Michigan Law Review

Volume 36 | Issue 6

1938

TAXATION - COMPENSATING USE TAX - THEORY - BURDEN ON INTERSTATE COMMERCE

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TAXATION — COMPENSATING USE TAX — THEORY — BURDEN ON INTERSTATE COMMERCE — The California Use Tax Act of 1935[1] imposes an excise tax on the storage or use of personal property purchased in other states and brought into California. Plaintiff railroad bought materials and supplies in other states and stored them in California before installation on its interstate railroad system, and the tax was assessed on them. *Held*, the tax is unconstitutional as applied to such property as a direct burden on interstate commerce. Where the property was purchased for the sole purpose of being reserve equipment in an interstate commerce plant it is employed in interstate commerce from the time of its purchase. *Southern Pacific Co. v. Corbett*, (D. C. Cal. 1937) 20 F. Supp. 940.

The purpose of the use tax in states which have already established a sales tax is to prevent domestic consumers from avoiding the payment of the sales tax

[1] Cal. Stat. (1935), c. 361, p. 1297.

by buying goods outside the state and thus putting the domestic sellers at a disadvantage.[2] The use tax in theory does away with a discrimination against domestic merchants. So long as the use tax is equal in amount to the state sales tax it is not a discrimination against interstate commerce, as it taxes goods imported in interstate commerce at no higher a rate than the tax on domestic goods.[3] In passing on the discrimination question the sales and use tax statutes may be considered together.[4] As the California Use Tax is complementary to a state sales tax of equal amount it is not discriminatory.[5] The question remains whether the use tax is a direct burden on interstate commerce and thus prohibited under the commerce clause of the Federal Constitution. Considering the supplies in the principal case only as subjects of interstate commerce, the tax would appear to be valid as to them, as it has been held that goods imported from another state lose their immunity from state taxation as subjects of interstate commerce on being unloaded and stored in the state, and are then subject to a non-discriminatory state excise tax.[6] This is true even though the importer imports solely for his own use and stores or uses the goods himself.[7] Consequently, in the principal case if the purchaser had intended to use the supplies purely in intrastate business the tax would seem to be valid. As the materials and supplies in the principal case are to be used for replacements and repairs on an interstate railroad, however, there is a further problem whether they are exempt from state taxation as instrumentalities of interstate commerce. On this question it has been held that a use tax is invalid as applied to goods purchased outside the state and not stored within the state, but used solely within the state as an instrumentality of interstate commerce.[8] However, in *Nashville, C. & St.*

[2] See Traynor, "The California Use Tax," 24 CAL. L. REV. 175 (1936); 9 So. CAL. L. REV. 259 (1935); Warren and Schlesinger, "Sales and Use Taxes: Interstate Commerce Pays its Way," 38 COL. L. REV. 49 (1938).

[3] Gregg Dyeing Co. v. Query, 268 U. S. 472, 52 S. Ct. 631 (1932); Henneford v. Silas Mason Co., Inc., 300 U. S. 567, 57 S. Ct. 524 (1934). As the sales tax rests on the seller and the use tax on the consumer, this conclusion involves the assumption that the sales tax is always passed on to the consumer, an assumption which, it has been argued, is not always justified. See 31 MICH. L. REV. 275 (1932); HAIG and SHOUP, THE SALES TAX IN THE AMERICAN STATES (1934); Warren and Schlesinger, "Sales and Use Taxes: Interstate Commerce Pays Its Way," 38 COL. L. REV. 49 (1938).

[4] Gregg Dyeing Co. v. Query, 286 U. S. 472, 52 S. Ct. 631 (1932).

[5] The California Use Tax Act of 1935 was passed two years after the California Retail Sales Act. Cal. Stat. (1933), c. 1020, p. 2599, as amended by Cal. Stat. (1935), c. 355, p. 1252, and c. 357, p. 1256. Both provided for a tax of 3% on the purchase price.

[6] Nashville, C. & St. Louis R. R. v. Wallace, 288 U. S. 249, 53 S. Ct. 345 (1933); Edelman v. Boeing Air Transport Co., 289 U. S. 249, 53 S. Ct. 591 (1933); Bowman v. Continental Oil Co., 256 U. S. 642, 41 S. Ct. 606 (1920); Gregg Dyeing Co. v. Query, 286 U. S. 472, 52 S. Ct. 631 (1932); Hart Refineries v. Harmon, 278 U. S. 499, 49 S. Ct. 188 (1929).

[7] See cases cited supra note 6.

