# STATE TAXATION OF A FOREIGN CORPORATION ENGAGED IN EXCLUSIVELY INTERSTATE COMMERCE

*Minnesota v. Northwestern States Portland Cement Co.*
*250 Minn. 32, 84 N.W. 2d 373 (1957)*
*Probable Jurisdiction Noted, 355 U. S. 911 (No. 606) (1958)*

This case places squarely before the United States Supreme Court a question frequently discussed in dicta and the subject of extensive commentary by constitutional law scholars: Can a state levy a net income tax upon a foreign corporation carrying on exclusively interstate commerce within the taxing state if the tax in question is nondiscriminatory and reasonably allocated to that portion of the corporation's income arising out of the taxing state?

The defendant cement manufacturer is an Iowa corporation with its principal place of business at Mason City, Iowa. Although it had conducted extensive sales campaigns in Minnesota over a 30-year period, defendant had never qualified as a foreign corporation in that state. In accordance with section 290.03, Minnesota Statutes Annotated,[1] the state tax commissioner requested defendant to prepare tax returns for the period 1933-1948; when defendant refused to do so, the commissioner prepared the returns on the basis of information available to him, utilizing a three-factor formula to determine the proportion of defendant's net income allocable to business conducted within Minne-

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[1] The portions of M.S.A. §290.03 pertinent to this case are as follows: "An annual tax for each taxable year, computed in the manner and at the rates hereinafter provided, is hereby imposed upon the taxable net income for such year of the following classes of taxpayers:

"(1) Domestic and foreign corporations not taxable under section 290.02 which own property within this state or whose business within this state during the taxable year consists exclusively of foreign commerce, interstate commerce, or both;

"Business within the state shall not be deemed to include transportation in interstate or foreign commerce, or both, by means of ships navigating within or through waters which are made international for navigation purposes by any treaty or agreement to which the United States is a party; . . ."

To view the Minnesota taxing structure as a whole, M.S.A. §290.03 must be read in conjunction with M.S.A. §290.02, which follows: "An annual tax is hereby imposed upon every domestic corporation, except those included within section 290.03, for the privilege of existing as a corporation during any part of its taxable year, and upon every foreign corporation, except those included within section 290.03, for the grant to it of the privilege of transacting or for the actual transaction by it of any local business within this state during any part of its taxable year, in corporate or organized form.

"The tax so imposed shall be measured by such corporations' taxable net income for the taxable year for which the tax is imposed, and computed in the sota.[2] In the district court judgment was given the state; appeal to the Minnesota supreme court resulted in affirmance, two of the court's seven justices dissenting. The United States Supreme Court has granted review of the defendant's two principal contentions:[3] that the statute in question is in conflict with, and consequently void under, the Commerce and Due Process clauses of the United States Constitution.

The defendant corporation had used Minnesota as an outlet for some 48 per cent of its sales, employing five salesmen to contact potential customers there and to urge them to buy cement through defendant's established Minnesota outlets, maintaining a sales office at Minneapolis with a full-time secretary, and allowing one salesman to hold himself out as district manager. Nonetheless the Minnesota operation remained entirely under the control of defendant's home office: all employees were hired at Mason City; all sales were subject to approval there and all shipments were F.O.B. Mason City; salesmen's automobiles, all office equipment and supplies except postage stamps were requisitioned through the home office; salary payments were made by Mason City and expense allowances were processed there. The Minnesota court made no attempt to find any "intrastate" commerce conducted by defendant in Minnesota.

Defendant's due process objection to the taxing statute presents a lesser problem than does his second contention. "So far as due process is concerned the only question is whether the tax in practical operation has relation to opportunities, benefits, or protection conferred or afforded by the taxing state. . . . Those requirements are satisfied if the tax is fairly apportioned to the commerce carried on within the state."[4] The obvious benefits accruing to the defendant from the state where it sold 48 per cent of its product would seem clearly to satisfy the basic relational requirement; ample precedent abounds in sustaining state power to tax in the circumstances presented by *Great Atlantic & Pacific Tea Co. v. Grosjean*,[5] *Wisconsin v. J. C. Penney Co.*,[6] and *General Trading Co. v. Tax Commissioner*.[7] Defendant raises no question con-

manner and at the rates provided in this chapter."

The statutes are the same except for internal labeling: that covering domestic corporations and foreign corporations qualified to do business in Minnesota is called a "privilege" tax while that applicable to non-qualified foreign corporations carefully avoids any such reference. The tax falls with equal weight upon all corporations transacting business in Minnesota and is upon that portion of net income allocated to such business without distinction as to "intrastate" or "interstate."

