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Paul J. Hartman

STATE AND LOCAL TAXATION—1956 TENNESSEE SURVEY

PAUL J. HARTMAN*

As indicative of the growing importance to the bench and bar of state and local taxation, the Tennessee Supreme Court was called upon to decide three significant tax cases during the period covered by this survey article. During this period, objecting taxpayers spearheaded vigorous assaults against various privilege taxes on commerce and due process clause grounds.

The Commerce Clause and the States' Power to Levy Taxes in Connection with the Transportation of Natural Gas and Oil

In *Tennessee Natural Gas Lines v. Atkins*[1] the Tennessee Supreme Court sustained, over commerce clause objections, a Tennessee gross receipts tax as applied to the receipts from the sale of gas transmitted from an out-of-state source of supply, but bought by taxpayer in the State, and delivered to a local consumer by the taxpayer. The taxpayer (Tennessee Natural Gas Lines), a Tennessee corporation operating entirely within the state, bought natural gas from an interstate pipeline company (Tennessee Gas Transmission Company) and resold the taxed portion of the gas to a large industrial user (Dupont Company) in the state. This gas sold to Dupont was delivered to that consumer from a metering station which taxpayer maintained on Dupont's premises, where the pressure was reduced for the purpose of delivering the gas to Dupont for consumption. Gas was also delivered by taxpayer to wholly owned subsidiary corporations, which, in turn, sold the gas to consumers within the state. The taxing authority of Tennessee did not seek to tax the proceeds of the sale of gas by taxpayer to these subsidiary corporations. Tennessee applied her gross receipts tax only to the proceeds of the gas sold to Dupont for consumption within the state. Taxpayer-distributor resisted the tax on the gas sold to Dupont on commerce clause grounds upon the theory that the taxed proceeds were from a sale that was an integral segment of interstate commerce and therefore immune from the tax. Taxpayer took the position that since the gas originated in Texas and Louisiana and flowed without interruption through these states into Tennessee and came to rest at the plant of the consumer, Dupont, that the whole process was exclusively interstate commerce.

The Court rejected taxpayer's contention and concluded that the interstate transmission of the gas ended when it was purchased in

* Professor of Law, Vanderbilt University; member, Tennessee Bar.

1. 287 S.W.2d 67 (Tenn. 1956).

Tennessee by the taxpayer for resale to the local consumer. The Court then held that taxpayer's business of supplying the local consumer constituted taxable local business even though the gas was brought from another state and drawn for distribution directly from interstate pipelines.

The case at hand properly raises for consideration the broader question of when does the commerce clause immunize from various excise taxes gas (and oil) that has crossed state borders in pipelines.

Privilege Taxes on Transportation of Oil and Gas: In the field of transportation of oil and gas, the Supreme Court of the United States drew the line, in part, several years ago between valid and invalid taxation of the privilege of transportation of those commodities. It did so in *United Fuel Gas Co. v. Hallanan*,[2] and *Eureka Pipe Line Co. v. Hallanan*,[3] involving respectively natural gas and oil. In those two cases the taxpayers questioned, on commerce clause grounds, a West Virginia tax on the transmission of gas and oil in pipe lines within the taxing state. The ultimate destination of the great bulk of both commodities was beyond the borders of the taxing state, but the oil and gas transported by the taxed carriers were produced within the taxing state. The questioned West Virginia statute prohibited engaging in the business of transporting oil and gas without the payment of a tax for the privilege of so doing. The taxpayers apparently were not producers of oil and gas, and most of the commodities were gathered or purchased within the taxing state. The oil and gas were carried either by pipelines of the taxpayers or those of connecting companies to whom much of the gas and oil was sold. The taxed pipeline companies conceded the taxability of the gas and oil to the extent that it was gathered in the taxing state and distributed to in-state purchasers who were engaged in the refining business. The controversy hinged on the application of the tax statute to the quantity of the commodity which came from within the taxing state and was matched by the same quantity which was withdrawn from the pipelines at points beyond the state.

In striking down the tax in both cases, the Court held that the test of ultimate destination of the product was determinative of whether the transportation was taxable local business, or interstate commerce that was free from such taxes. The whole of the transportation with respect to that part of the oil and gas which ultimately moved out of the state was held to constitute interstate commerce and beyond reach of the taxing power of the state insofar as the privilege tax was concerned. These two cases seemed to make it clear that a state has no power, consistent with the commerce clause, to impose

2. 257 U.S. 277 (1921).
3. 257 U.S. 265 (1921).

a tax on the privilege of transporting oil and gas where the ultimate destination of the transported products lies beyond the borders of the taxing state, even though the taxed transportation activities carry oil and gas produced within the taxing state.

A decade after the *United Fuel Gas* and *Eureka Pipe Line* decisions, there came before the Supreme Court of the United States a Mississippi privilege tax statute as applied to a pipeline company which brought gas into the state and delivered it to another pipeline company, which distributed the gas to consumers. The tax, as applied, was resisted on commerce clause grounds in *State Tax Commission v. Interstate Natural Gas Co.*[4] The objecting taxpayer owned a trunk line of pipes through which it carried gas from the gas fields in Louisiana into Mississippi and back into Louisiana. Taxpayer's trunk line in Mississippi was tapped by distributing companies and deliveries were made by taxpayer to those distributors. These deliveries to distributors by taxpayer were the incidence of the tax levied for the privilege of doing business. The amount of gas delivered to the distributors was measured by a thermometer and a meter furnished by taxpayer, and the pressure of the gas was reduced before it passed into the hands of the distributors. As applied to taxpayer, the tax was upset as repugnant to the commerce clause. Neither the reduction of the pressure by taxpayer nor the measuring of the gas was thought by the Court to constitute local, taxable business. The work done by taxpayer upon the flowing gas was to help delivery, thought Justice Holmes, who spoke for the Court; and as such, the work was plainly incident to the interstate transmission of the gas. The nub of the matter is succinctly stated by Justice Holmes when he declared that, "The plaintiff [objecting taxpayer] simply transports gas and delivers it wholesale not otherwise worked over than to make it ready for delivery to independent parties that dispose of it by retail."[5] In passing, it is significant to note that the Court emphasized that the reduction in pressure was not for delivery to consumers as a local business but was merely incident to the convenient delivery by taxpayer to the wholesale distributing company which, in turn, would make resale to consumers.[6]

A local privilege tax upon a pipeline transportation company, where taxpayer delivered gas directly to the consumers, was before the Supreme Court of the United States in *Southern Natural Gas Corp. v. Alabama.*[7] This called into commerce clause judgment an Alabama tax imposed upon foreign corporations doing business in the state.

