State Taxation Under the Commerce Clause: An Historical Perspective

Jerome R. Hellerstein

VANDERBILT LAW REVIEW

VOLUME 29 MARCH 1976 NUMBER 2

SYMPOSIUM
STATE TAXATION OF INTERSTATE BUSINESS
Foreword
State Taxation Under the Commerce Clause: An Historical Perspective

*Jerome R. Hellerstein**

Although Congress has plenary power under the commerce clause to regulate state taxation of interstate commerce, that power remained virtually unexercised until 1959. As a consequence of the silence of Congress, the task of reconciling the competing interests of states, multistate businesses, and local businesses, and accommodating those interests to the needs of a national economy fell by default to the Supreme Court. The instrumentality available to the Court for dealing with the complex political, fiscal, and economic controversies inherent in state taxation of multistate business was the commerce clause (augmented by due process restrictions and, to a lesser extent, the equal protection clause).

I. Development of Judicial Commerce Clause Doctrine

The earliest Supreme Court decisions invalidating state taxes as violations of the unexercised power of Congress to regulate interstate commerce were handed down during the last quarter of the nineteenth century.[1] The doctrine developed during that era under the commerce clause created a tax haven for foreign corporations

* Adjunct Professor of Law, New York University. B.A., University of Denver, 1927; M.A., State University of Iowa, 1928; LL.B., Harvard University, 1931.

1. In preparing this brief survey of the Supreme Court's decisions on state taxation under the commerce clause, I have drawn on J. HELLERSTEIN, STATE AND LOCAL TAXATION: CASES AND MATERIALS 162-272 (3d ed. 1969) and J. Hellerstein, *State Franchise Taxation of Interstate Business*, 4 TAX L. REV. 95 (1948).

that conducted an exclusively interstate business, by freeing those corporations of some of the state franchise, license, gross receipts, and sales taxes imposed on intrastate businesses. The Court's approach to the commerce clause gave rise to tenets such as, "The conduct of interstate commerce may not be taxed by the states," and, "Direct taxes impose an undue burden on interstate commerce," and, hence, violate the commerce clause. The Court's decisions, however, did not debar the states from taxing the property of interstate businesses, including railroads, telegraph and telephone companies, and other instrumentalities of commerce, that used their property exclusively in interstate operations. Such levies were sustained as "indirect taxes," which do not impose an "undue burden" on commerce. Similarly, the states remained free to impose franchise or other excise taxes on manufacturing, producing, mining, and other businesses conducted within their borders, although those taxes were measured by gross receipts or net income derived from interstate sales. Such levies were regarded as being imposed on activities taking place before the commerce began, and the inclusion in the tax base of gross receipts or net income derived from interstate sales of a product created within the state, therefore, was held not to constitute a "direct tax" or an "undue burden" on the commerce.

This judicial approach to state taxation under the commerce clause predominated roughly from the post-Civil War period to the eve of World War Two. It spanned the era in which the infrastructure of the twentieth century American economy was being laid, with the building of the canals and railroads and the opening of the Midwest and Far West to settlement and trade, the creation of the vast American breadbasket for the burgeoning domestic population and world markets, and the industrialization of the United States. This approach remained the essential commerce clause jurisprudence during World War One and the post-war period, in which the United States emerged as a leading economic, military, and political world power.

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

It was not until the Great Depression and the rise of the new political liberalism that swept the country during the early Roosevelt administrations that a new approach to state taxation under the commerce clause was enunciated by the Supreme Court. In 1938 Mr. Justice Stone, the chief architect of the Court's new judicial philosophy, repudiated the tax-free haven approach to the commerce clause and interpreted that provision as forbidding discrimination against, or multiple taxation of, interstate commerce.[2] Under the multiple taxation doctrine, interstate businesses no longer were immune from taxation merely because the levy was imposed on interstate commerce, or on income or receipts from interstate transactions. Instead, such levies were regarded as invalid only if the Court thought they subjected interstate commerce to a risk of multiple taxation not borne by local commerce. As a consequence, the permissible area of state taxation was broadened. The Court approved levies on interstate businesses that were apportioned by methods it considered reasonably designed to measure the state's nexus with the receipts, income, or property taxed. Thus apportionment became one of the keys to the validation of state taxes. At the same time, as a natural result of its measuring the interstate or local nature of activities by the yardstick of multiple taxation, the Court narrowed the definition of an interstate business or transaction. Unapportioned levies that the Court found did not subject interstate commerce to the prohibited risks of multiple taxation increasingly were characterized as taxes on local incidents; levies that were found to run afoul of the multiple taxation test were proscribed as taxes on interstate transactions.

The liberalization of commerce clause restrictions on the states' taxing power reached a new milestone in 1959 when, in the *Northwestern States-Stockham Valves* cases,[3] the Court held for the first time, at least explicitly, that the commerce clause does not debar a state from levying a fairly apportioned net income tax on a foreign corporation that carries on exclusively interstate business in

2. Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938); *see* McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940).

