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THE USE TAX: ITS RELATIONSHIP TO THE SALES TAX

EUGENE GREENER, JR.*

I. INTRODUCTION

The use tax was conceived as a necessary supplement to the successful administration of the sales tax. With a use tax, in addition to a sales tax, legislators felt they had developed a taxing method that was symmetrical and complete.

Thus, if for some reason a sale at retail of tangible personal property escaped tax, "the use, the consumption, the distribution, and the storage [of the property would be taxed] after it has come to rest in this state and has become a part of the mass of property in this state."¹

But as the poet Robert Burns intimated about the best laid plans, the perfect scheme proved to be imperfect. For out of the relationship between the sales tax and the use tax, problems arose, mainly of two types—the constitutionality of the statute or of its application and the administration and collection of the tax with particular emphasis on the combating of tax evasion. No one had anticipated that different kinds of governmental units would adopt and administer different kinds of so-called "sales" taxes at different rates, some with and some without use taxes, but, as a matter of fact, the sales-use tax did spread throughout the country in accordance with no pattern and with no over-all planning.

In that regard, sales and use taxes have been adopted by thirty-two states and various cities. A graphic example of the confusion that can result even in a limited area is pointed out by D. L. Pierce in his article, "California Has a Sales Tax Headache."² Mr. Pierce says that the single state has 163 sales taxes and 92 use taxes with rates varying from 3 to 4½%. Further, 162 of 310 cities have sales taxes superimposed on the state sales tax. Many of the cities have the use tax along with the sales tax, under the theory they are protecting the local merchant by providing a complete and symmetrical tax method. But the opposite has often been the result.

For example, if the canny consumer lives in a city with no use tax (whether or not a sales tax is in effect) he simply buys elsewhere, where there either is no sales tax or where the sales tax rate is lower. But if he has bought out of the city and his city has a use tax, rather than meekly paying the use tax, he makes the city "come and collect it." Now the city can do this easily if the selling company has a

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1. TENN. CODE ANN. § 67-3007 (1955).

2. 6 NAT'L TAX J. 168 (1953).

branch or property in the city, by making the retailer a "dealer" and collecting on many such transactions at one time.

But if, as is the case often, the seller does not collect the tax, either because the consumer is not a resident of the same city as the seller or because the seller delivers by mail or carrier the product to the out-of-city consumer, and if the seller has no branch or property in the city of the consumer's residence, which city has the sales tax and also a use tax to "protect local merchants," the city, as a practical matter, cannot collect a use tax from each of thousands of individual consumers on innumerable transactions.

To bring order out of this chaos, it has been suggested that all sales in California bear tax at the same rate and part of the proceeds be apportioned to the cities. Likewise from an over-all viewpoint, to solve the problems of administration and collection and the constitutional problems, it has been suggested that a uniform sales tax statute be adopted by all states.³ Perhaps then there will be a truly symmetrical and complete scheme.

Before we actually face some of the specific problems and their proposed solutions involved in the relationship between the use and the sales tax, it is well to pause long enough to remember that despite difficulties, this tax method is truly worthwhile, that the sales-use tax is a revenue measure par excellence. In 1953, in money produced, it led all other sources of tax collections of individual states. Being then in only 31 states, it produced 23.1% of the total produced—while the motor fuel tax which was in all states produced 19.1%, state income taxes 16.9% and the old property tax 3.5%.⁴

And with proper administration the revenue from this source could probably be increased.

II. CONSTITUTIONAL QUESTIONS POSED BY THE RELATIONSHIP OF THE SALES AND THE USE TAX

A. *Type of Tax and State Constitutions*

That the sales tax is an excise or privilege tax and not a property tax (which state constitutions require to be uniform and equal) has been an easy decision for courts of last resort. The sales tax is a tax on the privilege of selling at retail, and this is true even though the burden is probably shifted to the ultimate consumer.⁵ The court finds comfort in pointing out that "it is a privilege tax levied upon the merchant. The State can only enforce its claim for taxes solely against the merchant. All penalties for nonpayment run against the retailer."⁶

3. Snell, *Sales Taxes and Interstate Commerce*, 27 TAXES 37 (1949).

4. 32 TAX DIGEST 172, 173 (1954).

