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CONSTITUTIONAL LAW-TAXATION-GROSS RECEIPTS TAXES IN RELATION TO INTERSTATE COMMERCE-FREEMAN v. HEWIT

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COMMENTS

CONSTITUTIONAL LAW—TAXATION—GROSS RECEIPTS TAXES IN RELATION TO INTERSTATE COMMERCE—FREEMAN V. HEWIT—The scope of state taxation of interstate commerce has been redefined in two recent Supreme Court cases involving the application of state gross receipts taxes. In *Freeman v. Hewit*[1] and *Joseph v. Carter and Weekes Stevedoring Co.*,[2] the Court discarded the cumulative burdens test, which for the past eight years had served as the basis for determining the extent of state taxation of interstate commerce, and readopted the direct and indirect burden test.

In *Freeman v. Hewit*, the Court had before it the Indiana Gross Income Tax. The tax had been imposed on the gross receipts from the sale of securities by a resident owner through a nonresident broker. The securities were sent via an Indiana broker through the mails to a New York broker, sold by him in New York City, and the proceeds, less broker's commissions, were remitted to the owner in the same manner. The Indiana Supreme Court held the tax valid and applicable on the ground that the situs of the securities was in Indiana. The majority of the United States Supreme Court, speaking through Justice Frankfurter, held the transaction to be a sale in interstate commerce, and the tax to be inapplicable as one imposing a direct burden on interstate commerce. Justice Rutledge concurred separately in the result, Justices Douglas and Murphy dissented with opinion. Justice Black dissented without opinion.

Joseph v. Carter and Weekes Stevedoring Co., involved the general business tax laws of New York City. The respondent was engaged in the stevedoring business, loading and unloading ships moving in interstate and foreign commerce. The act imposed a percentage tax on the entire gross receipts of their activities. The entire business of the respondent took place within the territorial limits of New York City. The comptroller of the City of New York determined that the respondents were liable for these taxes. The Supreme Court of New York County, Appellate Division, held the tax inapplicable on the authority of *Puget Sound Stevedoring Co. v. Tax Commission*,[3] and this

[1] 329 U.S. 249, 67 S. Ct. 274 (1946).
[2] 330 U.S. 422, 67 S. Ct. 815 (1947).
[3] 302 U.S. 90, 58 S. Ct. 72 (1937).

was affirmed by the Court of Appeals of the State of New York. The majority of the United States Supreme Court, speaking through Justice Reed, affirmed the decision of the state court, holding stevedoring to be part of interstate commerce and the tax to be inapplicable as imposing a direct burden on such commerce. Justices Douglas, Rutledge and Murphy dissented with opinion. Justice Black dissented without opinion.

These cases indicate the end of an era in Supreme Court interpretation, as noted by Justice Douglas in his dissent in the *Joseph* case, ". . . *Freeman v. Hewit* marked the end of one cycle under the Commerce Clause and the beginning of another." The Freeman decision is the occasion for this comment analyzing the Court's thinking for the twenty years leading up to this change.

I

For many years the Court used the direct and indirect burden test as the means of measuring the validity of state gross receipts taxes as applied to interstate commerce.[4] This was the test which the late Chief Justice Stone had deprecated in his dissent in *DiSanto v. Pennsylvania* saying, ". . . the traditional test of the limit of state action by inquiring whether the interference with commerce is direct or indirect seems to me too mechanical, too uncertain in its application, and too remote from actualities, to be of value. In thus making use of the expressions, 'direct' and 'indirect interference' with commerce, we are doing little more than using labels to describe a result rather than any trustworthy formula by which it is reached."[5] In 1938, in the case of *Western Live*

[4] Early gross receipts taxes were upheld as taxes on the local right to do business, Osborne v. Mobile, 16 Wall. (83 U.S.) 479 (1872); or on income after it is divorced from commerce, State Tax on Railway Gross Receipts, 15 Wall. (82 U.S.) 284 (1872). Such taxes were later held unconstitutional as direct burdens on interstate or foreign commerce, United States Glue Co. v. Town of Oak Creek, 247 U.S. 321, 38 S. Ct. 499 (1918); Crew Levick Co. v. Pennsylvania, 245 U.S. 292, 38 S. Ct. 126 (1917). But a gross receipts tax is allowed if imposed in lieu of a property tax, United States Express Co. v. Minnesota, 223 U.S. 335, 32 S. Ct. 211 (1912); or if on a local privilege such as doing business, Osborne v. Mobile, supra, or manufacturing, American Mfg. Co. v. St. Louis, 250 U.S. 459, 39 S. Ct. 522 (1919). Apportioned gross receipts taxes were upheld, Maine v. Grand Trunk Ry., 142 U.S. 217, 12 S. Ct. 121 (1891).