3. Northwestern States Portland Cement Co. v. Minnesota, consolidated on appeal with Williams v. Stockham Valves & Fittings, Inc., 358 U.S. 450 (1959).

the state. The next year the Court upheld the power of a state to require out-of-state vendors, operating in the state only through independent contractors or brokers, to collect use taxes on shipments of goods to local customers.[4] These decisions probably reached the high-water mark of the liberalization of the power of the states to tax multistate businesses.

As is inevitable in dealing with important political and economic questions, with split decisions and changing courts, the multiple taxation doctrine did not achieve full sway. There were some reversions to the earlier approach. Thus, the Supreme Court has reaffirmed the highly conceptual distinction between a franchise tax, measured by apportioned net income, as applied to an exclusively interstate business, which it invalidated in *Spector Motor Service*,[5] and an apportioned direct net income tax, which it upheld in *Northwestern States-Stockham Valves*.[6] The Court also drew unrealistic lines between a tax levied by the state of destination on interstate sales, which it found to constitute an undue burden on interstate commerce, and the obligation of the interstate vendor to collect a use tax, which it found to impose no such burden.[7] Yet, an apportioned net income-based franchise tax and a sales tax levied by the state of destination involve no greater risks of multiple taxation than do the levies upheld by the Court. Neither of these regressions from the multiple taxation approach is of any great practical importance, however, because the states have ample power, by drafting their statutes as income and use taxes, to impose the taxes and collect the revenues at stake from multistate businesses.[8]

The emergence of the multiple taxation doctrine coincided with the recognition of the pressing need for congressional regulation of

---

4. Scripto, Inc. v. Carson, 362 U.S. 207 (1960).

5. Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602 (1951).

6. Northwestern States Portland Cement Co. v. Minnesota, consolidated on appeal with Williams v. Stockham Valves & Fittings, Inc., 358 U.S. 450 (1959).

7. General Trading Co. v. State Tax Comm'n, 322 U.S. 335 (1944); McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944).

8. There are, however, some practical differences between the franchise and income taxes. Business interests have been able to prevent a number of states from substituting direct net income taxes for their franchise taxes, or adding a so-called second-tier income tax to their franchise taxes. Moreover, under the intergovernmental immunities doctrine, the states are prohibited from applying their income taxes to interest from securities issued by the United States Government or its agencies, whereas the states are not barred from including in the measure of a tax on the privilege of doing business in the state (a typical type of franchise tax) interest from such securities. As a consequence, a foreign corporation that engages in an exclusively interstate business in a state but is taxable under the state's net income tax, escapes the state's tax on interest from United States securities. It is to preserve the tax on such interest that many states apply their franchise taxes, measured by net income, to corporations doing some intrastate business in the state, and the second-tier direct income tax to exclusively interstate businesses, which cannot otherwise be taxed.

state taxation of interstate commerce. Urging congressional action were Justices of such widely divergent commerce clause philosophies as Mr. Justice Frankfurter, the most eloquent spokesman for the tax-free haven approach, and Mr. Justice Rutledge, the leading exponent of the multiple taxation doctrine enunciated by Justice Stone.[9] As Professor Paul J. Hartman has argued persuasively in his writing, the institutional nature of a judicial tribunal and the constitutional inability of the Supreme Court under the commerce clause to do more than restrain undue state tax burdens on interstate commerce make the Court inherently incapable of dealing adequately with the complex problems posed by state and local taxation of multistate enterprises.[10] Congress, on the other hand, with its committees, staffs, and public hearings, can examine problems and develop solutions that it has the power to implement by legislation.

II. Congressional Response

The judicial plea for congressional action was not heeded until 1959, when the Supreme Court's decision in the *Northwestern States-Stockham Valves* cases triggered congressional response. Within seven months after the decisions came down, Congress broke its 170 years of virtual commerce clause silence by enacting Public Law 86-272, which prohibits the states from imposing net income-based taxes on foreign corporations engaging in interstate commerce if their operations within the state are confined to the minimal activities enumerated in the statute.[11] This jurisdictional restriction on state taxation, however, was of no great importance to most of the large multistate and multinational businesses whose effective lobbying efforts lay behind the enactment of the statute. Because of their sheer magnitude, these enterprises are compelled by business needs to maintain locations and employees in most of the states whose markets they exploit. Consequently, these corporations already were taxable under pre-multiple taxation era principles, so that Public Law 86-272 did little to immunize them

9. The opinions of the Justices calling for congressional action are cited in 1 Special Subcomm. on State Taxation of Interstate Commerce, House Comm. on the Judiciary, State Taxation of Interstate Commerce, H.R. Rep. No. 1480, 88th Cong., 2d Sess. 13 nn.22-27 (1964) [hereinafter cited as Willis Subcommittee Report].

10. P. Hartman, State Taxation of Interstate Commerce 275-85 (1953).

11. "Imposition of net income tax—Minimum standards," Pub. L. No. 86-272, 73 Stat. 555, 15 U.S.C. § 381 (1970). For a discussion of Pub. L. No. 86-272, see Hartman, *"Solicitation" and "Delivery" under Public Law 86-272: An Uncharted Course,* 29 Vand. L. Rev. 353 (1976).

from state income-based taxes. The *Northwestern States-Stockham Valves* decisions primarily affected middle-sized and smaller multistate businesses, and those businesses are the principal beneficiaries of the "minimal activities" jurisdictional limitations of the congressional act.