5. *Hooten v. Carson*, 186 Tenn. 282, 209 S.W.2d 273 (1948).

6. *Id.* at 287, 209 S.W.2d at 275. These conclusions seem somewhat doubtful. See hereinafter the section on collection and administration.

Uniformly also, the use tax has been held to be an excise, rather than a property tax. Logically this conclusion is probably harder to defend. For although the use tax has been conceived as the alter ego of the sales tax, it is generally collected from the ultimate consumer, although as hereinafter concluded, taxing authorities collect it from other than the consumer wherever and whenever possible.

But theoretically isn't the use tax a true property tax? No, say the courts. Because "use" is generally defined as every incident of ownership, except selling at retail in the regular course of business. Or as per Mr. Justice Cardozo, "The privilege of use is only one attribute, among many, of the bundle of privileges that make up property or ownership. A state is at liberty if it pleases, to tax them all collectively, or to separate the faggots and lay the charge distributively."⁷ And since "use" is one attribute short of the full bundle of property rights, and the legislatures have declared "use," as so defined, a "privilege," the tax, ergo, is an excise tax.

Thus, the legislatures have established a revenue scheme that is extremely productive, and the courts have dutifully done their job, and probably reached a good result, although some logician might be troubled by the process. For the arguments which the court found important in upholding the sales tax, are not available for the use tax.⁸

B. Federal Constitutional Questions—the Problem of Multiple Burden

State statutes righteously provide "nor is it the intention of this chapter to levy a tax on bona fide interstate commerce."⁹

But, beginning with the famous *Berwind-White* case, the United States Supreme Court, in fifteen years, has totally changed former conceptions of taxing interstate commerce. That case upheld the sales taxation by New York City of a sale contracted there between a Pennsylvania seller and New York buyers of coal, most of which was to be delivered from Pennsylvania to New York City; however, there were two loads to be delivered elsewhere.¹⁰ Many decisions have appeared approving taxation by states in similar factual situations. But, according to one commentator, the picture is still extremely confused with taxes on intrastate commerce upheld, regardless of their impact on interstate commerce, unless a formal and obvious discrimination is involved, while taxes imposed directly on interstate commerce are held invalid, even though nondiscriminatory in substance.¹¹

7. *Henneford v. Silas Mason Co.*, 300 U.S. 577, 582 (1937).

8. *Hooten v. Carson*, 186 Tenn. 282, 209 S.W.2d 273 (1948).

9. TENN. CODE ANN. § 67-3007 (1955).

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

11. Barrett, "Substance" v. "Form" in the Application of the Commerce Clause to State Taxation, 101 U. PA. L. REV. 740 (1953).

However, we are here concerned with only the federal constitutional questions involved by *the relationship* of the sales and the use tax. Primarily this boils itself down to taxation by more than one state of a single transaction, or the so-called problem of multiple burden. To consider this problem in its proper perspective, one should keep in mind the continuing fight that is and must be waged against sales and use tax evasion.

Amazingly enough to the author, some apparently well-known economists have seriously contended that a sales tax in one state and a use tax in another on the same transaction does not even involve a double burden, because the retail seller does not shift the tax burden of the sales tax to the consumer. They say that courts are naive to believe this burden can be shifted.¹² This author, while quick to admit that he does not possess the qualifications necessary properly to evaluate this opinion, nevertheless believes and therefore concurs with the Supreme Court of Tennessee and others that the sales tax is shifted to the ultimate consumer by the retailer.¹³

For the sake of this discussion, it is assumed hereafter, that the burden of the sales tax is shifted to the ultimate consumer. It is submitted that if this assumption be incorrect, the courts have wasted a vast amount of time, and that the questions and solutions written about immediately hereafter are all moot and unnecessary.

Many states provide a compensatory feature to prevent a multiple tax burden. If a tax has been paid in another state on the same transaction the amount of which is greater than the tax in the state concerned, then no tax will be collected. If a tax has been collected in another state but the tax is less than that of the state concerned, there will be collected only the difference between its tax and the tax already paid.

