Sales and Use Tax Credits, Discrimination Against Interstate Commerce, and the Useless Multiple Tax Concept

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INTRODUCTION***

Readers may wonder why any article would address sales and use tax credits in 1987.† Such curiosity is not without foundation. Today

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***We are pleased to be a part of this Symposium honoring Ed Barrett. We have known him for years, and long before we met him we knew of him through his scholarly articles and his constitutional law casebook, which has become one of the leading course books.

†As this Article was going to press, the *Vanderbilt Law Review* published a symposium on state and local taxation. Included in that symposium is an article by Philip Tatarowicz and Rebecca Mims-Velarde that offers a new method of analyzing the constitutionality of allegedly discriminatory state taxes. *See* Tatarowicz & Mims-Velarde, *An Analytical Approach to State Tax Discrimination Under the Commerce Clause*, 39 VAND. L. REV. 879 (1986). In some respects the analysis in that article is similar to our analysis of the types of tax discrimination that should be invalidated by the judiciary. Both articles attempt to discard formal definitions of discrimination in favor of a realistic analysis of the effects of a particular tax. However, Tatarowicz and Mims-Velarde give more credence than we do to the "multiple tax burden" concept, and they do not analyze the central problem addressed in this Article: the constitutionality of a state sales and use tax statute that denies a taxpayer a credit for sales tax paid to another state. *See id.* at 912-22.

Also in the Vanderbilt symposium, Professors Hellerstein and Hartman published articles analyzing many aspects of modern sales and use taxes. However, neither addressed the question of whether a state could deny a taxpayer a credit against the state's use tax for a sales tax previously paid to another state on an item of personal property. *See* Hartman, *Collection of the Use Tax on Out-of-State Mail-Order Sales*,

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all but a few states have a general sales and use tax. Virtually all states with use taxes grant, as a credit against the use tax, the amount of sales taxes paid to other states.[1] Why, then, would one write on this topic? In addition to our desire to contribute to a symposium honoring Ed Barrett, an outstanding scholar and teacher, there are two answers.

First, if history is an accurate guide, we may expect that sometime within the next decade or so states will review their sales and use tax statutes with an eye to increasing revenues. While there were some limited sales and use taxes prior to the 1930's, the rapid expansion in those taxes came during the Great Depression with the need for states to raise their revenues in a politically acceptable manner.[2] Today, federal taxing and spending reductions may cause state and local governments to again look to sales and use taxes to generate more income.

Even though, after 1986, state and local sales taxes are no longer deductible from federal income taxes, sales and use tax changes may be a politically popular way to increase local revenues, at least when compared to available alternatives. Property taxes, for example, would seem to be an unlikely source for increased revenue. Collection of personal property taxes is quite difficult.[3] Political opposition to real prop-

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39 VAND. L. REV. 993 (1986); Hellerstein, *Significant Sales and Use Tax Developments During the Past Half Century*, 39 VAND L. REV. 961 (1986).

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[1] A few states require, as a condition to granting the credit for out-of-state sales taxes, reciprocity from the seller state. Only Nevada denies a credit for its sales and use tax for taxes on the same property previously paid to another state. "All state and use tax states and the District of Columbia, except Arkansas and Nevada allow a use tax credit for sales taxes paid on the same property in another state, although reciprocity may be required. Arkansas, however, has adopted the Multistate Tax Compact which contains provisions allowing a credit against a use tax for amounts paid as sales tax on the same property in another state or subdivision thereof." C.C.H., State Tax Guide, 6013-14 (2d ed. 9-86). Cases interpreting state use tax statutory provisions regarding credits for out-of-state sales taxes are collected in Annotation, *Validity and Construction Provisions Allowing Use Tax Credit for Tax Paid in Other State*, 31 A.L.R. 4th 1206 (1984). The Supreme Court of Kentucky has upheld the state's denial for a credit against its use tax for sales taxes paid to another state if the property was used in the sales tax state prior to use in Kentucky. Genex/London, Inc. v. Kentucky Bd. of Tax Appeals, 622 S.W.2d 499 (Ky. 1981). This Article examines whether a state may deny a use tax credit for sales tax paid to another state when the property is immediately transported from the state of sale to the use tax state.

[2] *See generally* R. HAIG & C. SHOUP, THE SALES TAX IN THE AMERICAN STATES (1934); THE TAX FOUNDATION, RECENT TRENDS IN MAJOR STATE TAXES: 1941-47, at 10-14 (Project Note No. 20) (Feb. 1948).

[3] A few states have abolished personal property taxes. These states are: Delaware, Hawaii, Illinois, New York, Pennsylvania, and (except for "centrally assessed prop-

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erty taxes, as evidenced by California's constitutional amendment,[4] may mean that states will have difficulty raising significant additional revenue in this manner. Increasing state income tax rates is one possible alternative, but this would run counter to the political movements that have resulted in restructuring the federal tax system and lowering federal tax rates. Further, tax shelters cannot be employed to avoid sales and use taxes, and the consumer does not have to file any annual return.

Increasing consumption taxes, including sales and use taxes, might appeal to state legislators. Many states have lessened such taxes' regressive impact by exempting certain commodities, such as food and medicine.[5] Once necessities are exempted, taxing goods purchased or used in a state has some political appeal. Although a significant across-the-board increase in sales and use rates might cause political problems, little political opposition would result from increasing revenues by eliminating the credit against the use tax for sales taxes paid to other states.

Second, the constitutionality of a state sales tax that denies a credit for sales taxes paid to another state is of theoretical importance. Legal commentators throughout the past half-century have doubted whether a state use tax constitutionally could credit its own sales tax but deny a credit for sales taxes paid to another state.[6] Under that assumption, a congressional committee recommended uniformity in state sales and use

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erty") South Dakota. St. & Loc. Taxes (BNA): All States Unit, ¶ 101, at 103-05 (9-85). In Illinois, the difficulty of creating an effective and equitable system for collecting personal property taxes led to their constitutional abolition. ILL. CONST. art. IX, § 5 (1970).

[4] California's limitation on real property taxation, commonly referred to as "Proposition 13," is contained in CAL. CONST. art. 13A. *See also id.* art. 13, § 22: "Not more than twenty-five percent of the total appropriations from all funds of the State shall be raised by means of taxes on real and personal property according to the value thereof."

[5] "Of the forty-five states imposing sales and use taxes, twenty-eight states and the District of Columbia currently provide exemptions for sales of food and forty-two states and the District of Columbia provide exemptions for sales of drugs." STATE TAX GUIDE (C.C.H.) 6022 (2d ed. 10-86).

[6] This theory was particularly popular with Harvard Law Review student writers. *See* Note, *Developments in the Law — Federal Limitations on State Taxation of Interstate Business*, 75 HARV. L. REV. 953, 999 (1962); Note, *Problems Arising from* Hennford v. Silas Mason Co., 51 HARV. L. REV. 130 (1937). Professor Hartman did not explore whether "double taxation" in such situations was unconstitutional, but he did recognize that "no case has been found where such double taxation was held to constitute unconstitutional discrimination." P. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION 617 (1981).

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taxes, although Congress has never acted on this recommendation.[7] The Supreme Court has not ruled on whether a state must grant a credit against its use tax of sales taxes paid to another state. However, it hinted, in *Williams v. Vermont*,[8] that the Constitution might require such a credit.[9]

The basis for this professional, legislative, and judicial assumption appears to be the belief that granting a credit against use taxes for state sales taxes paid, but denying a credit for sales taxes paid to another state on a product purchased out-of-state (but eventually used in the taxing state) would result in unconstitutional discrimination against interstate commerce or the unconstitutional imposition of a form of multiple taxation on interstate commerce prohibited by the commerce clause. Analyzing whether such a use tax system discriminates against interstate commerce may be a useful vehicle for understanding the meaning of unconstitutional discrimination against interstate commerce in the tax area and for determining whether the concept of "multiple taxation" is a fruitful one.

We will first set forth an explanation of how a hypothetical use statute that would deny a use tax credit for out-of-state sales taxes would work. We will then examine whether the hypothetical statute is, in fact, a form of discrimination against, or multiple taxation of, interstate commerce prohibited by the comity, commerce, due process or equal protection clauses. In so doing, we will show that the multiple taxation

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[7] STATE TAXATION OF INTERSTATE COMMERCE, REPORT OF THE SPECIAL SUBCOMMITTEE ON STATE TAXATION OF INTERSTATE COMMERCE OF THE COMMITTEE ON THE JUDICIARY, H.R. REP. NO. 565, 89th Cong., 1st Sess. 893-95, 1136 (1965). This report is commonly referred to as the "Willis Committee" or "Willis Subcommittee" report. *See infra* note 9.

[8] 472 U.S. 14 (1985).

[9] Justice White stated:

> Such a requirement [of a credit against the use tax for out-of-state sales taxes] has been endorsed by at least one state court, *Montgomery Ward and Co. v. State Board of Equalization*, 272 Cal. App. 2d 728, 78 Cal. Rptr. 373 (1969), *cert. denied*, 396 U.S. 1040, 90 S. Ct. 688, 24 L. Ed. 2d 684 (1970), was advocated twenty years ago in the much cited Report of the Willis Subcommittee, H.R. Rep. No. 565, 89th Cong., 1st Sess. 1136, 1117-78 (1965), is adopted in the Multistate Tax Compact, Art. v, §1, and has significant support in the commentary, e.g., J. Hellerstein & W. Hellerstein, State and Local Taxation 637-38 (1978); Developments in the Law: Federal Limits on State Taxation of Interstate Business, 75 Harv. L. Rev. 953, 999-1000 (1962). Appellants urge us to hold that it is a constitutional requirement. Brief for appellants 31-35. Once again, however, we find it unnecessary to reach this question.

Id. at 2471.

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concept is not useful for determining a state tax's constitutionality. Although the multiple taxation concept is a handy label for taxes that judges and scholars wish to find unconstitutional, it is not a fruitful analytical tool.

I. The Problem and Its Solution: The Property Protection Tax

A state can tax sales in several ways. One is a direct tax on the sale itself — a traditional sales tax. Another is a gross receipts tax requiring a certain type of seller (or all sellers) to pay a percentage of gross sales receipts to the state.

A state may also tax a business' income based upon its sales in the state. Most states determine the percentage of a multistate or multinational corporation's income that is attributable to its activities in the state through a multiple factor formula. However, states may use a single factor formula based on the amount of sales in the state.[10] In other words, a state corporate income tax may take the total income from the corporation's unitary business (whether this unitary business is conducted in many states or even internationally) and multiply that figure by a fraction, the numerator of which is the amount of the business' sales in the state and the denominator of which is the amount of sales made by the unitary business, nationwide or worldwide.

Regardless of whether a state imposes a sales tax, a gross receipts tax, or an income tax based on a sales factor, the sales that are attributable to a state (and that may be the subject of state taxation) remain the same. A state may impose a tax on a sale of tangible personal property[11] when the seller is located in the state and delivery of the product (the sale) takes place in the state. This result remains true even when an in-state sale is made to an out-of-state purchaser who will take the product out of the state immediately after delivery.[12] However, a state may not impose a sales tax on the sale of tangible personal property by an in-state seller to an out-of-state purchaser when the delivery — the taxable event — occurs outside of the state.[13]

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[10] Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978).

[11] This Article discusses only sales and use taxes on tangible personal property. Sales of services often are taxed differently: the state may tax services substantially performed in the state. The ownership or transfer of intangible personal property such as stocks or instruments evidencing debt are beyond the scope of this Article.

[12] State Tax Comm'n v. Pacific States Cast Iron Pipe Co., 372 U.S. 605 (1963) (per curiam); International Harvester Co. v. Department of Treasury, 322 U.S. 340 (1944).