[2] The defendant attacks neither the accuracy of the commissioner's report nor the fairness of the apportionment formula employed.

[3] 26 U.S.L. WEEK 3197 (U.S. Jan. 6, 1958) (Case No. 606).

[4] Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169 (1949).

[5] 301 U.S. 412 (1937).

[6] 311 U.S. 435 (1940).

[7] 322 U.S. 335 (1944).

cerning the fairness of the apportionment. There is here present none of the vice of extraterritoriality which has condemned state taxation[8] and regulation[9] of property held or activity occuring beyond the jurisdiction.

The commerce clause issue in this case serves to highlight the conflict which has troubled the United States Supreme Court for the past 20 years — the setting of outer limits upon state taxation of interstate commerce. The conflict is sharply illustrated in *Spector Motor Service v. O'Connor*,[10] the most recent Supreme Court case in this area. The Connecticut statute in *Spector* imposed a nondiscriminatory, reasonably apportioned tax upon net income derived from commerce within the state, including exclusively interstate commerce carried on by a foreign corporation. Spector was a Missouri trucking corporation, authorized by the Interstate Commerce Commission and the state public utilities commission to engage in interstate trucking into and out of Connecticut. It maintained two terminals there, employed 27 persons within the state, used in its terminal operations numerous pickup trucks registered in Connecticut. The state supreme court had described the Connecticut tax as "a tax or excise upon the franchise of corporations for the privilege of carrying on or doing business in the state, whether they be domestic or foreign."[11] Adopting the state court's view as to the nature of the tax, the Supreme Court of the United States struck down the statute as violative of the Commerce Clause, but not without three dissents.

The fundamental dichotomy of approach within the Court to the problem posed by *Spector* is brought home by comparing the language of the majority and dissenting opinions. The essence of the prevailing view is found in these words of Mr. Justice Burton:

> This court heretofore has struck down, under the Commerce Clause, state taxes upon the privilege of carrying on a business that was *exclusively* interstate in character. The constitutional infirmity of such a tax persists no matter how fairly it is apportioned to business done within the state.[12] . . .
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> In this field there is not only reason but long-established precedent for keeping the federal privilege of carrying on exclusively interstate commerce free from state taxation. To do so gives lateral support to one of the cornerstones of our constitutional law—M'Culloch v. Maryland (US) 4 Wheat. 316, 4 L ed 579, supra.[13]

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[8] Treichler v. Wisconsin, 338 U.S. 251 (1949), reaffirming the rule that land and taxable personalty are taxable only by the state of situs.

[9] Baldwin v. Seelig, 294 U.S. 511 (1935).

[10] 40 U.S. 602 (1951); see 13 OHIO ST. L.J. 280 (1952).

[11] 135 Conn. 37, at 56, 57 (1950).

[12] Emphasis original; 340 U.S. 602, at 609.

[13] *Id.* at 610.

In contrast, Mr. Justice Clark reasoned for *Spector's* three dissenters that:

> . . . the Connecticut tax meets every practical test of fairness and propriety enunciated in cases upholding privilege taxes on corporations doing a mixed interstate and intrastate business. These cases should govern here, for there is no apparent difference between an "exclusively interstate" business and a "mixed" business which would warrant different constitutional regard. There is nothing spiritual about interstate commerce. It is rarely devoid of significant contact with the several states.[14]

The opposing views expressed in *Spector* characterize the larger conflict occupying the Court in interstate commerce taxation questions. The majority reads into the commerce clause the strongest possible negative implications and zealously guards "exclusively" interstate commerce from any privilege tax, relying upon *Cheney Brothers Co. v. Commonwealth of Massachusetts*[15] and *Alpha Portland Cement Co. v. Commonwealth of Massachusetts.*[16] It fails to recognize any inconsistency in sustaining an apportioned, nondiscriminatory net income tax upon the privilege of doing business when a taxpayer carries on both interstate and intrastate activities within the taxing state.[17] Exclusively interstate commerce remains sacrosanct. Clark and the other dissenters rely instead on the philosophy underlying the cases laying out Justice Stone's "multiple burdens doctrine,"[18] to wit: that the economic effect of the tax in question and the absence of "cumulative burdens not imposed on local commerce"[19] determine whether the tax shall be allowed to stand. This philosophy seems carried to its logical limits in *Memphis Natural Gas Co. v. Beeler*:[20]

> . . . even if taxpayer's business were wholly interstate commerce, a nondiscriminatory tax by Tennessee upon the net income of a foreign corporation having a commercial domicile there . . . or upon net income derived from within the state . . . is not prohibited by the commerce clause upon which alone the taxpayer relies.[21]

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[14] *Id.* at 612, 613.