See 38 MICH. L. REV. 1292 at 1295-1300 (1940); Jackson, "The Supreme Court and Interstate Barriers," 207 ANNALS 70 (1940); Brown, "The Legal Aspects of Trade Barriers," 25 BUL. OF NAT. TAX ASSN. 98 (1940); 34 ILL. L. REV. 44 (1939); MAHANY, COMMERCE CLAUSE TAX PROBLEMS 122-148 (1940); Powell, "Contemporary Commerce Clause Controversies over State Taxation," 76 UNIV. PA. L. REV. 773, 958 (1928); 42 COL. L. REV. 1333 (1942); Dowling, "Interstate Commerce and State Power," 27 VA. L. REV. 1 at 3-10 (1940).

[5] 273 U.S. 34 at 44, 47 S. Ct. 267 (1927).

Stock v. Bureau of Revenue,[6] Justice Stone, in speaking for the Court, propounded the cumulative burdens doctrine. According to this doctrine, state taxation of interstate commerce would be allowed provided that interstate commerce was not subjected to multiple taxation resulting in cumulative burdens which would place interstate commerce at a competitive disadvantage with local commerce.[7]

The cumulative burdens test became firmly established when the Indiana Gross Income Tax Act was held inapplicable in *Adams Mfg. Co. v. Storen*[8] to receipts derived from interstate sales, and the Washington Business Activities Tax on the gross receipts of business done in the state was held inapplicable to the receipts of such business from interstate transactions in *Gwin, White & Prince v. Henneford*[9] on the ground that interstate commerce would be subjected to cumulative tax burdens if these taxes were allowed. In accordance with this theory, a New York City Sales Tax on an interstate sale was upheld in *McGoldrick v. Berwind-White Coal Mining Co.*[10] because it was levied on the happening of a local event, delivery of the goods within the taxing jurisdiction, an event upon which no other state could levy a tax.

It was stated in these decisions that a state tax on gross receipts derived from interstate commerce would be valid if apportioned. Over a period of years the Court has come to associate a definite meaning with the word "apportion."[11] The apportionment of a tax is dependent upon a formula to be worked out by the taxing state on a proportionate basis by taking the ratio of salaries paid, work done, property held and sales made within the taxing state to those respectively paid, done, held or made without the state. Under an apportionment theory the taxing state is trying to tax its "fair" share of the whole transaction. In the *Adams*, *Gwin* and *Berwind-White* cases it would have been possible for the taxing states to have worked out such a formula and to

[6] 303 U.S. 250, 58 S. Ct. 546 (1938).

[7] For a general treatment of the cumulative burdens doctrine see, Dowling, "Interstate Commerce and State Power," 27 VA. L. REV. 1 at 8-19 (1940); 38 MICH. L. REV. 1300 (1940); MAHANY, COMMERCE CLAUSE TAX PROBLEMS 60, 138 (1940); Lockhart, "The Sales Tax in Interstate Commerce," 52 HARV. L. REV. 617 (1939); Traynor, "State Taxation and the Commerce Clause in the Supreme Court, 1938 Term," 28 CAL. L. REV. 168 (1940); Powell, "New Light on Gross Receipts Taxes," 53 HARV. L. REV. 909 (1940); Brown, "State Taxation of Interstate Commerce, and Federal and State Taxation in Intergovernmental Relations—1932-1935," 24 GEO. L. J. 584 (1936); 52 HARV. L. REV. 502 (1939); 42 COL. L. REV. 1333 (1942).

[8] 304 U.S. 307, 58 S. Ct. 913 (1938).

[9] 305 U.S. 434, 59 S. Ct. 325 (1939).

[10] 309 U.S. 33, 60 S. Ct. 388 (1940).

[11] See Maine v. Grand Trunk Ry. Co., 142 U.S. 217, 12 S. Ct. 121 (1891); Wisconsin & M. Ry. Co. v. Powers, 191 U.S. 379, 24 S. Ct. 107 (1903); Cudahy Packing Co. v. Minnesota, 246 U.S. 450, 38 S. Ct. 373 (1918); United States Express Co. v. Minnesota, 223 U.S. 335, 32 S. Ct. 211 (1912).

have justified their taxes on that ground. But in the *Gwin* case, Justice Stone stated that a tax is apportioned if applied to intrastate activities.[12] Also in the *Berwind-White* case he stated that a tax conditioned on a local event is apportioned and valid.[13] This expression of opinion showed that he was concerned not with the use of formulas whereby several states might levy taxes upon fractional parts of a single transaction in interstate commerce, but rather with the finding of a local event that would furnish an adequate basis for a state's taxing the entire transaction where there was no danger that the same kind of tax on the same transaction would be levied by another state. This is more consonant with a theory of allocation of taxing power to a state than with a theory of apportionment.