[13] EVCO v. Jones, 409 U.S. 91 (1972) (per curiam); J.D. Adams Mfg. Co. v.

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Use taxes on tangible personal property have two justifications. First, a use tax compensates the state for providing state law protection for the property's use in the state. Thus regarded, a use tax is a type of one-time property tax. In essence, the state imposes an initial fee for state protection of the person's ownership and use of the property. Thus, a state may tax the storage of airplane fuel that is brought into the state from out-of-state, stored in the state, and then used to fuel airplanes at in-state airports, even though the airplanes then depart for out-of-state destinations.[14]

The second justification for a use tax is that it compensates the state for the losses of sales tax revenue occasioned by in-state persons traveling to other states to make purchases of products that they will then use in the use tax state. The compensating use tax is an adjunct to the sales tax. The use tax rate will be the same as the sales tax rate. A person will not have to pay both a sales tax and a use tax on the same item to the same state if the use tax is only a compensating use tax. The use tax compensates the state for the loss of the sales tax.

Presently, all general use taxes (imposed on all personal property used in the state rather than only on a single type of commodity, such as airplane fuel) are compensating use taxes. Almost all states with a general use tax give a credit against that tax for the amount of sales tax paid to any state.[15] States will allow a credit against the use tax only for the amount of sales tax paid in the same state or the amount of sales tax actually paid to another state.[16]

Storen, 304 U.S. 307 (1938); *cf.* McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944) (state of destination and use cannot impose a sales tax on a product purchased by an in-state person in another state if delivery and title transfer took place out-of-state; the tax is invalid even though the state could have imposed a use tax).

[14] Edelman v. Boeing Air Transp., Inc. 289 U.S. 249 (1933). Taxes on fuel stored in a state prior to use in interstate commerce (such as interstate airplane flights) may be justified as a tax on "storage," a type of use in the state. *See* United Air Lines, Inc. v. Mahin, 410 U.S. 623 (1973). A use tax on the consumption of gasoline in interstate flights might still be invalid. *See* Helson & Randolph v. Kentucky, 279 U.S. 245 (1929). *Helson* seems contrary to modern commerce clause analysis, which allows some tax on in-state use in interstate commerce so long as the tax is related to in-state activity, is reasonable in the nature of the charge, does not discriminate against interstate commerce, and is fairly apportioned. However, the Court in *United Air Lines* distinguished *Helson* because the tax on United Air Lines was viewed as one on storage rather than mere use in interstate commerce. *See United Airlines*, 410 U.S. at 631.

[15] *See supra* note 1.

[16] Differing sales and use tax rates and differing exemptions from the taxes' coverage make the granting of credits more complex. Assume that a piece of farm machinery (a tractor) will be used in State *A* and the purchaser took delivery in State *B*. If State *A* has no sales or use tax and State *B* imposes a $1000 sales tax, State *B* is the only

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Obvious problems exist in collecting use taxes from unwilling taxpayers. Almost every state having a use tax imposes a legal duty on all persons subject to the state's jurisdiction to pay to the state a use tax on any item brought into the state if that item would be subject to the state sales tax if purchased in the state. The state compensating use tax may apply to a wide variety of products even though most persons who bring personal property into a state are unlikely to send a check for the use tax to the state's department of revenue.[17] Effectively imposing a use tax on a commodity purchased out-of-state and thereafter brought into the state is only realistic in two circumstances. First, a state can collect a use tax when the product's use is difficult to hide from state taxing agencies. Thus, use taxes are easy to collect on automobiles, which owners must register with the state.

Second, the state can collect the use tax on all items purchased by an in-state purchaser from an out-of-state seller if the state can constitutionally require the out-of-state seller to collect the use tax and remit it to that state. The state's ability to impose a duty on out-of-state sellers to collect the use tax for it when products are sold to its residents is limited by due process and commerce clause principles. Although the determination is complex, the legal rule is easily summarized: a state may force an out-of-state seller to collect use taxes when the seller's contacts with the state (such as business activities beyond sending in advertising by mail or television) make it fair for the state to impose

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recipient of tax dollars from this transaction. If State *A* imposes a $1000 purchase or use tax and State *B* has no sales tax, then the farmer who used the tractor in State *A* must pay $1000 to State *A*, because there is no State *B* sales tax to credit against the use tax. If State *A* has a $1000 sales or use tax and State *B* has a $500 sales tax, then the purchaser must still pay $500 to State *A* (because the credit against State *A*'s use tax is only for the amount actually paid to State *B*).

If State *A* has a $500 sales or use tax and State *B* has a $1000 sales tax, then the purchaser owes no sales or use tax to State *A*. She would not receive a tax rebate. In this situation, a resident who chooses to go out-of-state must pay a higher tax than if she had purchased the item in-state (because State *A* had a lower sales tax than State *B*). However, no one would argue that this burden on interstate commerce is one that should be constitutionally prohibited. Thus, with even this simple introductory example, one can begin to understand why the multiple taxation concept is useless.

[17] Thus, if a person moves to State *A*, having purchased clothing in State *B*, and State *B* (but not State *A*) exempted clothing from their sales and use tax, then she must pay a use tax to State *A* for using the clothes in the state. States may decide not to impose a use tax on items brought in from out-of-state when they believe they have no realistic possibility of enforcing it. If a state exempted from taxation property brought into the state, courts should not deem the exemption to unconstitutionally discriminate against in-state persons who paid a tax on similar property. *Cf.* Allied Stores, Inc. v. Bowers, 358 U.S. 522 (1959).

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this type of collection agent duty on the seller.[18]

States may increase their revenue from sales and use taxes in several ways. First, the state could retain its sales and use tax system and merely raise the rates for those taxes. States could use this option with either of the following alternative plans.

Second, if the state now gives a credit against its use taxes for sales taxes paid to it or to other states, the state could eliminate sales tax credits entirely. The state then would tax every sale that takes place within the state and every item used within the state, regardless of whether a sales tax was paid to the taxing state or to any other state. However, it is unlikely that a state would choose this option because it could result in a higher tax on products sold and used in-state than on products sold in the state and transported out-of-state. For example, if State *A* imposes a two percent tax on automobile sales and a two percent tax on their use, a person who purchases and uses a car in State *A* will pay a four percent tax. If State *B* has a sales tax of less than two percent, a State *A* resident who purchases a car in State *B* and brings it into State *A* will pay less total tax. This creates an incentive to purchase automobiles out-of-state and defeats the very reason for enacting the use tax: to avoid incentives for in-state residents to leave the state to make their purchases.

Third, a state could eliminate the credit against its use tax for sales taxes paid to another state. There are two ways to accomplish this goal. One way is for the state to impose a use tax on all items used in the state and eliminate the credit for sales taxes paid to the state or to any other state. To avoid the problems in the previous alternative (having a double tax on items sold and used in the state), the state would eliminate its own sales tax. Thus, if a state had previously charged a four percent use tax and a four percent sales tax (but allowed the credit of the sales tax against the use tax), it would now have a four percent use tax alone. A state might choose this option to encourage out-of-state persons to purchase items from in-state businesses.[19] The use statute is

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[18] *Compare* National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967) (state may not impose a duty on an out-of-state mail order seller to collect a sales or use tax for products sold to in-state residents when the seller's only contact with the state is sending advertising or sales brochures through the mail) *with* National Geographic Soc'y v. California Bd. of Equalization, 430 U.S. 551 (1977) (state may require out-of-state seller to collect use tax upon mail order sales when the seller maintained two business offices in the state, even though the business office did not provide services relating to the out-of-state sales).

[19] Granting an exemption to out-of-staters does not deny equal protection to in-state residents. *Allied Stores*, 358 U.S. at 529.

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nondiscriminatory because it imposes a flat four percent use tax and does not allow a credit for any taxes paid anywhere.

In deciding whether to use this option, the state would have to assess whether its loss of income from failing to tax sales to out-of-state purchasers taking delivery in the state is outweighed by its ability to effectively collect the use tax from persons bringing products into the state (without giving those persons a credit for sales taxes paid to other states). The state legislature also would have to consider whether exempting in-state sales for out-of-state use is enough incentive to in-state economic activity to offset any loss of tax revenue. If the state attempted to impose its use tax on sales to out-of-state persons who took delivery in-state, it would face the issue raised by the next option.

A state may want to eliminate the credit against its use tax for sales taxes paid to another state while continuing to tax the in-state sale and delivery of a product immediately transported out-of-state. The state may accomplish this goal artfully or inartfully.

The inartful method is to repeal the use tax credit for out-of-state sales taxes but to retain the credit against the use tax for in-state sales taxes. This method is "inartful" because it leaves the tax system's goals unclear and gives a false appearance of discriminating against out-of-state commerce.

The more artful and forthright approach is to create a hybrid sales and use tax, which we will call a "property protection" tax.[20] The property protection tax is a one-time charge for extending state law protection to property in the state. When an in-state seller sells a product to an in-state consumer, both the seller and the buyer are equally liable for the tax, although the legal liability to collect the tax and remit the proceeds to the state is typically imposed on the seller. When a person uses property purchased out-of-state, the state should have the right to tax the user for protecting the property, regardless of whether the property previously was taxed in another state. When an in-state seller (in State *A*) sells to an out-of-state purchaser and delivers the

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[20] Some states, such as Illinois, have a hybrid sales and use tax that simultaneously imposes a sales and use tax on the same transaction but only requires the seller to transmit one tax. The current hybrid sales and use taxes are designed to impose merchant liability for collecting and remitting the tax. *See* F. CZERWIONKA, PRENTICE-HALL ILLINOIS TAX HANDBOOK chs. 11, 12 (1986). Use taxes may impose liability on sellers who are negligent in collecting the tax, *e.g.*, the seller was unreasonable in accepting buyers' assurances that they were engaging in an exempt transaction. The current hybrid taxes are not designed to increase revenue, as demonstrated by the fact that all currently allow a credit for sales taxes paid to other states, at least if the other state provides a reciprocal tax credit.

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product in another state, the property protection tax will not apply (in State *A*), due to the same constitutional limitations on state jurisdiction that apply to traditional sales or use taxes.

The property protection tax does not discriminate against out-of-state consumers or interstate commerce. Imposing an identical tax at the time of in-state sales to in-state consumers eliminates preferences for in-state consumers. Also, the state is extending state law protection to the out-of-state purchaser who takes delivery in the state. It is irrelevant whether the property is consumed in the state slowly or consumed immediately (for state purposes) by its removal from the state. Taking the property out of the state is the equivalent of immediate and total consumption from the vantage point of the state. The property protection tax, unlike a yearly personal property tax, is not geared to protecting the property's day-to-day use; it is a one-time fee for state protection. The taxable event is the sale or use of the property within the state.

The economic effect of the artfully drawn and inartfully drawn statutes are the same. A tax of X percent is imposed at the time of the in-state sale or when property is brought into the state for in-state use. In effect, a tax of X percent is imposed on the use of all items in the state, but the state collects this tax earlier (at the time of sale) if the item was sold in the state.

Although we believe that the mere description of the artfully drawn statute gives a strong indication as to why it neither discriminates against interstate commerce nor imposes an improper burden on interstate commerce or out-of-state persons, we need to address the constitutionality of the refusal to grant a credit for sales taxes paid to other states against the use tax (or, as we have termed it, the property protection tax). States have assumed that this seemingly logical way to tax property is unconstitutional. This assumption has led almost all states with a general use tax to credit sales taxes paid to any state.

