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State Taxation of Interstate Commerce

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With these adjustments, together with the increasing willingness of the courts to experiment in solving union controversies, the Southern jurisdictions appear equipped to assume their responsibilities in this sphere of the development of the industrial South.

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STATE TAXATION OF INTERSTATE COMMERCE: CONSTITUTIONALITY OF NET INCOME TAX ON OUT-OF-STATE CORPORATIONS

In *Northwestern States Portland Cement Co. v. Minnesota*,[1] the Supreme Court recently granted states the broad power to tax earnings of out-of-state corporations from business done within each state. Justice Clark, speaking for the majority, laid down the doctrine that "the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs."[2] The purpose of this note is to analyze the doctrine, its background and possible economic consequences.

bers of Labor Organizations." The amendment declares that no labor union shall limit the right of any member to seek redress in any court or administrative agency, provided that the member exhausts reasonable internal procedures which do not exceed a six-month lapse of time from the date they are initiated. Since this provision is patently intended to apply to state as well as federal courts, its enactment into law would accomplish the reform suggested above, with the added advantage of providing a standard procedure in all courts. Labor-Management Reporting and Disclosure Bill of 1959, S. 1555, 86th Cong., 1st Sess. § 101(a)(4) (1959).

This amendment to the original Kennedy bill also provides: Members are assured equal rights of participation in union affairs § 101(a)(1). Members are assured the right to assemble freely with other members to discuss union matters, and to express freely views on union candidates or issues. This is subject to the right of the union to enforce reasonable rules "as to the responsibility of every member toward the organization as an institution and to his refraining from conduct that would interfere with its performance of its legal or contractual obligations." This provision does not appear to diminish the wide latitude given unions to censor public criticism by members. § 101(a)(2). Rates of dues and initiation fees are frozen as of the effective date of the statute and can be changed only by a majority secret vote of the local membership or international convention. § 101(a)(3). No member may be fined, suspended, expelled, or otherwise disciplined unless such member has been (A) served with written specific charges; (B) given a reasonable time to prepare his defenses; and (C) afforded a full and fair hearing. § 101(a)(5). Any provision of the constitution or bylaws of any union inconsistent with the "Bill of Rights" is held to be of no force and effect. § 101(a)(6). The bill confers jurisdiction for enforcement of these provisions upon the United States district courts, § 102, and declares that nothing contained in it shall limit the rights and remedies of any union member under any state or federal law or union constitution or bylaws, § 103.

1. 79 Sup. Ct. 357 (1959).
2. *Id.* at 363.

I. History of State Corporate Income Taxation[3]

Although the imposition of state corporate income taxes, begun by Wisconsin in 1911, is a relatively late development in the tax field, it has spread rapidly, especially during and since the depression. Thirty-five states now tax corporations on a net income basis. The main reasons underlying the acceptance of this tax are that it is more equitable than property or gross receipts taxes, more popular with the rank-and-file voter than the sales or use tax, and tends to moderate extreme fluctuations in the level of national income. Due to the enactment of the federal corporation income tax in 1913, corporate records and other information used in the computation of income, as well as a standard definition of net income, are available making compliance with and administration of the state taxes much easier.

State corporate net income taxes are important fiscal instruments. Tax experts and economists have favored the net income tax in lieu of other forms of taxation on the ground that it reflects the corporation's ability to pay and the value of benefits received from the state better than any other part of the company's operations.[4] In order that the tax be applied to only that portion of the corporation's income that may reasonably be attributed to its productive activities within the state, many states decide how much of the company's profits to tax through the use of a complex three part computation known as the Massachusetts formula. This apportionment computation takes into account the amount of the company's sales in the state, in relation to its total sales; the company's payroll in the state, compared with its total employment expense; and tangible property holdings in the state, in relation to the company's total tangible property. The average of these three ratios is then applied to the company's total profits to determine the amount of tax due the taxing state. States which do not employ the Massachusetts formula usually use one or two of these factors to determine their share of the company's profits. The differences in allocation formulas are magnified by the fact that not all states define sales alike. Sales are variously defined as taking place in the state in which the goods to be shipped are located, in the state in which the sales are negotiated, and in the state in which the orders are approved.[5]

It is apparent that differences in allocation formulas could give

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3. For a more complete discussion of the history of state net income taxes, see Studenski & Glasser, *New Threat in State Taxation,* Harv. Bus. Rev., Nov.-Dec. 1958, p. 77, and the source materials cited therein. The article analyzes the characteristics of corporate net income taxes in each state in terms of date adopted, tax rate, deductibility of federal income taxes, and revenue yield.

4. See *Preliminary Report,* Proc. 12th Ann. Conf. Nat. Tax Ass'n 426 (1919).

5. For a breakdown of various formulas used, see Harv. Bus. Rev., note 3 *supra* at 83-84.

rise to duplications among states resulting in combined states taxes in excess of 100 per cent. Until recently, however, the states themselves restricted the tax to only those companies maintaining some permanent establishment in the state such as a manufacturing plant, a warehouse, or an office that accepts orders for delivery. Therefore, corporations were generally spared from multiple tax burdens on net income.[6] The National Tax Association,[7] in an effort to avoid multiple taxation, has recommended that the states adopt a uniform allocation formula and a policy of limiting net income taxation to corporations which maintain a permanent business establishment[8] within the state. The Allocation Committee of the Association is opposed to the application of the tax to out-of-state corporations that merely solicit orders or maintain small sales offices in the state.[9] But within the last fifteen years there has been a trend toward the extension of the tax to cover any corporation doing business within the state.[10] The application of the tax to out-of-state corporations has been justified on the ground that local corporations would otherwise be placed in a competitively disadvantageous position and that the state that provides the market place has a rightful claim to a portion of the income produced therein. These alterations in the application of corporate income taxes raise legal as well as economic difficulties. The Supreme Court had not heretofore passed on the application of the direct[11] net income tax

6. *Id.* at 78, 84.

