Death Knell for "Free Trade" Immunity: *Complete Auto Transit, Inc. v. Brady*

Courts have applied two competing theories in evaluating the permissibility of state taxation of the transportation industry engaged in interstate commerce. First, it has been held that under the commerce clause of the United States Constitution[1] interstate commerce should receive "free trade" immunity from state taxation[2] and, second, that interstate commerce should be made to "pay its way."[3]

I. *COMPLETE AUTO TRANSIT, INC. V. BRADY*

On March 7, 1977, in *Complete Auto Transit, Inc. v. Brady*,[4] the United States Supreme Court announced a decision which heralds acceptance of the "pay" concept and rejection of the "free trade" view. This may result in significant changes in the law of state taxation of interstate commerce and have major effects on the transportation industry.

Complete Auto Transit, Inc. (Complete Auto), a Michigan corporation operating in every state except Hawaii and Alaska, transported motor vehicles by motor carrier for General Motors Corporation on a contract basis.[5] Motor vehicles were shipped by rail to Jackson, Missis-

1. U.S. CONST. art. I, § 8, cl. 3 states that "[t]he Congress shall have power: . . . To regulate commerce with foreign nations, and among the several States, and with the Indian tribes."

2. [T]he Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States. In short, the Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States. . . . This limitation on State power . . . does not merely forbid a State to single out interstate commerce for hostile action. A State is also precluded from taking any action which may fairly be deemed to have the effect of impeding the free flow of trade between States. It is immaterial that local commerce is subjected to a similar encumbrance. Freeman v. Hewit, 329 U.S. 249, 252 (1946); *quoted in* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 278 n. 7 (1977).

3. "It is a truism that the mere act of carrying on business in interstate commerce does not exempt a corporation from state taxation. 'It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.' Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938)." Colonial Pipeline Co. v. Traigle, 421 U.S. 100, 108 (1975), *quoted in* Complete Auto Transit, Inc. v. Brady, 430 U.S. at 288 (1977).

4. 430 U.S. 274 (1977).

5. *Id.* at 276.

sippi from assembly points outside the state. In Jackson they were loaded onto Complete Auto's trucks for delivery to General Motors' dealers throughout Mississippi.

Although Complete Auto had been operating in Mississippi since early 1960, it was not until 1971 that the state assessed taxes and interest for 1968 through 1971.[6] The taxes were assessed pursuant to sections 10105 and 10109(2) of the Mississippi Code of 1942 which respectively provide:

> There is hereby levied and assessed and shall be collected, privilege taxes for the privilege of engaging or continuing in business or doing business within this state to be determined by the application of rates against gross proceeds of sales or gross income or values, as the case may be. . . .[7]

> Upon every person operating a pipeline, railroad, airplane, bus, truck, or any other transportation business for the transportation of persons or property for compensation or hire between points within this state, there is hereby levied, assessed, and shall be collected, a tax equal to five per cent of the gross income of such business. . . .[8]

Complete Auto paid the tax under protest and sought a refund.

At the trial court level, Complete Auto argued that its activities were only one part of an interstate movement, and therefore the taxes which were levied were unconstitutional because they were applied to operations in interstate commerce. Although recognizing that other state taxes can be levied on interstate commerce as long as they are non-discriminatory, Complete Auto, relying on *Spector Motor Service, Inc. v. O'Connor*,[9] argued that a state privilege tax, even if non-discriminatory, is an impermissible direct burden on and a forbidden regulation of interstate commerce because the privilege of conducting interstate business is not subject to the sovereign power of a state.[10]

In reply the Mississippi State Tax Commission argued that the taxed activities were wholly intrastate, and that the tax was not a privilege tax like that at issue in *Spector*, but rather a sales tax. Furthermore, the Tax Commission argued that there was no possibility of cumulative burdens on interstate commerce, or repetition by other states of the tax on Complete Auto's activities because the only transactions taxed were those which had taken place entirely within Mississippi state borders.[11]

Although the Mississippi Supreme Court did not expressly find that

6. *Id.* at 277.
7. Current version at Miss. Code Ann. § 27-65-13 (1972).
8. Current version at Miss. Code Ann. § 27-65-19(2) (1972) (amended 1972).
9. 340 U.S. 602 (1951).
10. 430 U.S. at 278.
11. Brief for Appellee at 8, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

Complete Auto's operations in Mississippi involved interstate commerce,[12] it upheld the assessments on the basis of the absence of cumulative burdens or repetition.[13]

Complete Auto appealed the decision to the United States Supreme Court, and the Court seized the opportunity to clarify its interpretation of the commerce clause. The Court traced the history of state taxation of interstate commerce and concluded that the *Spector* rule bore no relationship to economic realities.