II. Constitutional Objections to the Property Protection Tax

Our phrase, "property protection" tax, refers to a tax system that: (1) taxes all property used in the state; (2) collects the tax at the time of an in-state sale (regardless of whether the purchases will immediately take the property out-of-state);[21] (3) taxes all persons (at an identical

[21] The tax would not apply to sales by in-state businesses to out-of-state purchasers when delivery took place outside of the taxing state; such an attempt to apply a sales

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tax rate) who would *use* property in the state if the state did not collect a property protection tax at the time of sale;[22] and (4) does not credit any tax previously paid to another state.

A state enacting a property protection tax would face challenges to its taxing system involving (1) the privileges and immunities clause of article IV, (2) the equal protection clause, (3) the due process clause of the fourteenth amendment, and (4) the commerce clause. We have listed these possible objections to the tax on the basis of the increasing difficulty of the argument or analysis presented under each, with the commerce clause arguments being the most difficult.

A. The Comity Clause

Article IV's privileges and immunities clause, also referred to as the comity clause, restricts taxing systems with classifications based upon state or local citizenship or residency.[23] Such classifications are invalid unless the state demonstrates that the classification is substantially related to a significant state goal (other than local residents' enrichment at the expense of out-of-state persons).[24] Such open discrimination is difficult, if not impossible, to defend in a tax statute.[25]

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related tax is barred by jurisdictional requirements previously established by the Supreme Court. *See supra* note 13.

[22] The state could only impose a duty on out-of-state sellers to collect the property protection tax on sales made to residents of the taxing state if the seller had some substantial business activity in the state. *See supra* note 18.

[23] This principle has been settled for over a century. *See, e.g.*, Ward v. Maryland, 79 U.S. (12 Wall.) 418 (1870).

[24] *See* Supreme Court of N.H. v. Piper, 470 U.S. 274 (1985); United Bldg. & Constr. Trades Council v. Mayor, 465 U.S. 208 (1984). The clause is inapplicable to certain types of activities that do not involve a fundamental national right that relates to promoting harmony and comity between the states. *Compare* Baldwin v. Montana Fish & Game Comm'n, 436 U.S. 371 (1978) (no comity clause violation from differential fee imposed on in-state and out-of-state recreational hunters and fishers) *with* Toomer v. Witsell, 334 U.S. 385 (1948) *and* Mullaney v. Anderson, 342 U.S. 415 (1952) (the comity clause is violated by license fees for commercial fishing operation that impose a higher fee on nonresident commercial fishermen than on resident commercial fishermen).

[25] *See, e.g.*, Austin v. New Hampshire, 420 U.S. 656 (1975) (finding that a New Hampshire "Commuters' Income Tax" that in effect imposed a special tax on nonresidents' income violated the comity clause). A distinction between nonresidents and residents in a tax or regulatory statute might be valid if the classification was substantially related to a significant state interest. *See* Travelers Ins. Co. v. Connecticut, 185 U.S. 364 (1902). Laws that appear on their face to discriminate against out-of-state residents or interests often are not challenged under the comity clause because the primary entities disadvantaged by such laws are out-of-state corporations. Corporations are not

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We may dispense with the comity clause argument summarily because the property protection tax does not employ any classification based upon the residency or citizenship of the seller, the buyer, or the product's user. Both in-state and out-of-state residents are subject to the property protection tax if they purchase a product in another state, pay a sales tax to that state, and then bring the product into the taxing state. Similarly, the property protection tax is imposed on every purchaser of a product in the state; every in-state seller who makes an in-state delivery must collect the tax and remit it to the state regardless of whether the purchaser is an in-state or out-of-state resident. If the property was not purchased in-state but only used in-state, the user must pay a use tax, without regard to her residency. Therefore, the property protection tax does not present problems under the comity clause.

B. Equal Protection

Taxes involving suspect classifications, such as race or national origin, are invalid unless necessary to promote a compelling or overriding state interest.[26] A tax that applies only to persons of one race or ethnic background should be unconstitutional. Similarly, a tax on the exercise of a fundamental right should be invalid or, in certain circumstances, invalid absent a liberal waiver provision for those who cannot pay the tax.[27] Laws taxing female but not male business operators, taxing illegitimate children but not legitimate children, or taxing lawfully resident aliens but not United States citizens should be invalid under the protection clause because of the constitutional scrutiny of laws involving gender, illegitimacy, or citizenship classifications.[28]

The property protection tax does not tax a fundamental right or a protected classification. Rather, this tax represents a classic form of eco-

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"citizens" and therefore do not receive the protection of the comity clause. *See* Blake v. McClung, 172 U.S. 239 (1898). However, perhaps associations or corporations could bring such claims if raised in terms of the discrimination against the individual association members or corporation shareholders. *See, e.g.*, United Bldg. & Const. Trades Council v. Mayor, 465 U.S. 208 (1984); Travelers Ins. Co. v. Connecticut, 185 U.S. 364 (1902).

[26] *See* 2 R. ROTUNDA, J. NOWAK & J. YOUNG, TREATISE ON CONSTITUTIONAL LAW §§ 18.3, 18.11-18.12 (1986).

[27] *Cf.* Lubin v. Panish, 415 U.S. 709 (1974) (candidate filing fee); Bullock v. Carter, 405 U.S. 134 (1972) (candidate filing fee); Boddie v. Connecticut, 401 U.S. 371 (1971) (court filing fee for divorce actions); Harper v. Virginia Bd. of Elections, 383 U.S. 663 (1966) (voting taxes totally invalid).

[28] 2 R. ROTUNDA, J. NOWAK & J. YOUNG, *supra* note 26, §§ 18.3, 18.11-18.12.

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nomic and social welfare legislation, and should be upheld so long as any classifications within the tax have a rational relationship to any legitimate governmental end.[29] The proposed tax's purpose is to raise revenue for a state extending the protection of its law to tangible personal property purchased or used therein. The property protection tax uniformly taxes all property sold or used in the state regardless of where the property is purchased and regardless of whether it was first used (and a sales tax paid) in another state. There is no classification that arbitrarily burdens out-of-state persons or property.

The case law shows that there is no economic discrimination in violation of equal protection, although two recent cases deserve some discussion.[30] In *Metropolitan Life Insurance Co. v. Ward*,[31] the Supreme Court held that a state tax imposing a higher "gross premiums" tax on out-of-state insurance companies' premiums and income than on premiums and income collected by in-state insurance companies violated the equal protection clause. This type of discrimination normally would violate the commerce clause, but the Court believed that Congress had removed any commerce clause barrier to state laws that discriminated against out-of-state insurance companies.[32] Nonetheless, the Court found that the purpose of enriching local businesses through discriminating against out-of-state competition was not legitimate. Therefore, the tax (which had no provision allowing for equalizing the tax bur-

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[29] 1 *id.* § 13.7 (1980); 2 *id.* § 18.3 (1986).

[30] Arbitrary discrimination against out-of-state taxpayers, such as in WHYY, Inc. v. Borough of Glassboro, 393 U.S. 117 (1968) (per curiam) would be analyzed and distinguished in the same manner as the cases discussed in the text. For example, in *WHYY* the complaining taxpayer was a nonprofit public television station incorporated in Pennsylvania. The corporation registered with and qualified to do business in the State of New Jersey; it constructed a transmittal station and tower in New Jersey. Later, the taxpayer applied for a property tax exemption from New Jersey, which denied the exemption even though it would have granted an exemption for a New Jersey nonprofit corporation identical in every respect to the taxpayer except for its state of incorporation. The state asserted that it should be able to favor in-state charities over out-of-state charities, but could not show any rational relationship to any interest other than the desire to impose a higher tax on out-of-state persons. For this reason, the law had no rational relationship to a legitimate end and was so arbitrary as to violate equal protection. *WHYY* is distinguishable from the property protection tax cases in precisely the same way in which the next two cases that are discussed in the text are analyzed and distinguished.

[31] 470 U.S. 869 (1985).

[32] *Id.* at 877. Congress' ability to validate state legislation under the commerce clause and to make it immune from commerce clause attack is well established. *See* Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System, 472 U.S. 159 (1985); 1 R. ROTUNDA, J. NOWAK & J. YOUNG, *supra* note 29, § 11.5.

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dens on premiums paid to out-of-state versus in-state insurance companies) had no rational relationship to any legitimate governmental end. The Court did allow the state, on remand, to attempt to establish that the law was designed to promote other, legitimate purposes such as increasing local control over insurance companies and improving the service provided to state residents.[33]

Unlike the situation in *Ward*, the property protection tax would not discriminate against out-of-state competition. The tax would be applied uniformly to all products, regardless of whether the use is temporary or long-term and regardless of whether the product was purchased in-state or out-of-state. The only arguable basis for labeling the property protection law as discriminatory is that it might be seen as imposing "multiple burdens" on property purchased out-of-state when a sales tax was paid to the other state and a property protection tax is now demanded of the person who would be using the property in the taxing state. However, this type of burden would not be one designed to enrich local businesses any more than the current compensating use tax, which merely removes the incentive to go out-of-state to make purchases to avoid the in-state tax. Because there is no outright discrimination designed to enrich local businesses or to protect local consumers from competition from out-of-state buyers, there is no equal protection violation. Thus, unless the property protection tax is invalid under the commerce clause, an issue we consider below,[34] the courts should uphold the tax.

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[33] *Ward*, 470 U.S. at 873 n.5.

The Supreme Court's decision in Northeast Bancorp, Inc. v. Board of Governors, 472 U.S. 159 (1985), decided the same term as *Ward*, demonstrates that the Court is using the traditional rational basis test when examining taxes and regulations that appear to be tariffs or trade barriers and that are challenged under the equal protection clause rather than the commerce clause. In *Northeast Bancorp*, the unanimous Court upheld state statutes that permitted an out-of-state bank holding company to acquire an in-state bank only if the holding company had its principal place of business in one of the New England states. The Court's opinion, by Justice Rehnquist, found that Congress had authorized these laws so that they could not violate the commerce clause. The classification did not violate equal protection because it was conceivable that the law promoted a legitimate state interest rooted in a concern for local control over the banking industry. Because the restriction on out-of-state and out-of-region interests related to a state goal other than the simple desire to discriminate against out-of-state or out-of-region competition, the Court in *Northeast Bancorp* found that this restriction survived scrutiny under the traditional rational basis test.

[34] For commerce clause analysis of the property protection tax, see *infra* text accompanying notes 47-64.

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In *Williams v. Vermont*[35] the Court invalidated that portion of the Vermont use tax on automobiles that credited sales taxes paid to another state if the purchaser was a Vermont resident, but denied a credit if the person was a nonresident when the automobile was purchased. The statute was not invalidated on the theory that it discriminated against out-of-state businesses but, rather, because it discriminated in the nature of tax burdens imposed on persons depending on the date they became residents of the state. The Vermont tax, in short, discriminated on the basis of state residency; but the property protection tax is not levied based on state residency. Although dicta in *Williams* questioned whether states with use taxes were constitutionally required to credit sales taxes paid to other states, the Court explicitly avoided ruling on that issue.[36]

The Supreme Court has held that a state may not dispense benefits to, or impose burdens on, persons based upon length of state residency.[37] Thus, a state could give a one-time grant of money to all state residents and deny similar benefits to persons who later became state residents because they were not residents on the date of the welfare distribution. However, the state cannot allocate welfare based upon each state resident's length of residency.[38] Because states cannot distinguish between long-term and recent residents, states cannot grant continuing property tax exemptions to armed services veterans who were residents of the state before a specific date, but deny a similar tax exemption to veterans who are newly arrived residents and property owners.[39]

The proposed property protection tax denies a credit to all persons for sales taxes paid to other states, thus avoiding the vice inherent in the Vermont automobile tax. The property protection tax is not a function of state residency; it is a function of where an item is sold or used. Thus, no federalism concern exists as to whether the state was differen-

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[35] 472 U.S. 169 (1985).