7. The largest body of economic materials, legislative proposals, and legal analyses in the field of state corporate net income taxation appears in the reports of the annual proceedings of the National Tax Association. See, *e.g.*, Hendricks, *The Influence of State and Local Taxes on Locational Decisions*, PROC. 50TH ANN. CONF. NAT. TAX ASS'N 191 (1957); *Interim Report of Committee on Interstate Allocation of Business Income*, PROC. 50TH ANN. CONF. NAT. TAX ASS'N 339 (1957); Ford, *Some Aspects of Uniformity in State Tax Systems*, PROC. 48TH ANN. CONF. NAT. TAX ASS'N 409 (1955).

8. The term "permanent" business establishment as used herein refers to a business establishment where goods are manufactured or held for sale or where orders are accepted for delivery.

9. *Report of Committee on the Apportionment Between States of Taxes on Mercantile and Manufacturing Business*, PROC. 15TH ANN. CONF. NAT. TAX ASS'N 198 (1922).

10. A few attempts were made by the states during the first quarter of the century to tax out-of-state corporations not maintaining permanent business establishments in the taxing state. Most of these attempts were not challenged since the tax was not enforced. A Massachusetts *privilege* tax levied on the net income of out-of-state corporations maintaining in-state sales offices was declared unconstitutional by the Supreme Court in 1925. Alpha Portland Cement Co. v. Massachusetts, 268 U.S. 203 (1925). See discussion of this case at p. 913 *infra*.

California and Minnesota, in the 1930's, enacted *direct* income taxes on such out-of-state corporations, and since World War II, Arizona, Arkansas, Colorado, Connecticut, Georgia, Louisiana, New Jersey, Oregon, and Pennsylvania have followed suit. The California tax was upheld by the Supreme Court in a *per curiam* opinion in 1947. West Publishing Co. v. McColgan, 328 U.S. 823 (1946), discussed at p. .. *infra*. The Pennsylvania tax was declared unconstitutional in 1956. Pennsylvania v. Eastman Kodak Co., 385 Pa. 607, 124 A.2d 100 (1956).

11. A distinction is made between a franchise or privilege tax and a direct

to the mere solicitation of business within the state, and the doctrines of the earlier related cases are in conflict.

II. Historical Interpretation of The Commerce Clause

The early conflict among the justices of the Supreme Court on the question whether the mere grant of power to Congress to regulate interstate commerce operated as a limitation on state action in the absence of any congressional action resulted in the compromise decision of *Cooley v. Board of Wardens.*[12] This celebrated case did not provide a test which adequately defined the boundaries of state regulation of commerce. Under the *Cooley* rule, state action in this area is sometimes valid and sometimes invalid depending on whether the nature of the subject regulated permits a diversity of local laws or demands a uniform national rule.[13]

A. Local Activities Test

Chief Justice Taney's view that the taxing power of the states should be restrained only when it comes into conflict with an act of Congress[14] was rejected in favor of the view that the commerce clause itself censors state taxation of interstate commerce. The Court in deciding the *State Freight Tax* case[15] in 1872, adopted the *Cooley* rationale, treating state taxation as an area of regulation of interstate commerce demanding a uniform national rule. By this rationale, it invalidated a tax on the transportation of goods by an interstate

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tax. Originally, the theory behind this distinction was that a taxpayer, upon payment of a privilege tax, gains from the state a right to engage in certain activities which he would not otherwise possess and which the state has the power to withhold, while the payment of a direct tax does not confer upon the taxpayer any such "new" rights. Since the commerce clause was designed to prevent state trade barriers, it has been held that only the national government has the power to grant or deny persons the right to engage in interstate commerce. See Hartman, State Taxation of Interstate Commerce 61-63 (1953).

There is no difference in the operation of privilege and direct taxes in the area of corporate net income taxation since in neither case is the tax collected until a gain exists nor is payment of the tax prerequisite to the right to engage in interstate commerce. *Id.* at 65 n.63; Frank, *The United States Supreme Court: 1950-51,* 19 U. Chi. L. Rev., 165, 183 (1952). However, as will be pointed out later, the Court has retained this distinction for purposes of net income taxation.

12. 53 U.S. (12 How.) 298 (1851).

13. This theory of the commerce clause, sometimes referred to as the "selective exclusiveness" theory, replaced the view set out in Brown v. Maryland, 25 U.S. (12 Wheat.) 419 (1827), that the commerce power is vested exclusively in Congress and also Justice Taney's view that the states have concurrent power to regulate interstate commerce.

14. See The Passenger Cases, 48 U.S. (7 How.) 282, 481 (1849). For a comparison of Chief Justices Marshall and Taney's views of state power to tax interstate commerce, see Frankfurter, The Commerce Clause 53-55 (1937). Hartman, State Taxation of Interstate Commerce 21-48 (1953) outlines in detail the historical development of commerce clause interpretation in regard to state taxing power.

