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# Constitutional Law -- State Taxation of Interstate Commerce

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this stage in the proceedings.<sup>70</sup> In addition, the legislature is faced with the problem of deciding whether to provide for appointed counsel at the time of arrest.<sup>71</sup> Even if no immediate statutory action is taken, preparation should be made for the possibility of such a requirement through future Supreme Court decisions.

ROY H. MICHAUX, JR.

### Constitutional Law—State Taxation of Interstate Commerce

The State of Washington imposed a tax upon the privilege of a foreign corporation's doing business in that state,<sup>1</sup> the tax being measured by the corporation's gross receipts from sales of motor vehicles, parts, and accessories to independent retail dealers in Washington. The taxpayer, General Motors, protested<sup>2</sup> the tax on the grounds that it constituted a levy upon the privilege of engaging in interstate business and thus was repugnant to both the due process and commerce clauses of the Constitution. Concluding that "the tax is levied on the incidents of a substantial local business,"<sup>3</sup> the Supreme Court of the United States sustained the tax.

As typifies such a corporate giant in this modern era, the sales organization maintained by General Motors is complex.<sup>4</sup> For pres-

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<sup>70</sup> For a discussion of the amendments proposed in the federal rules to provide for appointed counsel before the defendant ever sees the judge, see note 14 *supra*.

<sup>71</sup> See notes 42 & 43 *supra* and accompanying text for the proposition that appointed counsel should be provided at the time of arrest in all felony cases.

<sup>1</sup> REV. CODE WASH. 82.04.270 (1962).

<sup>2</sup> The Supreme Court of Washington sustained the tax. *General Motors Corp. v. Washington*, 60 Wash.2d 862, 376 P.2d 843 (1962).

<sup>3</sup> *General Motors Corp. v. Washington*, 377 U.S. 436, 439 (1964).

<sup>4</sup> Chevrolet, Pontiac, Oldsmobile, and General Motors Parts are all substantially independent "divisions" of the corporation. For sales and administrative purposes, each "division" is geographically divided into "zones" which in turn are further sub-divided into "districts." During the period in question, all "divisions" except General Motors Parts maintained formal "zone" offices in Portland, Oregon. In Seattle, Washington, was situated a warehouse operated by the Parts Division and a "branch" office under the Chevrolet "zone" headquarters. There were no offices at the "district" level, and the "district managers" operated largely out of their homes under the jurisdiction of the Portland office. Their primary functions were to oversee the dealer organization and to otherwise work with and advise the dealers in the promotion of sales. It should be noted that these "district managers" had no authority to accept orders from the dealers; this was a function performed at the "zone" level. Note also the fact that executive personnel from the Portland office visited each dealer in the "zone" regular-

ent purposes, its most interesting aspect lies in the fact that, except for one branch office of the Chevrolet Division and a warehouse operated by the Parts Division, the corporation maintained no formal offices in the taxing state. Many of the "District Managers" of the organization were residents of Washington, but the activities of these employees were confined to promotional work and acting as liaison between the far-flung retail dealers and the "zone" office in Portland, Oregon. Orders from the retail dealers for products, and the subsequent sales and deliveries to them, were all approved and handled through the Portland office. Practically speaking then, the state in imposing its tax on the gross receipts from wholesale sales made to its citizens was taxing sales that were consummated entirely outside the state.

In both the due process and commerce clauses of the Constitution, barriers have been found which preclude certain types of state taxation of multistate operations. Satisfaction of the due process strictures requires that the taxing state have some threshold connection with the transaction upon which to base its jurisdiction to tax. This jurisdictional requirement is met when the state can show "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax."<sup>5</sup> As stated by one member of the present Court, this "nexus" between the state and the taxpayer is "the most fundamental precondition on state power to tax."<sup>6</sup> The very essence of a multistate operation, however, is that a given transaction may be factually connected with a number of states, each of which could rationally claim sufficient "nexus" to tax. Since multiple "nexus" claims are no rarity, the real battleground is at the second of the constitutional barriers—that posed by the commerce clause.

