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## SOME CONSTITUTIONAL LIMITATIONS ON STATE SALES TAXES

By LAURENCE M. JONES*

### I. INTRODUCTION

ALTHOUGH there has in the past been agitation for sales taxes and though such taxes had to a limited extent been adopted, it was not until the past few years that they became of any considerable importance as part of the American fiscal system. The need for additional revenue, the clamor for the reduction of taxes on real estate, and the inability of a net income tax, in these times, to supply the necessary money, have caused the states to turn to the sales tax as a way out of their difficulties. The introduction of a new method of taxation, of course, presents many legal problems.[1] This article, however, is limited to a discussion of the problems raised by those clauses of the federal constitution prohibiting state taxation of imports and exports[2] and relating to interstate commerce.[3]

### II. IMPORTS AND EXPORTS CLAUSE

The constitution of the United States provides that:

"No state shall, without the consent of the Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws."[4]

The word imports as used in this prohibition refers only to

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[1]A recent case, Stewart Dry Goods Co. v. Lewis, (1935) 294 U. S. 550, 55 Sup. Ct. 525, 79 L. Ed. 1054, held a graduated gross sales tax unconstitutional as a violation of the fourteenth amendment, irrespective of whether the tax applied to imports or exports, or interstate or intrastate commerce.

[2]United States constitution, art. I, sec. 10.

[3]United States constitution, art. I, sec. 8.

[4]United States constitution, art. I, sec. 10.

goods coming into a state from foreign countries and not to goods coming from sister states.[5] Likewise the word exports refers only to goods going to foreign countries.[6] In determining how far this provision prevents the application of a sales tax to the sale or business of selling imports and exports the writer has arranged the cases in the following order. First are cases dealing with taxes on the sale or business of selling imported goods in the original packages in which they are imported. Then come the cases of taxes on sales of imported goods made after the original packages have been broken. These are followed by the cases on the taxing of sales of exports.

A tax on the sale or occupation of selling imports while they still remained in the possession of the importer in the original package was held invalid in *Brown v. Maryland.*[7] Mr. Chief Justice Marshall, in refuting the argument that the tax was not on the article imported, but on the sale or occupation of selling it and therefore not within the terms of the constitution, said:

"It is impossible to conceal from ourselves that this is varying the form, without varying the substance. It is treating a prohibition which is general, as if it were confined to a particular mode of doing the forbidden thing. All must perceive that a tax on the sale of an article, imported only for sale, is a tax on the article itself. . . . So, a tax on the occupation of an importer is, in like manner, a tax on the importation."[8]

The case was approved and followed in *Cook v. Pennsylvania*[9] which held unconstitutional a tax on auction sales as applied to the sale of goods which had been imported and which the auctioneer had sold for the importers in the original packages. In both these cases the tax in question was discriminatory, the effect being to place imports at a disadvantage as compared to local products. The court, however, did not place its decision on the grounds of discrimination, but laid down the general rule that no tax could apply to sales, by the importer, of imports while they remained in the original package in which they were imported.

In *Anglo-Chilean Nitrate Sales Corp. v. Alabama*[10] the Alabama corporate franchise tax was held inapplicable to a cor-

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[5]Woodruff v. Parham, (1869) 8 Wall. (U.S.) 123, 19 L. Ed. 382; Brown v. Houston, (1885) 114 U. S. 622, 5 Sup. Ct. 1091, 29 L. Ed. 257.

[6]Dooley v. United States, (1901) 183 U. S. 151, 22 Sup. Ct. 62, 46 L. Ed. 128.

[7](1827) 12 Wheat. (U.S.) 419, 6 L. Ed. 678

[8](1827) 12 Wheat. (U.S.) 419, 444, 6 L. Ed. 678.

[9](1878) 97 U. S. 566, 24 L. Ed. 1015.

[10](1933) 288 U. S. 218, 53 Sup. Ct. 373, 77 L. Ed. 710.

poration engaged exclusively in importing nitrate and selling it within the state in the original packages in which it was imported. The tax was based on the amount of capital employed in the state and was interpreted by the state court to be on the actual doing of business within the state rather than on the authorization or privilege of doing business. The corporation employed no capital in Alabama other than that represented by the nitrate imports, and, though having qualified to do so, did not engage in business other than the selling of the imports in the original packages. Mr. Justice Butler, for the majority, declared:

"The right to import the nitrate included the right to sell it in the original bags while it remained the property of the appellant and before it lost its distinctive character as an import. . . . Alabama was powerless, without the consent of Congress, to tax the nitrate before such sales or to require appellant by the payment of occupation or franchise tax or otherwise to purchase from it the privilege of selling goods so imported and handled."[11]

Mr. Justice Cardozo, for the minority, insisted that, since "the appellant was not satisfied to stand upon its federal right" and had "asked for and obtained a license or franchise . . . to do a local business as well as one related to interstate or foreign commerce," the state of Alabama was competent to tax the privilege granted. The interpretation of the state court, in the opinion of the majority, had precluded upholding the tax on such grounds.

The case on its facts is much like *Ficklen v. Shelby County Taxing District*[12] which sustained a tax measured by gross receipts, even though the business transacted was entirely interstate commerce, on the ground that the defendant had taken out a license to do a general business. Neither Mr. Justice Butler, for the majority, nor Mr. Justice Cardozo, for the minority, mentioned the *Ficklen Case.* This is somewhat surprising, although the *Ficklen Case* has been consistently distinguished by the court in later cases. The *Crew Levick*[13] Case had previously undermined most of the grounds of the *Ficklen Case,* leaving only the possibility that the tax in the *Ficklen Case* might be sustained as an occupation tax. The reasoning in the *Nitrate Case* is opposed to such a solution, thus apparently removing the possibility of measuring a tax on doing local business or the privilege of doing such business by a percentage of the gross receipts from all business.