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

carrier. While subsequent cases have declared that the commerce clause is the source of this restriction on state taxing power,[16] and have cited the *State Freight Tax* case as authority for their position, commentators have often noted that the Court has permitted the theoretical basis of such restriction to become obscure.[17] Though the Court has not expressly relied on the *Cooley* "selective exclusiveness" doctrine,[18] as applied in the *State Freight Tax* case, it seems that this theory is the most reasonable theoretical explanation for the inconsistent pattern of later decisions and is implicit in their holdings.[19] In any event, the traditional view disallows state taxation of interstate commerce and confers upon the Court the duty to enforce the commerce clause by invalidating all taxes levied on any phase of interstate commerce.[20]

The often repeated rule that states are prohibited from taxing interstate commerce is not an accurate statement of the cases if "interstate commerce" is defined to mean all commerce which falls within the regulatory power of Congress. Since congressional power extends to events which by other standards would be considered local,[21] sources of state revenue would be extremely limited if states could tax only that commerce which falls outside the regulatory power of Congress.

Having once adopted the view that interstate commerce cannot be taxed at all, the Court was faced with the troublesome problem of prescribing a definition for "interstate commerce" which would allow the states to tax foreign and domestic corporations within their borders despite interstate activities. It has approached this as a *defini-*

16. The due process clause of the fourteenth amendment also imposes restrictions on state taxing power. This clause is satisfied if the tax is fairly apportioned to the business done within the territorial jurisdiction of the taxing state and will not be invoked to invalidate a tax which merely places an unconstitutional burden on interstate commerce under the commerce clause. See Magnano Co. v. Hamilton, 292 U.S. 40, 44-45 (1934); HARTMAN, note 14 *supra* at 13-20.

17. See HARTMAN, note 14, *supra* at 24-27, 30. While the Court has often employed the *Cooley* doctrine when the constitutionality of state regulatory measures are in question, *e.g.*, California v. Thompson, 313 U.S. 109, 113 (1941), the doctrine has hardly been mentioned in tax cases since The Freight Rate case, note 15 *supra*.

18. See note 13 *supra*.

19. Language which suggests that the *Cooley* doctrine is still applied in state tax cases is found in Townsend v. Yeomans, 301 U.S. 441, 455, 457-58 (1937); Fisher's Blend Station, Inc. v. State Tax Comm'n, 297 U.S. 650, 655 (1936); Clyde Mallory Lines v. Alabama, 296 U.S. 261, 267-68 (1935).

20. *E.g.*, McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 62 (1940) (dissenting opinion) and cases cited; Hellerstein & Hennefeld, *State Taxation in a National Economy,* 54 HARV. L. REV. 949 (1941); Lockhart, *The Sales Tax in Interstate Commerce,* 52 HARV. L. REV. 617 (1939).

21. Mr. Justice Murphey's phrase that Congressional power over interstate commerce "is as broad as the economic needs of the nation" is only a mild exaggeration. See American Power & Light Co. v. SEC, 329 U.S. 90, 104 (1946).

tional problem and has attempted to formulate a particular definition of interstate commerce for state tax purposes.[22] The Court has redefined "interstate commerce" for state taxation purposes to exclude commercial transactions growing out of so-called "local activities" within the taxing state. A state may tax these local activities since such a tax will not be considered as a levy on interstate commerce.[23] This test, though easily stated, has been most difficult to apply.[24] The Court has found it practically impossible to define the term "local activities" without making arbitrary, uneconomic distinctions.

The local activity requirement is met if the corporate taxpayer is chartered within the taxing state, and a nondiscriminatory tax, fairly apportioned to the business done within the state, will be sustained.[25] For purposes of state taxation, the privilege of being a domestic corporation is a taxable local event even though the corporation is engaged in interstate commerce. Likewise the local activity requirement is satisfied by an out-of-state corporation which maintains some permanent business establishment in the state such as a manufacturing plant,[26] a warehouse,[27] a wholesale or retail outlet[28] or perhaps even an office that accepts orders for execution.[29] But an out-of-state corporation which maintains a sales office or sends resident or nonresident salesmen into the state to solicit orders or ships goods to customers there in fulfillment of orders has been held to be engaged in nontaxable "exclusively interstate commerce" for purposes of sales and gross income taxation.[30] These decisions prevent nonindustrial or so-called "market" states in which out-of-state corporations sell their goods from tapping an important and desirable source of state revenue.

The local activity test has not served as a useful lever for the Court in these cases. It has led courts to indulge in narrow, unfruitful lines of argument and economically unsound distinctions. Whether a corpo-

22. Though the Court has not often expressly concerned itself with the fiscal needs of the states in determining the constitutionality of a given tax, the adoption of the local activities-intrastate commerce nomenclature extends state taxing power into areas of congressional regulatory power and indicates that the Court recognizes the importance of state revenue needs.

23. *E.g.*, American Mfg. Co. v. St. Louis, 250 U.S. 459 (1919).

24. The Court has sometimes upheld state taxes as "indirect" rather than "direct" burdens on interstate commerce without employing the local activities terminology. However, the direct-indirect approach appears to be merely another way of stating the local activities test. See Crew Levick Co. v. Pennsylvania, 245 U.S. 292 (1917).

25. Virginia v. Imperial Coal Co., 293 U.S. 15 (1934).

26. Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920).