[8] Helson and Randolph v. Kentucky, 279 U. S. 245, 49 S. Ct. 279 (1929), and

L. R. R. v. Wallace,[9] it was held that a state storage tax on gasoline was valid and not a direct burden on interstate commerce when applied to gasoline which an interstate railroad had bought outside the state, brought into the state and placed in its own storage tanks. None of the gasoline was sold by the railroad, all of it being withdrawn and used as a source of motive power in its interstate railway operation. The Supreme Court specifically found that "storage of the gasoline is a preliminary step to such use in interstate commerce." [10] The facts in this case would seem to be on all fours with those in the principal case. In attempting to distinguish it, the court in the principal case points out, first, that in the *Nashville* case there was neither contention nor proof that the goods taxed had been set aside or allocated by the taxpayer to an interstate use at the time of taxation whereas in the principal case such a contention was the basis of the assertion of immunity, and second, that in the *Nashville* case no federal agency had recognized that such gasoline was in use in interstate commerce while in the principal case the Interstate Commerce Commission had inferentially recognized such use by directing how such supplies should be carried on the railroad's accounts.[11] Neither of these distinctions is very persuasive. The first would seem to be a tribute to the astuteness of counsel in the principal case rather than a fundamental distinction between the cases on which the validity of the tax should be rested; and as to the second, it is recognized that property may be subject to the federal power to regulate interstate commerce and at the same time subject to non-discriminatory state taxation if it has come to a place of rest within the state.[12] Rather than on the *Nashville* case, the court in the principal case chose to rest its decision on cases involving taxes on property actually being used as instrumentalities of interstate commerce at the time of taxation,[13] through the device of a finding that storage of the supplies itself con-

see Northern Pac. Ry. v. Henneford, (D. C. Wash. 1936) 15 F. Supp. 302, cited by the court in the principal case, in which on facts strikingly similar the Washington compensating use tax was held unconstitutional as applied to such goods as a direct burden on interstate commerce. Noted in 36 COL. L. REV. 1179 (1936).

[9] 288 U. S. 249, 53 S. Ct. 345 (1933). See also Edelman v. Boeing Air Transport Co., 289 U. S. 249, 53 S. Ct. 591 (1933), concerning a similar tax on gasoline imported into the state by an interstate air line for its own use.

[10] Nashville C. & St. Louis R. R. v. Wallace, 288 U. S. 249 at 265, 53 S. Ct. 345 (1933). In the principal case the court found that the storage was a use in interstate commerce.

[11] CLASSIFICATION OF INCOME, PROFIT AND LOSS, AND GENERAL BALANCE SHEET ACCOUNTS FOR STEAM ROADS, prescribed by the Interstate Commerce Commission, Issue of 1914, Sec. 716, "Materials and Supplies."

[12] Minnesota v. Blasius, 290 U. S. 1, 54 S. Ct. 34 (1933); Bacon v. Illinois, 227 U. S. 504, 53 S. Ct. 299 (1913); and see Stafford v. Wallace, 258 U. S. 495 at 525, 42 S. Ct. 395 (1922), involving the validity of the Packers and Stockyards Act of 1921 [42 Stat. L. 159 (1921), 7 U. S. C., § 181 (1935)], where the principle was recognized.

[13] Helson and Randolph v. Kentucky, 279 U. S. 245, 49 S. Ct. 279 (1929), involving a state use tax on gasoline bought outside of the state being used to propel an interstate ferry; Bingaman v. Golden Eagle Western Lines, 297 U. S. 626, 56 S. Ct. 624 (1936), involving a state use tax on gasoline brought into the state in the gasoline tanks of interstate buses and being used to propel the buses; and Cooney v. Mountain States Tel. Co., 294 U. S. 384, 55 S. Ct. 477 (1935), involving a tax on telephone instruments attached to an interstate system.

stituted a use in interstate commerce. That such a result is not inevitable is apparent from the decision in the *Nashville* case. By regarding such storage either as a use in interstate commerce or as preliminary [14] to such use, the tax can be regarded either as a direct or an indirect burden on interstate commerce. Thus the fundamental question is seen to be one of policy concerning the advisability of subjecting the carriers to such taxation. In view of the prevailing tendency to make interstate commerce "pay its way," [15] and the fact that in the principal case actual interstate movement had not started at the time of taxation, it seems at least questionable whether the decision will be affirmed if appealed.

Brackley Shaw

[14] This was the basis of the decision in the Nashville case. See also Coe v. Errol, 116 U. S. 517, 6 S. Ct. 475 (1886).

[15] Justice Holmes dissenting in New Jersey Bell Tel. Co. v. State Tax Board, 280 U. S. 338 at 351, 50 S. Ct. 111 (1930), quoting from the opinion of Justice Clark in Postal Telegraph & Cable Co. v. Richmond, 249 U. S. 252 at 259, 39 S. Ct. 265 (1919). And see Warren and Schlesinger, "Sales and Use Taxes: Interstate Commerce Pays Its Way," 38 COL. L. REV. 49 (1938).