[36] *Id.* at 169.

[37] *See* 2 R. ROTUNDA, J. NOWAK & J. YOUNG, *supra* note 26, § 18.38; Cohen, *Equal Treatment for Newcomers: The Core Meaning of National and State Citizenship*, 1 CONST. COMMENTARY 9 (1984).

[38] Zobel v. Williams, 457 U.S. 55 (1982).

[39] Hooper v. Bernalillo County Assessor, 472 U.S. 612 (1985). Similarly, the state may give a preference in civil service employment to all armed services veterans, Personnel Adm'r v. Feeney, 442 U.S. 256 (1979), but cannot give such a preference only to those residents who served in the military during the time of war and who were state residents at the time they entered the service, Attorney Gen. v. Soto-Lopez, 106 S. Ct. 2317 (1986).

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tiating between its residents solely upon the basis of their date of arrival in the state.

C. The Due Process Clause

In *Complete Auto Transit, Inc. v. Brady,*[40] the Supreme Court set forth a four-part test for analyzing state taxation issues under both the commerce and due process clauses. Justice Blackmun, writing for a unanimous Court, stated that a tax will survive commerce clause analysis "when the tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State."[41]

Although the four-part test was phrased in terms of the commerce clause, parts one and four of the test actually embody due process clause as well as commerce clause principles. The due process clause prohibits a state from taxing out-of-state transactions with which it has no substantial connection. The due process clause thus restricts the portion of a multistate or multinational business' income that the state can include in its apportionment formula. Although a particular apportionment formula might be proper when viewed alone, the state cannot apply that formula to that share of the multistate business' income that is unconnected to the business conducted within the state.[42]

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[40] 430 U.S. 274 (1977).

[41] *Id.* at 279 (bracketed numbers included to clarify the parts of the test).

[42] Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980); Mobile Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980). For example, assume that an oil refining company owns or franchises retail gasoline stations in State *A* and many other states. Assume also that it owns a gambling casino in State *B*. State *A* may apply its income tax apportionment formula to determine its fair share of all of the income produced by the oil exploration, oil refining, and oil sales business of the corporation because all of those activities are a part of the unitary business relating to petroleum and gasoline products conducted in State *A*. For State *A* to apply its apportionment formula to income from the casino, however, the operation of the casino must be a part of the corporation's unitary business operations. Otherwise, applying the apportionment formula to the corporation's income generated by the casinos would violate due process. This due process violation occurs because the income was produced by an activity, unrelated to the unitary business, that has never received the protection of the taxing state's laws. Thus, parts one and four of the test, that both require a relationship between the tax and the services provided by the state, incorporate both due process and commerce clause principles. If a tax meets the first and fourth prongs of the *Complete Auto Transit* test, it should withstand due process analysis. *Cf.* Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981).

This analysis of the due process basis of the *Complete Auto Transit* test is supported

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The property protection tax meets the requirements of *Complete Auto Transit*. First, it is applied to an activity with a "substantial nexus" with the taxing state. Items sold and used in the taxing state clearly receive state protection. Even if an item was purchased in another state, the taxpayer's action of bringing the property into the taxing state extends state law protection to the property. The fact that the property was purchased or first used in another state is irrelevant to whether the taxing state may make property owners or users share in supporting the state services provided.

Interestingly, the activity subject to the property protection tax with the least connection to the state does not involve property purchased or used in another state: an in-state sale with delivery within the state to a buyer who immediately transports the property out-of-state constitutes the taxed activity with the least connection to the state. Nevertheless, even this type of activity has a "substantial nexus" with the state and justifies imposing a property protection tax. The state has extended the protection of its laws to the manufacturer or seller, without whom the buyer could not make the desired purchase, and also to the new property owner at the time of the sales transaction. It is for this reason that courts have upheld traditional sales taxes on precisely this type of sale.[43] Thus, traditional sales and use tax cases establish that the property protection tax meets the first prong of the *Complete Auto Transit* due process test.

The fourth prong of the *Complete Auto Transit* test (the second due process test) is whether the tax "is fairly related to the services provided by the State." When a person brings property into the state, the state extends the protection of its laws and services to the property owner and the property. Whether the property was first used elsewhere is irrelevant. The fact that a sales tax was previously paid to another state merely indicates that another state received compensation for extending its state law protection to the person who sold or used the property. When property is brought into a second state, that state may impose not only annual property taxes but also a one-time charge for the ex-

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in Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272-73 (1978):

> "The due process clause places two restrictions on a state's power to tax income generated by the activities of an interstate business. First, no tax may be imposed unless there is some minimal connection between those activities and the taxing State . . . . Second, the income attributed to the State for tax purposes must be rationally related to values connected with the taxing State" (internal quotations omitted).

[43] *Mobil Oil*, 445 U.S. at 425.

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tension of its services and laws to the property and property owner.[44]

Persons who are bringing property into the state, or persons who are taking property out of the state immediately after an in-state sale, may complain that the state should not impose a uniform tax on its protection of property. In essence, they are complaining that they are taxed at the same rate as persons who will use the property solely in the taxing state. However, the Supreme Court rejected any requirement that states closely tailor taxes to the services provided by the state or to the nature of the protection in *Commonwealth Edison Co. v. Montana.*[45] The Court ruled that a state could tax the removal of natural resources, such as oil and gas, from land within the state. Dismissing the claim that such taxes were not reasonably tailored to compensate the state for the services it provided in relation to severing natural resources from the land or the protection for that act under state law, the Supreme Court responded:

> [Those persons attacking the tax] have completely misunderstood the nature of the inquiry under the fourth prong of the *Complete Auto Transit* test . . . . The Court has indicated that States have considerable latitude in imposing general revenue taxes. The Court has, for example, consistently rejected claims that the Due Process Clause of the Fourteenth Amendment stands as a barrier against taxes that are "unreasonable" or "unduly burdensome" . . . . [T]here is no requirement under the Due Process Clause that the amount of general revenue taxes collected from a particular activity must be reasonably related to the value of services provided to that activity.[46]

D. The Commerce Clause

The final and most difficult test of the property protection tax's validity is whether it survives the remaining two prongs of the *Complete Auto Transit* analysis. These prongs require that the tax be "fairly apportioned" and that it not "discriminate against interstate commerce."

These prongs of the *Complete Auto Transit* test mirror two well-established commerce clause principles. The commerce clause prohibits state regulation of interstate commerce that either (1) discriminates

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[44] This assertion assumes that the state does not use a discriminatory system of valuation that would impose a higher tax on property brought from out-of-state than property purchased in-state by evaluating identical property brought from out-of-state at a higher rate. For an examination of the valuation problem and the concept of discrimination against interstate commerce, see *infra* notes 65-100 and accompanying text.

[45] 453 U.S. 609 (1981).

[46] *Id.* at 621-22.

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against interstate commerce or (2) imposes a burden on commerce that clearly outweighs the legitimate local benefits produced by the regulation.[47]

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[47] *See* 1 R. ROTUNDA, J. NOWAK & J. YOUNG, *supra* note 29, §§ 11.1-11.10. These two commerce clause tests are explained in terms of regulatory and tax laws in the following paragraphs in the text. There is a third standard for judging the constitutionality of state regulatory legislation under the dormant commerce clause, which is sometimes referred to as the Cooley Rule of Selective Exclusiveness. This rule comes from the case of Cooley v. Board of Wardens, 53 U.S. 299 (1851). The test of selective exclusiveness prohibits a state from regulating a subject of interstate commerce that by its very nature requires national uniformity of regulation. Because of the inherent local interest in taxation, there is no direct application of the *Cooley* principle to state taxation cases. However, the same considerations that underlie the *Cooley* rule are seen in the Court's decisions regarding the extent to which states may tax items in international commerce. In Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979), the Supreme Court invalidated the imposition of an *ad valorem* personal property tax on cargo containers (owned by Japanese shipping companies) used in transporting goods by ocean-going vessels in international commerce. These containers were subject to property taxes in Japan; they were taxed on their total value in that country. California tax authorities attempted to impose a nondiscriminatory property tax on these items. The Court invalidated the tax and stated that in addition to the normal commerce clause inquiries, there must be two additional inquiries when the tax involves items in international commerce: first, whether the tax creates a substantial risk of international multiple taxation; and second, whether the tax prevents the federal government from speaking with one voice in regulating commercial relations with foreign governments.

The restriction on "multiple taxation" should be stricter in the international commerce area because the Court has no ability to police the apportionment formulas of other nations. More importantly, the federal interest in "speaking with one voice" in regulating foreign trade comes close to making this an area of exclusively federal interest. In Department of Revenue v. Association of Wash. Stevedoring Cos., 435 U.S. 734 (1978), the Court found that the prohibition on the taxing of imports and exports included in article I, section 10, did not prohibit the application of Washington's business activities tax, measured by gross receipts, to stevedoring enterprises that handled goods destined for foreign countries. Similarly, in Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976), the Court upheld a nondiscriminatory *ad valorem* tax on property that was imported from other countries and that was included in an inventory maintained at a wholesale distribution warehouse in the state. When the state taxation of domestic companies meets the due process and commerce clause tests, it will not be held invalid merely because part of the company's income was generated by foreign subsidiaries, as long as the tax is properly apportioned. *See* Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159 (1983). The concern for protecting the uniquely federal interest in foreign commerce is also seen in some preemption cases such as Xerox Corp. v. County of Harris, 459 U.S. 145 (1982) (imposing nondiscriminatory *ad valorem* personal property taxes on imported goods stored under bond in a customs warehouse that were destined for sale in other countries was preempted by federal regulations of customs duties).

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A half century ago, in *Henneford v. Silas Mason Co.*,[48] the Supreme Court held that use taxes on products from another state did not violate the commerce clause, at least when the state gave a credit against its use tax for sales taxes paid to another state. It may fairly be said that Justice Cardozo's majority opinion in *Silas Mason* found that a use tax met both prongs of the commerce clause test established decades later in *Complete Auto Transit*. He ruled that such a tax imposed neither an undue burden on commerce, because it was fairly apportioned, nor did it discriminate against interstate commerce. The use tax was nondiscriminatory, even though its purpose was eliminating the tax advantages of purchasing products in another state to avoid the state's sales tax.

A use tax does not involve discrimination in the nature of a tariff or trade barrier because no competitive advantage is given to in-state products. There is an equal tax on products sold in-state and out-of-state. Similarly, use taxes do not create an undue burden on interstate commerce; Justice Cardozo found that a use tax was not a tax on interstate commerce because "[t]hings acquired or transported in interstate commerce may be subjected to a property tax, nondiscriminatory in its operation, when they have become part of the common mass of property within the state of destination . . . . This is so, indeed, though they are still in the original packages."[49] Cardozo made clear in *Silas Mason* that a use tax was not an attempt to tax property outside of the state or income generated outside of the state. Justice Cardozo's finding that there was no tax on interstate commerce would be the equivalent of a finding under *Complete Auto Transit* that the tax was fairly apportioned.

In *Silas Mason* the Supreme Court did not explicitly decide the constitutionality of a use tax crediting sales taxes paid to that state but not crediting sales taxes paid to other states. However, in dicta, Justice Cardozo indicated that such a tax system might be valid. He stated:

> [A] word of caution should be added here to avoid the chance of misconception. We have not meant to imply by anything said in this opinion that allowance of a credit for other taxes paid to Washington made it mandatory that there should be a like allowance for taxes paid to other states. A state, for many purposes, is to be reckoned as a self-contained unit, which may frame its own system of burdens and exemptions without heeding systems elsewhere. If there are limits to that power, there is no need to mark them now. It will be time enough to mark them when a taxpayer paying in the state of origin is compelled to pay again in the

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[48] 300 U.S. 577 (1937).