4. 284 U.S. 41 (1931).
5. *Id.* at 44.
6. *Cf.* Texas Gas Transmission Corp. v. Atkins, 197 Tenn. 123, 270 S.W.2d 384 (1954), where delivery to a distributor was thought to be interstate commerce, but the tax was upheld on another ground.
7. 301 U.S. 148 (1937).

This annual franchise tax was measured by the capital employed in the state. The questioned tax was applied to a Delaware corporation (taxpayer), which was qualified to do business in Alabama and which maintained its commercial domicile there. Taxpayer was engaged in the business of purchasing natural gas in Louisiana and Mississippi gas fields, transporting it through its pipeline system into Alabama, and selling it in Alabama and other states. The gas moved continuously from the extra-state gas fields under natural pressure to the points of delivery. Of the gas delivered in Alabama, part of it went under full pressure to distributors, and the rest was sold for consumption to industrial plants after the pressure of the gas had been reduced. The controversy over the tax actually concerned only the gas delivered by taxpayer to consumers in Alabama. The Court did not pass upon the validity of the tax as applied to the sales at full pressure to the distributors since the tax could be sustained if the Court found that taxpayer engaged in *some* local business.

The Court concluded that the taxpayer was not engaged exclusively in interstate commerce and sustained the tax over commerce clause objections. Taxpayer's operating and financial headquarters within the taxing state may have been enough to sustain the tax. Nevertheless, the Court's opinion seems to make it clear that the sales to the consuming industrial plants within the taxing state, after reducing the gas pressure, constituted taxable local activity.

Thus, under the rationale of this case the state can tax the first sale or delivery of gas brought in from an extra-state source, if the sale is also the last sale because delivered to the consumer. Such a sale or delivery is a local event which can serve as the incidence of a privilege tax in connection with the transportation of gas. However, as we saw in connection with the *Interstate Natural Gas* case, it is not constitutionally competent for the states to tax the first sale in the state if it is to a *distributing* company which, in turn, resells the gas, even though taxpayer reduces the pressure of the gas and meters it before delivery into the purchaser's pipes. There the activity is treated simply in furtherance of additional interstate transportation operations and is not a taxable local privilege. Moreover, under the *United Fuel Gas* and *Eureka Pipe Line* cases, we saw that there is no sufficient localism to support a privilege tax on the transportation of oil and gas intended for an out-of-state destination even though the oil and gas were produced within the state where the taxed transportation operated.

A pipeline company may, of course, transport gas and oil through a state in its own pipelines either without acquiring the product within the state, or without making any sales or deliveries in the state, either to consumers or to connecting distributors. That was the situation in *Ozark Pipe Line Corp. v. Monier,*[8] which involved a Missouri tax as applied to a Maryland corporation operating a pipeline extending from Oklahoma through Missouri to a destination in Illinois. Missouri undertook to apply her privilege tax to taxpayer for the privilege of doing business within the state. This taxed pipeline company had within Missouri more than half of its property, including its main office, pipelines, and appurtenances used to transport oil. It had qualified as a foreign corporation to do local business and was granted the power to exercise the right of eminent domain. It also did other things in connection with its business. However, oil was neither received nor delivered in the taxing state. All its property and activities were thought by the Court to be the means and instrumentalities used to conduct a business that was exclusively interstate commerce. Having concluded that all that was done within the state was in furtherance of the transportation operation that was solely interstate, the Court held the tax inimical to the commerce clause as a tax upon the privilege of engaging in interstate commerce. Justice Brandeis dissented vigorously from the *Ozark Pipe Line* decision on the grounds that the incidence of the tax was the privilege of carrying on business in corporate form, with the corporation's main place of business and much property within the state, and with the grant to the corporation of the power to exercise for its purposes the right of eminent domain. This business which this foreign corporation sought leave to do in corporate form, Justice Brandeis thought, was local as well as interstate. Justice Brandeis pointed out that there was no claim that the questioned tax discriminated against interstate commerce; and he concluded that the state must either give up its franchise tax or discriminate against its own local business which must be saddled with the tax.

Although Missouri was denied the constitutional power to tax the pipeline company for the privilege of doing business under the statute as there drafted and applied, it does appear that the company did engage in activities within Missouri which could have been used to support a valid privilege tax. Not only did the pipeline company have within Missouri more than half of its property, its principal offices, its bank accounts, and payrolls, but in addition it purchased supplies, employed labor, maintained telegraph lines, made its contracts for the sale of oil; it was qualified to do local business, was granted power to exercise the right of eminent domain, and maintained three pumping stations to accelerate the propulsion of the oil through the pipelines.

By careful statutory draftsmanship it would seem that a valid privilege tax could be drafted by Missouri and states similarly situ-

8. 266 U.S. 555 (1925).

ated. Had Missouri singled out some of those various means and instrumentalities used to transport the oil interstate, instead of applying her tax to the broad privilege of engaging in transportation, the tax might well have warded off the commerce clause assault. The activities of the pipeline company within Missouri were similar to those upon which other privilege taxes have been sustained. One such activity was made the subject of a valid privilege tax in *Coverdale v. Arkansas-Louisiana Pipe Line Co.*[9] There the Court sustained, over commerce clause objections, a privilege tax as applied to the production of the mechanical power (the compressor stations) used to propel gas through an interstate pipeline. Although the compressor stations appear to be indispensable to the interstate gas business (since gas would not flow through the pipes without the compression), nevertheless the Court was of the opinion that the stations were local activities, separate and apart from interstate commerce.