But unfortunately "more than half of the use tax states do not have any such compensating feature."¹⁴ We must first face whether or not such a feature is necessary to assure federal constitutionality of a sales and use tax statute and further what alternatives might be available.

Mr. Brown in his article entitled "Future of Use Tax" is of the opinion that multiple burden, if it occurs solely as the result of the several intrastate aspects of a transaction, is constitutional; thus, if a resident of State A personally goes to State B, a sales tax state, makes a purchase, pays a sales tax and receives delivery in State B, and then returns with his property to State A, State A may impose a use tax on the same piece of property, give no credit for the sales

12. Warren & Schlesinger, *Sales and Use Taxes: Interstate Commerce Pays Its Way*, 38 COLUM. L. REV. 49 (1938).

13. *Hooten v. Carson*, 186 Tenn. 282, 209 S.W.2d 273 (1948).

14. Brown, *The Future of Use Taxes*, 8 LAW & CONTEMP. PROB. 495, 498 (1941).

tax that has been paid, and no constitutional violation would have occurred. And local merchants would have been protected. To the author of this article, this conclusion sounds doubtful and the reader is referred to Mr. Snell's article wherein he expresses the opinion that the second taxing is discriminatory, "by virtue of the interstate goods' bearing a tax burden to which local purchases are not exposed."¹⁵

However, we are hereinafter mainly concerned with multiple burden in a transaction with interstate *aspects and appearance*, such as might have occurred in the *Berwind-White*¹⁶ case, had the state to which two of the shipments were made (other than New York City) attempted to collect a use tax and allow no credit for the sales tax already paid. We must observe, however, that this distinction, as to whether a given situation has the *appearance* of affecting interstate commerce, as opposed to one that *appears* to have only intrastate aspects, certainly gives weight to the proposition previously mentioned in the article entitled, "'Substance' v. 'Form' in the Application of the Commerce Clause to State Taxation."¹⁷

It is further to be noted that when the Supreme Court okayed the use tax in the *Henneford* case,¹⁸ the statute in question did have a compensatory feature, but the Court did not say it would have been bad without this. And the Court okayed the California Use Tax Statute without a compensatory feature, because it said it would not void a statute based merely on a *potential* multiple burden of taxation on interstate commerce.¹⁹ And, further, it has been said that the Supreme Court itself is divided as to whether *potential* risk of double taxation will invalidate, or whether *actual* burden is the standard.²⁰

About the only safe conclusion seems to be that each factual situation will be examined by the courts, and, if a multiple burden is found to exist, the application of the tax in that situation will be voided. The over-all trend more and more is to uphold the tax, or, as it has been said, interstate commerce is paying its way. But the above mentioned factor of the general *appearance* of the whole transaction remains important, and the judges of the Supreme Court themselves differ as to whether actual or potential burden is the standard to cause invalidity.

To play it safe, avoid having to become embroiled in this shifting situation, and prevent evasion, several procedures for possible inclusion in the pertinent statutes have been devised and are briefly mentioned immediately hereafter.

15. Snell, *supra* note 3, at 45.

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

17. Barrett, *supra* note 11.

18. *Henneford v. Silas Mason Co.*, 300 U.S. 577, 582 (1937).

19. *Southern Pacific Co. v. Gallagher*, 306 U. S. 167 (1939).

20. Snell, *supra* note 3.

The above-referred-to compensatory feature, also known as the credit allowance, has been adopted by some states and seems on its face a simple and effective device. Alas, it has been unpopular, because some states worry that it encourages extra-state purchasing. It is argued that if no credit is allowed, the consumer will buy at home to escape paying two taxes. (See Mr. Brown's example above where everything is intrastate in appearance.) It can be contended, however, that this argument does not actually have too much merit (as note the California situation mentioned above) for the consumer simply can order for delivery by mail or common carrier (and probably pay no sales tax) from an out-of-state retailer with no establishment in or connection with the buyer's home state; considering how difficult it is to collect the use tax from an individual, such consumer might possibly pay neither tax, regardless of whether or not a credit is allowed. Another suggested procedure is apportionment of the tax so that it would only be collected on that portion of the price attributable to activities within the state. This would clearly seem bad if the item in interstate commerce is subjected to a tax load, which local purchases are not. If apportionment were to apply to the tax rather than to the purchase price of the article, and if in no event could the burden be more than the full tax of a single jurisdiction, this device might be constitutional, but it still poses difficult, if not impossible, administrative burdens, such as arriving at a fair apportionment formula.