[15] 246 U.S. 147 (1917).

[16] 268 U.S. 203 (1925).

[17] Cheney Brothers Co. v. Commonwealth of Massachusetts, *supra* note 15.

[18] Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938); J. D. Adams Manufacturing Co. v. Storen, 304 U.S. 307 (1938); Gwin, White & Prince v. Henneford, 305 U.S. 434 (1939); McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940).

[19] Western Live Stock v. Bureau of Revenue, *supra* note 18.

[20] 315 U.S. 649 (1942).

[21] The majority in *Spector* specifically distinguished this excerpt as dictum and pointed out that the gas company was found by the state court to be a "profit-sharing joint adventurer" and not a mere seller of an interstate product. In other

The Stone doctrine, called by one author a "test of substance,"[22] remained the dominant philosophy of the Court for but a brief span, beginning with *Western Live Stock*[23] in 1938 and continuing no later than *Interstate Oil Pipeline Co. v. Stone*[24] in 1949 when it could gather but four members of the Court to the fold.[25]

Further extension of the doctrine met the vigorous opposition of Mr. Justice Frankfurter, chief dissenter in *Interstate Oil* and author of *Freeman v. Hewit.*[26] The latter case and *Joseph v. Carter & Weekes Stevedoring Co.*[27] reiterate the ancient doctrine that states are impotent to tax interstate commerce. Though never overruling the cases developing the "multiple burdens doctrine," Justice Frankfurter and his fellow interstate commerce protectionists have indicated clearly that they intend the doctrine to go no further.

Reading *Spector* in this context of intra-Court conflict, it appears clear that the Minnesota court has rejected both the philosophy and the precedents that motivated *Spector's* majority. It is possible that the Supreme Court will accept the feature which the Minnesota court selected to distinguish *Spector*—i.e., the absence of a "privilege" label in the applicable Minnesota statute.[28] The practical effect of the Supreme Court's acceptance of this technical distinction would be to limit *Spector's* holding so sharply as to adopt the Stone doctrine except in those cases in which a state legislature carelessly used the wrong label. Other arguments presented by the state court are not determinative here. That the tax is upon net income and hence an indirect burden upon interstate commerce has been determinative only where the tax was upon a corporation domiciled in the taxing jurisdiction[29] or doing both interstate and intrastate business there.[30] That the tax does not discriminate against

words there was interstate activity upon which to base the tax upheld there.

22 See Menard, *State Taxation of Interstate Commerce: From Form to Substance and Back Again*, 18 OHIO ST. L.J. 9 (1957).

23 *Supra*, note 16.

24 337 U.S. 662 (1949).

25 Justice Rutledge, speaking for four of the court in *Interstate Oil:* "Since all the activities upon which the tax is imposed are carried on in Mississippi, there is no due process objection to the tax. The tax does not discriminate against interstate commerce in favor of competing intrastate commerce of like character. The nature of the subject of taxation makes apportionment unnecessary; there is no attempt to tax interstate activity carried on outside Mississippi's borders. No other state can repeat the tax. For these reasons the commerce clause does not invalidate the tax." Justice Burton concurred separately solely upon the basis that the commerce in question was intrastate not interstate.

26 329 U.S. 429 (1946).

27 330 U.S. 422 (1947).

28 *Supra*, note 1.

29 United States Glue Co. v. Town of Oak Creek, 247 U.S. 321.

30 Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113.

interstate commerce is merely the first test to be satisfied before sustaining any tax.[31]

However, the Court that will hear the appeal from the Minnesota judgment is not the Court that decided *Spector* seven years ago. Although one Federal court foreswore "Gallup-polling"[32] the Supreme Court while *Spector* was winding its weary way through Connecticut and Federal courts, the temptation to do so is strong under the present circumstances. Of six justices voting with the majority then, only Justice Burton and Justice Frankfurter remain. The three dissenting justices —Clark, Douglas and Black—continue with the result that a mere even split among the Court's four new members will be sufficient to revive the Stone philosophy.

Until Congress sees fit to exercise its power to regulate taxation of interstate commerce, the Supreme Court — at best a poor agency to weigh conflicting state and national interests when only the facts of an individual case are before it — would appear to have more success in weighing the actual economic factors in the case rather than to adhere to a policy of label-finding. Striking down only those statutes which discriminate in fact or make possible multiple burdens should prove sufficient protection for interstate commerce.

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31 Welton v. Missouri, 91 U.S. 275 (1875).

32 Spector Motor Service v. O'Connor, 181 F.2d 150 (2d Cir. 1951).