[11](1933) 288 U. S. 218, 225-26, 53 Sup. Ct. 373, 77 L. Ed. 710.
[12](1892) 145 U. S. 1, 12 Sup. Ct. 810, 36 L. Ed. 601.
[13](1917) 245 U. S. 292, 38 Sup. Ct. 126, 62 L. Ed. 295.

Where the sales of the imports are not by the importer himself but by subsequent purchasers from him, they are taxable even though the goods still remain in the original packages. Thus a tax on merchants and traders measured by a percentage of their gross sales was upheld where the sales were of imports purchased by the seller from the importers and later sold by him.[14] The court pointed out the limit of the exemption as follows:

"Importers selling the imported articles in the original packages are shielded from any such state tax but the privilege of exemption is not extended to the purchaser, as the merchandise by the sale and delivery, loses its distinctive character as an import."[15]

Once the original package in which the goods were imported into this country has been broken, sales of the contents may be taxed. The limits of the doctrine that the first sale of the original package is exempt were indicated by Mr. Chief Justice Marshall in *Brown v. Maryland* when he said:

"when the importer has so acted upon the thing imported that it has become incorporated and mixed up with the mass of property in the country, it has, perhaps, lost its distinctive character as an import, and has become subject to the taxing power of the state; but while remaining the property of the importer, in his warehouse, in the original form or package in which it was imported, a tax upon it is too plainly a duty on imports to escape the prohibition in the constitution."[16]

The importer "has so acted upon the thing imported" that it loses its immunity from taxation when he breaks the original package and sells a part of the contents.[17] The goods being once incorporated into the general mass of property in the state by the breaking of the original package, the sales of the contents are taxable whether made by the importer himself or by others.

Sales of exports made directly to foreign buyers may not be taxed under a general mercantile license tax, measured by a percentage of the gross sales, levied on all dealers irrespective of the kind of business in which they are engaged.[18] The merchants in question were engaged in both local and foreign commerce, and the state attempted to exact a license tax measured by the receipts from both sources. This was not allowed, the court declaring:

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[14]Waring v. Mobile, (1869) 8 Wall. (U.S.) 110, 19 L. Ed. 342.
[15](1869) 8 Wall. (U.S.) 110, 123, 19 L. Ed. 342.
[16](1827) 12 Wheat. (U.S.) 419, 441-42, 6 L. Ed. 678.
[17]Waring v. Mobile, (1869) 8 Wall. (U.S.) 110, 19 L. Ed. 342.
[18]Crew Levick Co. v. Pennsylvania, (1917) 245 U. S. 292, 38 Sup. Ct 126, 62 L. Ed. 295.

"the . . . imposition of a percentage upon each dollar of the gross transactions in foreign commerce seems to us to be, by its necessary effect, a tax upon such commerce, and therefore a regulation of it; and for the same reason, to be in effect an impost or duty upon exports."[19]

The seller made no objection to the validity of the small fixed tax imposed on all vendors, but did object to "that portion of the tax which is measured by the receipts from foreign commerce." Such a tax varies directly with the volume of commerce and operates to lay a direct burden on it. The state relied largely on the *Ficklen*[20] *Case*, but the court distinguished it. The distinctions, however, were formal rather than substantive, and the reasoning of Mr. Justice Pitney's opinion is opposed to the use of the gross receipts from exempt sales as the measure of a privilege tax. In view of the reasoning in the *Nitrate*[21] *Case* it seems probable that such a tax will not be allowed.

Neither may sales for exportation made through commission merchants be taxed, even though the merchant technically acquires title to the goods before shipment. In *Spalding & Bros. v. Edwards*[22] the goods were bought by a commission merchant on an export order for a foreign purchaser, the manufacturer delivering the goods direct to the exporting carrier. The transfer of the title through the commission merchant to the foreign buyer was merely a step in the sale to the latter. The fact that the commission merchant theoretically acquired title to the goods and could have retained them for his own use was not regarded as controlling. "Theoretical possibilities," said Mr. Justice Holmes, "may be left out of account."[23] Although the case dealt with a federal tax under the War Revenue Act, it indicates the extent of the constitutional immunity from state taxation because of the similarity of the constitutional prohibitions against federal and state taxation of exports.[24]

From this review of the cases one may conclude that any attempt to apply a sales tax to sales, by the importer, of imports remaining in the original package would be unconstitutional. All subsequent sales, however, and all sales of the contents of broken packages may be taxed; the imports in such instances having

[19](1917) 245 U. S. 292, 295-296, 38 Sup. Ct. 126, 62 L. Ed. 295.
[20](1892) 145 U. S. 1, 12 Sup. Ct. 810, 36 L. Ed. 601.
[21](1933) 288 U. S. 218, 53 Sup. Ct. 373, 77 L. Ed. 710.
[22](1923) 262 U. S. 66, 43 Sup. Ct. 485, 67 L. Ed. 865.
[23](1923) 262 U. S. 66, 70, 43 Sup. Ct. 485, 67 L. Ed. 865.
[24]United States constitution, art I, sec. 9 and 10.

become incorporated into the general mass of property within the state, the immunity from taxation is lost. Any sales for export, whether made directly to the foreign buyer or to commission merchants in the course of exportation to foreign purchasers, must also be exempt from the operation of a sales tax. Nor may a tax be levied on the privilege of engaging in any of these exempt transactions. But where the business consists both of exempt and non-exempt transactions, a tax may be levied on the non-exempt sales. However, any attempt to measure an occupation or privilege tax on such a business by the total sales would apparently no longer be countenanced.