II. Decline of Free Trade Immunity

The *Spector* rule declares taxation on the "privilege of doing business" as unconstitutional per se, whether or not such taxation is discriminatory in effect. Although this free trade view existed in the nineteenth century, it gained modern recognition in *Freeman v. Hewit*[14] in which a direct state tax on interstate sales was held unconstitutional per se, even if fairly apportioned and non-discriminatory. The Court admitted that a state could constitutionally tax local manufacture, impose license taxes on corporations doing business in the state, tax property within the state, and tax the privilege of residence as measured by net income, including that derived from interstate commerce. Nevertheless, the Court in *Freeman* expressed the free trade view that the commerce clause was a limitation on state power: the state was "precluded from taking any action which may fairly be deemed to have the effect of impeding the free flow of trade between States,"[15] and it was "immaterial that local commerce was subjected to a similar encumbrance."[16]

The Court in *Complete Auto Transit* noted Justice Rutledge's concurring opinion in *Freeman* in which he asserted that the tax should be judged by its economic effects rather than by its formal phrasing.[17] The

12. Although the character of Complete Auto's activities was of central importance to the parties, the Mississippi Supreme Court failed to make a specific finding that Complete Auto was engaged in interstate commerce. Instead, the court stated that the case was controlled by cases such as Interstate Oil Pipe Line Co. v. Stone, 203 Miss. 715, 35 So.2d 73 (1948), *aff'd* 337 U.S. 662 (1949), in which the United States Supreme Court "said in a plurality opinion that it would not pause to consider whether the business . . . was in interstate commerce, for the State had the power to impose the tax involved." Complete Auto Transit, Inc. v. Brady, 330 So.2d 268 (Miss. 1976).

The United States Supreme Court also noted the absence of a specific finding of fact on the character of Complete Auto's activities: "[t]he Mississippi courts, in upholding the tax, assumed that the transportation is in interstate commerce. For present purposes, we make the same assumption." Complete Auto Transit, Inc. v. Brady, 430 U.S. at 276, n.4.

13. Complete Auto Transit, Inc. v. Brady, 330 So.2d 268 (Miss. 1976).

14. 329 U.S. 249 (1946).

15. *Id.* at 252.

16. *Id.*

17. *Id.* at 270.

Court recognized that commentators have considered *Freeman* a "triumph of formalism over substance."[18] Additionally, it cited with disfavor later decisions which narrowed the *Freeman* rule from one of constitutional prohibition to one of draftsmanship because they made a strained distinction between a tax on the "privilege of doing business" and a tax on the "privilege of exercising corporate functions within the State."[19] The latter form of taxation was considered permissible as compensation for protection of local activities by the state.[20]

The prohibition of state taxation on the "privilege" of engaging in interstate commerce was firmly embraced by *Spector*, in which the facts were similar to those in *Complete Auto Transit*. Spector Motor Service was a Missouri corporation involved exclusively in interstate motor carriage. Connecticut imposed a "tax or excise upon its franchise for the privilege of carrying on or doing business within the State,"[21] because some of its activities originated or terminated there. This tax was measured by apportioned net income and the Court struck it down because "the United States had the exclusive power to tax the privilege to engage in interstate commerce."[22]

The premise upon which *Spector* was decided, that only the federal government has the power to tax interstate commerce, was ignored by later courts and the case was used only to discourage poor draftsmanship. For example, the *Spector* rule was applied in *Railway Express Agency v. Virginia*[23] (*Railway Express I*) to invalidate an annual license tax for the privilege of doing business in the state. However, when the wording of the state statute was revised to impose a "franchise tax" on "intangible property," the statute was upheld.[24] As the Court points out in *Complete Auto Transit*, there was actually no difference between the statutes in *Railway Express I* and *Railway Express II*[25] in terms of their economic effects.