Spokesmen for big business nevertheless pushed the new legislation because they saw in it a chance later to win for themselves rewards greater than the "minimal activities" restrictions on state taxation. Public Law 86-272 was merely stop-gap legislation, in which Congress also directed its committees to study the overall problems of state taxation of interstate commerce and to make recommendations for more permanent legislation. Six years later, after an exhaustive survey, the Willis Subcommittee recommended stringent curbs on state income, capital stock, gross receipts, sales, and use taxes as applied to interstate commerce.[12] Since 1965, when these proposals first were introduced in Congress,[13] a stream of other measures designed to establish sweeping new federal restrictions on state taxation of interstate commerce has been introduced in each session of Congress, but no new legislation has been enacted. Let us note briefly the major proposals that the large multistate and multinational enterprises have been pressing Congress to adopt, which the states generally are vigorously opposing.[14]

---

12. WILLIS SUBCOMMITTEE REPORT.

13. H.R. 11,798, 89th Cong., 1st Sess. (1965).

14. The principal competing bills are the industry-supported S. 1245, 93d Cong., 1st Sess. (1973) (the Mathias bill), and S. 2092, 93d Cong., 1st Sess. (1973) (the Magnuson bill). *See* P-H STATE & LOCAL TAXES, ALL STATES UNIT ¶ 5000 *et seq.* The views of the spokesmen for various groups and others are set forth in *Hearings on Proposals Regarding State Taxation of Interstate Commerce Before the Subcomm. on State Taxation of Interstate Commerce of the Senate Comm. on Finance*, 93d Cong., 1st Sess. (1973) [hereinafter cited as *Mondale Committee Hearings*].

In 1975, Senator Mathias modified his proposed legislation by introducing a new bill, S. 2080, 94th Cong., 1st Sess. (1975), which would impose somewhat less stringent restrictions than S. 1245 on the powers of the states to tax interstate businesses. The major changes in the new bill affecting state net income-based taxes include: the adoption of the UDITPA "throwback" rule with respect to receipts from the sale of goods; an easing of the S. 1245 prohibition of state taxation of dividends to permit the states to tax dividends paid by subsidiaries that are less than 80% owned by their parents, if the underlying earnings of the payor corporation are derived from sources within the United States. S. 2080 makes a significant departure from Senator Mathias' earlier bill by authorizing combined reports at the option of either the state or the taxpayer, whereas S. 1245 prohibited the states from requiring combined reports, in the absence of a showing of distortion by non-arm's length dealings between affiliates. In this respect, S. 2080 has moved closer to the Magnuson bill, but retains the provision of S. 1245 excluding foreign source income from the apportionable income base, a restriction not contained in the Magnuson bill. It is to be observed, however, that neither the Magnuson bill nor S. 2080 treats as an affiliate, for purposes of combined reporting, a corporation substantially all of whose income is derived from foreign sources.

Under these business-sponsored proposals, dividends recieved from subsidiaries (fifty percent or more owned) and dividends that constitute foreign source income received from nonsubsidiaries would not be taxable by the states. Congress would prescribe uniform apportionment and allocation provisions that all states imposing taxes based upon income or capital stock would be required to permit multistate businesses to utilize, at their own election, as an alternative to any other methods used by the states to divide the tax base. Mandatory combined apportionment of the income of a taxpayer that is a component of a multicorporate unitary business would be precluded, but the state could make the combined approach elective with the taxpayer. The business-nonbusiness income distinction embodied in the Uniform Division of Income for Tax Purposes Act (UDITPA), under which dividends, interest, and other income from intangible property that constitute business income are apportioned under the formula, would be abolished; instead such income would be allocated to the state of the taxpayer's commercial domicile. The "throw-back" rule of UDITPA, which attributes to the state from which goods are shipped the receipts from sales to customers located in states in which the interstate vendor cannot be taxed, would be eliminated. The alternative "throw-out" rule proposed by the National Association of Tax Administrators for dealing with "no-man's land" income[15] also would be precluded. Foreign source income of the taxpayer (dividends from foreign sources, as indicated above, are dealt with separately) would be excluded from the taxable base.

III. THE MULTISTATE TAX COMPACT

In order to stave off what they fear will be crippling federal legislation that would give multistate businesses what the states regard as unwarranted tax privileges, and to offset the severe criticism levelled by the Willis Subcommittee against the widespread diversity in state apportionment and allocation methods, a group of states developed the Multistate Tax Compact, which became effective in 1967, on its adoption by seven states.[16] The Compact, *inter alia*, adopts UDITPA, one notable feature of which is the use of the sales destination test of attribution of receipts from sales of goods for purposes of the receipts factor. This test recognizes the claim of the states whose markets are exploited by interstate manufacturers and merchants to a share of income-based taxes. Professor Hartman

15. *Mondale Committee Hearings*, *supra* note 14, at 314.