Following the allocation analysis, Justices Stone and Rutledge came to the conclusion that the state of the buyer's market should be the state to tax an interstate transaction.[14] Justice Rutledge also makes clear in his dissent to *McLeod v. Dilworth* that the tenuous jurisdictional theories inherent in the name of due process of law which lead to multiple taxation are not an adequate guide in the construction of the commerce clause.[15] Interstate commerce should not be subjected to multiple tax burdens. Danger arises if more than one state levies the same tax; but if only one state is allowed to tax both interstate and wholly local transactions at the same rate, there is no undue discrimination or burden. By the same process of reasoning taxes levied by the state of origin should not be held invalid, if this state seeks to recover only the balance due under its tax rates after allowing a credit for taxes paid in the state of the buyer's market.

Such was the trend of thought introduced by Justice Stone in the *Western Live Stock* case. It recognized that interstate commerce could be subjected to a fair amount of state taxation provided that such taxation did not impose or leave open the possibility of cumulative burdens.

[12] 305 U.S. 434 at 440, 59 S. Ct. 325 (1939).

[13] 309 U.S. 33 at 58, 60 S. Ct. 388 (1940).

[14] See Lockhart, "The Sales Tax in Interstate Commerce," 52 HARV. L. REV. 617 at 625 (1939); Powell, "New Light on Gross Receipts Taxes," 53 HARV. L. REV. 909 at 925 (1940); Justice Rutledge's dissent in McLeod v. Dilworth Co., 322 U.S. 327 at 357, 64 S. Ct. 1023 (1944).

[15] 322 U.S. 327 at 357, 64 S. Ct. 1023 (1944). "The great difficulty in allocating taxing power as a matter of due process between the State of origin and the State of market arises from the fact that each state, considered without reference to the other, always has a sufficiently substantial relation in fact and in tax benefit conferred to the interstate transaction to sustain an exertion of its taxing power. . . ."

". . . Each state has a sufficiently close and substantial connection with the transaction, whether by virtue of tax benefit conferred in general police protection and otherwise or on account of ideas of territorial sovereignty concerning occurrence of 'taxable incidents' within its borders, to furnish the due process foundation necessary to sustain the exercise of its taxing power." Id. at 356.

It recognized in the Court an inherent power, in the absence of Congressional action, to review state legislation on a realistic basis in order to establish a rational scheme for state taxation of interstate commerce. A definite trend had developed in which the Court looked to the economic incidence of the state tax in determining its validity. What has now happened to that trend?

2

It was in the case of *Freeman v. Hewit*, involving the Indiana Gross Income Tax,[16] that the Court, speaking through Justice Frankfurter, chose to quit the cumulative burdens test and to return to the direct and indirect burdens test. At two places in his decision, Justice Frankfurter makes it clear that this is no thoughtless oversight of the recent principles stated by the Court. That this case is to lead the way to a return to a theory of immunity of interstate commerce from state taxing power is made clear in the following language:

> ". . . In two recent cases[17] we applied the principle that the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States. In short, the Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States. . . . A State is also precluded from taking any action which may fairly be deemed to have the effect of impeding the free flow of trade between the States. It is immaterial that local commerce is subjected to a similar encumbrance. . . ."[18]

To make clear the definite departure from the cumulative burdens doctrine, the following language is used:

> ". . . If another State has taxed the same interstate transaction, the burdensome consequences to interstate trade are undeniable. But that, for the time being, only one State has taxed is irrelevant to the kind of freedom of trade which the Commerce Clause generated. The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment. . . .

[16] Indiana Laws, as amended, Laws 1937, Ind. Stat. Ann. (Burns, 1933) § 64-2601 et seq. This act has been before the Court many times in a series of cases beginning with Adams Mfg. Co. v. Storen, 304 U.S. 307, 58 S. Ct. 913 (1937).

[17] Southern Pacific Co. v. Arizona, 325 U.S. 761, 65 S. Ct. 1515 (1945); Morgan v. Virginia, 328 U.S. 373, 66 S.Ct. 1050 (1946). (Footnote added.)