## III. Commerce Clause

Unlike the prohibition against state taxation of imports and exports, the so-called commerce clause of the federal constitution does not expressly forbid state taxation of interstate commerce. It merely provides that Congress shall have the power "To regulate commerce with foreign nations, and among the several states, and with the Indian tribes."[25] This is interpreted as giving Congress the exclusive power to regulate those subjects of commerce that are national in their character, and the interchange of commodities between the states is held to be national in its character. Taxation of such commerce, being a form of regulation, is thus forbidden. By this method of reasoning, the court has granted to interstate commerce protection from the burden of state taxation which intrastate commerce must bear. In considering the application of this doctrine in connection with a sales tax, the cases have been divided into two main classes: first, cases in which the tax is imposed by the state of destination of the goods sold, and second, cases where the tax is imposed by the state of origin of the commodities.

### 1. Taxes Imposed by the State of Destination.

The cases dealing with taxes imposed by the state of destination have been grouped according to the physical location of the goods, at the time of sale, with respect to the buyer in the state of destination. The first group of cases deals with taxes imposed on the sale or occupation of selling goods which at the time of the sale are not within the state of destination. The second group of

[25]United States constitution, art. 1, sec. 8.

cases comprises taxes imposed on the sale or occupation of selling goods which previous to the time of sale have been brought within the state of destination.

A. TAXES ON THE SALE OR OCCUPATION OF SELLING GOODS WHICH AT THE TIME OF SALE ARE OUTSIDE THE STATE OF DESTINATION.—Where the buyer in the state of destination purchases goods which at the time of sale are in another state, and the title to which by the terms of the transaction passes directly to the buyer, no tax may be imposed by the state of destination.[26] The interchange of commodities being interstate commerce, the constitution prohibits the states from taxing it. This privilege of engaging in interstate commerce without being subject to the taxing power of a state extends to the solicitation of orders for goods which at the time are outside the state. Such solicitation is "in numberless instances, the most feasible, if not the only practicable, way for the merchant or manufacturer to obtain orders in other states;" it is an indispensable part of interstate commerce and therefore protected by the constitution. Solicitation of the sale of out of state goods is exempt whether made by a traveling salesman selling to local merchants,[27] by a house to house canvasser selling to consumers,[28] or by a broker or commission merchant representing numerous out of state concerns.[29]

But where the sale is made or solicited by local merchants, the out of state goods being shipped to the merchant, who then delivers them to the purchaser, the sale may be taxed. Such a transaction really involves two sales, one to the merchant and another by the merchant to the purchaser; the latter sale, being purely a local transaction, can be taxed. Thus in *Banker Brothers Co. v. Pennsylvania*[30] sales of automobiles by the Pennsylvania representative of a New York manufacturer were held taxable although the representative kept no stock on hand but ordered each car after securing a purchaser, the car being shipped to the representative, who paid for it and in turn delivered it to the purchaser in

[26]Robbins v. Shelby County Taxing Dist., (1887) 120 U. S. 489, 7 Sup. Ct. 592, 30 L. Ed. 694.
[27]Robbins v. Shelby County Taxing District, (1887) 120 U. S. 489, 7 Sup. Ct. 592, 30 L. Ed. 694.
[28]Real Silk Hosiery Mills v. Portland, (1925) 268 U. S. 325, 45 Sup. Ct. 525, 69 L. Ed. 982.
[29]Stockard v. Morgan, (1902) 185 U. S. 27, 22 Sup. Ct. 576, 46 L. Ed. 785.
[30](1911) 222 U. S. 210, 32 Sup. Ct. 38, 56 L. Ed. 168.

Pennsylvania. Mr. Justice Lamar in speaking of the relationship of the representative to the purchaser said:

"as between Banker Brothers Company and the Pittsburgh purchaser, there can be no doubt that it occupied the position of vendor. As such it was bound by its contract to him, and under the duty of paying to the state a tax on the sale."[31]

The tax sustained was the Pennsylvania mercantile license tax measured by a percentage of the gross sales.

But *quaere,* in the case of a merchant who makes a special order for a purchaser, the goods going direct from the out of state seller to the purchaser, who pays the merchant? In such a case the merchant takes part in the credit transaction only; his function is analogous to that of a commission merchant, which is not taxable. In a similar case dealing with exports, the court held the sale exempt from taxation, although the title to the goods technically passed through the commission merchant.[32] It has been suggested that in the case of interstate commerce where there is no express prohibition against taxation such technicalities might make a difference.[33]

B. Taxes on the Sale or Occupation of Selling Goods Which Previous to the Time of Sale Have Been Brought into the State of Destination.—The prohibition against the taxation of interstate commerce by the states does not prevent the taxing of sales which previous to the time of sale have been brought into the state and become incorporated into the general mass of property in the state. On an analogy to the case of imports, the breaking of the original package or the first sale of the goods would subject them to taxation. But where the goods are offered for sale in the original package in which they were brought into the state, the applicability, to interstate commerce, of the original package doctrine must be determined. When Mr. Chief Justice Marshall laid down the rule in *Brown v. Maryland,*[34]

[31](1911) 222 U. S. 210, 213, 32 Sup. Ct. 38, 56 L. Ed. 168.

[32]Spalding & Bros. v. Edwards, (1923) 262 U. S. 66, 43 Sup. Ct. 485, 67 L. Ed. 865.

[33]Powell, Contemporary Commerce Clause Controversies Over State Taxation, (1928) 76 U. of Pa. L. Rev. 773, 777, note 13.