[49] *Id.* at 582.

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state of destination.[50]

Almost since the minute he wrote those words, commentators have wondered how Justice Cardozo could have believed that a tax like our property protection tax, which does not allow a credit for sales taxes paid to other states, could be valid. The problem is not difficult, viewed in terms of the *Complete Auto Transit* test and the property protection tax.

1. The "Fair Apportionment" Concept

The property protection tax is "fairly apportioned." Although the state (State *A*) in effect grants a credit for in-state sales taxes but allows no credit for sales taxes paid to other states, State *A* may impose such taxes without regard to what other states may or may not do. In effect, State *A* only imposes a tax on the use of all items in the state, but then collects the tax earlier (at the time of sale) if the item was also sold in State *A*. The concept of fair apportionment in Supreme Court cases relates to whether a state is taxing only its fair share of property use or income.

The apportionment concept has come up in two primary areas.[51] First, the Court has required apportionment of state property taxes on the instrumentalities of interstate commerce.[52] Thus, the state of domicile of a trucking company could impose its annual property tax on the full value of the fleet of trucks owned by the company unless the company could demonstrate that there was a substantial use of the trucks in other states and that other states, in fact, were imposing a tax on that

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[50] *Id.* at 587.

[51] Apportionment is examined in a number of state taxation cases, such as those determining the state-by-state tax base for the assessment of annual franchise taxes on corporations. *See, e.g.*, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977); Colonial Pipeline Co. v. Traigle, 421 U.S. 100 (1975). However, personal property tax apportionment on the instrumentalities of interstate commerce and the apportionment of multistate businesses' income best exemplify the nature of the *Complete Auto Transit* apportionment requirement and the way in which it is met by the property protection tax.

[52] This Article uses examples involving the apportionment of property taxes on vehicles used in interstate commerce. However, the apportionment principle, with modifications to fit the problems presented by other types of instrumentalities, is equally applicable to other interstate commerce instrumentalities such as interstate communication systems. For further detailed analysis of the types of apportionment problems that can arise when several states attempt to tax the instrumentalities of interstate commerce, see P. HARTMAN, *supra* note 6, ch. VII; 1 R. ROTUNDA, J. NOWAK & J. YOUNG, *supra* note 29, § 13.2(d).

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share of the value of the trucks that represented the percentage of miles or time that the trucks spend in the other states.[53] Nondomiciliary states must have a proper apportionment formula to tax that percentage of value of the truck fleet that is roughly equivalent to the percentage of time or miles that the trucks spend in the state.[54] The domiciliary must allow a reduction in the percentage of value tax once it is established that other states are taxing a properly apportioned fraction of the value of the trucking fleet.[55]

Apportionment is necessary here to prevent taxation of property that was not truly located in the state (for the percentage of time or miles that the truck was used elsewhere). Also, unapportioned property taxes would unduly burden interstate commerce by discriminating against interstate trucking companies. For example, assume that State *A* and State *B* both impose an annual tax of five percent of the value of all personal property used in the state. Ms. *X*, Mr. *Y*, and Ms. *Z* all establish trucking companies with $100,000 fleets of trucks. Ms. *X*'s trucks operate solely in State *A*, Mr. *Y*'s trucks operate solely in State *B*, and Ms. *Z*'s trucks operate an exactly equal amount of time in State *A* and State *B*. If both states had unapportioned taxes, they might each tax Ms. *Z* the full $5000. Thus, she would have to pay twice as much tax as Ms. *X* and Mr. *Y*, solely because Ms. *Z*'s business is interstate. Such discrimination would violate the commerce clause.

The apportionment concept is also important in the division of the income tax base of multistate or multinational income-producing ventures.[56] A state could impose a gross receipts tax or income tax based

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[53] Central R.R. v. Pennsylvania, 370 U.S. 607, 614-15 (1962) (appellant sustained burden of proof by showing that a determinable portion of its freight cars were taxed in New Jersey); *cf.* Standard Oil Co. v. Peck, 342 U.S. 382 (1952) (domiciliary state barred from imposing property tax when barges are used continuously outside of state during the year).

[54] Braniff Airways, Inc. v. Nebraska State Bd. of Equalization and Assessment, 347 U.S. 590 (1954) (Nebraska can tax the appellant who was not incorporated in Nebraska but made 18 stops per day in Nebraska); Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169 (1949) (state assessments based on ratio between number of miles of line within the state and the total number of miles of entire line); Pullman's Palace Car Co. v. Pennsylvania, 141 U.S. 18 (1891) (tax assessed on basis of the number of miles of railroad in state and the total number of miles of railroad lines).

[55] *See supra* note 54.

[56] For a more detailed discussion regarding the division of the income tax of multistate and multinational businesses for the imposition of individual state income taxes, see P. HARTMAN, *supra* note 6, ch. IX; J. HELLERSTEIN, STATE TAXATION — CORPORATE INCOME AND FRANCHISE TAXES (1983 & Supp. 1985); 2 R. ROTUNDA, J. NOWAK & J. YOUNG, *supra* note 26, § 13.4.

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solely on sales within the state. Such a gross receipts tax on sales income would be fairly apportioned by definition.[57]

A manufacturing state may decide that it would not receive a fair share of multistate businesses' income by taxing only income generated from sales within the state. For example, assume that State *A* is the home of a large oil refinery owned by a vertically integrated oil company, although the oil company is incorporated in another state and has its corporate headquarters in yet a third state. The oil company may make almost one hundred percent of its oil, gas, and gasoline sales outside of the state. It would be unfair to restrict the state income tax to that portion of the oil company's income that results from a few retail sales consummated in the state. The Supreme Court has allowed states to create fair apportionment formulas that take into account a variety of business operations that generate income for multistate or multinational corporations, including, for example, the direct production of goods later sold. Thus, State *A* could create a formula that fairly approximates the share of the multistate oil company's income attributable to its in-state oil refining activity as well as to its in-state sales. The state could multiply all of the multistate oil company's income by a fraction that represented the portion of the corporation's property, payroll, and sales located in the taxing state.[58]

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[57] This statement assumes that the state can and does identify only those sales that actually occur within the state and impose its gross receipts tax only upon the income generated from those sales. The gross receipts tax, like a sales tax, does not apply to sales or income involving delivery and transfer of title to a purchaser outside of the taxing state. However, in the case of interstate businesses with substantial business activities in a state, the state may impose a nondiscriminatory gross receipts tax on the income generated by the interstate businesses from their sales within the taxing state. *See, e.g.*, Standard Pressed Steel Co. v. Washington Dep't of Revenue, 419 U.S. 560 (1975) (Washington State's business and occupation tax was levied on unapportioned gross receipts of appellant); General Motors Corp. v. Washington, 377 U.S. 436 (1964) (tax measured by gross receipts is constitutionally proper if fairly apportioned). When the Court upheld a state's income tax that assigned income from a multistate business to itself based only on the "sales factor" (the percentage of the company's income was made to equal the percentage of its sales that took place in the state), the Supreme Court stated: "[I]t is evident that appellant would have no basis for complaint if, instead of an income tax, Iowa had imposed a more burdensome gross receipts tax on the gross receipts from sales to Iowa customers." Moorman Mfg. v. Bair, 437 U.S. 267, 280 (1978).

[58] Almost all states use a "three-factor formula," which is endorsed both in the Uniform Division of Income for Tax Purposes Act and the Multistate Tax Compact. Nonbusiness income, including investment income, is attributed to the state of domicile. Business income is allocated among the states imposing an income tax on the business. Each state that uses the three-factor formula determines its share of taxable income by

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Two problems arise in applying a state apportionment formula to multistate businesses. First, the state can apply its apportionment formula only to activities that are a part of the unitary business conducted in the state. Once again, assume that an oil company owns an oil refinery in State *A* and that it owns several retail gasoline stations in State *A*. The oil company engages in no other business in State *A*. Assume also that the oil company owns a computer hardware corporation located in State *B*. The computer corporation does no business in State *A*. The conglomerate's income from its computer company has no relationship to its oil refining business in State *A*. It would violate due process to include a share of the conglomerate's income from the computer company in the tax base that is subject to State *A* apportionment.[59] The unitary principle requires states to tax their fair share of a multistate business' income by taxing only that income relating to in-state activity.

Second, an apportionment formula that is unreasonable in attributing income to the state would violate both the due process clause, by taxing income that was generated in another jurisdiction, and the commerce clause, by imposing a discriminatory burden on interstate commerce. The discriminatory burden on interstate commerce results because, to the extent that the state was taxing income that was unrelated to in-state activity, the state is subjecting the income of an interstate business to a higher tax than that imposed on a business with the same amount of income located entirely within the state.

Because the income from a multistate business attributable to activi-

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taking the unitary business' total income and multiplying it by a fraction or percentage. That fraction or percentage is determined by adding together three factors and dividing by three.

The three factors are: (1) the payroll factor (the numerator is the amount of compensation paid to employees in the state during the tax year and the denominator is the total compensation paid everywhere during the tax period); (2) the property factor (the numerator is the average value of the property owned or rented and used in the unitary business in the state and the denominator is the average value of all the property owned or rented and used in any location); and (3) the sales factor (the numerator is the total amount of sales made in the state and the denominator is the total amount of the unitary business' sales). For an examination of the technical problems in determining how each factor is computed, see J. HELLERSTEIN, *supra* note 56.

[59] Determining whether wholly owned subsidiaries or other branches of a conglomerate form a part of a "unitary business" is not easy. *See* Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980) (appellant, a vertically integrated petroleum company doing business in several states, was a "unitary business"); Mobil Oil Corp. v. Vermont Comm'r of Taxes, 445 U.S. 425 (1980) (sufficient nexus between state and appellant to justify tax).

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ties in a particular state is not always clearly identifiable, the Supreme Court has found that states need not have absolutely precise apportionment formulas. In *Moorman Manufacturing Co. v. Bair,*[60] the Supreme Court ruled that a state's apportionment need only be a reasonable, fair means of approximating the share of a multistate business' income that is attributable to in-state activity. No specific apportionment formula is constitutionally required by either the commerce or due process clause. Thus, if a business operates in two states, each state may claim the right to tax more than fifty percent of the corporation's income if each state's formula is different but if each is also a fair attempt to approximate the amount of income attributable to the state. Severe "double taxation" of income makes it clear that one state's formula is unreasonable. However, states are not required to have matching formulas guaranteeing a precise division of a corporation's income between all of the states in which it does business.[61]

In *Moorman*, the Supreme Court allowed a state to use an apportionment formula for its income tax based solely on in-state sales. Thus, the following example could occur.[62] A computer company does business in both State *A* and State *B*; its total net income for the year from its unitary computer business is $1 million. Its sales are divided evenly between State *A* and State *B*. Three-fourths of its property and three-fourths of its payroll are located in State *A*; one-fourth of its property and one-fourth of its payroll are located in State *B*. If both states use the so-called three-factor formula, State *A* could tax two-thirds of the computer company's income by its income tax rate, and

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[60] 437 U.S. 267 (1978).

[61] *Id.* at 279-80:

> The prevention of duplicative taxation, therefore, would require national uniform rules for the division of income. Although the adoption of uniform code would undeniably advance the policies that underlie the Commerce Clause, it would require a policy decision based on political and economic consideration that vary from State to State . . . . It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all states to adhere to uniform rules for the division of income. It is to that body, and not this Court, that the Constitution has committed such policy decisions.

[62] Justice Powell, dissenting in *Moorman*, demonstrated how the single factor tax could result in multistate businesses bearing a heavier tax burden than single state businesses or businesses domiciled in the state with a single factor income tax. To some extent, the following example is built upon his dissent. *See* 437 U.S. at 284 n.2 (Powell, J., joined by Blackmun, J., dissenting). Justice Blackmun also wrote a separate dissent, as did Justice Brennan in *Moorman*.