Primarily to prevent evasion but also apparently to avoid multiple burden taxation is a third scheme—the taxing of use or consumption at a higher rate than if the tax had been paid at the time of the sale. Thus, assuming no sales tax by the out-of-state seller's state, the scheme then hopes that the seller will, in order to retain the goodwill of the buyer who will be taxed at a higher rate, pay the tax. This hope seems exceedingly naive except in unusual cases. By treating inter- and intra- state transactions the same, however, the device may pass the constitutional test.

To combat the constitutional problem of multiple burden and the administrative one of tax evasion (discussed more fully hereafter) the uniform law, above referred to, also has been proposed. This law provides that all taxation shall be done by the state of the buyer and establishes a uniform system of crediting taxes previously paid. It is said that "the buyer's state is the one in which the burden of the tax necessarily will fall equally on both local and interstate classes of trade."²¹ And the same author says, "the dangers of inequality and discrimination, the original considerations behind the rule that inter-

21. *Id.* at 47.

state sales were not to be subject to state taxation, do not exist in the case of a tax imposed by the buyer's state."²²

Interestingly enough, in addition to constitutional grounds, the use tax which heretofore has been considered merely a supplement to the sales tax, is preferred by another author on the grounds of logic and consistency.²³ The use tax, he says, is a uniform tax on consumption, while the sales tax, being subject to the inadequacies of a multi-level tax, is a mere system of selective excises. Thus, in collecting the sales tax, the taxing governmental unit has various and difficult problems of administration and construction—such as “what is a sale?”—“what is a sale *at retail*?”—“when is material *directly* used in production?”²⁴

Even if a uniform use tax law adopted by all states would solve the present constitutional problems and, although such a tax is more logical and consistent, it seems doubtful that such a system will be achieved. This solution fails to face the major drawback of the use tax, if it were standing alone, that is, the difficulty of collection. Even with the present confused situation, the governmental unit has relatively little trouble collecting the sales tax. The retailer painlessly collects the tax at the time of each sale, and the sales tax is accordingly an extremely productive tax. Since the use tax, with some exceptions, has to be collected from the vast number of consumers, it is submitted that, as a revenue device, it could not be nearly so effective as that we presently have, even with all the problems that have resulted.

B. Collection from Out-of-State Sellers

A further interesting question arises involving the relationship between the sales and use tax. Can the use tax constitutionally be collected from an out-of-state seller and under what circumstances? Without the ability so to collect, evasion could run wild.

As early as 1941, such collection was validated by the Supreme Court where the foreign corporate seller was also “doing business” in the levying state, although the buyer had no dealing whatsoever with the local branch.²⁵ Later the Court went further, by allowing collection from an out-of-state seller not qualified to do business in the state nor maintaining any office there. This decision was based on the fact the seller had traveling salesmen in the state, but all sales were subject to out-of-state acceptance, and the property was shipped by common carrier or mailed in.²⁶

22. *Id.* at 48.

23. Taylor, *Toward Rationality in a Retail Sales Tax*, 5 NAT'L TAX J. 79 (1952).

24. For an analysis of such problems under the Tennessee statute see Greener, *Local Problems under the Tennessee Sales and Use Tax Act*, 20 TENN. L. REV. 647 (1949).

25. *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359 (1941).

26. *General Trading Co. v. State Tax Comm'n*, 322 U.S. 335 (1944).