On its face,<sup>7</sup> the commerce clause prohibits all state interference with interstate commercial activity. As a practical matter, however, the decisions have not attempted to enforce the totality of immunity expressed in that language. State and local enactments which clearly affect such commerce have frequently been sustained in both

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ly, although not frequently. See *General Motors Corp. v. Washington*, 377 U.S. 436, 442-46 (1964).

<sup>5</sup> *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954).

<sup>6</sup> Brennan, J., in *General Motors Corp. v. Washington*, 377 U.S. 436, 450 (1964) (dissenting opinion).

<sup>7</sup> "The Congress shall have power . . . To regulate commerce . . . among the several states. . . ." U.S. CONST. art. I, § 8.

regulatory<sup>8</sup> and tax<sup>9</sup> spheres. In determining the validity of state action under the prohibitions of the commerce clause, the Court has stated a number of very general rules, none of which offer a reliable standard of constitutionality against which a litigant may measure his case. The Court, when faced with problems of state taxation, has long been torn between conflicting policy considerations: requiring interstate commerce to pay its fair share of the state tax burden<sup>10</sup> and preserving a degree of free trade among the states to which a tariff barrier of state taxation is inimical.<sup>11</sup> These conflicting policies have spawned equally conflicting decisions. Stating the time-honored "direct burdens" test of validity, the Court has said that the states are not allowed "one single-tax-worth of direct interference with the free flow of commerce."<sup>12</sup> In other cases,<sup>13</sup> statutes have been sustained on the grounds that the tax was predicated upon the "local activity" of the multistate operation, thereby affecting interstate commerce only "indirectly," and not to an unconstitutional degree. To the recurring, formalized question of what constitutes "local" activity, the Court has never supplied a uniformly applicable answer.<sup>14</sup>

During one period<sup>15</sup> in the recent history of the Court, however, it appeared that the decisions had finally adopted a reasonable and workable approach. Under the guidance of Justices Stone and Rutledge, the Court seemed to abandon the "direct-indirect" test

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<sup>8</sup> *E.g.*, *Cities Serv. Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179 (1950); *Minnesota Rate Cases*, 230 U.S. 352 (1913); *Willson v. Black Bird Creek Marsh Co.*, 27 U.S. (2 Pet.) 245 (1829).

<sup>9</sup> *E.g.*, *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33 (1940); *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938); *Wiloil Corp. v. Pennsylvania*, 294 U.S. 169 (1935).

<sup>10</sup> See *Postal Telegraph-Cable Co. v. City of Richmond*, 249 U.S. 252, 259 (1919).

<sup>11</sup> See *Freeman v. Hewit*, 329 U.S. 249, 254 (1946) (Frankfurter, J.); *McLeod v. J. E. Dilworth Co.*, 322 U.S. 327, 330 (1944).

<sup>12</sup> *Freeman v. Hewit*, *supra* note 11, at 256; *quoted with approval in Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959).

<sup>13</sup> *E.g.*, *Wiloil Corp. v. Pennsylvania*, 294 U.S. 169 (1935); *Postal Telegraph-Cable Co. v. City of Richmond*, 249 U.S. 252 (1919); *Banker Bros. Co. v. Pennsylvania*, 222 U.S. 210 (1911).

<sup>14</sup> See *Di Santo v. Pennsylvania*, 273 U.S. 34, 44 (1927) (dissenting opinion of Stone, J.). See generally Hartman, *State Taxation of Interstate Commerce: A Survey and an Appraisal*, 46 VA. L. REV. 1051, 1069-74, 1082-86 (1960).

<sup>15</sup> Roughly, the period was the eight years following the decision in *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938). The reverse trend was signaled in *Freeman v. Hewit*, 329 U.S. 249 (1946).

of tax validity in favor of an approach founded upon the actual operative impact of the tax in question. Under this theory, assuming sufficient "nexus" to confer jurisdiction, the states were permitted to tax interstate transactions so long as the tax did not subject the taxpayer to the risk of "multiple" tax burdens not borne by competing local activity.<sup>16</sup> This approach represented a radical doctrinal departure from prior decisions. As succinctly put by a leading writer in the field,

the "direct-indirect" burdens test was predicated on the theory that a tax on interstate commerce always is invalid. The "multiple burdens" test, on the other hand, is based on the theory that a tax on interstate commerce is valid if the tax is of such a nature that the taxed facet of interstate commerce cannot be taxed elsewhere, and thus subject interstate commerce to the *risk* of a multiple tax burden not borne by local business.<sup>17</sup>