Also, in *Memphis Natural Gas Co. v. Stone,*[10] involving a Mississippi statute, the Court upheld over commerce clause objections, a privilege tax as applied to the activities of "maintaining, keeping in repair and otherwise in managing" the pipeline facilities used in transporting gas through the state, although the taxpaying pipeline company was engaged *exclusively* in interstate transportation of gas. The Mississippi tax was measured by all the capital employed within the state. Ozark Pipe Lines engaged in activity within Missouri which would seem to support a privilege tax patterned after that sustained in *Memphis Natural Gas.* Moreover, in *Memphis Natural Gas* the Court expressly limited *Ozark Pipe Line Corp. v. Monier* to a tax "upon the privilege or right to do business" and said that if *Ozark Pipe Line Corp. v. Monier* held that the in-state activities could not be taxed, it disagreed with the conclusion.[11] The rationale of these two cases, *Coverdale* and *Memphis Natural Gas,* would seem to support the proposition that the states may constitutionally impose privilege taxes on the means and instrumentalities indispensable to the transportation of oil and gas in interstate channels, even though the taxpayer is engaged exclusively in interstate commerce. While taxes on the privilege of engaging in transportation in these two cases ostensibly would have been banned, yet these privileges closely connected with the interstate transportation were regarded as distinct from the transportation for purposes of taxation.[12]

9. 303 U.S. 604 (1938).
10. 335 U.S. 80 (1948).
11. *Id.* at 94.
12. Likewise property taxes on means and instrumentalities used to carry on interstate commerce are valid. See, *e.g.,* Northwest Airlines, Inc. v. Minnesota, 322 U.S. 292 (1944). The writer has elsewhere made a much fuller discussion of property taxes on such property. See HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 122-79 (1953).

The decisions examined thus far make it clear that where the incidence of the tax is attributable only to interstate pipeline transportation of oil and gas,[13] as distinguished from some "local" event closely related to the transportation,[14] or as distinguished from the local activity of delivery to consumers,[15] the tax has been declared a burden forbidden by the commerce clause.

The latest pronouncement by the Supreme Court of the United States dealing with the impact of the commerce clause on a tax levied in connection with the interstate transportation of gas is *Michigan-Wisconsin Pipe Line Co. v. Calvert*.[16] There the controversy was whether a Texas tax as applied had as its incidence an activity attributable to a judicially recognized, taxable local event or whether the incidence was solely attributable to interstate transportation of gas.

The questioned statute imposed upon every person engaged in gathering gas an occupation tax for the privilege of engaging in such business, measured by the volume of gas gathered. The statutory definition of the term "gathering" became crucial to the decision. As to this definition, the statute provided that "in the case of gas containing gasoline or liquid hydrocarbons that are removed or extracted at a point within the State by scrubbing, absorption, compression or any other process, the term 'gathering gas' means the first taking or the first retaining of possession of such gas for other processing or transmission, whether through a pipeline, either common carrier or private, or otherwise after such gas has passed through the outlet of such plant." The statute prohibited the "gatherer" as therein defined from shifting the burden of the tax to the producer of the gas. The objecting taxpayer neither produced nor sold gas in Texas. All of its gas was bought from a Texas producer. The gas involved was produced, collected from the well-heads by the producer, and piped into a gasoline plant where certain liquefiable hydrocarbons, oxygen, sulphur, hydrogen sulphide, dust and foreign substances were removed preparatory to the transmission of the gas. After the dry gas had passed through producer's separation plant, it then flowed through producer's pipes for a short distance where it was delivered to taxpayer's pipeline at the outlet of the plant. The gas then continued to move in a constant flow to a compressor station owned and operated by taxpayer, at which station the pressure of the gas was raised to facilitate movement to distant extra-state markets. The taxed event, as found by the Texas court, was the "taking or retaining of the gas at the gasoline plant outlet." The Texas court upheld

13. See textual material supported by cases in notes 2, 3, 4, and 8 *supra*.
14. See textual material supported by cases in notes 9 and 10 *supra*.
15. See textual material supported by note 7 *supra*.
16. 347 U.S. 157 (1954).

the tax statute as thus applied since it was of the opinion that the incidence of the tax was a local event and the tax was not subject to repetition elsewhere.

The Supreme Court of the United States agreed with the Texas tribunal as to the incidence of the tax but declared that the statute had delayed the incidence of the tax beyond the step where production and processing had ceased and transmission in interstate commerce had begun.[17] Calling the statutory definition of the term "gathering gas" a "beggared definition,"[18] the Court observed that taxpayer obviously was not engaged in "gathering gas" within the meaning of that term in its ordinary usage and that the tax statute gave the term a transcendent scope.[19] The Court then concluded that the incidence of the tax (gathering gas) occurred *after* the gas had been produced, gathered, and processed by others than the taxpayer and that the "gathering of the gas" was essentially a part of interstate commerce itself.[20]

As a constitutional predicate for its decision, the Supreme Court was of the opinion that it is "now well settled that a tax imposed on a local activity related to interstate commerce is valid if, and only if, the local activity is not such an integral part of the interstate process, the flow of commerce, that it cannot realistically be separated from it."[21] Having thus reasoned, the Court held that the questioned tax was a forbidden levy on interstate commerce itself. The privilege taxed, namely the taking of the gas, was not so separate and distinct from interstate transportation as to support the tax.

The Texas statute as applied in the *Calvert* case was not incident to the local activities of production and processing, preceding the entry of the gas into the interstate transportation system. Rather, the tax appears to bear directly on activities that are solely attributable to the interstate transportation of the gas. As such, the case is in line with earlier cases that struck down taxes on activities attributable solely to the interstate transportation itself.[22]

Although Texas was rebuffed in the *Calvert* case, nevertheless, by a change in legislative drafting, Texas should be able to harvest revenue from the various activities of this pipeline company. Perhaps the Supreme Court of the United States might put its stamp of constitutional approval on certain legislatively designated local events in connection with the processing of the gas in extracting the liquid

17. *Id.* at 166.
18. *Id.* at 161.
19. *Id.* at 164.
20. *Id.* at 167.
21. *Id.* at 166.
22. State Tax Comm'n v. Interstate Natural Gas Co., 284 U.S. 41 (1931); Ozark Pipe Line Corp. v. Monier, 266 U.S. 555 (1925); United Fuel Gas Co. v. Hallanan, 257 U.S. 277 (1921); Eureka Pipe Line Co. v. Hallanan, 257 U.S. 265 (1921); all of which cases we have examined herein.