27. Independent Warehouses, Inc. v. Scheele, 331 U.S. 70 (1947).

28. Norton Co. v. Department of Revenue, 340 U.S. 534 (1951).

29. See McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940).

30. McLeod v. Dilworth Co., 322 U.S. 327 (1944). *Cf.* Norton Co. v. Department of Revenue, 340 U.S. 534, 539 (1951); Freeman v. Hewit, 329 U.S. 249 (1946).

ration owns or leases its sales office in the taxing state, the number of secretaries it employs and the value of the office furniture used have at times become factors to be weighed in determining whether the business conducted is "intra" or "inter" state commerce.[31]

A commerce clause distinction is also made between a franchise tax measured by gross income and a direct tax on gross income. The Supreme Court has indicated on several occasions that a state may not levy a *direct* tax on the gross income from interstate business done by a corporation engaged in both interstate and intrastate business within the state,[32] but on other occasions the Court has held that a state may levy a *franchise* tax on the same corporation's "local activities" measured by gross income from both interstate and intrastate commerce.[33]

B. Multiple Burden Test

Apparently dissatisfied with the local activities test, Justice Stone in 1938 introduced a new doctrine allowing states to tax "exclusively interstate commerce" so long as there is no risk of multiple state taxation of the same commercial transactions.[34] Justice Stone reasoned that interstate commerce should bear its just share of state tax burdens but should not be made to bear cumulative burdens not imposed on local commerce. Although it does not clearly appear from Justice Stone's formulation of the doctrine whether the test to be used is *actual* multiple burden or *theoretical* capacity for multiple burden, it seems that he intended for the latter to be the touchstone.[35]

But the few decisions which employed the multiple burden test also relied to some extent on the local activities test. Thus the multiple burden test never achieved a completely independent status. In *Freeman v. Hewit*[36] Justice Frankfurter dismissed the multiple burden doctrine as a "fashion in judicial writing" and condemned a fairly apportioned Indiana gross income tax as a tax on exclusively interstate commerce. The *Freeman* case is usually treated as marking a distinct retreat from the so-called "economic" test erected by Justice Stone and a return to the older local activity test.[37] A strong minority on the Court, however, has remained in favor of allowing state taxation of exclusively interstate commerce and the retreat to

31. *E.g.*, Alpha Portland Cement Co. v. Massachusetts, 268 U.S. 203 (1925); Cheney Bros. Co. v. Massachusetts, 246 U.S. 147 (1918); Stockham Valves & Fittings, Inc. v. Williams, 213 Ga. 713, 101 S.E.2d 197 (1957).

32. Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938). See 4 Mo. L. Rev. 64 (1939).

33. American Mfg. Co. v. St. Louis, 250 U.S. 459 (1919).

34. Western Livestock Co. v. Bureau of Revenue, 303 U.S. 250 (1938).

35. See Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434 (1939).

36. 329 U.S. 249 (1946).

37. See Dunham, *Gross Receipts Taxes on Interstate Transactions*, 47 Colum. L. Rev. 211 (1947); Note, 56 Yale L.J. 898 (1947).

the old test has been less than complete.[38] The local activities test as subsequently applied seems to retain some vestiges of the multiple burden theory. The conflicting viewpoints on the Court since 1938 have produced an inconsistent pattern of decisions,[39] and there has been a recent indication that the Court would return to the Stone approach. In *Field Enterprises, Inc. v. Washington*,[40] decided without opinion in 1956, the Court, relying on precedents not strictly in point, seems in effect to have allowed a gross income tax on commerce which would be classified as "exclusively interstate" under the old test.

C. Comparison of Judicial Treatment Of Gross Income And Net Income Taxation.

The role of the local activity-multiple burden rationale in the net income tax cases has never been clear. The doctrines originate within the framework of gross income tax cases. Before the recent *Northwestern States* case, it was not clear whether a corporation engaged in exclusively interstate commerce could be subjected to a fairly apportioned net income tax. In *United States Glue Co. v. Oak Creek*[41] and *Underwood Typewriter Co., v. Chamberlain*,[42] Connecticut and Wisconsin were allowed to levy a direct *net* income tax on the interstate business of corporations maintaining permanent business establishments (a manufacturing plant) within the state and doing both interstate and intrastate business therein. On the other hand, the Supreme Court has indicated on several occasions that states may not levy a direct *gross* income tax on the interstate business done by a corporation engaged in both interstate and intrastate business within the state.[43] In *United States Glue*, Justice Pitney gave an economically sound reason for distinguishing between gross income and net income taxes. He explained that:

> [A] tax upon gross receipts affects each transaction in proportion to its magnitude and irrespective of whether it is profitable or otherwise. . . . A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and

38. See Justices Black, Douglas and Clark's dissents in Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951); Freeman v. Hewit, 329 U.S. 249 (1946); Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938). *But see* Michigan-Wisconsin Pipe Line Co. v. Calvert, 347 U.S. 157 (1954).

39. *Compare* Freeman v. Hewit, 329 U.S. 249 (1946), *with* West Publishing Co. v. McColgan, 27 Cal. 2d 705, 166 P.2d 861 (1946), *aff'd per curiam*, 328 U.S. 823 (1946).

40. 47 Wash. 2d 852, 289 P.2d 1010 (1955), *aff'd per curiam*, 352 U.S. 806 (1956). See Strecker, *"Local Incidents" of Interstate Business*, 18 OHIO ST. L.J. 69 (1957).

41. 247 U.S. 321 (1918).

42. 254 U.S. 113 (1920).