The new rationale offered many advantages over its predecessor. It attempted to assess the actual economic consequences of the tax to the taxpayer and to avoid the imposition of commercial disadvantage upon him. The old formalism was supplanted by substantive inquiry, providing greater flexibility and ease in application to

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<sup>16</sup> See, e.g., *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939); *J. D. Adams Mfg. Co. v. Storen*, 304 U.S. 307 (1938); *Western Live Stock v. Bureau of Revenue*, *supra* note 15 (alternative holding). See generally Hartman, *State Taxation of Interstate Commerce: A Survey and an Appraisal*, 46 VA. L. REV. 1051, 1074-82 (1960); Hartman, *Sales Taxation in Interstate Commerce*, 9 VAND. L. REV. 138, 185-90 (1956); Hellerstein, *The Power of Congress to Restrict State Taxation of Interstate Commerce*, 12 J. TAXATION 302, 303 (1960). Implicit in the "multiple burdens" approach is the idea that even though a transaction was clearly taxable in several states, a tax in one of them was still valid if the tax were properly apportioned to taxpayer's business activity in the taxing state. See *International Harvester Co. v. Evatt*, 329 U.S. 416 (1947). Thus, for example, if taxpayer's in-state activity relative to a taxed transaction represented 35% of the total activity expended in the entire transaction, a tax rate based on 35% of gross receipts would be valid. The theory here is, of course, that fair apportionment removes the risk of tax duplication elsewhere, since each state will tax only that part of the whole attributable to local activity. It should be noted that the Washington statute employed as its basis 100% of gross receipts to General Motors from sales in Washington, and was, therefore, as the Court pointed out, "unapportioned." 377 U.S. at 448.

<sup>17</sup> Hartman, *State Taxation of Interstate Commerce: A Survey and an Appraisal*, 46 VA. L. REV. 1051, 1076 (1960). It is appropriate to note at this point that Professor Hartman's many excellent contributions to the literature in this area of tax law are invaluable. His lucid analyses of the complexities of state taxation problems have been an indispensable source of aid to this writer.

the cases.<sup>18</sup> The upshot was that while interstate commerce was taxed, it paid only its fair share of the burden.

Just as this formula was gaining acceptance, the Court apparently abandoned it in favor of a return to its previous posture by reasserting its adherence to the "direct-indirect" test.<sup>19</sup> Even this turnabout, however, did not dispose of the problem, for the Court has since vacillated, uttering sometimes the language of the old test,<sup>20</sup> sometimes the language of the new,<sup>21</sup> and more often that of both.<sup>22</sup>

Amidst a growing clamor for consistency, the present litigation came before the Court. Arguably, the tax could have been defeated by due process requirements, since "nexus" is indeed slight where a taxpayer's contacts with the taxing state are as limited as were those of General Motors with Washington.<sup>23</sup> But, even having safely skirted the due process barrier, it would still appear that the tax must succumb under the more lethal strictures of the commerce clause, regardless of which test of validity the Court elected to apply.<sup>24</sup> The transactions in question, comprised chiefly of sales contracts formed in Oregon with f.o.b. deliveries at the Missouri

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<sup>18</sup> See the opinion of Stone, J., in *Di Santo v. Pennsylvania*, 273 U.S. 34, 43 (1927) (dissenting), in which the Justice vented his ire upon the "direct-indirect" formula as being too mechanical and remote from actualities. *Id.* at 44. See generally Hartman, *State Taxation of Interstate Commerce: A Survey and an Appraisal*, 46 VA. L. REV. 1051, 1081-82 (1960).

<sup>19</sup> See *Freeman v. Hewitt*, 329 U.S. 249 (1946).

<sup>20</sup> *E.g.*, *Michigan-Wisconsin Pipe Line Co. v. Calvert*, 347 U.S. 157 (1954); *Spector Motor Serv., Inc. v. O'Connor*, 340 U.S. 602 (1951).