Spector's vitality waned further in *Northwestern Cement Co. v. Minnesota*,[26] when the Supreme Court upheld a properly drafted statute which would have taxed activity that was exclusively involved in interstate commerce if the tax met a threshold test.[27]

18. Complete Auto Transit, Inc. v. Brady, 430 U.S. at 281.
19. Memphis Natural Gas Co. v. Stone, 335 U.S. 80, 92 (1948).
20. *Id.* at 96.
21. Conn. Gen. Stat. § 418c (Cum. Supp. 1935).
22. Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602, 608 (1951).
23. 347 U.S. 359 (1954).
24. Railway Express Agency v. Virginia, 358 U.S. 434 (1959) (*Railway Express II*).
25. 430 U.S. at 284.
26. 358 U.S. 450 (1959).
27. The first part of the test required that there be no discrimination "against interstate commerce either by providing a direct commercial advantage to local business (citations omitted) or by subjecting interstate commerce to the burdens of 'multiple taxation' " and the

The United States Supreme Court's acceptance of the "pay its own way" concept of interstate commerce taxation became evident in its recent decision, *Colonial Pipeline Co. v. Traigle*.[28] Colonial Pipeline, a Delaware corporation, owned an interstate pipeline which ran through Louisiana. Louisiana assessed a state tax on the "qualification to carry on or do business in this state or the actual doing of business within this state in a corporate form."[29] The United States Supreme Court upheld the tax because it pertained to an aspect of interstate commerce to which the state bore a special relation and because the state bestowed certain powers, privileges, and benefits upon the taxpayer.[30]

Apparently succumbing to the criticisms of commentators,[31] the Supreme Court chose *Complete Auto Transit* to overrule *Spector* and to remove the distinction between privilege taxes and other forms of permissible taxes on interstate commerce. It rejected the proposition that interstate commerce is immune from state taxation and firmly embraced the principle that interstate commerce must pay its way.[32]

However, the Court did leave the following defenses to state taxation intact: (1) the activity is not sufficiently connected to the state to justify a tax; (2) the tax is not fairly related to benefits provided to the taxpayer; (3) the tax discriminates against interstate commerce; and (4) the tax is not fairly apportioned. Unfortunately, the rather limited scope of the decision is little consolation when the ramifications of the decision for the transportation industry are analyzed.

III. The Impact of *Complete Auto Transit*

If *Complete Auto Transit* could be limited to its facts, that is, to transactions taking place solely within one state, then its holding might

---

second part demanded a proper apportionment of the tax to local taxpayer activities forming a sufficient nexus to justify that state's imposition of the tax. *Id.* at 458.

28. 421 U.S. 100 (1975).

29. La. Rev. Stat. Ann. § 47:601(1) (West Supp. 1975), amended by Acts 1970, No. 325, § 1 eff. July 13, 1970.

30. Colonial Pipeline Co. v. Traigle, 421 U.S. at 109.

31. One commentator concluded:

"After reading *Colonial*, only the most sanguine taxpayer would conclude that the Court maintains a serious belief in the doctrine that the privilege of doing interstate business is immune from state taxation." W. Hellerstein, "State Taxation of Interstate Business and the Supreme Court, 1974 Term: *Standard Pressed Steel* and *Colonial Pipeline*," 62 Va. L. Rev. 149, 188 (1976).

430 U.S. at 288.

Less charitably put:

"In light of the expanding scope of the state taxing power over interstate commerce, *Spector* is an anachronism. . . . Continued adherence to *Spector*, especially after *Northwestern States Portland Cement*, cannot be justified." Comment, "Pipelines, Privileges and Labels: Colonial Pipeline Co. v. Traigle," 70 Nw. U.L. Rev. 835, 854 (1975).

430 U.S. at 288 and n.14.

32. *See* note 3 *supra*.

not be so ominous to those involved in interstate commerce. But the Court's assumption that Complete Auto's operations were interstate rather than intrastate[33] and the Court's expansive language that interstate commerce must pay its way, strikes a death knell for the "free trade" immunity enjoyed by interstate commerce up to this time.

The *Complete Auto Transit* decision subjects carriers which are engaged in interstate commerce to all of the taxes of every state, municipality, and other local jurisdiction in which they operate unless the presumption of constitutionality which attaches to every tax is surmounted. This will be particularly burdensome for companies like Complete Auto which serve dealers throughout each state in the continental United States. When auditing, accounting, bonding, identification, recording, and reporting are also considered, the costs to the companies and consequent costs to the public are staggering.