43. See note 32 *supra*.

> losses, and the tax can not be heavy unless the profits are large. Such a tax . . . is but a method of distributing the cost of government, like a tax upon property, or upon franchises treated as property. . . .[44]

Similarly Justice Brandeis, in the *Underwood Typewriter* case, said:

> That a tax measured by net profits is valid, although these profits may have been derived in part, or indeed mainly, from interstate commerce, is settled. . . . Whether it be deemed a property tax or a franchise tax, it is not obnoxious to the commerce clause.[45]

Much later Justice Stone stated by way of dictum:

> In any case, even if taxpayers's business were wholly interstate commerce, a nondiscriminatory tax by Tennessee upon the net income of a foreign corporation having a commercial domicile there . . . or upon net income derived from within the state . . . is not prohibited by the Commerce Clause. . . .[46]

It would seem from this reasoning that the local activity test does not apply to net income taxation and that a permanent establishment within the taxing state is unnecessary. The language, if not the holdings, of these cases suggests that a corporation need not be engaged in intrastate business in order to be subject to a net income tax on the interstate business done within the taxing state.[47]

Nevertheless, in *Cheney Brothers Co. v. Massachusetts*[48] and *Alpha Portland Cement Co. v. Massachusetts*,[49] the Court struck down taxes on corporate net income derived from the solicitation of exclusively interstate business. The Court, applying the local activity test, discussed the number of salesmen employed, the nature of their activities within the state, and the size of the sales office and found that the corporations were engaged in no intrastate business. More recently, in *Spector Motor Service, Inc. v. O'Connor*,[50] the Court disallowed a Connecticut tax on the net income of an interstate carrier maintaining no permanent business establishment in the state even though the taxed income was derived solely from business done therein. Justice Burton, speaking for the majority, commented that Justice Stone's statement quoted above "was not essential to the decision."[51]

It is important to note in the *Spector, Cheney* and *Alpha* cases that the "subject" of the tax was said to be the privilege of doing inter-

44. 247 U.S. at 329.
45. 254 U.S. at 120.
46. Memphis Natural Gas Co. v. Beeler, 315 U.S. 649, 656 (1942).
47. It should be noted, however, that the language of each of these quotations is guarded. Justice Brandeis carefully uses the phrase "derived in part, or indeed mainly" while Justice Stone may intend to limit the application of net income taxes by his use of the term "corporation having a commercial domicile."
48. 246 U.S. 147 (1918).
49. 268 U.S. 203 (1925).
50. 340 U.S. 602 (1951).
51. *Id.* at 609 n.6.

state business within the state and that corporate net income was merely the "measure" of the tax. The Court has often said that the national government alone has the power to grant corporations the "right" to engage in interstate commerce.[52] But in each of the cases, payment of the tax was not a condition for doing business within the state and enforcement was by the ordinary tax collection process.[53] "Privilege tax" as used in such statutes seems to mean only that the tax is levied in recognition of advantages or benefits provided by the state such as highways, police and fire protection, and access to its courts. Thus the distinction between privilege taxes measured by net income and taxes levied directly on net income derived from interstate commerce is purely a verbal one unless the Court reasoned that the word "privilege" is synonomous with "right" and that the states, by their use of the term, were attempting to invest themselves with the power to control the "right" of corporations to engage in interstate commerce.

The *Spector* line of cases then can be reconciled with *United States Glue* and *Underwood Typewriter* on either one of two grounds: (1) A state may levy a corporate net income tax on interstate commerce so long as it is labelled as a tax levied directly on the income and not imposed for the privilege of doing interstate commerce,[54] or (2) a state may levy a net income tax on interstate commerce so long as the taxpaying corporation was created by or maintains a permanent business establishment in the taxing state.

In *West Publishing Co. v. McColgan*,[55] decided in 1946, the Court affirmed without opinion a decision of the Supreme Court of California sustaining a direct net income tax on a corporation "solely engaged in interstate commerce."[56] Though the facts, as set out by the California court, indicate that the corporation maintained no permanent place of business within the state, some of its business therein could, by stretching the local activity test, be classified as intrastate.[57] The Supreme Court merely cited the cases holding that states can levy a direct net income tax on the interstate business of corporations maintaining a permanent business establishment within

52. Crutcher v. Kentucky, 141 U.S. 47, 57 (1891).

53. See note 11 *supra*.

54. This distinction has caused some states to redraft their revenue acts substituting direct net income taxes for privilege taxes. For example, Connecticut, shortly after the Court declared its privilege tax unconstitutional in the *Spector* case, adopted a direct tax. This was merely a change in wording, and the operation of the tax remained the same.

55. 328 U.S. 823 (1946).