16. The Multistate Tax Compact is printed in P-H STATE & LOCAL TAXES, ALL STATES UNIT ¶ 6310 *et seq.* and is included in this Symposium as an appendix to Note, *The Constitutionality of the Multistate Tax Compact*, 29 VAND. L. REV. 453 (1976).

has long been an eloquent spokesman for the claims of the market state and use of the sales destination test.[17] The Compact also relieves interstate vendors of irksome provisions affecting their obligation to collect sales and use taxes, and it provides for joint audits of multistate taxpayers. At the beginning of 1976, the Compact was in effect in twenty-one states.[18] It represents the most notable collaborative action in half a century of efforts to achieve substantial uniformity in apportionment and allocation of the income of multistate businesses, and it appeared to hold out great promise of significant reform of outmoded methods of tax administration, through joint audits of multistate enterprises.

The further spread of the Compact and joint auditing under its aegis, however, has been seriously hampered since 1972 by the bitter opposition of the larger multistate corporations. United States Steel Corporation and a number of other major corporations instituted a federal court suit in 1972 seeking to have the Compact declared unconstitutional and to enjoin joint audits. This suit and related actions in other federal and state courts have been dragging, and the *United States Steel* case has not, at this writing, been decided on the merits by the district court.[19] Whatever may be the outcome of the pending actions, the fate of the Compact and the joint audit program of member states ultimately may be decided by Congress. While a number of states have been trying to obtain the consent of Congress to the Compact, and thereby put an end to any doubts about its validity and, they hope, the constitutionality of the Multistate Tax Commission's joint audits, leading business organizations have been seeking legislation that would undermine or invalidate the Compact and prohibit joint audits.[20]

---

17. *See* Hartman, *State Taxation of Corporate Income from a Multistate Business*, 13 VAND. L. REV. 21, 43 (1959).

18. The member states are listed in P-H STATE & LOCAL TAXES, ALL STATES UNIT ¶ 5150. South Dakota is the most recent state to adopt the Compact; it will become a member effective July 1, 1976, making it the twenty-second full member. In 1975, however, the Compact suffered a loss when Illinois withdrew from the Compact. *See* Corrigan, *Interstate Corporate Income Taxation—Recent Revolutions and a Modern Response*, 29 VAND. L. REV. 423, 441 n.44 (1976).

19. United States Steel Corp. v. Multistate Tax Comm'n, No. 72 Civ. 3438 (S.D.N.Y., filed Sept. 17, 1972); opinion on motion to dismiss, 367 F. Supp. 101 (1973); opinions on motions in the case and in related cases in other states may be found in P-H STATE & LOCAL TAXES, ALL STATES UNIT ¶ 6617 *et seq.* For a brief discussion of this case, see Note, *The Constitutionality of the Multistate Tax Compact*, 29 VAND. L. REV. 453, 464 (1976). For a summary of the decisions to date relating to the Compact see Krol, *Taxpayers Balking at Submitting to Audits of Multistate Tax Commission*, 43 J. TAX. 364 (1975). A decision by the Washington Supreme Court since Krol's article has upheld the multistate audit provisions of the Compact in a case involving a tax measured by gross receipts, against challenges based on lack of congressional consent and on the equal protection and commerce clauses. Kinnear v. Hertz, 545 P.2d 1186 (Wash. 1976).

20. *See* notes 14 and 15 *supra*.

IV. THE SUPREME COURT'S ACTION SINCE 1959

In the meantime the business of the Supreme Court goes on, and it may be useful to turn to the course of its commerce clause decisions since Congress enacted Public Law 86-272. It is appropriate to begin a review of the decisions with the challenges made by some states to the constitutional power of Congress to restrict state taxation of interstate business. There was never any suggestion in these attacks that Congress could not *broaden* the powers of the states to tax interstate businesses, but it was argued that Public Law 86-272 was unconstitutional because Congress did not have the power to *narrow* state taxation. While the Supreme Court has not decided the question on its merits, the issue appears to have been put to rest, as a practical matter, by the Court's denial of certiorari in a Louisiana case and by decisions of the highest courts of Oregon and Missouri, which joined the Louisiana court in sustaining the power of Congress to restrict state taxation of interstate commerce.[21]

In 1972 the Court upheld airport user taxes in two cases that may fairly be regarded as overruling the century-old decision in *Crandall v. Nevada*.[22] In *Crandall* the Court had held that Nevada's one-dollar tax on every person leaving the state by railroad, stagecoach, or other vehicle employed in the business of transporting passengers for hire violated the commerce clause because it "may totally prevent or seriously burden all transportation of passengers from one part of the country to the other."[23] Coincidentally, the tax rates imposed in the two airport levies challenged in the recent cases were likewise one dollar per passenger emplaning at the Indiana airports on a commercial plane, and fifty cents to one dollar per passenger in the New Hampshire case (depending on the gross weight of the plane), although the tax burden in the *Crandall* case was, of course, much heavier in view of one hundred years of inflation of the dollar. Relying on a line of cases upholding taxes drawn as levies compensating the state for the use of interstate and intrastate transportation facilities, which the court found reasonable in

21. Mouton v. International Shoe Co., 379 U.S. 902 (1964), *denying cert. to* International Shoe Co. v. Cocreham, 246 La. 244, 164 So. 2d 314 (1964); State *ex rel.* CIBA Pharmaceutical Prod., Inc. v. State Tax Comm'n, 382 S.W.2d 645 (Mo. 1964); Smith Kline & French Laboratories v. State Tax Comm'n, 241 Ore. 50, 403 P.2d 375 (1965).