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State *B* could tax one-third by its income tax rate. Assume that State *A* has a substantial number of manufacturing companies and in fact uses the three-factor formula to maximize the income attributable to it from the multistate businesses operating in State *A*. State *B* is primarily a "consumer" state and chooses to have a one-factor formula based solely on sales. State *A*, by using the three-factor formula, is entitled to tax two-thirds of the corporation's income. State *B* may apply its income tax rate to one-half of the computer company's net income. This example and the *Moorman* decision show that the requirement of apportionment was not established to avoid the possibility of multiple taxation, but rather to insure that each state has not discriminatorily burdened interstate commerce by subjecting interstate businesses to a higher rate of taxation than in-state businesses.

Assuming a uniform, nondiscriminatory means for valuing property, the property protection tax should comply with the fair apportionment requirement of *Complete Auto Transit*. Assume that State *A* adopts a property protection tax and eliminates the credit against its use tax for sales taxes paid to other states. State *A* imposes a five percent use or personal property protection tax on all property used within the state. State *B* has a traditional five percent sales tax. A resident of State *A* travels to State *B*, purchases a $20,000 automobile, and pays a $1000 sales tax to State *B*. When the State *A* resident returns home and attempts to register her car, State *A* will not credit the out-of-state sales tax. State *A* will require her to pay a $1000 (five percent) property protection tax before she may register her automobile. This tax is constitutional. Fair apportionment is not a problem because State *A* would also subject the purchaser of a $20,000 automobile in State *A* to a $1000 tax. Because the use of the automobile is in State *A*, the five percent tax by definition is fairly apportioned on the basis of the use of the $20,000 automobile in the state.

The only possible apportionment problem under the property protection tax involves the valuation of property that is used for a substantial period of time in two states. For example, assume that a resident of State *B* purchased an automobile for $20,000 in State *B* and paid a $1000 sales tax to State *B*. The person then used the automobile in State *B* for five years before moving to State *A*. If State *A* imposed the five percent property protection tax based on the automobile's *original* purchase price, a court might find that State *A* had not fairly apportioned its tax: the automobile was five years old and no longer worth $20,000. The basis for this ruling is not that the property protection tax creates an improper multiple burden on interstate commerce, but rather that the state valuation system imposed a special burden on au-

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tomobiles brought in from out-of-state.

If a five-year-old automobile were resold in State *A*, it would be taxed at a lower rate. Assume that a person in State *A* purchased an automobile in-state for $20,000 and paid a $1000 (five percent) property protection tax to State *A* in 1980. In 1985, the person resells the automobile in-state for $5000. Although a new State *A* property protection tax is due at the time of the resale based upon the new purchase price,[63] there is no multiple taxation problem. Because the personal property tax on the resale in State *A* is based on a lower valuation, there is a strong argument that after property is used for a significant period of time in another state it should also be revalued for property protection tax purposes based on the property's fair market value at the time it is brought into the state. The revaluation problem already exists for traditional use taxes and the property protection tax in reality is not a different problem.[64]

Assuming that the state valuation process does not discriminate against out-of-state purchases, there is no fair apportionment problem inherent in the property protection tax or a use tax that does not include a credit for sales taxes paid to other states. Regardless of whether a sales tax was paid to another state, the state is imposing a uniform, nondiscriminatory tax on all property used or sold in the state.

2. "Multiple" or "Double" Taxation Arguments

The most likely objection to our commerce analysis is the assertion that a use tax that credits sales taxes paid in the state but does not

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[63] This valuation analysis assumes that the state would tax the resale of the commodity. Some states will exempt from sales taxation all resales or those sales that are not made in the regular course of business dealings but are, rather, isolated sales by either a noncommercial seller or a business that does not normally engage in sales transactions. J. HELLERSTEIN & W. HELLERSTEIN, *supra* note 9, at 590-620, 648; STATE TAX GUIDE (CCH) 6012 (2d ed. 1986); ST. & LOC. TAXES (BNA): ALL STATES UNIT ¶ 92,572.

[64] If a state exempted the resale of a commodity previously taxed in the state, the state would have to be very careful in having a valuation system that valued property for the property protection tax or use tax at the property's actual market value at the time it is brought into the state. The failure to have such a valuation system might not be a fatal defect in the tax system; nonetheless it would make it difficult to uphold the law against the charge that it was discriminatory against out-of-state persons. For example, if the value of a car brought in from out-of-state is only $5000, and the state taxes it as a new car worth $20,000, while the state exempts from taxation the in-state resale of a $5000 automobile that was originally sold and taxed in the state at a $20,000 value, the out-of-state person is subject to a higher tax for the sole reason that she made her original purchase out-of-state and is a new resident of the state.

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credit sales taxes paid out of the state (which is effectively the same as our property protection tax) imposes a "multiple burden" or "double taxation" on products that are sold or used in interstate commerce. If there were a constitutional prohibition on a state taxing a product that was once taxed in another state, such an objection would be significant. Although some scholars and judges are wedded to the "multiple taxation" or "double taxation" labels as if they explained when a tax will be unconstitutional, there is no constitutional prohibition on applying a uniform, nondiscriminatory tax to property or income merely because that property or income has been subject to tax elsewhere. Our extended discussion of the apportionment concept was meant to demonstrate this point. The Court's refusal to require a single apportionment formula for income taxes clearly contemplates the possibility of "multiple taxation" of some share of a business' multistate income.

The property protection tax will result in a person paying two taxes on the same piece of property because she purchases it in one state, which imposes a sales tax, and then brings it to another state, which imposes a use or property protection tax. Nevertheless, there is no basis for asserting that the property protection tax creates an unconstitutional multiple taxation. The Constitution does not prohibit uniform nondiscriminatory taxes on property or income merely because that property or income was subject to tax elsewhere. The Court's refusal to require a single apportionment formula for income taxes clearly contemplates the possibility of "multiple taxation" of some share of a business' multistate income.[65]

Complete Auto Transit[66] did not create a multiple taxation test. The purpose of the fair apportionment and nondiscrimination tests of *Complete Auto Transit* is to avoid both hidden and overt discrimination against interstate commerce. The property protection tax meets due process jurisdictional principles and is fairly apportioned because the state imposes a tax on the value of property used in the state. Therefore, courts should not invalidate the tax unless it fails the fourth prong of the *Complete Auto Transit* test by discriminating against interstate commerce.

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[65] Regardless of whether the state gives a credit for out-of-state sales taxes, a valuation system for sales and use taxes that is set up to discriminate against interstate commerce by placing a lower value on a product that is produced or sold in the state than an identical product produced or sold outside of the state would violate the commerce clause. *See* Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64 (1963), discussed *infra* notes 86-87 and accompanying text.

[66] *See supra* notes 40-41 and accompanying text. On why and how labels and language can mystify, see generally R. ROTUNDA, THE POLITICS OF LANGUAGE (1986).

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Some judges and scholars might claim that the property protection tax system violates the commerce clause because it unconstitutionally discriminates against property that has traveled in interstate commerce by imposing a multiple burden. To answer this challenge, one must examine the meaning of commerce discrimination under the Supreme Court's decisions.

In both regulation and taxation cases, the Supreme Court has established a per se rule of invalidity for state laws that effectively create a tariff or trade barrier. A tariff or trade barrier is discriminatory because it eliminates out-of-state competition (for local dollars or products) in order to enrich some segment of the local populace. The cases on discrimination and trade barriers fall into two categories: (1) explicit tariffs or barriers to competition, and (2) trade barriers arising from a seemingly nondiscriminatory law that, in effect, makes it difficult for money, jobs, or local resources to leave the state. The property protection tax violates neither branch of the Court's rulings regarding tariffs and trade barriers.

The Supreme Court has adopted virtually a per se prohibition against explicit trade barriers that prohibit competition from out-of-state dollars for local resources (thereby guaranteeing lower prices for in-state purchasers) or bans on importing particular types of products or services (which protects local businesses from competition). Thus, the Court has invalidated laws requiring privately owned oil and gas companies to give preferential pricing to in-state customers[67] or prohibiting the shipment out-of-state of a wide variety of products.[68] The Supreme Court also has invalidated state or local laws restricting incoming commerce, such as laws prohibiting the importation of milk from other states,[69] or the importation of garbage, which competes with local garbage for space in privately owned landfills.[70]

Courts will uphold a state law that on its face discriminates against interstate commerce or out-of-state economic interests only if the state can demonstrate that its law promotes a clearly legitimate state interest that the state cannot achieve by nondiscriminatory means. Under this test, the Supreme Court has upheld quarantine laws that exclude products from a state when the infected products endanger public safety or

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[67] *See* Pennsylvania v. West Virginia, 262 U.S. 553 (1923).

[68] *See* New England Power Co. v. New Hampshire, 455 U.S. 331 (1982) (energy produced by privately owned federally licensed power station); Hughes v. Oklahoma, 441 U.S. 322 (1979) (fish).

[69] *See* Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366 (1976).

[70] *See* Philadelphia v. New Jersey, 437 U.S. 617 (1978).

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state ecological systems and the state cannot effectively screen the incoming product to avoid such harm.[71] Absent such health concerns, embargoes are invalid. Thus, any tax imposing differing tax burdens on persons, property, or income based on their location in-state or out-of-state should not be upheld. Such open tax discrimination protects local economic interests through discriminatory means. For this reason, the Court has found that a state cannot exempt from sales taxes only locally produced wines.[72]

A discriminatory state tax would violate the equal protection clause as well as the commerce clause. If the state cannot justify the basis for treating out-of-state property or income differently from in-state property or income on any basis other than the desire to enrich local residents or to protect local business from competition, the law is invalid under the equal protection clause because it relates to no legitimate state interest.[73]

The Supreme Court has also invalidated state regulations of commerce that did not openly establish a trade barrier or discriminate against out-of-state interests but that effectively did so by capturing some economic benefit for local residents at the expense of out-of-state interests. The commerce clause will not tolerate even a seemingly nondiscriminatory law if it operates as a tariff or trade barrier by enriching the local populace through shifting burdens to out-of-state economic interests. *Pike v. Bruce Church, Inc.*[74] is an example. Arizona prohibited persons who produced or purchased cantaloupes grown in Arizona from shipping them outside of the state unless they were packed in Arizona in state-approved containers. The Supreme Court held the statute unconstitutional. Justice Stewart, writing for a unanimous Court, stated:

> [T]he Court has viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere. Even where the state is pursuing a clearly legitimate local interest, this particular burden on commerce has been declared to be virtually *per se* illegal.[75]

The reason for the rule's strictness is clear: states should not be allowed to capture a share of the interstate job market by requiring a business

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[71] Maine v. Taylor, 106 S. Ct. 2440 (1986).

[72] *See* Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) (21st amendment does not justify state law creating tariff for trade barrier that discriminates against out-of-state alcoholic beverages).

[73] *See* 1 R. ROTUNDA, J. NOWAK & J. YOUNG, *supra* note 29, §§ 11.1-.10.

[74] 397 U.S. 137, 145 (1970).

[75] *Id.*

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to locate part of its enterprise in the state, thereby shifting to other states the economic burden for protecting local jobs. Only if the state is willing to offer a company a direct subsidy for locating business operations in the state should courts uphold such actions. In such a situation, the state bears internally, through its own tax dollars, the cost for producing local jobs.[76]

A law that appears nondiscriminatory but in fact operates as a barrier to export in order to keep prices low for in-state consumers is also invalid. Thus, in *H.P. Hood & Sons v. Du Mond*,[77] the Supreme Court overturned a state restriction on the number of milk "receiving depots" when the state's denial of a license to receive milk and establish a new receiving depot limited access to locally produced milk products for persons who wished to take the milk out-of-state. A state can help local residents buy milk by offering them a direct subsidy for the purchase of milk, but it cannot create a regulatory system that is a barrier to the milk's export.