See also, Wiloil Corp. v. Pennsylvania, (1935) 294 U. S. 169, 55 Sup. Ct. 358, 79 L. Ed. 838, upholding a state tax of three cents per gallon on "liquid fuels used or sold and delivered" within the state, as regards fuel ordered by a distributor within the state from a company outside the state, the fuel to be delivered direct to the purchasers within the state, the bill of lading naming the distributor as consignor and the purchaser as consignee.

[34](1827) 12 Wheat. (U.S.) 419, 6 L. Ed. 678.

he assumed that it applied alike to foreign and interstate commerce. His successors, however, have taken a different view. In *Woodruff v. Perham,*[35] a tax on the sale of goods brought into the state from a sister state and there sold in the original packages was upheld, the tax being non-discriminatory. But in later cases the court held that goods of extra-state origin while still in the original packages were immune from a tax on their sale,[36] or on the occupation of selling them.[37] In the meantime such goods had been held subject to the general property taxes of the state of destination,[38] and a tax on itinerant vendors going about from place to place carrying goods with them and disposing of them by sale was upheld irrespective of the fact that the goods were of extra-state origin and still in the original packages.[39]

A later case[40] indicated that in the future taxes on the sale of goods in the original package in which they were brought into the state would be sustained where the tax was not discriminatory. Finally in *Sonneborn Brothers v. Keeling,*[41] the court settled the matter by holding that an occupation tax of two per cent of the gross sales was constitutional as applied to the sales of goods shipped into Texas and afterwards sold in the unbroken original packages. Mr. Chief Justice Taft pointed out that the "cases subsequent to *Brown v. Maryland* show that the analogy between imports and articles in original packages in interstate commerce in respect of immunity from taxation fails."[42] As Mr. Justice Sutherland put it in a late case:

[35](1869) 8 Wall. (U.S.) 123, 19 L. Ed. 382.

[36]Foote v. Stanley, (1914) 232 U. S. 494, 34 Sup. Ct. 377, 58 L. Ed. 698; Standard Oil Co. v. Graves, (1919) 249 U. S. 389, 39 Sup. Ct. 320, 63 L. Ed. 662; Bowman v. Continental Oil Co., (1921) 256 U. S. 642, 41 Sup. Ct. 606, 65 L. Ed. 1139.

[37]Askren v. Continental Oil Co., (1920) 252 U. S. 444, 40 Sup. Ct. 355, 64 L. Ed. 654.

[38]Brown v. Houston, (1885) 114 U. S. 622, 5 Sup. Ct. 1091, 29 L. Ed. 257; American Steel and Wire Co. v. Speed, (1904) 192 U. S. 500, 24 Sup. Ct. 365, 48 L. Ed. 538.

[39]Wagner v. Covington, (1919) 251 U. S. 95, 40 Sup. Ct. 93, 64 L. Ed. 157. The sales taxed were made by a Cincinnati, Ohio, bottling works, which regularly sent a truck loaded with bottled drinks across the river into Covington, Kentucky, to supply the needs of their customers. There was no solicitation of orders prior to the introduction of the goods into Kentucky, but there was a regular course of business and a fairly steady assurance of sales.

[40]Texas Co. v. Brown, (1922) 258 U. S. 466, 42 Sup. Ct. 375, 66 L. Ed. 721.

[41](1923) 262 U. S. 506, 43 Sup. Ct. 643, 67 L. Ed. 1095.

[42](1923) 262 U. S. 506, 510, 43 Sup. Ct. 643, 67 L. Ed. 1095.

"Interstate transportation having ended, the taxing power of the state in respect of the commodity which was the subject of such transportation, may, so far as the commerce clause of the federal constitution is concerned, be exerted in any way which the state's Constitution and laws permit, provided, of course, it does not discriminate against the commodity because of its origin in another state."[43]

The sale of gas or electricity of extra-state origin presents an interesting problem in connection with the application of a state sales tax. The business may be carried on in two ways: first, the same company may transmit the gas or electricity from the state of origin to the state of destination and there sell it to the individual consumers; second, the transmitting company may, in the state of destination, sell the gas or electricity to a local company which distributes to the consumers. In either case the lines used for the interstate transmission and the lines used for the local distribution will be permanently connected, the only break in the direct transmission from the state of origin to the consumer being the stepping down of the pressure or voltage as the case may be. May the the sale to the local consumers be taxed? The answer is yes. Mr. Justice Butler, after recognizing that the transportation of gas from one state to another was interstate commerce, continues:

"But when the gas passes from the distribution lines into the supply mains, it necessarily is relieved of nearly all the pressure put upon it at the stations of the producing companies, its volume thereby is expanded to many times what it was while in the high pressure interstate transmission lines, and it is divided into the many thousand relatively tiny streams that enter the small service lines connecting such mains with the pipes on the consumers' premises. So segregated the gas in such service lines and pipes remains in readiness or moves forward to serve as needed. The treatment and division of the large compressed volume of gas is like the breaking of an original package, after shipment in interstate commerce, in order that its contents may be treated, prepared for sale and sold at retail. . . . It follows that the furnishing of gas to consumers in Ohio municipalities by means of distribution plants to supply the gas suitably for the service for which it is intended is not interstate commerce but a business of purely local concern exclusively within the jurisdiction of the state."[44]

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[43]Hart Refineries v. Harmon, (1929) 278 U. S. 499, 501-502, 49 Sup. Ct. 188, 73 L. Ed. 475.

[44]East Ohio Gas Co. v. Tax Commission, (1931) 283 U. S. 465, 470-471, 51 Sup. Ct. 499, 75 L. Ed. 1171. See Howard, Gas and Electricity in Interstate Commerce, (1934) 18 MINNESOTA LAW REVIEW 611, 702.