22. 73 U.S. (6 Wall.) 35 (1867); *see* Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines, Inc., 255 Ind. 436, 265 N.E.2d 27 (1970) (charge constitutes unreasonable burden on interstate commerce); Northeast Airlines, Inc. v. New Hampshire Aeronautics Comm'n, 111 N.H. 5, 273 A.2d 676 (1971) (charge constitutional). On a consolidated appeal, the Supreme Court reversed the Indiana decision and affirmed the New Hampshire decision. Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines, Inc., 405 U.S. 707 (1972).

23. 73 U.S. (6 Wall.) at 46.

amount and fixed according to uniform, fair, and practical standards, the Court upheld both airport taxes as reasonable amounts charged to defray the costs of building or maintaining the airport facilities used by the passenger.[24] Hence, one may regard the interment of *Crandall v. Nevada* as foreshadowed by decades of cases upholding highway and other tolls for the use of the state's transportation facilities in interstate traffic. In any event, this victory for the states in airport taxation was shortlived. In 1973, the year after the decisions came down, Congress, acting under its commerce clause powers, prohibited such levies.[25]

In *National Bellas Hess*[26] the Court held that a state cannot require an out-of-state mail order house that maintains no business locations, employees, or stocks of goods in the state to collect the state's use tax from local customers to whom it sold and shipped goods. This duty to collect was found to impose an undue burden on commerce and therefore was repugnant to the commerce clause. The decision was a serious setback to state and local governments since, as a practical matter, use taxes on most goods are largely uncollectible if the seller is not obliged to collect the tax for the taxing authority. A good deal of revenue is at stake in the out-of-state mail order business; sales and use taxes have increased rapidly in recent years as governmental expenditures have been expanding, and they are now the second largest source of state and local governmental revenues. Moreover, as sales and use tax rates have risen to between five and eight percent in a number of areas, the *National Bellas Hess* decision gives the out-of-state mail order vendor a substantial competitive advantage over local businesses, which tend to be smaller and weaker than many of their multistate competitors.[27]

In other aspects of state taxation under the commerce clause the Court has made no substantial departures from earlier decisions and no significant doctrinal changes. It has largely preserved the

24. Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines, Inc., 405 U.S. 707 (1972).

25. 49 U.S.C.A. § 1513 (Supp. 1976).

26. National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967).

27. In another use tax case, United Air Lines, Inc. v. Mahin, 410 U.S. 623 (1973), the Court sustained the Illinois use tax on the storage and withdrawal of aviation fuel from the airlines' storage facilities in the area of the O'Hare and Midway airports. The taxed fuel was stored in the airport facilities for a period of 2 to 12 days and was withdrawn for use in interstate flights. The Court rejected the airline's contention that it should reconsider and overrule Edelman v. Boeing Air Transp., Inc., 289 U.S. 249 (1933), a case virtually on all fours with United's case, in which a use tax had been upheld. Amici briefs argued that *Edelman*, which represented "a high-water mark in the Court's search in the early thirties for formulas that would assist states in finding additional sources of revenue," had outlived its usefulness. *See* 410 U.S. at 629 n.6.

status quo ante with respect to the delineation of the local activities by an out-of-state manufacturer shipping goods to local customers that give a state jurisdiction to impose a "doing-business" tax.[28] The Court also has reaffirmed the power of a state to levy a franchise tax, measured by apportioned capital stock, on a foreign corporation operating an interstate pipeline in the state.[29] The Court has continued to fractionate the stream of commerce by separating out, as locally taxable events, activities immediately preceding the commerce, although an integral part of it. Thus, in sustaining an Alaska license tax measured by the value of fish caught in the state's territorial waters by the taxpayer's "catcher boats," which loaded their catch onto freezer ships located within and without the state's waters for transportation to canneries in the State of Washington, the Court held that a local activity, separable from interstate commerce, was being taxed.[30] In deciding a property tax case involving unapportioned taxes on railroad rolling stock, the Court also continued its earlier practice of hinging the determination on a decision of the elusive question as to whether railroad cars have acquired a situs outside the state of the railroad's commercial domicile.[31]

Historically, the Court has been zealous to strike down under the commerce clause state taxes that discriminate against interstate commerce, no matter how artfully drawn to disguise the discrimination. The Court followed that tradition in a 1963 decision in which

28. Standard Pressed Steel Co. v. Washington Dep't of Revenue, 419 U.S. 560 (1975). Pub. L. No. 86-272 was inapplicable to the case because tbe tax was measured by gross receipts, not net income. This case and Colonial Pipe Line Co. v. Traigle, 95 S. Ct. 1538 (1975), are considered at length in W. Hellerstein, *State Taxation of Interstate Business and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline*, 62 VA. L. REV. 149 (1976).