<sup>21</sup> *E.g.*, *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653 (1948).

<sup>22</sup> *E.g.*, *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959).

<sup>23</sup> This was one of the grounds upon which Mr. Justice Goldberg, joined by Justices Stewart and White, dissented from the majority opinion. 377 U.S. at 456. His opinion expressed the view that the decision in *Norton Co. v. Department of Revenue*, 340 U.S. 534 (1950) (which was one of the cases cited by the majority) "rested solidly on the fact that the taxpayer had a branch office and warehouse . . ." situated in the taxing state. 377 U.S. at 456. The three Justices found it "difficult . . . to distinguish between the in-state activities of the [district managers] . . . and the in-state activities of solicitors or traveling salesmen . . ." citing *McLeod v. J. E. Dilworth Co.*, 322 U.S. 327 (1944), for the proposition that the activities of the latter group form an insufficient basis for a levy upon interstate sales. 377 U.S. at 456. The *Norton* decision, however, seems to place more emphasis upon "business activity" than upon the location of the formal office. See *Norton Co. v. Department of Revenue*, *supra* at 539.

<sup>24</sup> See Note, 38 WASH. L. REV. 277, 280-81 (1963), which was written during the pendency of this litigation before the Supreme Court. Analyzing the decision of the Washington Supreme Court in this case, it was predicted that the tax would be struck down under either approach.

factory, would seem to be clearly interstate in character; and just as clearly, the gross receipts tax seems to be a "direct burden" thereon. On the other hand, since the tax was unapportioned and at least two other states appeared to have a "nexus" claim, there was an apparent risk of tax multiplication which would be anathema to the commerce clause under the "multiple burdens" doctrine.

In its opinion, the Court has missed yet another chance to make a definitive pronouncement in this confused area. Instead, it again seems to have handed down a hybrid decision.<sup>25</sup> Starting "with the proposition that '[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden . . .,'" <sup>26</sup> the Court found it "well established that taxation measured by gross receipts is constitutionally proper if it is fairly apportioned."<sup>27</sup> Having thus paid lip service to the "multiple burdens" concept, the Court proceeded to recognize that although a state cannot impose a tax on the privilege of engaging in interstate commerce,<sup>28</sup> "an in-state activity may be a sufficient local incident upon which a tax may be based."<sup>29</sup> This language is clearly that of the pre-"multiple burdens" era, and from the philosophical standpoint, it describes an entirely different concept of constitutionality under the commerce clause. Having thus referred to both tests, the Court does not clearly apply *either*. Addressing itself to the problem of whether the gross receipts from sales were fairly related to General Motors's business activities within the state,<sup>30</sup> the Court offered the following:

[The tax] is unapportioned and . . . is, therefore, suspect. We must determine whether it is so closely related to the local activities of the corporation as to form "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax."<sup>31</sup>

As discussed above,<sup>32</sup> this is the language of the "nexus" test, customarily used to determine whether, under the due process clause,

<sup>25</sup> See *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959).

<sup>26</sup> 377 U.S. at 439, quoting with approval from *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254 (1938).

<sup>27</sup> 377 U.S. at 440.

<sup>28</sup> *Id.* at 446.

<sup>29</sup> *Id.* at 447.

<sup>30</sup> *Id.* at 441.

<sup>31</sup> *Id.* at 448.

<sup>32</sup> See text accompanying notes 5-6 *supra*.

the state has bare jurisdiction to impose *any* tax. In addition to applying the test to resolve the jurisdictional question, it seems that the Court here used "nexus" between the tax and the activity sought to be taxed as a basis for sustaining, in the absence of apportionment, the *measure* of the tax. Thus, it has apparently solved the substantive commerce clause problem of nonapportionment by application of the once purely procedural test of due process.<sup>33</sup>

Since the question of apportionment is not pertinent where application of the "direct burdens" formula is sought,<sup>34</sup> it may be that the Court attempted to decide the case by a "multiple burdens" approach. The opinion, however, casts doubt upon any such conclusion; for, in closing, the Court "refrained from passing on the question"<sup>35</sup> raised by General Motors to the effect that a decision sustaining the present tax would subject the corporation to multiple taxation. The reason given was that there had been no affirmative showing that the transactions had *actually* been subjected to tax elsewhere.<sup>36</sup> Although this decision is not the first to require a demonstration of *actual* tax multiplication,<sup>37</sup> it hardly comports with the ideas expressed by Mr. Justice Rutledge. To him, the mere *risk* of cumulative burdens was sufficient reason to condemn an unapportioned tax.<sup>38</sup> Thus, if the Court employed a "multiple burdens" test in this case, that test has become quite different from the original doctrine.