hydrocarbons, or removal of such substances as water, sulphur, dust, foreign substances, etc., at the scrubber or dehydration plants.[23] Likewise, the legislature might be successful in finding taxable local events in connection with gathering the gas from the wells.[24] Constitutionality might be achieved even in connection with the purchase of the gas by the pipeline company, as distinguished from the Texas statutorily defined event of "gathering" gas.[25] Such tax, of course, favors those producers who transport their own gas from their own wells. However, all the mentioned activities appear to be local pursuits attributable only to production, processing, and collecting gas and are prefatory to interstate transportation of the gas. It is sound constitutional gospel, of course, that the fact that goods are being manufactured, processed or prepared for transportation in interstate channels has not exempted from various sorts of privilege taxes either the activities of producing or preparing of the articles themselves, or those who produced or otherwise processed or prepared the article for interstate passage.[26] Moreover, there ought to be sufficient localism in the operation of the gas compressors, under previous authority, to support a tax for the privilege of operating them.[27] Also, we just saw that Mississippi got her privilege tax on interstate transportation of gas over the commerce clause hurdle by applying the tax to the privilege of "maintaining, keeping in repair and otherwise in managing" the pipeline facilities used to transport the gas through the state.[28]

Sales Taxes as Applied to Transportation of Gas and Oil: A convenient way of deriving revenue from the oil and gas industry is through the imposition of a tax on gross receipts derived either from the sale of the oil and gas or derived from the sale of services in connection with transporting these commodities. Generically speaking, sales taxes, as here treated, are a species of privilege tax and could

23. *Cf.* Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922) (processing coal for market).

24. See Michigan-Wisconsin Pipe Line Co. v. Calvert, 347 U.S. 157, 166-67 (1954).

25. In International Harvester Co. v. Department of Treasury, 322 U.S. 340 (1944), sales contracts made within the taxing state for the sale of goods to go into interstate commerce were held to be taxable sales.

26. See, *e.g.,* Chassaniol v. City of Greenwood, 291 U.S. 584 (1934) (occupation tax on buying and selling cotton locally produced, processed, and warehoused after it had been ginned, upheld); Federal Compress & Warehouse Co. v. McLean, 291 U.S. 17 (1934) (license tax levied on privilege of operating a cotton compress and warehouse, sustained, although interstate commerce followed); Utah Power & Light Co. v. Pfost, 286 U.S. 165 (1932) (license tax on manufacture, generation or production of electricity transmitted instantaneously in interstate commerce, held valid); Hope Natural Gas Co. v. Hall, 274 U.S. 284 (1927) (privilege tax on production of gas sold interstate, sustained); Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923) (occupation tax on mining ores, held valid).

27. See textual material supported by note 9 *supra.*

28. See textual material supported by note 10 *supra.*

properly have been considered under the preceding heading dealing with privilege taxes as such. Purely for convenience in discussion, however, sales taxes have here been put in this separate category.

As we have just had occasion to observe, mining, manufacturing and production have been treated by the Supreme Court of the United States as purely local pursuits, and interstate commerce does not begin until the articles start their final movement for transportation from the state of production to that of their destination. Such was the reasoning evolved by the Court at an early date as a criterion for determining tax validity under the commerce clause. As long as there was a perceptible pause or break between production and transportation, there was no judicial difficulty in applying this test of constitutionality; but modern business does not necessarily accommodate itself to the convenience of the mental processes of the judiciary. We find this illustrated in the first case involving a privilege tax, measured by gross receipts from sales, as applied to the production of gas. In *Hope Natural Gas Co. v. Hall*,[29] the Supreme Court of the United States had before it a West Virginia occupation tax upon the business of producing natural gas and other named resources, the tax being measured by the gross proceeds from the sale irrespective of the place of sale. Most of the product of the taxpayer moved directly from the producing wells in West Virginia into Ohio and Pennsylvania where it was consumed.

Where gas is released from the producing wells in one state and is transmitted in a continuous movement to the burner-tips in another state by a single operation of opening a valve or turning a gas jet in the latter state, it is not possible to mark, in any satisfactory or realistic manner, the dividing line between production and interstate transportation so as to conform to prior patterns of judicial reasoning. In the *Hope Natural Gas* case the taxpayer ostensibly assumed that there could be valid state taxation of the value of the gas at the well. The only objection to which the Court addressed itself was the use of gross receipts from extra-state sales as a factor in fixing that value. The Supreme Court of the United States accepted the state court's interpretation of the West Virginia statute as being applicable to the value of the gas within the state and before it entered interstate commerce, and that the gross proceeds from sales in another state were only to be taken into account for finding that value. Accepting this interpretation of the highest state tribunal, our highest federal tribunal sustained the *Hope Natural Gas* tax. Gross receipts from extra-state sales of the gas were thus properly used, thought the Court, to fix the value of the gas produced at the well for tax purposes.

29. 274 U.S. 284 (1927).

In the *Hope Natural Gas* case the gross proceeds from the interstate sale of gas were taxed by the state of production. In *East Ohio Gas Co. v. Tax Commission*,[30] the taxpayer (East Ohio Gas) resisted a tax imposed by the state of the consumer on gross receipts from sales of gas by the taxed pipeline company to consumers.

For all practical purposes, this case is about the same situation as that in the Tennessee case of *Tennessee Natural Gas Lines v. Atkins*,[31] which is the subject of this comment.

In the *East Ohio Gas* case an Ohio excise for the privilege of engaging in business was applied to a pipeline company distributing gas to consumers. A percentage of the gross receipts from sales in local business was the legislatively designated measure of the tax. The issue in the case was the determination of what business could properly be included in the measure of the tax. East Ohio (taxpayer) obtained three-fourths of its supply of gas from West Virginia and Pennsylvania and one-fourth in Ohio. This taxed distributor furnished to some customers gas exclusively from outside the taxing state, to some only gas from Ohio, and to other customers a mixture of that originating within and without the state. The crux of the controversy had to do only with the tax on the receipts from customers receiving gas only from wells outside the taxing state. Taxpayer purchased this gas from producing and carrying companies at the state line. The tax was challenged on commerce clause grounds, but was sustained by the Supreme Court of the United States. This furnishing of gas at wholesale to this distributor-taxpayer was declared by the Court to constitute interstate commerce, but the Court held that interstate commerce ended when the gas was delivered to taxpayer. The reduction of gas pressure by passing through reducing stations and the division into many relatively tiny streams that entered the small service lines for delivery by taxpayer to consumers were said by the Court to be like the breaking of an original package, after shipment in interstate commerce, in order that its contents may be treated, prepared for sale, and sold at retail. The Court concluded, therefore, that this whole process of furnishing gas by taxpayer to consumers in the taxing state (the taxed sale) by means of distribution plants did not constitute interstate commerce, but was purely a local activity. With the interstate nature of the taxed activity thus gone, there remained no commerce clause infirmity in the tax imposed on the gross proceeds from the sale by the taxpayer to the consumer.