Thus, the Court has gone very far in aiding in the collection of the tax. This aid is no doubt reflected in the productivity of the tax. But very recently a warning note has been sounded. There is a limit. It was held in the *Miller Brothers* case that an out-of-state Delaware seller with practically no connection with Maryland did not have to collect Maryland's use tax.²⁷

No doubt, the case will be studied carefully by sellers that might obtain benefit from its application. In passing, it is worth noting that the use of separate local corporations has been suggested as a way to escape the above referred to type of collection obligation. Such an organizational setup and the new rule of the *Miller Brothers* case might be considered.

III. PROBLEMS OF ADMINISTRATION AND COLLECTION POSED BY THE RELATIONSHIP

Throughout this article, it has been indicated that evasion of the sales-use tax is a major problem. The use tax was conceived because of the extent of the evasion;²⁸ undoubtedly it has helped reduce evasion. In this connection, again reference must be made to how productive, despite evasion, this revenue device has been.²⁹

Despite the use tax, however, a substantial amount of total or partial evasion (paying less than should be collected) continues. Much evasion succeeds because of the tremendous difficulty in collecting the use tax from the millions of individual consumers on the hundreds of millions of transactions.

It would take an army of investigators and collectors, and probably of attorneys too, even to begin to collect the use tax in full. The cost of administration would probably be much greater than the extra revenue yielded.

So the taxing authorities have concentrated on what is easily collectible. And that is why the sales tax has remained so popular. Also, as far as the use tax is concerned, collection has been from other than the consumer wherever possible; collection even from an out-of-state seller has proved an economical and fairly easy method of collection.

Thus, Tennessee, for example, by providing the tax is collectible "from all persons engaged as dealers" and by broadly defining "dealer" has made collection of the tax from other than the consumer a definite and well-defined procedure.

In Tennessee "a dealer" for collection purposes is: (1) every person (and a person is defined as practically any type of business organiza-

27. *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954).

28. See *Broadacre Dairies, Inc. v. Evans*, 193 Tenn. 441, 246 S.W.2d 78 (1952).

29. 32 TAX DIGEST 172, 173 (1954).

tion as well as any individual) "who manufactures or produces tangible personal property for sale at retail, for use, or consumption, or distribution, or for storage to be used or consumed in this state"; (2) every person "who imports or causes to be imported, tangible personal property from any state or foreign country, for sale at retail, for use, or consumption, or distribution, or for storage to be used or consumed in this state"; (3) every person "who sells at retail, or who offers for sale at retail, or who has in his possession for sale at retail, or for use, or consumption, or distribution, or storage to be used or consumed in this state, tangible personal property"; (4) any person "who has sold at retail, or used, or consumed, or distributed, or stored for use or consumption in this state, tangible personal property and who cannot prove that the tax levied by this chapter has been paid on the sale at retail, the use, the consumption, the distribution, or the storage of said tangible personal property"; (5) any person "who leases or rents tangible personal property . . . for a consideration, permitting the use or possession of said property without transferring title thereto"; (6) any person "who is the lessee or rentee of tangible personal property . . . and who pays to the owner of such property a consideration for the use or possession of such property without acquiring title thereto"; (7) any person "who maintains or has within this state, directly or by a subsidiary, an office, distributing house, sales room, or house, warehouse, or other place of business."³⁰

Further, the Tennessee Act provides that every "dealer" making sales "whether within or outside the state" shall collect the tax at the time of making the sale. Further a "dealer" must pay the tax on all property imported and used by him, and the "use, or consumption, or distribution, or storage . . . shall each be equivalent to a sale at retail."

And the Act further provides the "dealer" not only is liable for the tax, but if he fails, neglects or refuses to collect it or advertises or holds out to the public that he will absorb it, he shall be guilty of a misdemeanor and subject to fine and imprisonment.³¹ And the dealer's property may be subjected to distraint and sale if the tax has not been paid.³²

Thus, in its desire and in fulfillment of its purpose to collect the sales-use tax from other than the consumer, the Tennessee legislature has defined "dealer" to include manufacturers, importers of property into the state, retailers and persons in the business of rental. Further on any item that has been sold, used, consumed, distributed or stored, he must *prove* that the tax has been paid.

This provision, plus the obligation on anyone importing any property

30. TENN. CODE ANN. § 67-3017 (1955).

31. *Id.* § 67-3019.