29. Colonial Pipe Line Co. v. Traigle, 95 S. Ct. 1538 (1975). On its facts, this case is essentially a counterpart to Memphis Natural Gas Co. v. Stone, 335 U.S. 80 (1948), and it could readily have been disposed of merely by citing that case. The *Colonial* case had excited considerable interest when the Supreme Court noted probable jurisdiction because the statute involved in the case was drawn as a tax on the privilege of doing business in corporate form. The state court, in upholding the levy, distinguished the *Spector* case, 340 U.S. 602 (1951), on the ground that a tax on the conduct of business in corporate form is not a tax on doing business, but instead is a levy on the exercise of corporate franchises. This piece of unrealistic reasoning offered the Supreme Court an opportunity, if it so chose, to overrule the much criticized *Spector* doctrine in affirming the state court's decision. The Court, however, did not so choose. Instead, in a fuzzy opinion, it failed to overrule *Spector*, but it gave some support to the state court's distinction between a tax on doing business and a tax on doing business in corporate form and then went on to rest its decision on the *Memphis* case and on other special facts in *Colonial*. For a detailed critical analysis of the *Colonial* case, see W. Hellerstein, *supra* note 28.

30. Alaska v. Arctic Maid, 366 U.S. 199 (1961). *See also* Dunbar-Stanley Studios, Inc. v. Alabama, 393 U.S. 537 (1969).

31. Central R.R. v. Pennsylvania, 370 U.S. 607 (1962).

it set aside a Louisiana use tax as discriminatory because the tax was applied to an out-of-state taxpayer's labor and shop overhead costs of manufacturing specialized equipment that was brought into the state for use in the taxpayer's operations. These costs would have been excluded from the tax base of the sales and use taxes had the taxpayer manufactured the equipment in Louisiana.[32]

Apportionment, allocation, and other methods of dividing tax bases among the states, particularly the methods used in net income and gross receipts tax measures, have become the focal points of major controversies between the states and multistate and multinational businesses. The vigorous and highly competent California Franchise Tax Board has been largely responsible for developing a sweeping concept of the scope of the unitary business and has succeeded in obtaining judicial imprimatur for its approach from the California courts, and to some extent, from the Supreme Court of the United States.[33] The broad judicial delineation of the unitary business was developed principally in cases involving single corporations conducting multistate business through divisions or branches. Thereafter the unitary business principle was extended to multistate enterprises operating through a multicorporate structure. This was a sensible, and indeed, an essential step, since the unitary business apportionment concept is based on an economic approach that ought not be avoided by the technical niceties of legal distinctions between controlled subsidiaries and divisions or branches.[34] California's combined income approach to unitary enterprises organized under a corporate umbrella has spread to other states, and it is gaining new impetus under the aegis of the Multistate Tax Commission.[35]

---

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

33. *See* John Deere Plow Co. v. Franchise Tax Bd., 38 Cal. 2d 214, 238 P.2d 569 (1951), *appeal dismissed*, 343 U.S. 939 (1952) (dismissed for want of a substantial federal question); Edison Cal. Stores, Inc. v. McColgan, 176 P.2d 697, *aff'd on rehearing*, 30 Cal. 2d 472, 183 P.2d 16 (1947); Butler Bros. v. McColgan, 17 Cal. 2d 664, 111 P.2d 334 (1941), *aff'd*, 315 U.S. 501 (1942); Chase Brass & Copper Co. v. Franchise Tax Bd., 10 Cal. App. 3d 496, 95 Cal. Rptr. 805, *appeal dismissed*, 400 U.S. 961 (1970) (appeal was dismissed for want of jurisdiction; treating the papers as a petition for writ of certiorari, certiorari was denied).

34. Edison Cal. Stores, Inc. v. McColgan, 30 Cal. 2d 472, 183 P.2d 16 (1947). This matter is considered in Hellerstein, *The Unitary Business Principle and Multicorporate Enterprises: An Examination of the Major Controversies*, 27 TAX EXEC. 313 (1975), and Hellerstein, *Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business*, 21 NAT'L TAX J. 487 (1968). For differing views see Miller, *State Income Taxation of Multiple Corporations and Multiple Businesses*, in TAXATION OF INTERSTATE BUSINESS (Tax Foundation Inc. publ. 1970), and Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 TAX L. REV. 171 (1970).

35. *See* Peters, *Use of Combined Reporting Required by Increasing Number of States*, 41 J. TAX. 375 (1974).

A challenge to the California rules was presented to the Supreme Court in 1970 by a subsidiary of Kennecott Copper Corporation. The subsidiary appealed a decision of the California courts affirming a franchise tax assessment based on the determination of the taxpayer's California taxable income under an apportionment applied to the combined net income and apportionment factors of the Kennecott unitary business. The company attacked the constitutionality of the assessment under both the commerce and due process clauses. The Supreme Court rejected the taxpayer's petition, which was supported by briefs amici of the tax spokesmen for the major multistate corporations, by dismissing the appeal for want of jurisdiction.[36]

Two years later Kennecott Copper Corporation, the parent company, appealed to the Supreme Court from a decision by Utah's highest court holding that the tax commission of that state could tax Kennecott on a nonunitary, separate accounting basis; the assessment at issue in effect treated one division of Kennecott as the Utah taxpayer.[37] The taxpayer vigorously argued that it was being whipsawed by the inconsistent treatment accorded it by Utah and California. This time, surprisingly, the State of California joined business organizations by filing a brief amicus, urging the Court to hear the case and reverse the Utah court. Nevertheless, the Supreme Court refused to take the case.[38]

