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Constitutional Law - Commerce Clause - Power of States to Levy Net Income Tax on Businesses Engaged in Soley Interstate Commerce

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CONSTITUTIONAL LAW—COMMERCE CLAUSE—POWER OF STATES TO LEVY NET INCOME TAX ON BUSINESSES ENGAGED IN SOLELY INTERSTATE COMMERCE—Appellant, an Iowa corporation, maintained a sales office in Minnesota and employed salesmen who solicited orders from dealers within that state, though all of its sales contracts were made at the corporation's home office in Iowa. In accordance with a Minnesota statute,[1] a state net income tax, fairly apportioned to the state's share of the corporation's interstate business,[2] was levied upon appellant. In a suit brought by the state to collect this tax, appellant contended that the statute as applied violated the commerce and due process clauses of the Federal Constitution because it taxed the net proceeds of a business engaged in solely interstate commerce.[3] The Minnesota Supreme Court sustained the trial court's finding that the appellant was engaged in solely interstate commerce, but despite this finding upheld the statute and gave judgment for the state. On appeal to the United States Supreme Court, *held,* affirmed, three justices dissenting.[4] A fairly-apportioned, non-discriminatory state net income tax levied upon foreign corporations engaged in solely interstate commerce does not contravene the commerce or due process clauses of the Federal Constitution if there is sufficient activity in the taxing state to justify taxation. *Northwestern States Portland Cement Co. v. State of Minnesota,* 79 S. Ct. 357 (1959).[5]

1 Minn. Stat. (1947) §290.03.

2 The reasonableness of the apportionment was not in controversy. The apportionment was determined by a three-factor formula which took petitioner's total sales, tangible property, and payroll, and determined the percentage of those elements which were present in Minnesota.

3 Though there may have been some intrastate business, Minnesota did not rely upon this in its suit, and it is evident that the case was decided on the basis of state taxation of exclusively interstate commerce. See principal case at 368 and 371.

4 Justices Frankfurter, Whittaker and Stewart dissented.

5 In a companion case, involving similar facts, the Court upheld a Georgia statute for the reasons given in the principal case. Williams v. Stockham Valves and Fittings, Inc., 79 S. Ct. 357 (1959).

The Supreme Court has applied several tests in attempting to resolve the perennial problem of state taxation of interstate commerce.[6] In regard to state taxes on income derived from interstate commerce, it was long thought that the Court maintained a distinction between a tax on gross income, which was deemed invalid as a tax on a privilege that was not within the power of the state to grant,[7] and a fairly apportioned net income tax.[8] The rationale was that a tax on gross income was applied whether or not the business made a profit, thus burdening interstate commerce, whereas a tax on net income only affected a business if it made a profit from the interstate commerce, and thus did not burden the interstate commerce but merely taxed the profits derived from it.[9] The prior decisions supporting this distinction, however, all involved corporations which carried on some intrastate business. These decisions, therefore, go no farther than allowing a state either to tax intrastate business by using interstate sales within the state as one factor in its apportionment formula,[10] or to tax a portion of the total net income of a "domestic" corporation, even though that corporation is engaged in interstate commerce.[11] While it might have been possible to rationalize the facts of the principal case with these precedents,[12] the Court made it clear, by the stipulation of facts and by following the principal case in a per curiam decision,[13] that the states' power to levy a net income tax on corporations engaged in interstate commerce is not dependent in any way upon activity within the taxing state which can be categorized as intrastate commerce. As thus construed it must be questioned whether the principal case impliedly overrules *Spector Motor Service v. O'Connor*,[14] which also involved a fairly-

[6] For a general discussion of this area, see Brown, "State Taxation of Interstate Commerce—What Now?" 48 MICH. L. REV. 899 (1950); Anderson, "State Taxation of Interstate Commerce," 1952 WASH. UNIV. L. Q. 1 (1952); Powell, "More Ado About Gross Receipts Taxes," 60 HARV. L. REV. 510, 710 (1947).

[7] Freeman v. Hewitt, 329 U.S. 249 (1946).