The tax in question was a privilege tax measured by a percentage of the gross receipts from the sale of gas to consumers. But the sale of gas within the state of destination to distributing companies only cannot be taxed.[45] The sale in such a case is so connected with the interstate transportation of the gas that it constitutes part of the interstate commerce and not as in the above case a business of "purely local concern."

A tax on the occupation of selling goods which at the time of the sale are within the state of destination is constitutional even though the person taxed on such transactions is also engaged in selling goods which at the time of sale are outside the state, if the tax, by its terms or by construction by the state court, is limited to the sales of goods within the state, or if the tax is separable so that it can be applied only to the local commerce. Thus in *Kehrer v. Stewart*[46] a license tax was upheld as applied to the agent of an out of state packing house who took orders for meats which were later shipped from the packing house, and who also sold meats shipped to him without previous sale or order; the tax had been interpreted by the state court as applying only to the sale of the meat brought into the state prior to the solicitation of orders for its sale. This case was approved and followed in *Raley & Bros. v. Richardson*[47] which imposed a license tax on commission merchants, the tax being construed by the state court as applying only to sales of goods within the state at the time of sale. Mr. Justice Sutherland agreed with the state court that, as Raley Brothers had solicited sales of goods within the state, at the time of solicitation they were liable for the tax irrespective of the fact that they also solicited the sale of goods which were outside the state at the time.

"The complainants were definitely engaged in the domestic business described in the statute, and were liable to the tax, irrespective of the extent of it, and whether they engaged in interstate business in addition or not. . . . Certainly one cannot avoid a tax upon a taxable business by also engaging in a non-taxable business."[48]

In *Ratterman v. Western Union Tel. Co.*[49] a tax assessed upon

[45]State Tax Comm'n. v. Interstate Nat. Gas Co., (1931) 284 U. S. 41, 52 Sup. Ct. 62, 76 L. Ed. 156. See Howard, Gas and Electricity in Interstate Commerce, (1934) 18 MINNESOTA LAW REVIEW 611, 706.

[46](1905) 197 U. S. 60, 25 Sup. Ct. 403, 49 L. Ed. 663.

[47](1924) 264 U. S. 157, 44 Sup. Ct. 256, 68 L. Ed. 615.

[48](1924) 264 U. S. 157, 159, 44 Sup. Ct. 256, 68 L. Ed. 615.

[49](1888) 127 U. S. 411, 8 Sup. Ct. 1127, 32 L. Ed. 229.

the receipts of a telegraph company engaged in transmitting both local and interstate messages was held invalid to the extent that it applied to the receipts from interstate messages. The receipts being separable, the tax was upheld as applied to the local messages.

But if the sales of goods made after the property is brought within the state are nominal and incidental to the carrying on of the interstate commerce, they cannot be taxed.[50] In the *Kehrer Case* the court suggested that any local sales of meat made necessary because of the refusal of the buyer to accept a shipment from the out of state packer would not subject the agent to taxation. Such sales, the court said, would be a necessary part of the interstate commerce and thus exempt. A sales tax may, therefore, be applied to sales of goods which at the time of sale are within the state, even though the seller is also engaged in selling goods not within the state, unless the sales are merely incidental to and a necessary part of the latter business.

However, an attempt to measure a privilege tax on doing local business by the gross receipts both from sales of goods within the state and sales of goods outside the state at the time of sale would probably be unconstitutional. An early case, *Ficklen v. Shelby County Taxing District*,[51] upheld a privilege tax on merchandise brokers even though the tax was measured by a percentage of the gross commissions and all the sales negotiated were of goods outside the state at the time of sale. Mr. Ficklen, having taken out a license to do a general commission business, was held amenable to the tax. The *Ficklen Case* relied largely on *Maine v. Grand Trunk Ry. Co.*[52] as support for measuring the tax by the gross receipts from interstate commerce. The *Maine Case* has since been explained on other grounds by the court,[53] and later cases, as pointed out above,[54] have tended to discredit the *Ficklen Case*. This, together with the remarks of Mr. Justice Pitney in *United States Glue Co. v. Oak Creek*[55] in dis-

[50]See Kehrer v. Stewart, (1905) 197 U. S. 60, 25 Sup. Ct. 403, 49 L. Ed. 663, and Raley & Bros. v. Richardson, (1924) 264 U. S. 157, 44 Sup. Ct. 256, 68 L. Ed. 615.

[51](1892) 145 U. S. 1, 12 Sup. Ct. 810, 36 L. Ed. 601.

[52](1891) 142 U. S. 217, 12 Sup. Ct. 121, 35 L. Ed. 994.

[53]Galveston, H. & S. A. Ry. Co. v. Texas, (1908) 210 U. S. 217, 28 Sup. Ct. 638, 52 L. Ed. 1031.

[54]See pp. 463, 465. Brown v. Maryland, (1827) 12 Wheat. (U.S.) 419, 6 L. Ed. 678; Dooley v. United States, (1901) 183 U. S. 151, 22 Sup. Ct. 62, 46 L. Ed. 128.

[55](1918) 247 U. S. 321, 38 Sup. Ct. 499, 62 L. Ed. 1135; see also

tinguishing between "a tax measured by gross receipts and one measured by net income," leads one to believe that the *Ficklen Case* would no longer be followed.