[18] 329 U.S. 249 at 252, 67 S. Ct. 274 at 276 (1946).

Nor is there any warrant in the constitutional principles heretofore applied by this Court to support the notion that a State may be allowed one single tax-worth of direct interference with the free flow of commerce. An exaction by a State from interstate commerce falls not because of a proven increase in the cost of the product. What makes the tax invalid is the fact that there is interference by a State with the freedom of interstate commerce."[19]

There can be no doubt that the test now adopted by the Court will tend to restrict the use of state power to tax interstate commerce. Certainly in the *Joseph* case there was no danger of cumulative burdens on the commerce there sought to be taxed,[20] but the Court following *Freeman v. Hewit* condemned the tax as a direct burden on interstate commerce. The thesis expounded by Justice Stone to the effect that one tax on interstate commerce by any state should be allowed, where only one such tax could be levied, or by the state of the buyer's market where several states could levy taxes on the same transaction, has been forcefully shunted aside. The free flow of commerce test applied in the examination of state regulations of interstate commerce under their police power, is now to be carried over to the field of taxation. "A burden on interstate commerce is none the lighter and no less objectionable because it is imposed by a State under the taxing power rather than under manifestations of police power in the conventional sense."[21]

It is safe to assume that state taxes on gross receipts derived from interstate commerce, which have been thus far upheld by the Court, particularly in the form of sales and use taxes, will not be overthrown. The Court has indicated no intention of overruling the earlier decisions dealing with such taxes. Also a large portion of the revenues of many states are derived from these taxes. The Court will indeed be hesitant to disrupt the fiscal systems dependent upon such revenues. But it is safe to predict that the Court will frown upon attempts to widen the application of gross receipt taxes to interstate commerce.

From a practical point of view it is not difficult to justify the stand taken by the majority of the Court in *Freeman v. Hewit.* Certainly the Court may properly feel that the cumulative burdens test is more than a strictly judicial body can handle. The key to this feeling prompting the return to the direct and indirect burdens test is stated by Justice

[19] (Italics supplied.) 329 U.S. 249 at 256, 257, 67 S. Ct. 274 (1946). In Joseph v. Carter & Weekes Stevedoring Co., 330 U.S. 422 at 433, 67 S. Ct. 815 (1947), Justice Reed, speaking for the Court, says that stevedoring is a part of interstate commerce and quotes from Freeman v. Hewit in holding the tax thereon invalid as follows, "What makes the tax invalid is the fact that there is interference by a state with the freedom of interstate commerce."

[20] 330 U.S. 422, 67 S. Ct. 815 (1947).

[21] 329 U.S. 249 at 252, 67 S. Ct. 274 (1946).

Frankfurter in *Freeman v. Hewit*, ". . . Courts are not possessed of instruments of determination so delicate as to enable them to weigh the various factors in a complicated economic setting which, as to an isolated application of a State tax, might mitigate the obvious burden generally created by a direct tax on commerce. . . ."[22] Adequate determinations as to the incidence of all state taxes coming before the Court, as to the extent of the tax, where the weight of the tax is to be borne, the necessity for allocation, the effect on competition, the possibility of discrimination, etc., would involve extensive findings of a type which the Court is not properly equipped to make. Nevertheless the present majority of the Court does believe that the Court has a function to perform in seeing to it that interstate commerce is not burdened nor discriminated against by the states, by whatever test is applied, until such time as Congress shall give the matter its attention and state a legislative policy with regard to such taxation.[23]

Apparently alone in his views of the state taxing power in relation to interstate commerce is Justice Black.[24] He has unequivocally opposed the application of the cumulative burdens doctrine and is presently just as much opposed to the resurgence of the direct and indirect burdens test. He has dissented in all of the leading cases developing these various doctrines dealing with state taxing power where the result was to hold the state tax invalid. He dissented without opinion to the *Freeman* and the *Joseph* decisions, apparently feeling that his views on this subject had been stated adequately before. In his concurring opinion in *Morgan v. Virginia*,[25] Justice Black, in stating his views, said: "The Commerce Clause of the Constitution provides that 'Congress shall have the power . . . to regulate commerce . . . among the several states.' I have believed and still believe that this provision means that Congress can regulate commerce and the courts cannot. . . ."[26]

[22] 329 U.S. 249 at 256, 67 S. Ct. 274 (1946).

[23] All of the Justices except Justice Black may be included.

[24] For an interesting comment on this subject see 38 MICH. L. REV. 1306 (1940).