[8] United States Glue Co. v. Town of Oak Creek, 247 U.S. 321 (1918); Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920).

[9] The classic statement of this view was made in United States Glue Co. v. Town of Oak Creek, note 8 supra, at 328: "The difference in effect between a tax measured by gross receipts and one measured by net income . . . is manifest and substantial. . . . A tax upon gross receipts affects each transaction in proportion to its magnitude and irrespective of whether it is profitable or otherwise."

[10] International Harvester Co. v. Evatt, 329 U.S. 416, reh. den. 329 U.S. 834 (1947).

[11] Matson Navigation Co. v. State Board of Equalization of State of California, 297 U.S. 441 (1936).

[12] It could be argued that the principal case is in accord with these precedents on the ground that continuous solicitation within Minnesota should now be regarded as intrastate business even though the actual sales contracts were formally consummated in Iowa. The court has recently indicated that it might be ready to abandon the formal distinctions based on the place of contract. See Miller Bros. Co. v. Maryland, 347 U.S. 340 at 346 (1954).

[13] ET and WNC Transportation Co. v. Currie, 79 S. Ct. 602 (1959).

[14] 340 U.S. 602 (1951).

apportioned, non-discriminatory state net income tax on a corporation engaged in solely interstate commerce. In the *Spector* case the Court found that the tax was invalid once it had been labeled a "privilege" tax imposed upon the right to conduct interstate business. It is not clear whether the tax was invalidated only because of the "privilege" label affixed by the state court,[15] or also because of the fact that the tax was a "direct burden" on interstate commerce without any local incidence justifying taxation.[16] The three dissenters in the *Spector* case strongly objected to any use of the "privilege" label to invalidate the state tax. It was their position that taxation of the net income from interstate commerce was legitimate regardless of the way in which the tax was characterized.[17] Yet in the principal case Justice Clark, one of the former dissenters, rather than overrule the *Spector* case, distinguished it on the ground that it involved a "privilege" tax even though the Minnesota tax here upheld was in substance exactly like the tax there invalidated.[18] Thus, even though the principal case does not expressly overrule the *Spector* decision, it does through use of "magic-word" jurisprudence effectively limit the *Spector* rule to cases involving a tax which state authorities have unfortunately labeled a "privilege" tax on net income from interstate commerce.

In upholding the net income tax in the principal case, the Court appears to be making a definite return to the "multiple burdens" approach to state taxation of interstate commerce. The "multiple burdens" test was first enunciated in 1938 by Justice Stone when he upheld a state gross receipts tax because it could not, if fairly apportioned, be made a "multiple burden" upon interstate business by duplication in other taxing states.[19] The "multiple burdens" test was applied until 1944, when a more restrictive attitude became apparent in the Court's decisions.[20] This restrictive trend was fortified in 1947, when the "multiple burdens" test was definitely rejected.[21] The rejection was never unanimous, however,[22] and in 1956 a

[15] Spector Motor Service v. O'Connor, note 14 supra, at 606.

[16] Id. at 608 and 609.

[17] "[T]here is no reasonable warrant for cloaking a purely verbal standard with constitutional dignity." Justice Clark dissenting in Spector Motor Service v. O'Connor, note 14 supra, at 614. Justices Black and Douglas joined in this dissent.

[18] See the discussion of the Spector case in the principal case at 365. Justice Clark states that the tax involved in the Spector case "was not a levy on net income." It was a tax on net income, Spector Motor Service v. O'Connor, note 14 supra, at 604 and 611, but failed because it was held to be a privilege tax on exclusively interstate commerce. Spector, at 609.

[19] Western Livestock v. Bureau of Revenue, 303 U.S. 250 (1938). This case involved a domestic corporation, however.

[20] McLeod v. Dilworth Co., 322 U.S. 327 (1944). Chief Justice Stone was in the majority in this case.

[21] Joseph v. Carter & Weekes Stevedoring Co., 330 U.S. 422 (1947). See also Freeman v. Hewitt, note 7 supra.