In the essential commercial respects the *East Ohio Gas* case appears to be like *Tennessee Natural Gas Lines v. Atkins*.[32] Consequently, the

30. 283 U.S. 465 (1931).
31. 287 S.W.2d 67 (Tenn. 1956).
32. *Ibid.*

Tennessee Supreme Court's decision upholding the Tennessee tax is in line with this controlling decision of the Supreme Court of the United States on the commerce clause point.

Although the United States Supreme Court appears to give weight to the reduction of the pressure of the gas in sustaining the tax in the *East Ohio Gas* case, it must not be thought that the reduction of the pressure of gas is the touchstone to valid taxation insofar as the commerce clause is concerned. In *State Tax Commission v. Interstate Natural Gas Co.*[33] we saw that gas pressure was reduced merely as an incident to the convenient delivery by the wholesale distributing company (taxpayer) to another distributor who, in turn, would resell the gas. There the delivery by the taxed wholesaler to another distributor did not give the state a taxable grip. Neither does the increasing of pressure to facilitate interstate propulsion of gas through pipelines appear to be significant in determining the constitutionality of a privilege tax on transporting gas across the state lines, at least where the tax reaches the entire volume of gas. That conclusion seems implicit in the language of *Michigan-Wisconsin Pipe Line Co. v. Calvert*[34] which held that the tax offended commerce clause requirements. So the real distinction between those privilege taxes on transportation of gas which have been upheld and those struck down can hardly be anything about manipulating the pressure of the gas.

When a privilege tax in connection with the sale and transportation of gas and oil is opposed on commerce clause grounds, the rationale of the cases thus far examined seems to be the formulation of a judgment whether the incidence of the tax is attributable to one or more of the judicially recognized, taxable local activities in connection with the production and transportation of the commodity, on the one hand; or, on the other hand, is the incidence of the tax attributable only to a taxfree operation of purely interstate transportation. Thus, the Court has found sufficient localism for a tax where the state of production has sought to reach an extrastate sale by using the proceeds of the sale only to fix the value of the privilege of production.[35] Also, where the gas has been transported across the state lines coming into the taxing state, the delivery of the gas to consumers in the taxing state constitutes activity that can constitutionally be used as the incidence of a tax.[36] On the

33. 284 U.S. 41 (1931).

34. 347 U.S. 157 (1954). See textual material supported by notes 16 through 21 *supra*.

35. Hope Natural Gas Corp. v. Hall, 274 U.S. 284 (1927). See textual material supported by note 29 *supra*.

36. Southern Natural Gas Corp. v. Alabama, 301 U.S. 148 (1937), discussed in connection with note 7 *supra;* and East Ohio Gas Co. v. Tax Comm'n, 283 U.S. 465 (1931), discussed in connection with note 30 *supra.*

other side of the shield, taxes applied solely to the privilege of interstate transportation are forbidden by the commerce clause. Such taxes by the state of production will fall before a commerce clause attack where the taxed transportation operation starts with the initial step in a journey that has an extra-state destination;[37] and such a privilege tax by the state of production is also proscribed by the commerce clause when applied to transportation by a pipeline carrier that has received the product from another after the out-of-state movement already has begun.[38] Also, these tax-immune interstate transportation operations extend to the transportation of gas brought into the taxing state, where the taxed carrier simply delivers the product within the state only to another pipeline carrier,[39] as distinguished from delivery by a transportation company to consumers, which is taxable, local activity. Moreover, exclusively interstate transportation of oil (and presumably gas) that passes through the taxing states, without deliveries of any sort, is beyond the constitutional reach of the state insofar as taxes on the privilege of engaging in that transportation are concerned.[40] Of course, there are those valid privilege taxes applied to the privilege of using some vehicle or instrumentality connected with interstate transportation, even though indispendable to the transportation, but which the Court treats as separate and distinct from the interstate commerce for tax purposes.[41]

One rather late case does not fit into the rationale of the cases as heretofore developed. That is *Interstate Oil Pipe Line Co. v. Stone.*[42] There Mississippi had a statute levying a tax for the privilege of engaging in business, measured by gross income. Mississippi applied this tax to a pipeline company engaged in transporting oil. Taxpayer transported oil from lease tanks in various fields in Mississippi to loading racks adjacent to railroads elsewhere in the state. From these racks the oil was pumped into railroad tank cars for shipment to points outside the state. In the event no tank cars were available, the oil was stored in tanks near the racks, but delays in loading usually were of short duration and never exceeded a week. When

37. United Fuel Gas Co. v. Hallanan, 257 U.S. 277 (1921), and Eureka Pipe Line Co. v. Hallanan, 257 U.S. 265 (1921), which are discussed in connection with notes 2 and 3 *supra.*

38. Michigan-Wisconsin Pipe Line Co. v. Calvert, 347 U.S. 157 (1954), discussed in connection with notes 16 through 21 *supra.*

39. State Tax Comm'n v. Interstate Natural Gas Co., 284 U.S. 41 (1931), discussed in connection with note 4 *supra.*

40. Ozark Pipe Line Corp. v. Monier, 266 U.S. 555 (1925), discussed in connection with note 8 *supra.*

41. Coverdale v. Arkansas-Louisiana Pipe Line Co., 303 U.S. 604 (1938) (compressor stations), which is discussed in connection with note 9 *supra;* and Memphis Natural Gas Co. v. Stone, 335 U.S. 80 (1948) (pipe lines in ground), discussed in connection with note 10 *supra.*

42. 337 U.S. 662 (1949).

the oil was delivered to taxpayer it was accompanied by shipping orders from the producer or owner directing that the oil be transported to out-of-state destinations. There was no through bill of lading from the point of origin at the oil fields to the extra-state destinations. Taxpayer was engaged solely in transporting oil that went exclusively into interstate channels; no oil was sold in the taxing state. The tax was construed to be on the privilege of operating the pipelines with the gross proceeds from the transportation of the oil from the lease tanks to the loading racks used to measure the amount of tax. Taxpayer resisted the tax as an unconstitutional levy on the privilege of engaging in interstate commerce.