From these decisions it appears that a sales tax cannot be applied by the state of destination to sales of goods which at the time of the sale are outside the state, unless the goods pass through the hands of a local merchant so as to make the sale to the buyer in reality a local sale, separate and distinct from the transactions between the out of state seller and the merchant. Neither can a privilege or occupation tax measured by the gross sales be placed on the business of selling or soliciting the sale of goods outside the state at the time of the sale. But where the goods sold have been brought within the state previous to the time of sale, either a sales tax or an occupation tax measured by the gross sales may be applied, except where the sale of a product of extra-state origin is so closely connected with the interstate transportation as to constitute a part of the interstate commerce in the product, as in the case of the sale of gas or electricity to distributing companies. However, sales of such a product to consumers may be taxed where the sales require acts within the state analogous to the breaking of the original package in the case of imports. And persons engaged in selling goods which at the time of sale are within the state may be taxed on such sales even though they also sell goods which at the time of sale are outside the state, unless the sales are merely incidental to and a necessary part of the business of selling the goods outside the state. But an attempt to include the receipts from the sale of goods outside the state at the time of sale in the measure of a tax on the privilege of selling goods which at the time of sale are within the state would probably be held bad.

### 2. Taxes Imposed by the State of Origin.

The cases involving taxes imposed by the state of origin of the goods sold have been divided into two groups: first, cases dealing with taxes on the sale or occupation of selling goods, which at the time of sale are within the state, to buyers outside the state; second, cases involving taxes on acts or occupations carried on within the state precedent to the sale of the goods to out of state buyers.

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Peck & Co. v. Lowe, (1918) 247 U. S. 165, 38 Sup. Ct. 432, 62 L. Ed. 1049.

A. TAXES ON THE SALE OR OCCUPATION OF SELLING GOODS, WITHIN THE STATE AT THE TIME OF SALE, TO BUYERS OUTSIDE THE STATE.—A tax on the sale or occupation of selling goods, which at the time of the sale are in the state, is an unconstitutional regulation of interstate commerce where the sales are made directly to buyers outside the state. In *Heyman v. Hays*[56] a privilege tax was held bad as applied to the business of selling liquor by mail, all the sales being made to buyers outside the state. It was claimed that the receiving of the orders and the maintaining within the taxing state of a stock of goods and a clerical force necessary to pack and ship the liquor constituted a local business, separate and distinct from the interstate commerce, for which a tax could be imposed. To this the court answered:

"we are of the opinion that, giving the fullest effect to the conditions stated, they were but the performance of acts accessory to and inhering in the right to make the interstate commerce shipments, and therefore to admit the power, because of their existence to burden the right to ship in interstate commerce would necessarily be to recognize the authority to directly burden such right. In the nature of things the protection against the imposition of direct burdens upon the right to do interstate commerce, as often pointed out by this court, is not a mere abstraction, affording no real protection, but is practical and substantial, and embraces those acts which are necessary to the complete enjoyment of the right protected."[57]

If, however, the business consisted both in making sales to local buyers and also to out of state buyers, the sales to the local buyers could be taxed.[58] But any privilege tax which attempted to measure the quantum of the tax by the total receipts, including those from the sales to out of state buyers, would now undoubtedly be held invalid.[59]

Taxes on the sale or occupation of selling goods are constitutional where both the goods sold and the buyer are within the state at the time of the sale, even though the sale is made in the process of or preliminary to the transportation of the goods in interstate commerce. In *Superior Oil Co. v. Mississippi ex rel Knox*[60] the seller of gasoline delivered it within the state of origin

[56](1915) 236 U. S. 178, 35 Sup. Ct. 403, 59 L. Ed. 527.
[57](1915) 236 U. S. 178, 186, 35 Sup. Ct. 403, 59 L. Ed. 527.
[58]Ratterman v. Western Union Tel. Co., (1888) 127 U. S. 411, 8 Sup. Ct. 1127, 32 L. Ed. 229.
[59]See Crew Levick Co. v. Pennsylvania, (1917) 245 U. S. 292, 38 Sup. Ct. 126, 62 L. Ed. 295, and supra, (pp. 463, 465, 472).
[60](1930) 280 U. S. 390, 50 Sup. Ct. 169, 74 L. Ed. 504.

to the purchaser, who transported it into another state for resale there, the purchaser receiving a bill of lading calling for delivery to him in the other state. This subterfuge by the seller did not prevent the state of origin from taxing the sale, Mr. Justice Holmes declaring that "the connection of the seller with the steps taken by the buyer after the sale was too remote to save the seller from the tax." And in *Chassaniol v. Greenwood*[61] a municipal license tax on cotton buyers was upheld even though all the cotton purchased was later sold to buyers in other states. In both these cases there was an established course of business which regularly took the goods into other states. Earlier cases holding invalid police regulations over sales made entirely within the state but in the course of and preliminary to interstate commerce, were distinguished by the court. Those cases[62] provided for the licensing and regulation of grain buyers, who, although buying grain within the state, purchased the grain for shipment and sale to purchasers in other states. The court in these decisions is apparently making a distinction between state police power and state taxing power in the state of origin similar to the distinction applied in the state of destination.[63] Evidently the court will now allow state taxation of sales of goods made immediately precedent or antecedent to interstate transportation, although still condemning applications of the police power.

Sales of goods made to commission merchants within the state of origin in response to orders from out of state buyers would probably be exempt from taxation even though the title to the goods technically passed to the merchant and then to the buyer. This result would seem to follow by analogy from the result reached in the state of destination[64] and in the case of exports.[65]

B. TAXES ON ACTS OR OCCUPATIONS CARRIED ON WITHIN THE STATE PRECEDENT TO THE SALE OF THE GOODS TO OUT OF STATE BUYERS.—Taxes upon the acts or occupations of severing

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[61](1934) 291 U. S. 584, 54 Sup. Ct. 541, 78 L. Ed. 1004.