56. West Publishing Co. v. McColgan, 27 Cal. 2d 705, 708-09, 166 P.2d 861, 863 (1946).

57. See Northwestern States Portland Cement Co. v. Minnesota, 79 Sup. Ct. 357, 377, 380 (1959) (dissenting opinions).

the state and doing intrastate business therein.[58] Thus, the Court's rationale was unclear, and the constitutionality of the trend extending the tax to corporations merely soliciting business within the state remained uncertain.[59]

III. THE NORTHWESTERN STATES PORTLAND CEMENT CASE

In 1959, in the *Northwestern States* case, the Supreme Court combined for decision two cases. Georgia and Minnesota, using the three part Massachusetts formula, levied a net income tax on all corporations doing business in the state.[60] Both taxpayers were out-of-state manufacturing corporations which solicited orders and leased small sales offices within the taxing state. Neither corporation maintained an inventory in the state, and orders were accepted and delivered from out-of-state. The highest courts in both states found the corporations to be engaged in "exclusively interstate business." The Georgia court invalidated the tax.[61] The Minnesota court held it constitutional.[62]

The Supreme Court faced squarely the problems raised by the recent trend in corporate net income taxation and upheld the application of the tax to net income derived from exclusively interstate business. The Court was divided six to three. Justice Harlan, while joining in Justice Clark's majority opinion, wrote a separate concurrence answering the contentions set out by the dissenters, Justices Whittaker, Frankfurter and Stewart.[63]

A. Old Law or New

The Court here split, as in the *Berwind-White* case[64] decided twenty years before, on whether the law laid down is old or new. The

58. The Court relied on the United States Glue case, note 41 *supra*, and similiar cases.
59. Mr. Dixwell L. Pierce, Secretary of the California Board of Equalization, in his article, *State Fiscal Needs and Interstate Commerce*, 18 OHIO ST. L.J. 43, 51 (1957), remarks: "Perhaps the most disturbing aspect of the whole matter is the continuing uncertainty concerning the validity of the application of state tax laws to interstate activities." See the following articles by Edward Roeskin: *State Taxation of Foreign Corporations*, 28 TAXES 819 (1950); *The Impact of the Spector Decision*, 29 TAXES 523 (1951); *Recent State Tax Trends*, 30 TAXES 9 (1952).
60. Minnesota levied a privilege tax on corporations engaged in intrastate business, MINN. STAT. § 290.02 (1953); and a direct tax on other corporations doing business in the state, MINN. STAT. § 290.03 (1953). Georgia levied a direct tax on all corporations engaged in intrastate or interstate business in the state. GA. CODE ANN. § 92-3102 (1953).
61. Stockham Valves & Fittings, Inc. v. Williams, 213 Ga. 713, 101 S.E.2d 197 (1957), *cert. granted*, 356 U.S. 911 (1958).
62. Northwestern States Portland Cement Co. v. Minnesota, 250 Minn. 32, 84 N.W.2d 373 (1957), *prob. juris. notcd*, 355 U.S. 911 (1958).
63. Justices Frankfurter and Stewart concurred in Justice Whittaker's dissent, and Justice Frankfurter also wrote a separate dissent.
64. McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940). For an analysis of this case, see Powell, *New Light on Gross Receipts*, 53 HARV. L. REV. 909 (1940).

majority said that "any doubt as to the validity of our position here was entirely dispelled" by past decisions,[65] while Justice Whittaker flatly declared that "none of the cases relied on by the Court supports its holding."[66]

The disagreement springs from the fact that the precedents may be reconciled by either of the two theories explained above. The majority significantly limits its discussion to the *net* income tax precedents and in effect follows Justices Pitney and Brandeis'[67] view that the cases which disallow *gross* income taxes on interstate business are not applicable. The Court distinguishes the *Spector* line of cases on the ground that the taxes disallowed were for the privilege of engaging in interstate commerce,[68] and argues that the *per curiam* opinion delivered in the *West Publishing*[69] case shows that the existence of some income from intrastate business is not essential to the valid taxation of interstate business.[70] Justice Whittaker does not deny that these cases recognize a distinction between privilege and direct taxes, but he argues that they also apply the local activities test—formulated in the gross income tax cases—to net income taxation. He concludes, therefore, that these cases should not be distinguished solely on the ground that the taxes there imposed were for the *privilege* of doing interstate business.[71]

The *Spector* line of cases do invoke both the local activities test and the distinction between taxes levied directly on income and taxes levied on the privilege of doing business. There is language in these cases which suggests that a net income tax on exclusively interstate commerce is unconstitutional no matter what label is attached to it.[72] This language indicates that the Court was applying the same constitutional test to both net income and gross income taxes. But this rationale cannot fully explain the special treatment received by net income taxes in the *United States Glue, Underwood Typewriter* and *West Publishing* cases.[73] When, in the face of this conflict, it is remembered that the Court had not, prior to *Northwestern States,* passed on the validity of a direct tax on the net income of a corporation engaged in exclusively interstate commerce, Justice Frankfurter's evaluation of the majority's use of precedent seems most accurate and could easily be applied to the minority also:

65. 79 Sup. Ct. at 363.
66. *Id.* at 378.
67. *Supra,* pp. 911-12.
68. 79 Sup. Ct. at 365.
69. Note 55 *supra.*
70. 79 Sup. Ct. at 363, 366.
71. *Id.* at 377-78.
72. Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602, 609-10, 609 n.6 (1951); Alpha Portland Cement Co. v. Massachusetts, 268 U.S. 203, 217 (1925); Cheney Bros. Co. v. Massachusetts, 246 U.S. 147, 153 (1918).
73. See discussion of these cases *supra,* pp. 911-12.

> It is one thing, however, to recognize the taxing power of the States in relation to purely interstate activities and quite another thing to say that that power has already been established by the decisions of this Court. If new ground is to be broken, it must be justified and not treated as though it were old ground.[74]

B. Multiple Burden

The majority rejects the traditional view that exclusively interstate commerce cannot be taxed at all—at least in respect to taxes laid directly on net income.[75] But the opinion neither makes clear the precise constitutional test that is to be applied nor indicates whether the rejection of the traditional view for purposes of net income taxes will be expanded to other forms of taxation.