[22] Justices Black and Douglas dissented in McLeod v. Dilworth Co., note 20 supra, Joseph v. Carter & Weekes Stevedoring Co., note 21 supra, and Freeman v. Hewitt, note

per curiam decision upholding a Washington tax on facts somewhat similar to those in the principal case[23] indicated that the Court might again be favoring the "multiple burdens" approach. The return to this theory may be attributed to the fact that the Court is willing to change outmoded legal doctrines in order to make corporations pay for benefits received from the taxing state.[24] But by isolating instead of overruling the *Spector* case, the Court has left the way open for a return to the rationale of that decision in the event of a change in attitude by future members of the Court. For the present, however, it is clear that a more liberal treatment will be afforded state taxation of interstate commerce. How far this liberal treatment will extend is not yet settled. Although the principal case emphasizes the fact that the tax was a net income tax,[25] some of the views noted above do not seem to differentiate between the types of the taxes involved.[26] Furthermore, Justices Brennan and Harlan concurred in another case, decided the same day as the principal case, allowing a gross income tax on solely interstate commerce "in lieu of" all other "property" taxes,[27] even though they did not feel the tax was a true property tax.[28] The scope of the principal case may thus be broadened in the future to allow a fairly apportioned *gross* income tax on solely interstate commerce.

While the majority in the instant case has attempted to base its decision on precedent, the dissenters point out that the precedent relied on, with the possible exception of one case,[29] is merely dicta.[30] It is apparent, therefore, that this decision is more than a mere application of stare decisis.

7 supra. They joined Justice Clark in his dissent in the Spector Motor Service v. O'Connor, note 14 supra. Chief Justice Warren added his support by joining these justices in dissent in Miller Brothers Co. v. Maryland, note 12 supra, and Railway Express Agency, Inc. v. Virginia, 347 U.S. 359 (1954).

23 Field Enterprises, Inc. v. Washington, 352 U.S. 806 (1956). While this case may be distinguished from the principal case on the grounds that payments were sometimes accepted by salesmen within the state and the local office sometimes made credit investigations, the Court required less overall contact with the state than in previous cases.

24 This is in accord with the approach the Court has taken in the jurisdictional area. See International Shoe Co. v. Washington, 326 U.S. 310 (1945); Travellers Health Association v. Virginia State Corporation Commission, 339 U.S. 643 (1950).

25 Principal case at 359, 362, 363, 364, 365, 366, 367 and 368.

26 See note 22 supra. McLeod v. Dilworth Co., note 20 supra, involved a sales tax; Freeman v. Hewitt, note 7 supra, involved a gross income tax; Miller Brothers Co. v. Maryland, note 12 supra, involved a sales tax, and Railway Express Agency, Inc. v. Virginia, note 22 supra, involved a gross income tax.

27 Railway Express Agency v. Commonwealth of Virginia, 79 S. Ct. 411 (1959).

28 Id. at 418, 419 and 420.

29 West Publishing Co. v. McColgan, 328 U.S. 823 (1946). This was a per curiam opinion which was used by both the majority and dissent in support of their respective positions. In view of the honest controversy over its actual holding, it cannot be relied upon as strong precedent.

30 See the dissenting opinions of Justices Whittaker and Frankfurter, principal case at 368 and 379.

This is not to suggest that the Court should be reluctant to establish new precedent in the area, but that such a step when taken under the guise of stare decisis tends to add confusion to an already perplexing area.[31] It is unfortunate that a decision of such importance[32] is based upon such tenuous grounds, and that the outlines of its import are left uncertain.

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[31] See Blaustein and Field, " 'Overruling' Opinions in the Supreme Court," 57 MICH. L. REV. 151 (1958).

[32] A CCH news release of March 23, 1959 indicates that 28 states, Alabama, Alaska, Arizona, Arkansas, California, Colorado, Delaware, Georgia, Idaho, Iowa, Kansas, Kentucky, Louisiana, Maryland, Minnesota, Mississippi, Missouri, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Utah, Virginia, and Wisconsin, now have laws allowing them to tax interstate business. Seven other states, Connecticut, Massachusetts, Montana, New Jersey, New York, Tennessee, and Vermont, now tax intrastate business.