A state law that appears evenhanded, but in fact is designed to prevent price competition from out-of-state competitors, is also invalid. For example, in *Baldwin v. G.A.F. Seelig, Inc.*,[78] the Court invalidated a law that prohibited local milk producers from selling milk purchased in other states if the price paid was less than the price fixed by state law for purchasing milk from in-state farmers. The Court stated that the law was invalid because it attempted to regulate the price paid for milk in another state. However, the law was not invalidated because of a due process violation for an extraterritorial attempt to enforce state law; the Court relied only on commerce clause grounds.[79] The commerce clause

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[76] This is the rationale behind the so-called "market participant" principle that allows states to use state-owned resources to promote the economic interest of local residents. *See, e.g.*, Reeves, Inc. v. Stake, 447 U.S. 429 (1980); Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976). *See generally* Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VA. L. REV. 563 (1983); Rotunda, *The Doctrine of the Inner Political Check, the Dormant Commerce Clause, and Federal Preemption*, 53 TRANSP. PRAC. J. 263 (1986). Even when the state uses its own resources it is not totally free to disregard restrictions meant to prohibit discrimination against out-of-state persons or economic interests embodied in both the commerce clause and the comity clause. *See generally* South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82 (1984); United Bldg. & Constr. Trades Council v. Camden, 465 U.S. 208 (1984).

[77] 336 U.S. 525 (1949).

[78] 294 U.S. 511 (1935).

[79] A state would violate due process if it were truly attempting to give extraterritorial effect to its law. For example, assume that State *A* makes it a crime to commit a battery against a State *A* resident regardless of when and where the battery takes place. When a State *A* resident visits State *B*, a person in State *B*, who has no connection to

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vice was that it prohibited out-of-state farmers, who could produce milk more efficiently than in-state farmers, from exploiting their competitive advantage by selling milk at prices lower than in-state farmers could charge.

In *Milk Control Board v. Eisenberg Farm Products*,[80] the Supreme Court found that states could regulate the price paid to in-state farmers for milk produced in the state, even though this had the effect of raising the price of milk shipped in interstate commerce as well as that of milk ultimately used in the state. *Eisenberg Farm Products* distinguished *Baldwin* by finding that the restriction on the price paid for milk imported into the state "amounted in effect to a tariff barrier set up against milk imported into the enacting state."[81] In other words, the state was free to set a minimum price for milk sold from in-state cows if, but only if, it allowed out-of-state producers to attempt to sell milk at a lower price in the state.[82] A state is free to send a cash subsidy to

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State *A*, punches the State *A* resident in the nose. State *A* cannot subject the State *B* resident to criminal liability for the battery committed in State *B*. States, in fact, do not attempt to take such actions. *See* MODEL PENAL CODE § 1.03(1)(f) and comment to § 1.03 (1985). There must be some substantial connection between a person, her activities, or the effect in the state before its laws may apply to her. *Cf.* Phillips Petroleum Co. v. Shutts, 472 U.S. 797 (1985).

The Court has described the problem raised by applying price regulations to in-state sales of products that are tied to out-of-state activities as involving a commerce clause violation due to the attempt to regulate out-of-state commercial activities. *See, e.g.*, Brown-Forman Distillers Corp. v. New York Liquor Auth., 106 S. Ct. 2080 (1986) (invalidating a New York law that required liquor distillers to sell to in-state wholesalers at a price no higher than the lowest price charged in any other state because the state violated the commerce clause when it "projected its legislation" into other states). When in-state price activity is tied to out-of-state pricing or commercial practices, the state is not, in fact, attempting to project its legislation into other states but is making activity within the state boundaries legal or illegal, depending upon actions the persons has taken in another state. There is no fundamental unfairness or extension of state laws in such situations that violates due process. Rather, the vice of such statutes is that they attempt through regulation to capture a share of a market for in-state consumers or sellers. It is the barrier to interstate competition and the free flow of goods and services that constitutes the commerce clause violation in such situations.

[80] 306 U.S. 346, 353 (1939).

[81] *Id.*

[82] A law fixing the minimum price for a product produced in the state may be upheld as long as it does not prohibit out-of-state merchants from selling the product to in-state residents at a lower price. Some state court cases regarding the setting of minimum prices for the sale of milk would appear to approve a fixed price law that prohibited competition from out-of-state milk suppliers. National Dairy Prod. Corp. v. Hoffman, 40 N.J. 475, 193 A.2d 125 (1963). Although the Supreme Court has not precisely defined the scope of state authority to enact fixed price or minimum price legislation,

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in-state dairy farmers (open, and above board, and very costly), but it cannot protect them from out-of-state competition by regulations and tariff barriers.

A state cannot attempt to do through taxation what it could not accomplish through regulation. Thus, a state law effectively creating a tariff or trade barrier against out-of-state competition is unconstitutional under the commerce clause as a form of discriminatory legislation.[83] Similarly, a state tax imposing lower tax rates on transfers of corporate stock accomplished through an in-state stock exchange than those transferred through an out-of-state exchange is equally invalid.[84] And a New York franchise tax violated the commerce clause by giving a special credit with respect to gross receipts derived from shipments originating in New York, effectively creating a special tax burden on income produced by shipments from other states.[85]

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state legislation that prohibits price competition seems highly questionable under traditional commerce clause analysis unless it is approved by Congress or a federal agency. *Cf.* Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384 (1951) (state statute cannot justify price-fixing made illegal by federal statute). *But cf.* Parker v. Brown, 317 U.S. 341 (1943) (state control of sale of raisins grown in state does not violate either federal statutes or the commerce clause).

However, some statutes that prohibit sales "below cost" may not be subject to invalidation under the commerce clause if they are designed to avoid harm to free competition. *See* William Inglis & Sons Baking Co. v. ITT Continental Baking Co., 668 F.2d 1014 (9th Cir. 1981, as amended 1982); Annotation, *Validity, Construction and Application of State Statutory Provision Prohibiting Sales of Commodities Below Cost — Modern Cases*, 41 A.L.R. 4th 612 (1985).

[83] The commerce clause prohibition against taxes that function as a tariff or trade barrier has been a long standing one. *See, e.g.*, Welton v. Missouri, 91 U.S. 275 (1875).

[84] Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977). In this case, New York imposed a transfer tax on securities transferred or delivered in New York. This transfer tax applied to any type of stock transfer, including the transfer that takes place when a corporation's stock-transfer agent completes the transfer of stock shares between private sellers and purchasers of the corporation stock. Many large corporations have stock-transfer agents in New York, for obvious reasons. Thus, the New York tax applied to many transactions, although the stock's seller and purchaser might be located in another state and might be using a stock exchange other than the New York Stock Exchange. The New York law limited the stock-transfer tax if the sales were made in New York. Stock exchanges in other states successfully challenged the law as discriminating against their ability to compete for stock transactions by giving a tax preference to those persons who used the New York Stock Exchange. The Supreme Court found a violation of the commerce clause because "[a] state may no more use discriminatory taxes to assure that nonresidents direct their commerce to businesses within the state than to assure that residents trade only in intrastate commerce." *Id.* at 334-35.

[85] Westinghouse Elec. Corp. v. Tully, 466 U.S. 388 (1984). The discrimination in

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The property protection tax does not constitute either overt discrimination against interstate commerce or the creation of a discriminatory trade barrier. To avoid being stricken as a discriminatory tax, the property protection tax must (1) apply the same tax rate to in-state and out-of-state products; (2) have the same coverage and exemptions for in-state and out-of-state products; and (3) employ the same formula for establishing a value for products sold in-state and products brought into the state after an out-of-state purchase and use. Failure to establish complete uniformity in tax rate, the scope of the tax, or valuation would constitute the type of discrimination prohibited by the commerce clause.

For example, in *Halliburton Oil Well Cementing Co. v. Reily*,[86] the Supreme Court invalidated a Louisiana use tax insofar as it was applied in a discriminatory manner to the taxation of equipment used to provide mechanical servicing for oil wells. This equipment was not readily purchasable; companies that serviced oil wells often had to manufacture their own equipment from parts purchased separately. Under the Louisiana tax statute, if the product was produced by the taxpayer in Louisiana, it would be valued based on the value of the materials and articles used in the completed hardware unit; no share of the shop overhead or labor cost attributable to manufacturing the unit would be included in the value of the finished hardware for Louisiana use tax purposes. However, if the product was assembled outside of Louisiana, the Louisiana tax was based on a product value including not only the value of the materials, but also some share of the labor costs and shop overhead. Thus, the same item was valued higher for Louisiana use tax purposes if it was assembled out-of-state than if it was assembled in-state. This discrimination violated the commerce clause because, the Court said, "equal treatment of in-state and out-of-

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this case arose from a very complicated tax system regarding the income of domestic international sales corporations and the intersection of federal and state laws regarding their taxation. The statute's basic flaw was that it

> has the effect of treating differently parent corporations that are similarly situated in all respects except for the percentage of their DISC's shipping activities conducted from New York. This adjustment has the effect of allowing a parent a greater tax credit on its accumulated DISC income as its subsidiary DISC moves a greater percentage of its shipping activities into the State of New York. Conversely, the adjustment decreases the tax credit allowed to the parent for a given amount of its DISC's shipping activity conducted from New York as the DISC increases its shipping activities in other States.

Id. at 400 (footnote omitted).

[86] 373 U.S. 64 (1963).

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state taxpayers similarly situated is the condition precedent for a valid use tax on goods imported from out-of-state."[87] The Louisiana tax was invalid for the same reason as the invalid Arizona law in *Pike*: it was an attempt to capture jobs for local residents.[88]

A state using the property protection tax must value property in the same manner whether the property is first used or originally sold in-state or out-of-state. Any exemptions from the tax for in-state property must apply equally to property from out-of-state sources. If a state with a traditional use tax or our property protection tax exempts clothing or food sold in the state, it must grant an identical exemption to clothing or food purchased out-of-state. If a state determines the value of an automobile purchased in the state on the basis of the sales price less any trade-in allowance, it cannot determine that automobiles purchased out-of-state are valued at the total sales price without regard to any trade-in allowance.[89] The problems of requiring equality in the scope of the tax, the methods of evaluation, and the tax rates are no different for the property protection tax, which does not include a credit for sales taxes paid to other states, than for traditional compensating use taxes, which do credit out-of-state sales taxes.[90]

Does the property protection tax constitute a subtle discrimination against interstate commerce by imposing an unconstitutional multiple tax burden on property that travels through interstate commerce? If State *A* adopts the property protection tax, with a five percent tax rate imposed on automobiles, a State *A* resident who purchased a $20,000 automobile in State *A* would pay a $1000 tax to State *A*. A State *A* resident who traveled to State *B*, purchased a $20,000 car there, and returned to State *A* would owe State *A* $1000 under the property protection tax. However, the person who traveled to State *B* may also have paid a sales tax to State *B*. The person who made the purchase in State *B* would, in fact, pay more total initial taxes on the automobile than the person who both purchased and used the car in State *A*.

Those who believe that the phrases "multiple taxation" or "double taxation" provide a litmus test of the constitutionality of state taxes may now say, "Nice try, but you have finally had to admit that your

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[87] *Id.* at 70.

[88] *See supra* notes 74-76 and accompanying text.

[89] *See, e.g.*, Matthews v. Department of Revenue, 193 Colo. 44, 562 P.2d 415 (1977); Robert Emmet & Son Oil & Supply Co. v. Sullivan, 158 Conn. 234, 259 A.2d 636 (1969); Nuckols v. Athey, 149 W. Va. 40, 138 S.E.2d 344 (1964).