[25] 328 U.S. 373, 66 S. Ct. 1050 (1946).

[26] Id. at 386. It is interesting to note that Justice Black has been consistent in propounding his theory that in the absence of Congressional action, state statutes which are not discriminatory against interstate commerce should be upheld whether they regulate or tax interstate commerce. [As examples see Justice Black's dissents in Southern Pacific Co. v. Arizona, 325 U.S. 761, 65 S. Ct. 1515 (1945), and in Gwin, White & Prince v. Henneford, 305 U.S. 434, 59 S. Ct. 325 (1939).] A lone exception to this line of holdings is Justice Black's concurring opinion in the Morgan case, which held invalid a Virginia statute requiring segregation of negroes and whites in buses engaged in interstate commerce on the ground that this was a burdensome regulation of such commerce. In his concurring opinion Justice Black intimated that he followed the lead of the majority because he had received no support in his separate views. This was seized upon at the time as evidence of a possible change of position. In the present term

There never has been any doubt expressed by any of the members of the Court to the thesis that Congress has the paramount authority over interstate commerce, and a possible solution to the problem under consideration would be Congressional action defining the limits of state power to tax interstate commerce. As a practical matter it would be difficult for Congress to enact general legislation covering the entire field of state power to tax interstate commerce. It would be faced with the same problems confronting the Court, and past action seems to indicate that Congress will approach the problem in piecemeal fashion, in much the same manner as the Court approached it, taking each type of situation as it arises and dealing with it on its own merits. But even if Congress does enact legislation defining the limits of state power to tax interstate commerce, such legislation would have to be cast in general terms, merely setting the framework of a federal policy, and the question of the constitutionality of particular state statutes, passed in pursuance thereto, will still be brought before the Court. Whether in the presence or the absence of positive legislation, the Supreme Court is confronted with a role and responsibility which it must necessarily assume.

The cumulative burdens theory is far from extinct among the present justices sitting on the Court. Justices Rutledge, Douglas and Murphy have indicated by their positions taken in the *Freeman* and the *Joseph* cases that they follow the cumulative burdens test.[27] Among these justices there is the feeling that the Court not only can, but should, attempt an economic evaluation in determining the constitutionality of state gross receipts taxes. They do not find in the Constitution a mandate that interstate commerce shall be entirely free from the exercise of state taxing power. Whatever the immunity allowed to interstate commerce, they would hold that it should be determined by a rule of reason based on an economic determination of whether a given state tax imposes such cumulative burdens on interstate commerce as to discriminate against such commerce in favor of local commerce. They would follow the tenet that equality between interstate and intrastate commerce is the goal to be achieved through judicial review of

of Court Justice Black, by silently dissenting in the Freeman and the Joseph cases, quieted these conjectures and affirmatively indicated that he has maintained his old position.

[27] Justice Rutledge follows the cumulative burdens test in Freeman v. Hewit to hold the tax invalid, but Justices Douglas and Murphy would hold the Indiana tax applicable on the ground that it was a tax on a resident's income after it had been removed from the channels of interstate commerce; in the Joseph case Justice Murphy would hold the tax applicable in its entirety, while Justices Douglas and Rutledge would hold the tax applicable only in so far as it reaches gross receipts derived from loading and unloading vessels engaged in interstate commerce and not to such receipts from foreign commerce.

state action in this field, and not the protection of interstate commerce at the expense of local commerce or vice versa. They would agree with Justice Stone in holding that the direct and indirect burdens test is a mechanical unrealistic rule-of-thumb which states a legal conclusion rather than a usable standard.[28] It is doubtful whether a majority of the present Court could be swayed to this view with any degree of consistency, but there is always the possibility that the cumulative burdens test may again show vitality, or at least be used as a make-weight argument, when the Court, on a particular set of facts, wishes to uphold a state tax on gross receipts derived from interstate commerce.[29]

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[28] 329 U.S. 249 at 268, 67 S. Ct. 275 (1946); 67 S. Ct. 815 at 826 (1946).

[29] For recent treatment of the problem of state taxation of interstate commerce, see Powell, "More Ado about Gross Receipts Taxes," 60 HARV. L. REV. 501, 710 (1947); Dowling, "Interstate Commerce and State Power—Revised Version," 47 COL. L. REV. 547 (1947); Overton, "State Taxation of Interstate Commerce," 19 TENN. L. REV. 870 (1947); 14 UNIV. CHI. L. REV. 503 (1947); 56 YALE L. J. 898 (1947).