Confiicting methods of division of income or other tax bases that result in taxation of more than one hundred percent of the base are inequitable and oppressive to multistate taxpayers. Diversity in state or local tax apportionment, which often results in overall undertaxation of an enterprise, is likewise unfair to the governments and oppressive to competitive intrastate businesses. Nevertheless, the Supreme Court consistently had taken the position, long before 1959, that it is beyond its constitutional province to prescribe methods of dividing income or other tax bases for the states, and that diverse and conflicting methods of apportionment, mischievous though they be, do not violate the commerce clause or the due process clause, so long as each state's method, considered on its own merits, is not repugnant to the Constitution. In my judgment, the Court is on solid constitutional ground and is eminently wise in holding to this position. Unless adequate collaborative action is

36. Chase Brass & Copper Co. v. Franchise Tax Bd., 400 U.S. 961, *dismissing mem.* 10 Cal. App. 3d 496, 95 Cal. Rptr. 805 (1970).

37. Kennecott Copper Corp. v. State Tax Comm'n, 27 Utah 2d 119, 493 P.2d 632 (1972).

38. 409 U.S. 973 (1972). Presumably, California's action was taken in an effort to safeguard, or perhaps strengthen, that state's unitary apportionment approach.

taken by the states—perhaps along the lines of the Multistate Tax Compact—to achieve substantial uniformity in the division of the net income and other measures, this is an area that calls for congressional regulation. The courts cannot do the job; only the states and Congress are equipped to develop and administer workable policies.

Whether a particular state apportionment or allocation method or formula is inherently extraterritorial or by its nature imposes undue burdens on interstate business, or whether the application of a state apportionment formula to a particular taxpayer results in a capricious misattribution of the income or other base to the state, taxes extraterritorial income, or unduly burdens commerce—these are questions of a different order, to which the Court has responded. During the last quarter of the nineteenth century and the early part of the twentieth century, the Court invalidated tax apportionments in a number of railroad, express, and pullman car company cases. The Court, however, seldom has taken such action in more recent years. In 1931, in *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*,[39] the Court did set aside as unconstitutional a state income tax apportionment made against a manufacturer. That taxpayers face a seldom surmountable burden in overcoming the presumption of the validity of state apportionment, and that the courts are reluctant to disturb administration by state tax administrators of modern, multifactor apportionment formulas, is amply attested by the fact that *Hans Rees' Sons* stands alone in its class. The Court has never again invalidated a state tax apportionment of a corporate income tax, or a franchise tax based on net income, of a manufacturing or mercantile company. Indeed, the taxpayer in *Hans Rees' Sons* was never actually put to the proof of its case because of the procedural posture in which the case arose.

In light of this chariness in disturbing state tax apportionment, two recent decisions of the Court suggested, at least to this Supreme Court watcher, that a "shift may be taking place in the Court's policy of some four decades standing, of virtually abstaining from interfering in apportionment methods applied by the states in taxing businesses engaged in interstate commerce."[40] One of these decisions was a railroad property tax case, in which the Court concluded that the state had violated both the commerce and due process clauses in attributing the taxpayer's rolling stock to the

39. Hans Rees' Sons, Inc. v. North Carolina *ex rel.* Maxwell, 283 U.S. 123 (1931).

40. *See* Hellerstein, *Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business, supra* note 34.

state under the state's rail mileage method of apportionment.[41] The other case invalidated the use by the District of Columbia of a single factor sales receipts formula in determining the net income of General Motors Corporation attributable to the District. The company's sales receipts grew out of its sale to local dealers of motor vehicles and parts, all of which had been manufactured outside the District.[42] Although due process and commerce clause objections were raised by the taxpayer in challenging the formula, the Court rested its decision invalidating the formula on the narrower ground that the District Tax Commissioner was authorized by statute to prescribe only methods of apportionment that determined the "portion of the net income of the corporation . . . fairly attributable to . . . trade or business carried on . . . within the District."[43] Nevertheless, because this is essentially a due process-commerce clause standard and the Court discussed extensively its earlier decisions dealing with the constitutional aspects of apportionment, the *General Motors* opinion appeared to have broader significance. Moreover, in earlier cases broadening the power of the states to tax, the Court had made equitable division of the tax base the keystone to the elimination of multiple taxation, so that one might have expected the Court to scrutinize apportionment with a more critical eye than it had during earlier periods when the limitations on state taxation of interstate business had been more restrictive.