The Court at one point in its opinion seems to say that the multiple burden doctrine is still a valid criterion by which to measure the constitutionality of state taxes:

> 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 interstate commerce to the burden of "multiple taxation". . . .[76]

However, Justice Stone defined multiple burden in *Adams Mfg. Co. v. Storen*[77] and *Gwin, White & Prince v. Henneford*[78] as the risk or possibility of cumulative state taxation on the same commercial event. Had the Court applied this definition to the facts of the present case, the tax would have been invalidated since the difference in state allocation formulas creates a possibility of multiple taxation. The Court recognizes that there is a substantial risk that "the same income [will be] taxed twice,"[79] but replies that no such double burden "is shown to exist here."[80] While judgment is expressly reserved on the validity of a tax which imposes an *actual* multiple burden on interstate commerce,[81] the cryptic statement that the multiple burden test is still a valid constitutional doctrine, together with the remark that no actual multiple burden is shown to exist, indicates that the Court will pronounce such a tax unconstitutional.

It is felt that the Court's vagueness on this point is not unintentional since one or more members of the majority would probably be unwilling to deny the states the power to impose actual multiple burdens on interstate commerce.[82] It is also felt, however, that a majority

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74. 79 Sup. Ct. at 380-81.
75. *Id.* at 363.
76. *Id.* at 362.
77. 303 U.S. 307 (1938).
78. 305 U.S. 434 (1939).
79. 79 Sup. Ct. at 364.
80. *Ibid.*
81. *Id.* at 365.
82. See Justices Black and Douglas' dissent in Southern Pacific Co. v.

of the present Court will disallow actual multiple taxation of interstate commerce when presented with cases which raise this question.[83] It is not impossible that, in the absence of congressional action, the Court, by case-by-case determination, will slowly work out a uniform allocation formula and a uniform definition of sales.[84]

C. Solicitation

The corporations in both the Georgia and Minnesota cases maintained small sales offices within the taxing state. Though the Court did not expressly pass on the application of the tax to income derived from the mere solicitation of sales by resident or nonresident salesmen, the broad language used in its opinion indicates that such an extension of the tax would be upheld: "The entire net income of a corporation generated by interstate . . . activities, may be fairly apportioned among the states for tax purposes . . . ."[85]

The Court's statement that "a State 'cannot impose taxes upon persons passing through the state, or coming into it merely for a temporary purpose,' such as itinerant drummers"[86] may appear contrary to this interpretation of the case. But it should be noted that the Court cites as authority for this statement one of the so-called "drummer" line of cases which disallow flat fee and privilege taxes on salesmen engaged in interstate commerce.[87] The next sentence, "it is beyond dispute that a state may not lay a tax on the privilege of engaging in interstate commerce,"[88] seems to indicate that the "itinerant drummer" statement does not apply to taxes levied directly on net income derived from the solicitation of business by resident or nonresident salesmen. It appears that the Court is merely warning the states that the "drummer" line of cases disallowing flat fee and privilege taxes is not overruled. Moreover, the analysis of the *West Publishing* case seems also to indicate that a direct income tax will not be invalidated merely because the taxpaying corporation does not maintain a sales office in the state:

Arizona *ex rel.* Sullivan, 325 U.S. 761, 788, 795 (1945), and Justice Black's dissent in Adams Mfg. Co. v. Storen, 304 U.S. 307, 316 (1938). *But see* Capitol Greyhound Lines v. Brice, 339 U.S. 542 (1950); Hood & Son, Inc. v. DuMond, 336 U.S. 525, 545 (1949).

83. The three dissenting members together with Justices Harlan and Clark would most likely vote to invalidate such a tax. The views of Chief Justice Warren and Justice Brennan are uncertain.

84. Reference to the research of the National Tax Association would provide the Court with a great body of information on state net income taxation and a ready-made uniform formula. See notes 7 and 9 *supra*.

85. 79 Sup. Ct. at 363.

86. *Id.* at 362.

87. The Court cites Robbins v. Shelby County Taxing District, 120 U.S. 489 (1887), which invalidated a flat fee tax on travelling salesmen. *Accord,* Nippert v. City of Richmond, 327 U.S. 416 (1946); see Real Silk Hosiery Mills v. Portland, 268 U.S. 325 (1925). See 44 MICH. L. REV. 1135 (1946).

88. 79 Sup. Ct. at 362.

> The opinion was not grounded on the triviality that office space was given West's soliciters by attorneys in exchange for the chanceful use of what books they may have had on hand for their sales activities.[89]

IV. ECONOMIC CONSEQUENCES

Although the severity of the impact of the *Northwestern States* decision is only speculative at this time, many economic difficulties seem likely to occur. Many states will probably follow the lead of the small number of states now levying net income taxes on corporations engaged exclusively in interstate business within the state. If a substantial number of the states should pass such tax laws corporations will have difficulty in complying with them, states will be hard pressed to administer them equitably, and national free trade could be seriously harmed.

State tax administrators will find equal enforcement of such laws against all out-of-state corporations expensive and perhaps administratively impossible and will probably limit the application of the tax to those corporations which derive a substantial amount of taxable income from business done in the state. The practice of states now imposing such taxes seems to confirm this conclusion.[90]

Large corporations maintaining a substantial staff of accountants and lawyers will probably not find compliance with numerous state tax laws difficult, and perhaps to this extent, unequal enforcement is justified. But outside legal and accounting advice is expensive and small and medium-size corporations will find the filing of thirty or more individual tax returns extremely burdensome. In addition extensive records must be maintained for allocation purposes, and since it is unlikely that the states will adopt a uniform allocation formula[91] the risk of multiple taxation will be greatly increased.