[90] The problems of determining the value of a product subject to any type of sales or use tax are examined in J. HELLERSTEIN & W. HELLERSTEIN, *supra* note 9, ch. IX.

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tax is unconstitutional because it imposes a multiple taxation burden on interstate commerce." Such a challenge merely demonstrates that the concept of "multiple taxation" or "double taxation" does not help in determining a particular state tax's constitutionality; although these labels provide easy ways for courts to describe their rulings, they do not explain how the courts reached their results. The constitutional question is not whether the person who purchased the car in State *B* and returned to State *A* has paid more taxes but whether State *A* has done anything unconstitutional by establishing and enforcing its property protection tax.

State *A* has no more caused double taxation than has State *B* (recall that State *B* imposed its sales tax even though the purchaser returned to State *A*). The State *A* tax is not discriminatory because State *A*, when looked at by itself, imposes a uniform fee for extending state law protection to personal property. One could just as well claim that the barrier to interstate transactions comes not from State *A* receiving compensation for protecting such property, but rather, from State *B* imposing a sales tax on the same commodity. This analysis does not indicate that State *B* has done anything unconstitutional by taxing the sale of an automobile delivered in the state, for State *B* has extended the protection of its laws to the sales transaction and may tax the transaction if it so chooses.[91] Both the State *A* and State *B* taxes should meet the *Complete Auto Transit* tests.

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[91] Because the sale is completed in State *B*, it is constitutionally entitled to impose a sales or gross receipts tax upon the transaction. International Harvester Co. v. Department of Treasury, 322 U.S. 340 (1944); Sonneborn Bros. v. Cureton, 262 U.S. 506 (1923). In order to encourage out-of-state purchasers to purchase products in State *B*, State *B* could exempt out-of-state persons or purchasers from the local sales tax. Although this exemption would provide an incentive to come to the state to engage in economic activity, it would not be a tariff or trade barrier that would violate the commerce clause; the only discrimination is against local residents who are subject to a tax on the same type of transaction. The local residents, in effect, impose on themselves extra tax burdens. This type of discrimination is really no different from property tax rebates or tax holidays that some states offer to encourage out-of-state businesses to relocate in their state. Exempting out-of-state persons from a tax is rationally related to a legitimate goal of encouraging economic activity within the state. The local state political process (an inner political check) adequately protects the interest of in-state residents who are subjected to the tax from which out-of-state residents are exempted. Thus, exempting sales to out-of-state purchasers from sales taxation should withstand both commerce clause and equal protection analysis. *Cf.* Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522 (1959). *See generally* Rotunda, *The Doctrine of the Inner Political Check, the Dormant Commerce Clause, and Federal Preemption*, 53 TRANSP. PRAC. J. 263 (1986).

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In *Maryland v. Louisiana*,[92] the Supreme Court invalidated a Louisiana "first use tax" imposed on gas brought into the state that had not been subjected to a severance tax by another state. The tax fell on the owners of pipelines who brought natural gas from the outer continental shelf into Louisiana and then sold it in various forms in Louisiana and elsewhere. The Court found that the tax unconstitutionally discriminated against out-of-state purchasers and producers of natural gas. The Louisiana tax exempted outer continental shelf gas used in Louisiana for certain specified purposes; Louisiana also gave a tax credit against the tax that related to the amount of severance tax paid for oil and gas production in Louisiana. Thus, the tax created a discriminatory trade barrier that preferred local consumers and producers.

Louisiana attempted to defend the first use tax by claiming it was merely a compensatory tax on persons who had not paid a severance tax elsewhere, and that it was designed to equalize the tax burden that Louisiana imposed on the taking of its gas or oil. The Supreme Court found that the Louisiana tax could not be justified as compensatory because no in-state activity was involved in the importing of the natural gas that was equivalent to the severance of gas and oil resources from state land. Because Louisiana had "no sovereign interest in being compensated for the severance of resources from the federally owned OCS [outer continental shelf] land,"[93] it had no right to tax out-of-state gas merely to raise its price to that of the in-state gas or to "equalize" the tax burdens.[94]

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[92] 451 U.S. 725 (1981).

[93] *Id.* at 759.

[94] In explaining why the Louisiana first use tax was unconstitutional, the Court noted that importing the gas into Louisiana was not the same, in terms of the state's legitimate interests, as the taking of gas from land located within Louisiana. Louisiana, as any other state, had a right to impose a severance tax on the taking of minerals from both private and publicly held land within the state because that was a tax on a local event. The tax on the first use did not compensate the state for any loss of minerals or for any loss of severance tax dollars in that sense. The Supreme Court stated:

> The two events [the Louisiana first use tax and the Louisiana severance tax] are not comparable in the same fashion as a use tax complements a sales tax. In that case, a State is attempting to impose a tax on a substantially equivalent event to assure uniform treatment of goods and materials to be consumed in the State. No such equality exists in this instance.

Maryland v. Louisiana, 451 U.S. 759 (1981). As explained in this Article, the property protection tax does not suffer from the same vices as the Louisiana first use tax because the property protection tax is a tax on a single event — the extension of state law protection to the property. The absence of a credit for taxes paid to other states is irrelevant to determining whether the state is treating property equally in terms of its own tax system.

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Unlike the Louisiana first use tax, which favored locally produced products, the property protection tax imposes a uniform charge for state law protection of property used in the state. The denial of a credit for sales tax paid elsewhere is not discriminatory; it only insures that the state is uniformly compensated by property owners regardless of the source of their property. When a person brings a car into the state, the state's extension of its laws and services to her as an automobile owner is identical to the protection and services it extends to a person who purchased a car in the state.

The Court's decision in *Armco, Inc. v. Hardesty*[95] only superficially appears to support a multiple taxation challenge to the property protection tax or a use tax that does not include a credit for sales taxes paid to other states. *Armco* held that West Virginia's wholesale gross receipts tax discriminated against interstate commerce. The tax was computed on the gross receipts of sales made in West Virginia; the tax rate applied to gross receipts from in-state wholesale sales was 0.2 percent. The state exempted gross receipts generated by the sales of products manufactured within the state.

West Virginia argued that it did not discriminate because it had a separate manufacturing tax. West Virginia manufacturers were subject to a tax of 0.88 percent on the value of products manufactured in the state, and the value was measured by the gross proceeds derived from the sale of the products. For example, if a widget business manufactured widgets in Virginia and then sold them in West Virginia, it would be subject to the West Virginia gross receipts tax on the wholesale sales of its widgets. However, the sale of widgets from a widget manufacturing plant located in West Virginia would be exempt from the gross receipts tax. Thus, the in-state manufacturer of widgets would owe a tax of 0.88 percent on the value of widgets produced in the state, but the out-of-state seller would pay only a 0.27 percent tax on the gross receipts from its West Virginia widget sales.

Justice Powell, writing for the majority in *Armco*, ruled that the West Virginia manufacturing tax did not justify the discriminatory exemption of in-state manufacturers from the gross receipts tax. The two taxes were simply not analogous. The Court compared the tax classification in *Armco* to the tax at issue in *Maryland v. Louisiana* and said that: "Here, too, manufacturing and wholesaling are not 'substantially equivalent events' such that the heavy tax on in-state manufacturers can be said to compensate for the admittedly lighter burden placed on

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[95] 467 U.S. 638 (1984).

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wholesalers from out of State."[96] The manufacturing tax applied to West Virginia produced goods even when the goods were sold out of the state and the manufacturing tax was reduced when part of the manufacturing took place outside of the state. Thus, the Court found that the West Virginia "manufacturing tax is just that, and not in part a proxy for the gross receipts tax."[97]

Justice Rehnquist, in dissent, accused the majority of elevating form over substance by finding that the state could not equalize tax burdens.[98] However, the majority held that the West Virginia tax system involved discrimination against interstate commerce in reality as well as theory. For example, if a widget manufacturer in Virginia paid a Virginia manufacturing tax and that tax was not credited against the West Virginia sales tax, then the Virginia widget manufacturer was required to pay a much higher tax than the Virginia manufacturer who manufactured and sold products in Virginia and, although subject to the manufacturing tax, was exempted from the gross receipts tax.

Does the *Armco* ruling indicate that states must grant a use credit for out-of-state sales taxes and that our property protection tax is invalid for the failure to grant such a credit? No. West Virginia's tax in *Armco* was not held unconstitutional because there was double taxation of interstate commerce; rather, it was unconstitutional due to the discriminatory exemption for in-state manufacturers from the gross receipts tax. *Armco* explicitly recognized that multiple taxation in itself did not constitute unconstitutional discrimination. At the end of the majority opinion, Justice Powell said:

> It is true, as the State of Washington appearing as *amicus curiae* points out, that [the out-of-state seller] would be faced with the same situation that it complains of here if [a state other than West Virginia] imposed a tax only upon manufacturing, while West Virginia imposed a tax only upon wholesaling. In that situation, [an out-of-state manufacturer who sold products in West Virginia] would bear two taxes, while West Virginia sellers would bear only one. But such a result would not arise from impermissible discrimination against interstate commerce but from fair encouragement of in-state business.[99]

The property protection tax fits *Armco*'s last statement precisely. Any purported "double taxation" arises only because another state has chosen to tax the sale of, or a previous use of, the product. If State *A* wishes to encourage persons from other states to buy property and take

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[96] *Id.* at 644.
[97] *Id.*
[98] *Id.* at 646-48.
[99] *Id.* at 645.

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delivery in State *A* for out-of-state use, it may eliminate the tax on in-state sales to out-of-state purchasers. This Article assumed that states would wish to impose a tax on local sales to persons who would immediately remove the property from the state. Indeed, the taxation of such transactions demonstrates that the property protection tax is truly nondiscriminatory — the state is not attempting to gain a competitive market advantage by using its tax system to entice persons to make purchases within the state.[100]

Conclusion

We believe that states should be able to have a nondiscriminatory sales and use tax that imposes a charge for the extension of its protection and services to property sold or used in the state without granting a credit for taxes paid to other states. To avoid the appearance of a discriminatory classification, states wishing to adopt such a tax system should reenact their sales and use taxes as a "property protection tax." This repackaging of the state's sales and use tax system will demonstrate that the state is imposing a uniform tax to compensate it for the protection that it has bestowed on the sellers and users of property.

It is true that property purchased in one state and used in another, or used sequentially in two states, will be subject to two property protection taxes if both states adopted our tax system. However, that fact does not indicate that the property protection tax is an invalid method of multiple taxation. The property owner has received the protection of two states' laws and can be required to fairly compensate both states through payment of nondiscriminatory taxes. If a person travels through several states with toll roads, she must pay all the toll charges; if she stays home she will avoid multiple taxation. Nondiscriminatory toll road charges are not unconstitutional[101] and neither is a nondiscriminatory tax for the protection of tangible property in the state.

Properly analyzed, the property protection tax should withstand attacks under the comity, commerce, due process, and equal protection clauses. To strike such a law under the concept of multiple taxation would be to elevate form over substance. Thus, the half-century old worry about whether states can constitutionally enact a use tax that credits sales taxes paid to the state but denies credit for sales taxes paid elsewhere should no longer impede the adoption of such a tax system.

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[100] *See supra* notes 86-88 and accompanying text.

[101] It is for this reason that a state may charge a reasonable, nondiscriminatory fee for the use of local airports. Evansville-Vanderburgh Airport Auth. Dist. v. Delta Airlines, Inc., 405 U.S. 707 (1972). *See generally* J. NOWAK, R. ROTUNDA, & J. YOUNG, CONSTITUTIONAL LAW 287-88 (3d ed. 1986).

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