[62]Dahnke-Walker Milling Co. v. Bondurant, (1921) 257 U. S. 282, 42 Sup. Ct. 106, 66 L. Ed. 239; Lemke v. Farmers' Grain Co., (1922) 258 U. S. 50, 42 Sup. Ct. 244, 66 L. Ed. 458; Shafer v. Farmers' Grain Co., (1925) 268 U. S. 189, 45 Sup. Ct. 481, 69 L. Ed. 909.

[63]Powell, Contemporary Commerce Clause Controversies Over State Taxation, (1928) 76 U. of Pa. L. Rev. 773, 958-59.

[64]Stockard v. Morgan, (1902) 185 U. S. 27, 22 Sup. Ct. 576, 46 L. Ed. 785; see also Waring v. Mobile, (1869) 8 Wall. (U. S.) 110, 19 L. Ed. 342.

[65]Spalding & Bros. v. Edwards, (1923) 262 U. S. 66, 43 Sup. Ct. 485, 67 L. Ed. 865.

or extracting products of nature have been sustained by the court where the measure of the tax was a percentage of the value of the product determined at the time of severance or extraction. In *Lacoste v. Department of Conservation*[66] the Louisiana severance tax imposed on all skins and hides taken within the state irrespective of their destination was upheld. Since all the hides in question were shipped out of the state, it was claimed that the tax was an interference with interstate commerce. The court dismissed this by saying:

"The state's power to tax property is not destroyed by the fact that it is intended for and will move in interstate commerce. Such skins and hides may be taxed while in the hands of dealers before they move in interstate commerce."[67]

An earlier case[68] had upheld a Pennsylvania tax on each ton of anthracite coal, measured by a percentage of the value when mined and prepared for market, in spite of the fact that Pennsylvania had a virtual monopoly of such coal and that most of the coal was shipped out of the state. This was followed by *Oliver Iron Mining Co. v. Lord*[69] which sustained a tax on the occupation of mining iron ore, the tax being measured by a percentage of the value of the ore at the time of mining. As most of the ore was shipped directly from the mines to points outside the state, it was claimed the tax was an unconstitutional regulation of interstate commerce. To this the court answered:

"Plainly the facts do not support the contention. Mining is not interstate commerce, but, like manufacturing, is a local business, subject to local regulation and taxation. . . .

"The ore does not enter interstate commerce until after the mining is done, and the tax is imposed only in respect of the mining. No discrimination against interstate commerce is involved. The tax may indirectly and incidentally affect such commerce, just as any taxation of railroad and telegraph line does, but this is not a forbidden burden or interference."[70]

Severance or extraction taxes, it thus appears, are not in themselves repugnant to the commerce clause; the difficulty arises when an attempt is made to measure the quantum of the tax by a percentage of the gross sales, including the receipts from the sale of goods to buyers outside the state.

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[66](1924) 263 U. S. 545, 44 Sup. Ct. 186, 68 L. Ed. 437.

[67](1924) 263 U. S. 545, 551, 44 Sup. Ct. 186, 68 L. Ed. 437.

[68]Heisler v. Thomas Colliery Co., (1922) 260 U. S. 245, 43 Sup. Ct. 83, 67 L. Ed. 237.

[69](1923) 262 U. S. 172, 43 Sup. Ct. 526, 67 L. Ed. 929.

[70](1923) 262 U. S. 172, 178-79, 43 Sup. Ct. 526, 67 L. Ed. 929.

In *Hope Natural Gas Co. v. Hall*[71] a privilege tax on producers of natural gas was upheld although most of the gas was transported direct from the wells to other states and there sold. It was claimed that the act was unconstitutional because in determining the amount of the tax it took into consideration the gross receipts received from the sale of the gas both within and without the state. The state court had previously held that the receipts from the sale of gas outside the state could be used "only for the purpose of determining the value of such commodity within the state and before it enters interstate commerce." An injunction had therefore been issued prohibiting the state tax commissioner from treating the gross proceeds from the sale of gas outside the state as the worth of the gas within the state, but allowing him to base the tax on the value of the gas before it entered interstate commerce. Mr. Justice McReynolds, in upholding the tax, declared:

"we review the final decree and must accept the statute as authoritatively construed and applied. The plain result of the opinion and final decree is to require that the tax be computed upon the value of the gas at the well, and not otherwise. If, hereafter, the executive officers disregard the approved construction and fix values upon any improper basis appropriate relief may be obtained through the courts."[72]

The case, although not expressly deciding the point, indicates rather strongly that a severance or extraction tax could not be measured by the gross receipts from the sale of the product where part of the sales are made to persons outside the state.

Taxes on the act or occupation of processing or manufacturing goods within the state have also been upheld although a part or all of the goods were later transported and sold to buyers in other states. In *Utah Power and Light Co. v. Phost*[73] a license tax on the generation of electricity, measured by the amount of electricity generated, was held constitutional where the most of the electricity was transported into other states and there sold to consumers. It was claimed that the generation and transmission were substantially instantaneous so that the one could not be separated from the other and thus a tax on the generation was in fact a tax on the interstate transmission and sale. Mr. Justice Sutherland,

[71](1927) 274 U. S. 284, 47 Sup. Ct. 639, 71 L. Ed. 1049.

[72](1927) 274 U. S. 284, 288, 47 Sup. Ct. 639, 71 L. Ed. 1049.