That expectation has not been fulfilled, at least up to this point; there has been no discernible toughening of the Court's policing of state tax apportionment or allocation. Instead, during the 1975 term, the Court, in an uncritical and pedestrian opinion in the *Standard Pressed Steel* case, followed pre-*General Motors* decisions in upholding the validity of the State of Washington's privilege tax on doing business, which is measured by gross receipts, despite the fact that the tax was applied to the entire receipts from sales to local customers of goods manufactured outside the state.[44] This decision and its precursors reach strange results from both a fiscal and a constitutional viewpoint. Judged as obstacles to commerce, taxes based on gross receipts are substantially more burdensome than levies based on net income, since the former are payable regardless of whether the taxpayer's operations are profitable, a factor that the Court has taken into account in weighing burdens on interstate

41. Norfolk & Western Ry. v. Missouri St. Tax Comm'n, 390 U.S. 317 (1968).
42. General Motors Corp. v. District of Columbia, 380 U.S. 553 (1965).
43. *Id.* at 554.
44. Standard Pressed Steel Co. v. Washington Dep't of Revenue, 419 U.S. 560 (1975).

commerce.[45] Moreover, it is likely, in this writer's view, that if the tax at issue in *Standard Pressed Steel* had been measured by the entire net income, instead of the gross receipts derived from sales to local customers, the tax would have been invalidated. The decision is explicable, although by no means justified, by the Supreme Court's confusion of the State of Washington's manufacturers and wholesalers turn-over, cascade tax with a retail sales tax. This confusion apparently arose because the measure of the Washington tax at issue in the *General Motors* and *Standard Pressed Steel* cases was the same as that of retail sales taxes—gross receipts from sales.[46]

V. Conclusion

One can fairly conclude from a review of recent decisions that the intervention by Congress in state taxation of interstate commerce, as reflected by Public Law 86-272, has not resulted, up to this point, in significant change in the Supreme Court's role in the area of state taxation of interstate commerce. As the *National Bellas Hess* and airport tax cases indicate, the Court is still prepared, as it has been historically, to delineate the jurisdictional limitations on the power of the states to tax interstate commerce. The Court appears to be at home with such problems. When, however, it is confronted with highly technical and complex apportionment, allocation, separate accounting, unitary business, combined report, and similar problems, for which diverse solutions appear reasonable, the Court appears to recognize that these questions are beyond its capabilities. Hence, except in flagrant cases like *Norfolk & Western Railway*[47] and *General Motors*[48]—cases in which, as Professor Thomas Reed Powell liked to put the matter, tax administrators had "gone beyond the bounds of decency"—the Court has been in the past, and continues to be, unwilling to intervene. That these issues ought to be resolved by the experts in the field, tax administrators acting under legislative standards, and not by the Supreme Court acting under the vague and general language of brief clauses

45. *See* Northwestern States Portland Cement Co. v. Minnesota and Williams v. Stockham Valves & Fittings, Inc., 358 U.S. 450, 466 (1959) (Harlan, J., concurring); United States Glue Co. v. Town of Oak Creek, 247 U.S. 321, 327-29 (1918).

46. See the Court's reliance on Norton Co. v. Department of Revenue, 340 U.S. 534 (1951), a retail sales tax case, in Standard Pressed Steel Co. v. Washington Dep't of Revenue, 419 U.S. 560 (1975), and in General Motors Corp. v. Washington, 377 U.S. 436 (1964), which involved the Washington business activities tax at issue in *Standard Pressed Steel.* See also Mr. Justice Brennan's dissent from the taxation by the state of the unapportioned gross receipts in General Motors Corp. v. Washington, 377 U.S. 436, 449 (1964), and the critical comments on *Standard Pressed Steel* in W. Hellerstein, *supra* note 28.

47. Norfolk & Western Ry. v. Missouri St. Tax Comm'n, 390 U.S. 317 (1968).

48. General Motors Corp. v. District of Columbia, 380 U.S. 553 (1965).

in the Constitution, is the real meaning behind the heavy burden that taxpayers challenging the validity of state tax apportionment or allocation must carry. Moreover, as the Court has made clear, taxpayers are not without remedy; they have taken their appeals to the wrong chamber of government; their appeals ought to be to Congress, which has both the constitutional powers and the institutional facilities to remedy their ills.

What are likely to be the next steps in the enactment of federal legislation regulating state taxation of interstate commerce? The New Federalism espoused by the Nixon and Ford administrations, whose key postulate is the need to redistribute power from the national to state and local governments, has created an inauspicious climate of opinion for enacting further restrictions on state and local taxing powers. Moreover, the growing disenchantment with the role of big business in our economy militates against new legislation that would be likely to reduce the state and local taxes of the largest and most powerful corporations in the country, particularly at a time when state and local governments are sorely pressed for new revenues. These factors, however, may not have much influence on congressional action. The delineation of the states' jurisdiction to tax out-of-state enterprises and the prescription of apportionment and allocation rules are too technical and complex to excite public interest. Besides, the issues can easily be obfuscated by the public relations arms of the various interested groups. Consequently, any new federal legislation that may emerge may be determined more by the sheer political muscle of the groups with a direct stake in the matter than by a rational resolution of the legitimate positions of the state and local governments, multistate business, and its local competitors. With memories fresh in mind of Watergate exposures of large political contributions, legal and illegal, and the current revelations of massive bribes made by the blue chips of American multistate and multinational corporations to obtain contracts from foreign governments, one is left with the uneasy feeling that a congressional remedy of state tax ills may prove worse than the disease. The risk of such a denouement of the ten-year stalemate in congressional legislation regulating state taxation of interstate commerce may turn out to be the most persuasive argument for a continuation of the impasse, until such a time as, hopefully, conditions may be more hospitable to legislation drawn in the public interest.