The Supreme Court of the United States sustained the tax, with four members of the majority of the Court voting to uphold it even though the statute, as applied, levied a direct tax on the privilege of engaging in interstate commerce. The fifth member of the majority voted to sustain the tax on the ground that it was imposed on the privilege of transporting oil in Mississippi in local commerce. There was a strong dissent on the theory that the exaction was a forbidden levy on the privilege of engaging in interstate commerce.

Since the taxpayer (Interstate Oil Pipe Line) was engaged solely in transporting oil from a producer or owner to another connecting carrier that would transport the oil to a destination beyond the borders of the taxing state, the case does not fit into the commerce clause pattern of the cases thus far examined. Taxpayer's activities were not attributable to the taxable, local activity of production; neither did it deliver oil within the state for the taxable purpose of consumption. Although all taxpayer's operations took place within the taxing state, yet taxpayer was only a segment in an interstate conduit employed exclusively in interstate transportation, so to speak. The income from those transportation activities was the measure of the tax. As we have just seen, prior to *Interstate Pipe Line Co. v. Stone* privilege taxes on the transportation of oil and gas have been interdicted where the incidence of the tax was attributable solely to interstate transportation of those commodities.

As *Interstate Oil Pipe Line Co. v. Stone* actually stands, it is, however, of doubtful significance. While four members of the Court voted to sustain the tax even though imposed directly on the privilege of engaging in interstate commerce, later decisions by the Supreme Court make it clear that such judicial thinking is no longer in vogue.[43] Moreover, not even a majority of the Court voted to uphold the tax

43. Later decisions of the Supreme Court make it clear that the Court will make short shrift of a tax thought to be levied on the privilege of engaging in interstate commerce. See, *e.g.*, Michigan-Wisconsin Pipe Line Co. v. Calvert, 347 U.S. 157 (1954); Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951); *cf.* Railway Express Agency, Inc. v. Virginia, 347 U.S. 359 (1954).

on that ground. Mr. Justice Burton voted to sustain the tax as one levied on a local activity.

Much can be said in support of the view of those four members of the Court who would uphold this *Interstate Oil Pipe Line* privilege tax, even though levied directly on the privilege of engaging in interstate commerce. This view would require interstate commerce to bear its share of the expenses of the government under whose protection it operated. Moreover, this view removes the inequities of permitting interstate business to escape a tax with which local business must be saddled, for local business is thereby placed at a competitive disadvantage. Also, Mississippi tried to reach only her fair share of revenue. She taxed only those receipts derived from transportation operations within her borders. There was thus no danger of including extra-state values in the reach of her tax. Neither could any other state reach those values taxed by Mississippi; hence the tax could not be repeated elsewhere so as to place interstate business at a disadvantage with local business.

The Commerce Clause and the States' Power to Impose Privilege Taxes on Multi-state Investment Companies

Tennessee also saw another of her tax statutes clear the commerce clause hurdle, insofar as the Tennessee Supreme Court is concerned, in *Investors Syndicate of America, Inc. v. Allen.*[44] Two objecting taxpayers, The Investors Syndicate of America and Investors Diversified Services are engaged in the investment business. The latter corporation wholly owns the former and both are authorized to do business in Tennessee. Both are foreign corporations. Diversified Services has about 75 sales agents in Tennessee and it has sold and serviced large amounts of investment certificates to the citizens of Tennessee. Investors Syndicate, the subsidiary, had a contract with Diversified Services, the parent, whereby Diversified Services sells the investment certificates to the public for Investors Syndicate. The certificates are issued by Investors Syndicate.

Both corporations challenged, on commerce clause grounds, a Tennessee privilege tax levied against corporations, individuals and partnerships engaged in writing, issuing, servicing and/or collecting installments on investment contracts, whether such contracts are now being issued or heretofore issued or collecting installments thereon. The tax was measured by a percentage of the gross receipts of the business. The tax statute also exempted the business of selling and servicing investment certificates from all other taxes upon property owned by such investment companies, including all other privilege taxes. Both corporations claimed to be engaged exclusively in interstate com-

44. 279 S.W.2d 497 (Tenn. 1955).

merce and thus not subject to the privilege tax. To buttress its position that it was engaged exclusively in interstate commerce, Investors Syndicate took the position that Diversified Services was an independent contractor and was not Investors' agent. Therefore, Investors concluded that since it was a foreign corporation it was engaged only in an interstate business. The Tennessee Supreme Court, affirming the lower court, first concluded that Diversified Services was, in fact, the agent of Investors. Then, over the commerce clause objections, the Court sustained the tax finding that both corporations were engaged in local business, as well as in interstate business.

It is a well settled proposition of law that a foreign corporation engaged only in soliciting business within a taxing state is engaged exclusively in interstate commerce and neither the corporation nor the soliciting agent is subject to any tax for the privilege of soliciting business. The commerce clause bars the tax on both.[45] That a state may require payment of a tax for the privilege of engaging in a local business or occupation, although mingled with interstate business, is also a general proposition no longer within the arena of debate.[46] Although a business concern does not, by engaging in local business, forfeit its right to the protection of the commerce clause for its interstate business, it cannot channel business through a local outlet to gain advantage of a local business and also retain for the local business whatever immunity from taxation is furnished by the commerce clause to interstate business. So, the issue in the case at hand is whether the corporations engage in some local business, or is everything done by them only in furtherance of, or incidental to, a business that is exclusively interstate?

Having first found that Investors Syndicate was operating through its agent, Diversified Services, the Court then concluded that both corporations did some local business, as well as interstate business. Although the companies were not taking or receiving applications for investment certificates at the time of the levy of the tax, that alone did not render their business wholly interstate. Both corporations are qualified to do business in Tennessee; their investment contracts are being serviced, and the holders of the certificates are paying annually to the parent, Diversified Services, approximately $2,000,000; and Diversified Services had large amounts of money on deposit in the banks in the state. The Court was of the opinion that all these activities amounted to the doing of some taxable, local business.