[73](1932) 286 U. S. 165, 52 Sup. Ct. 548, 76 L. Ed. 1038. See Howard, Gas and Electricity in Interstate Commerce, (1934) 18 MINNESOTA LAW REVIEW 611, 696.

however, found that the "process of generation" was "essentially local" and therefore subject to state taxation. To him the generator and the transmission lines performed different functions, comparable to the manufacture of goods and their subsequent shipment and transportation in commerce. And in the more recent case of *Federal Compress & W. Co. v. McLean*[74] a license tax on the business of storing and compressing cotton was upheld "although in the ordinary course of business the cotton would ultimately reach points outside the state." The cotton was collected at the warehouse, compressed and held for shipment outside the state. In speaking of taxes on acts precedent to interstate commerce Mr. Justice Stone declared:

"A non-discriminatory tax upon the business of storing and compressing the cotton, which is not itself the subject of a movement in interstate commerce, is not forbidden. Most articles, before their shipment in interstate commerce, have had work done upon them which adapts them to the needs of commerce and prepares them for safe and convenient transportation, but that fact has never been thought to immunize from local taxation either the articles themselves or those who have manufactured or otherwise prepared them for interstate transportation. . . . Here the privilege taxed is exercised before interstate commerce begins, hence the burden of the tax upon the commerce is too indirect and remote to transgress constitutional limitations."[75]

The court evidently finds no difficulty with processing or manufacturing taxes as such; here again the trouble arises when the state of origin attempts to measure such a tax by a percentage of the gross receipts including those from the sale of the goods to out of state buyers.

The city of St. Louis, in accordance with power granted by a state statute, levied a privilege tax on manufacturers measured by a percentage of the gross sales of manufactured goods, irrespective of whether the goods were sold within or without the state, or whether the receipts came from intrastate or interstate commerce. It was objected, in *American Mfg. Co. v. St. Louis*,[76] that the tax was unconstitutional as applied to the receipts from sales of goods within the state at the time of sale to buyers outside the state, and the receipts from sales where both the goods sold and the buyers were outside the state at the time of sale. Mr. Justice Pitney in upholding the tax declared:

[74](1934) 291 U. S. 17, 54 Sup. Ct. 267, 78 L. Ed. 622.
[75](1934) 291 U. S. 17, 21-22, 54 Sup. Ct. 267, 78 L. Ed. 622.
[76](1919) 250 U. S. 459, 39 Sup. Ct. 522, 63 L. Ed. 1084.

"The city might have measured such tax by a percentage upon the value of all goods manufactured, whether they ever should come to be sold or not, and have required payment as soon as, or even before, the goods left the factory. In order to mitigate the burden, . . . it has postponed ascertainment and payment of the tax until the manufacturer can bring the goods into market. . . .

"In the outcome the tax is the same in amount as if it were measured by the sale value of the goods, but imposed upon the completion of their manufacture."[77]

Although the case in fact allowed the tax to apply to the gross receipts from interstate commerce and commerce entirely outside the state, it is apparent from the opinion that the court considered the gross receipts merely as a measure of the value of the manufactured product at the time of manufacture. Thus viewed the ordinance was a legitimate exercise of the taxing power. The case, therefore, merely recognizes the power of a state to impose a tax on the business of manufacturing and to measure the tax by the value of the product at the time of manufacture. It seems in accord with the later statements by Mr. Justice McReynolds in the *Gas Case*[78] and would probably furnish no support for the application of a sales tax by the state of origin to sales of goods to buyers in other states, nor for a privilege tax on the business of processing or manufacturing goods where the tax is levied directly on the gross receipts from the sale of the goods, a part of which are derived from sales to buyers in other states.

The conclusion from these cases is that the state of origin may not apply a sales tax or an occupation tax measured by a percentage of the gross sales to the receipts from the sale of goods, which at the time of sale are within the state, to buyers outside the state. But if the business consists in making sales both to out of state buyers and also to buyers within the state, the latter sales may be taxed. However, an attempt to measure an occupation tax by the receipts from both sources would probably be unconstitutional. The sale or occupation of selling goods to buyers within the state may be taxed even though the sales are made in the process of or preliminary to the interstate transportation of the goods, but sales to commission merchants probably may not be taxed where the goods are purchased in response to orders from out of state customers and shipped directly to the out of state buyers. The acts or occupations of severing, extracting, proces-

[77](1919) 250 U. S. 459, 463-64, 39 Sup. Ct. 522, 63 L. Ed. 1084.
[78](1927) 274 U. S. 284, 47 Sup. Ct. 639, 71 L. Ed. 1049.

sing, or manufacturing goods may be taxed by the state even though the goods so treated are intended for and do later move in interstate commerce. Such taxes may be measured by the value of the goods at the time the acts are performed, but an attempt to take the gross receipts from the sale of the goods after interstate transportation and sale as the basis for the tax would probably be unconstitutional as a tax on interstate commerce.

## IV. Conclusions

A categorical conclusion as to the constitutionality of a state sales tax is impossible; in some cases sales may be taxed, in others they may not. The above review of the decisions of the Supreme Court has indicated that a state's taxing power, as regards a sales tax, is limited by those clauses of the federal constitution dealing with imports and exports, and interstate commerce. The exemption in the case of imports extends only to the first sale, by the importer, in the original package. In the case of exports all sales made directly to foreign buyers, or to commission merchants in the process of exportation, are exempt from taxation. When the sale does not involve imports or exports, the important criterion in determining taxability is the physical relation between the purchaser and the goods sold. If at the time of sale the purchaser and the goods sold are in different states, and the consummation of the sale contemplates the transportation and delivery of the goods to the purchaser, the sale is exempt from taxation. The sale may also be exempt even though the purchaser and the goods sold are in the same state if the sale is incidental to, or constitutes a part of, the interstate commerce in the product. In these instances neither the sale, the privilege of engaging in the business of selling, nor the gross receipts from the sale may be taxed.