If the tax is strictly enforced, many corporations now doing marginal amounts of business within the taxing state may find such business unprofitable. As a result, competition in the nonindustrial or so-called market states could be substantially decreased. Two well-known economists contend that:

> many corporations may very well limit their sales to a regional rather than a national market, with a consequent curtailment of interregional

89. *Id.* at 364.

90. See CALIFORNIA FRANCHISE TAX BOARD, ANNUAL REPORT 81 (1956); Bates, *Problems of State Administration of Corporate Income Taxes*, PROC. 41ST ANN. CONF. NAT. TAX ASS'N. 540 (1948); Moyers, *Corporated Income Tax Compliance and Procedural Problems*, PROC. 41ST ANN. CONF. NAT. TAX ASS'N 526 (1948); Penniman, *A Survey of State Income Tax Administration*, PROC. 46TH ANN. CONF. NAT. TAX ASS'N 256 (1953).

91. It is likely that New York and other industrial states will continue to define sales as taking place in the state in which the goods to be shipped are located while market states define sales as taking place in the state in which the sales are negotiated.

> competition and of the efficient interreginal use of the country's economic resources. A good part of the unity of our national market would be destroyed for the first time in the history of our country. Actually, in the whole 170 years that have elapsed since the adoption of the federal constitution—which prohibited the erection of tariff barriers by the states and established one single national market—there has not been a comparable attempt at interference with interstate commerce.[92]

V. CONCLUSION

The precise holding of the *Northwestern States* case is that a state may lay a fairly apportioned, direct tax on the net income of an out-of-state corporation maintaining a small sales office within the taxing state even though such corporation is engaged in exclusively interstate commerce therein. The opinion seems to indicate that (1) the Court will continue to invalidate net income taxes levied on the privilege of engaging in exclusively interstate commerce within the taxing state; (2) a net income tax may be validly applied to out-of-state corporations sending salesmen into the taxing state to solicit orders; (3) actual multiple state taxation of interstate commerce will not be allowed. However, the opinion is not completely clear on these three points and is perhaps subject to several interpretations.

Since the Court in the present case limited itself to a discussion of the *net* income tax precedents and relied heavily on the *United States Glue* case, in which Justice Pitney laid a sound economic foundation for distinguishing net income taxes from other forms of state taxation,[93] it seems idle work to discuss whether the present case presages a complete shift of direction. Whether the Court will allow other forms of state taxation of exclusively interstate commerce such as gross receipts, occupational, sales and privilege taxes must be left to later decisions. It cannot be denied, however, that the present case and *Field Enterprises*[94] will constitute important precedents if such a change is in the making.

The majority[95] and dissenting members[96] of the Court agree that the Supreme Court has been highly unsuccessful in establishing a uniform national rule in the area of state taxation of interstate commerce and that the problem calls for detailed congressional investigation of the economic burdens imposed by such taxes "in order to determine the extent to which such burdens conflict with the necessities of national life."[97] Tax experts and economists feel that the solu-

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92. Studenski & Glasser, *New Threat in State Business Taxation,* Harv. Bus. Rev., Nov.-Dec. 1958., p. 90.
93. *Supra* pp. 911-12.
94. *Supra* p. 911.
95. See 79 Sup. Ct. at 322.
96. *Id.* at 382. *But see id.* at 372.
97. *Id.* at 382.

tion to an important and intricate national economic problem should not be left to the states or to the case-by-case method of determination employed by the courts.[98] The Supreme Court itself makes a strong appeal for congressional action, and Justice Frankfurter seems to speak for most of his colleagues when he says:

> Congress alone can formulate policies founded upon economic realities, perhaps to be applied to the myriad situation involved by a properly constituted and duly informed administrative agency.[99]

However, in view of the fact that recent Supreme Court decisions in the free speech and equal protection areas have aroused public opinion in some quarters against further "interference" in state affairs, it seems unlikely that Congress will impose limitations on state taxing power in the near future.[100]

The disagreement among the Justices in *Northwestern States* is apparently a disagreement over what attitude the Court should take toward state taxing power during the interim of congressional inaction. Should the Court allow the states to tax interstate commerce, even though the impact of such a policy may seriously harm national free trade, or should the Court attempt to hold the line against such interference as best it can? Perhaps the majority position in the present case is best suited to the occasion for several reasons. It allows market states to equalize the competitive positions of local and out-of-state corporations and to tax a share of corporate earnings derived from business within the state. It decides only the precise question before the Court and does not attempt to formulate a broad national policy without sufficient economic data. And, what is perhaps most important, it should have the effect of shortening the period of congressional inaction.

GILBERT S. MERRITT, JR.

98. See HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 275-85 (1953); Hellerstein & Hennefeld, *State Taxation in a National Economy*, 54 HARV. L. REV. 949 (1941).

99. 79 Sup. Ct. at 382.

100. The Wall Street Journal, Feb. 26, 1959, p. 2, reports that the general reaction in Washington to the decision indicates that Congress will not interfere with the right of states to tax corporate income. Congressman Cellar, Chairman of the House Judiciary Committee, said that it would be difficult at this time to get a drive going in Congress to change the ruling.