The measure of the privilege tax in the case at hand is the familiar

45. Norton Co. v. Department of Revenue, 340 U.S. 534 (1951); Nippert v. City of Richmond, 327 U.S. 416 (1946); Best & Co. v. Maxwell, 311 U.S. 454 (1940); Cheney Bros. Co. v. Massachusetts, 246 U.S. 147 (1918).

46. Chicago v. Willett Co., 344 U.S. 574 (1953); Norton Co. v. Department of Revenue, 340 U.S. 534 (1951); Dalton Adding Machine Co. v. Virginia, 246 U.S. 498 (1918).

one of using the gross receipts from the business. The Supreme Court of the United States, in passing on the constitutionality of a tax involving gross receipts, has often drawn an artificial distinction between taxes levied directly "on" gross receipts, and a tax "measured by" gross receipts, the latter having a much better chance of withstanding an attack on commerce clause grounds.[47] Also, the tax in the case at hand was levied in lieu of all other taxes. Even during much of our constitutional history when the Supreme Court has looked with distinct disfavor upon taxes involving gross receipts from interstate transactions, a tax involving gross receipts levied "in lieu of" all other taxes became a familiar and sanctioned tax.[48]

In sustaining the tax in the *Investors* Case, the Tennessee Court lays considerable stress on the fact that these two foreign corporations had qualified to do business in Tennessee. Under prior controlling decisions of the United States Supreme Court there is some doubt that this grant by the state could alone be used to support a valid privilege tax, if it be found that the business actually done was, in fact, only interstate commerce.[49] Moreover, if this case were to reach the Supreme Court of the United States, that Court will make its own independent decision as to whether the business done was wholly interstate.[50]

There is no doubt in the writer's mind that Tennessee should be able to exact this charge for the support of the state government under whose protection these corporations operate. Unfortunately, however, if a higher tribunal were to find that all that was done in Tennessee was in furtherance of a business that is exclusively interstate, then these foreign corporations perhaps could not, consistent with present views on the commerce clause, be made to bear their fair share of the cost of the government of Tennessee by paying this tax.[51]

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47. The writer has undertaken elsewhere to give a much fuller treatment of these various facets of the "gross receipts tax." See HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 180-214 (1953) (particularly 180-88).

48. Great Northern Ry. v. Minnesota, 278 U.S. 503 (1929); Pullman Co. v. Richardson, 261 U.S. 330 (1923); Northwestern Mutual Life Ins. Co. v. Wisconsin, 247 U.S. 132 (1918); United States Express Co. v. Minnesota, 223 U.S. 335 (1912).

49. Anglo-Chilean Nitrate Sales Corp. v. Alabama, 288 U.S. 218 (1933).

50. The Supreme Court will review the question of whether the state court erroneously classified the commerce as local when, in fact, it was interstate. Michigan-Wisconsin Pipe Line Co. v. Calvert, 347 U.S. 157 (1954); Central Greyhound Lines, Inc. v. Mealey, 334 U.S. 653 (1948); Eureka Pipe Line Co. v. Hallanan, 257 U.S. 265 (1921). However, the taxpayer claiming the immunity under the commerce clause is said to have the burden of establishing his exemption from the tax. Chicago v. Willett Co., 344 U.S. 574 (1953); Norton Co. v. Department of Revenue, 340 U.S. 534 (1951).

51. Ozark Pipe Line Corp. v. Monier, 266 U.S. 555 (1925); *cf.* Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951) (tax measured by net income struck down where business was exclusively interstate). The *Ozark Pipe Line* case is treated in considerable detail in the text supported by notes 8 through 12 *supra*.

The Impact of the Due Process Clause on Excise Taxes on a Foreign Corporation Doing a Multi-State Business.

Tennessee's corporate excise tax measured by net earnings was challenged on due process grounds in *W. S. Dickey Clay Mfg. Co. v. Dickinson.*[52] The objecting taxpayer was W. S. Dickey Clay Mfg. Co., a Delaware corporation, with general offices in Missouri but manufacturing glazed clay sewer pipe and allied clay products with five plants in four states, including a plant in Tennessee. The principal point in the case was whether the statutory tax formula for computing net earnings should be based on a percentage of the combined earnings of all five plants, or whether the tax should be applied only to the earnings of taxpayer's plant in Tennessee. A second question was, assuming that all five plants should be used, should a so-called "hardship" formula be used rather than the regular statutory formula.

The gist of taxpayer's due process objections was that its business is multiform and that the tax should have been computed only on the earnings of the Tennessee plant, whereas the lower court ruled that the business was unitary in character and that the tax should be based on a percentage of the net annual earnings of all the five plants, although some were located in other states. Taxpayer contended that the earnings so taxed from the extra-state plants were neither derived from, nor reasonably attributable to, business done in Tennessee. The excise tax in question was measured by a percentage of corporate net earnings from business done within the state. The Tennessee apportionment formula for determining the amount of taxpayer's net earnings allocable to Tennessee is the ratio obtained by taking the arithmetical average of the ratio of the value of three factors: (a) taxpayer's real estate and tangible personal property in Tennessee to the value of the taxpayer's entire real estate and tangible personal property; (b) the ratio of the total cost of manufacturing, etc., within the state to the total cost of manufacturing, etc., within and without the sate; (c) the ratio of the gross sales to customers in Tennessee to the total gross sales from all sources.[53]

Over the due process clause objections, the Supreme Court of Tennessee sustained the tax based on this three-factor formula, holding that taxpayer's entire business in all four states was unitary and that the tax should be computed on that basis. Also, the Court found no basis for applying the "hardship" formula which is provided for in the event unusual circumstances warrant using some other formula.[54]

In sweeping language the Supreme Court of the United States has laid down a due process clause limitation on state taxing powers, declaring that a "state may not tax real property or tangible personal

52. 289 S.W.2d 533 (Tenn. 1956).
53. TENN. CODE ANN. § 67-2707 (1956).
54. TENN. CODE ANN. § 67-2711 (1956).