From the foregoing, it seems abundantly clear that, as between the "direct" and "multiple" burdens approaches, the Court has adopted or abandoned neither; nor has it really assigned to either

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<sup>33</sup> This is the basis of the dissenting opinion of Brennan, J. 377 U.S. at 449-51.

<sup>34</sup> See note 16 *supra*.

<sup>35</sup> 377 U.S. at 449.

<sup>36</sup> *Ibid.*

<sup>37</sup> See *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 463 (1959), where such a requirement was imposed in a net income tax litigation. This requirement is not to be confused with the question of burdens of proof. State enactments have usually been accorded presumptive validity, and the general rule applied by the Court has been that the burden of rebuttal is on the protesting taxpayer. See *Norton Co. v. Department of Revenue*, 340 U.S. 534, 537 (1951). *But see Freeman v. Hewit*, 329 U.S. 249, 253 (1946); Hartman, *State Taxation of Interstate Commerce: A Survey and an Appraisal*, 46 VA. L. REV. 1051, 1064-65 (1960).

<sup>38</sup> "To require factual determination of forbidden effects in each case would be to invite costly litigation, make decision turn in some cases, perhaps many, on doubtful facts or conclusions . . ." *Freeman v. Hewit*, 329 U.S. 249, 279 (1946) (concurring opinion of Rutledge, J.).



an ascendant position. In short, the Court has yet to offer a dependable guide in this critical area, but has perhaps further confused the litter upon the commerce clause battleground. It is no doubt true, as suggested by many writers in the tax field,<sup>30</sup> that problems of this complexity are more amenable to legislative than to judicial solution. Hopefully, the solution will not be long in coming; for if one thing is certain in light of the ever-increasing economic needs of the states, it is that some consistent guide must be formulated for the convenience and protection of both states and taxpayers. It is submitted that the most equitable approach will be found within the philosophical framework of the "multiple burdens" doctrine in tandem with a realistic system of apportionment. As in other areas of life in this fast-paced world, the efforts expended in seeking absolute resolutions of problems will produce a greater net return if exerted instead in pursuit of equitable compromise.

HENRY STANCILL MANNING, JR.

#### **Corporations—De Facto Corporations—Estoppel—Model Business Corporation Act**

Although the submitted articles of incorporation were rejected, the defendant nevertheless began doing business as a corporation. Subsequently, defendant acquired plaintiff's business, giving the purported corporation's note therefor. Shortly thereafter, articles of incorporation were issued; but within six months, the corporation failed and was left without assets. Plaintiff, suing on the note given by the defendant on behalf of the purported corporation, sought to hold defendant personally liable on the basis that no corporation had existed at the time of the purchase. Defendant resisted liability on the grounds that plaintiff had dealt with either a de facto corporation or a corporation by estoppel. Defendant's contentions were rejected in *Robertson v. Levy*,<sup>1</sup> which construed statutory provisions<sup>2</sup> equivalent to sections 50<sup>3</sup> and 139<sup>4</sup> of the

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<sup>30</sup> See, e.g., Braden, *Cutting the Gordian Knot of Interstate Taxation*, 18 OHIO ST. L.J. 57 (1957); Annot., 67 A.L.R.2d 1324 (1959). For a view from the other side of the bench, see the opinion of Mr. Justice Frankfurter in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 476-77 (1959) (dissenting opinion).

<sup>1</sup> 197 A.2d 443 (D.C. Ct. App. 1964).

<sup>2</sup> D.C. CODE ANN. § 29-921c, -950 (1961).

<sup>3</sup> Upon the issuance of the certificate of incorporation, the corporate existence shall begin, and such certificate of incorporation shall be