hellerstein, *supra* note 10, ¶ 2.1. Similarly, while some state constitutions require uniformity in the "rate" of taxation, others impose this requirement with respect to the rule of taxation. *See* 71 Am. Jur. 2d *State & Local Taxation* § 159 (1973).

402. *See, e.g.*, Sperry Corp. v. State Tax Comm'n, 695 S.W.2d 464 (Mo. 1985) (disparity in ratio of assessed value to true value between class comprised of real property and class comprised of tangible personal property not a violation of uniformity provision of Missouri constitution because disparity in valuations not on the same class of subjects, but between constitutionally established classes of property).

403. *See, e.g.*, State *ex. rel.* Tomasic v. Kansas City, 237 Kan. 572, 701 P.2d 1314 (Kan. 1985) (uniformity provision held "substantially identical" to equal protection principles). For a discussion of tbe standard under the equal protection clause, see *supra* notes 323-39 and accompanying text.

404. *See, e.g.*, Teter v. Clark County, 104 Wash. 2d 227, 704 P.2d 1171 (1985) (if taxation scheme is administered in systematic, nondiscriminatory manner, it meets requirements of the State of Washington's constitutional uniformity requirement).

405. *See* Colorado Dep't of Social Servs. v. Board of County Comm'rs, 697 P.2d 1 (Colo. 1985) (Colorado constitution's uniformity provision applies only to ad valorem property taxes); Belcher Oil Co. v. Dade County, 271 So. 2d 118 (Fla. 1972) (constitutional requirements of equality and uniformity in taxation not applicable to excise taxes). For a discussion of the scope of commerce clause protection, see *supra* notes 51-55 and accompanying text.

can determine whether a particular state tax unconstitutionally discriminates against interstate or foreign commerce by investigating the following six questions: (1) Is the state tax subject to commerce clause scrutiny? (2) Is there disparate tax treatment? (3) Is the inequality being challenged caused by the state tax statute? (4) Does the unequal treatment weigh against a protected class of commerce? (5) Does the unequal treatment weigh in favor of local commerce? and (6) Can any other law alter the result under the commerce clause?

The analytical approach developed in this Article is merely a starting point in the development of a complete framework for analyzing state tax discrimination under the commerce clause. Further study will, no doubt, suggest additional points, possible deletions, and alterations that should be made to the approach set forth here. Perhaps additional questions will have to be added to the six questions developed in this Article to analyze new issues involving state tax discrimination under the commerce clause. State tax discrimination under the commerce clause is a very complex concept, and any analytical approach to it will have to evolve along with the law on the subject.

Nonetheless, this Article should provide some guidance for state tax practitioners attempting to determine if a particular state tax provision discriminates against interstate or foreign commerce in violation of the commerce clause. After answering the six questions, the state tax practitioner should have a good idea whether the provision is unconstitutionally discriminatory under the commerce clause. It must be remembered, however, that other laws, including other constitutional provisions, may prohibit certain state tax discrimination. Thus, an analysis of state tax discrimination should begin, but not end, with the commerce clause inquiry.