property lying outside her borders; nor may she lay an excise or privilege tax upon the exercise or enjoyment of a right or privilege in another state derived from the laws of that state and therein exercised and enjoyed."[55] Stated more affirmatively, due process is concerned with whether a tax in practical operation has relation to opportunities, benefits, or protection conferred or afforded by the taxing state.[56]

When a state imposes a tax upon the net income of a foreign corporation engaged in multi-state business, the Court has made it clear that the tax can withstand the impact of the due process clause if the tax reaches only that portion of the corporation's total net income which is attributable to sources within the state.[57] When a corporation carries on business both within and without the taxing state, a tax on net profits is valid, although such profits may have been obtained in part from interstate transactions, provided that the intrastate portion thereof is ascertained by apportionment.[58] Moreover, the Court recognizes that the value of the privilege of doing a local business is increased for tax purposes, by the use of property beyond the taxing state. The in-state property of such multi-state corporations does have a real intangible value above its physical worth owing to its use as part of one entire enterprise.[59]

When a corporation carries on business in several states, and if the operations are not closely allied, the business may be divided among the individual states for tax purposes by the separate accounting method. Taxpayer contended that such separate accounting method should have been used in the case at hand. On the other hand, if a business within each state is integrated with the business in other states, the separate accounting method need not be used. The entire business income from all states may then be apportioned among the relevant states on the basis of factors that produce the income.[60] The difficulty of making an exact apportionment is readily apparent in a far-flung, multi-state business enterprise, and hence the application of the formula for apportionment of the income to the taxing state will withstand a due process clause assault unless it produces an unreasonable and arbitrary result in a particular case. In a great number of decisions the Supreme Court of the United States has up-

55. Great Atlantic & Pacific Tea Co. v. Grosjean, 301 U.S. 412, 424 (1936).
56. See Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169, 174 (1949); Wisconsin v. J. C. Penney Co., 311 U.S. 435, 444 (1940).
57. See, *e.g.*, Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924) (foreign commerce); Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920).
58. Matson Navigation Co. v. State Bd. of Equalization, 297 U.S. 441 (1936); Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920).
59. International Harvester Co. v. Evatt, 329 U.S. 416 (1947); Ford Motor Co. v. Beauchamp, 308 U.S. 331 (1939).
60. For discussion of the problem, see Silverstein, *Problems of Apportionment in Taxation of Multistate Business*, 4 TAX L. REV. 207 (1949).

held tax apportionment formulas, over due process and commerce clause objections, where multi-state businesses have been taxed, notwithstanding the fact that the various taxing jurisdictions have not reached agreement on the factors that should go into this fiscal formula and in spite of the fact that inequities may be produced by variations in these formulas.[61] The burden is on the taxpayer challenging the fairness of the apportionment formula, on due process grounds, to make tax oppression manifest by clear and cogent evidence.[62] He has carried that burden, however, when he can successfully show that "in any aspect of the evidence" the income attributable to the taxing state by the use of the formula is "out of all appropriate proportion to the business" transacted by the taxpayer in the taxing state.[63] Mathematical exactness in apportioning, however, is not required of the taxing state.[64]

The United States Supreme Court case of *Butler Brothers v. McColgan*[65] sustained a California three-factor formula of property, payrolls, and sales, as applied to an entire multi-state business although the taxpayer (Butler Brothers) made the contention that a separate accounting would reveal a loss from California business operations. The entire operations of Butler Brothers, both within and outside of California, produced a net profit, and the Court held that the California operations must be considered as being only a portion of the entire unitary operations of the business.

In the case at hand, there were several factors indicating that taxpayer (Dickey) was a unitary operation, rather than multiform, and that the integrated business need not be taxed on a separate accounting from the Tennessee plant alone. The expense incident to maintaining the general offices in Missouri are prorated and allocated among the manufacturing plants in all the states. A research laboratory for the benefit of all the plants is operated at and by the central office in Missouri. The type and kind of equipment installed at the Tennessee plant was determined on the basis of the experience of the corporation as a whole. When the Tennessee plant was transferred from a coal burning unit to a gas burning unit, the capital outlay was borne from the general assets of the corporation. The manufacturing experiences at all of the plants is available to other plants. The Ten-

61. International Harvester Co. v. Evatt, 329 U.S. 416 (1947); Butler Bros. v. McColgan, 315 U.S. 501 (1942); Ford Motor Co. v. Beauchamp, 308 U.S. 331 (1939); Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1925); Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920); Maxwell v. Kent-Coffey Mfg. Co., 204 N.C. 365, 168 S.E. 397 (1933), *aff'd per curiam*, 291 U.S. 642 (1933).

62. See Norfolk & W. Ry. v. North Carolina *ex rel.* Maxwell, 297 U.S. 682, 688 (1936).

63. Hans Rees' Sons, Inc. v. North Carolina *ex rel.* Maxwell, 283 U.S. 123 135 (1931).

64. Nashville, C. & St. L. Ry. v. Browning, 310 U.S. 362 (1940).

65. 315 U.S. 501 (1942).

nessee plant maintains two bank accounts. Checks are drawn by this plant to cover the payrolls, freight charges and miscellaneous purchases. In other instances checks with vouchers attached are forwarded to the central plant in Missouri, where they are audited and mailed out. The board of directors of the taxpayer meets monthly in the Missouri offices and determine the policies of the corporation.

There are other items significantly indicating an integrated, unitary multi-state enterprise, rather than separate entities, for tax purposes. The corporation owns a clay pit in Tennessee near that plant. Another of taxpayer's plants in Alabama uses a substantial quantity of clay from the Tennessee plant. No profit is credited to the Tennessee plant for the clay furnished the Alabama plant. The cost of the operation of the clay pit is shared by the Alabama and Tennessee plants. Moreover, there is no competition among the various plants. Each plant is given its own exclusive territory for sales. A large flat discount is allowed when one plant purchases material from another. The ultimate control of sales price is with the central office.

In sustaining the tax, the Tennessee Court properly, it seems, upheld the chancellor who had held that the unity of ownership, the unity of management, and the unity of the use to a greater or lessor extent, sustained the right of the state to tax on the basis of an allocation formula applied to the entire multi-state operations of taxpayer.

There are not sufficient facts in the Court's opinion upon which to express an opinion whether there were any unusual circumstances warranting the use of the "hardship" formula rather than the regular formula that was applied.