32. *Id.* § 67-3033.

in the state and using it, would technically cause to be subject to tax all or most all of previously untaxed property of any person, family or business being moved into the state for the first time with the intent of establishing a permanent situs here. This probably is not the legislative intent and, as far as this author knows, these provisions are not being so administered by the State, but the broad language remains. Sections 67-3038—67-3040 further provide that any person importing property by means other than common carrier, say by family car, must obtain a permit from the Commissioner, and theoretically pay the tax, or have the contents seized as contraband. Thus, visualize a family moving to and intending to make its permanent residence in this state by private auto, conveying thereby certain items of tangible personal property previously untaxed, and further imagine the emotional reaction to what may first have seemed some kind of official greeting, when suddenly advised that since there is no permit, the possessions will be seized and sold as contraband.

Of course, no such application is intended or pursued, but just so far have legislatures gone in trying to prevent by statute, what may be unpreventable.

The best advice, from the point of view of the most return at the least cost, may be—continue as has been done—i.e., collect the sales tax in full, and collect the use tax from other than the consumer.

The one exception to the latter may be to set up a system whereby, even direct from the consumer, the use tax should be collected on large items, such as automobiles. Thus, where the return on one transaction is as much as \$30 to \$150, the effort is justified. The 1955 Tennessee legislature made it unlawful for any county court clerk to accept an application for a certificate of title for a motor vehicle unless the applicant can prove payment of the sales or use tax or can show authority from the Commissioner to file without payment.³³ It has long been the practice of Arkansas automobile retailers to try to attract Memphis customers by advertising "no sales tax collected." But, unless the Memphis customer undergoes the difficulty and the risk of falsely registering his automobile elsewhere, he pays the tax when he applies for title or attempts to buy a license. It would seem, however, that this device would be much less effective if the consumer could buy, pay no tax and register his automobile in another city or county of his own state, rather than having to register in another state. For example, in New York City for a long time there has been a city sales tax but no such tax in surrounding counties of the same state.

Even on large purchases direct collection from the consumer is difficult but must be worked on because of the large amounts in-

33. *Id.* § 59-305.

volved. The above device suggests further a fairly easy method of checking on the purchase and use of other larger items such as airplanes, boats, and other items which must be licensed with some governmental agency. Direct collection of the use tax, however, on the hundreds of millions of small purchases remains economically unfeasible, even if possible.

Before leaving this whole area, mention should be made of how two states, California and Mississippi, in a somewhat novel manner attempted to force collection of the use tax from out of state sellers. Both were apparently unsuccessful. California threatened to ruin the out-of-state seller's local business by prosecuting their customers,³⁴ if the seller would not collect the tax. Mississippi obtained a mandatory injunction against such a dealer, but this seems to have been an injunction against the commission of a crime, which itself is a questionable procedure.³⁵

The relationship between the sales and use tax from the practical point of view of obtaining maximum net return seems to boil down to the proposition of finding some way of the governmental unit's collecting the tax other than from the individual consumer.

IV. CONCLUSION—POSSIBLE HELP FROM THE EXCHANGE OF RELIABLE INFORMATION

More and more the sales-use tax revenue scheme where non-discriminatory in substance has been upheld as constitutional. Various factual situations have been presented. Only occasionally have courts seemingly wandered off the track because of the appearance, rather than the reality of a transaction.

Taxing entities have tried and are trying to prevent sales-use tax evasion by including strange and impractical remedies in their statutory authority but have used them sparingly. In general what has been easily and economically collected has been the main target, and few if any attempts have been directed at the rest.

In regard to the latter, if some feasible scheme could be devised whereby reliable information regarding interstate sales could be exchanged between states, perhaps taxing authorities would be nearer a solution of the problem of evasion.

Thus, if the name, address, amount of sale and other pertinent information were easily available to administrators, economical collection of the use tax from individual consumers would be much more likely—at least on larger transactions.

34. Brown, *The Future of Use Taxes*, 8 LAW & CONTEMP. PROB. 495 (1941).

35. State *ex rel.* Rice v. Allen, 180 Miss. 659, 177 So. 763 (1938).