The commerce clause delegates regulation of interstate commerce to the federal rather than to the state governments. The reason for this delegation was that city, county, and state taxing power could undermine the basic desire that the United States constitute one integrated economic unit. The problem inherent in state taxation of the type upheld in *Complete Auto Transit* is that such taxes are directed at particular activities, such as transportation, rather than being applied across-the-board. This allows manipulation of taxes to the advantage of local residents, at the expense of non-residents. Because the taxes are direct, the taxpayer is charged with the duty of collecting them for the state. The taxes are usually exacted from the consumer of the goods. Thus the danger lies in the potentiality for strategically located states to exploit their geographical advantages by levying taxes on property which passes through their jurisdiction. It is possible for these states to tailor their tax structures so that the burden will be borne primarily by non-resident consumers of the property.

The sole restraint on the taxing power of a state is a political one imposed by local voters.[34] While the Mississippi State Tax Commission made the appealing argument that intrastate and interstate carriers were taxed alike and thus treated equally,[35] such a contention is inaccurate. The intrastate carriers can elect legislators and thereby affect the tax structure, whereas interstate carriers cannot.

The problem of state taxation of interstate commerce is further aggravated by the Eleventh Amendment's preclusion of a citizen of one

33. *Id.* at 276, n. 4.

34. Brief for Appellant at 24, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). However, in recent years the increasing use of lobbyists has enabled out-of-state interests to exert at least some influence on unfavorable legislation.

35. Brief for Appellee at 23, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

36. U.S. CONST. amend. XI, states that "[t]he Judicial power of the United States shall not

state suing another state in federal court.[36] As a result, carriers seeking to challenge a state tax must do so in a state court, which will probably be insensitive to the argument that the carrier is already burdened by taxation from other states. Therefore, the carrier will be required to prove that the tax either discriminates against or overly burdens interstate commerce. The exigencies of the situation would probably prevent a carrier from pursuing expensive, time-consuming, and uncertain remedies in the courts of each of the multiple jurisdictions.[37]

IV. CONGRESSIONAL ACTION

Because the courts have indicated their endorsement of state taxation of interstate commerce, the transportation industry will have to look elsewhere for help in dealing with this problem. Congress appears to be the appropriate body to provide this assistance. In 1959, after the Supreme Court upheld a state tax on a company engaged exclusively in interstate commerce in *Northwestern States Portland Cement Company v. Minnesota*,[38] Congress quickly took action by enacting Public Law 86-272.[39] This statute set a federal minimum standard which restricted the imposition of state income taxes on interstate commerce and created a commission to formulate proposals for uniformly governing such taxes. While the statute was originally concerned with state net income taxes, it was broadened by Public Law 87-17[40] to include "all matters pertaining to taxation of interstate commerce by the states . . . or any political or taxing subdivision . . . ."[41] This latter statute was the congressional reaction to the Supreme Court's decision in *Scripto, Inc. v. Carson*,[42]

be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."

37. Brief for Appellant at 26, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

38. 358 U.S. 450 (1959).

39. 73 Stat. 555 (1959) (current version at 15 U.S.C. § 381 (1976)). The law was passed within seven months of the *Northwestern* decision. *See generally* S. REP. No. 658, 86th Cong., 1st Sess. 2 (1959), *reprinted in* [1959] U.S. CODE CONG. & AD. NEWS 2548, 2549.

40. 75 Stat. 41 (current version at 15 U.S.C. § 381 (1976)).

41. 75 Stat. 41, § 201.

42. 362 U.S. 207 (1960). In *Scripto*, a Georgia corporation was required to collect a use tax on behalf of the state of Florida from Florida purchasers of the corporation's products. The corporation had no property, no offices or regular full-time employees in Florida, and it did not stock merchandise or maintain bank accounts in Florida, however, there were ten independent wholesalers or jobbers who solicited sales of the products on a commission basis. The jobbers had no authority to make collections or incur debts. The tax was levied "on the privilege of using personal property" within the state and was collectible from dealers.

The United States Supreme Court, per Justice Clark, citing Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-45 (1954), stated the test as "some definite link, some minimum connection between a state and the person, property or transaction it seeks to tax." The Court noted that the tax was non-discriminatory and actually fell upon Florida residents unless the dealer failed to collect it. The Court found the minimum connections by characterizing the wholesalers as

where a use tax was upheld.[43]

Congress, rather than the judiciary, is best equipped to handle problems of multistate taxation of interstate commerce. Justice Frankfurter's dissent in *Northwestern States Portland Cement* discusses judicial inadequacy in this area:

> At best, this Court can only act negatively; it can determine whether a specific state tax is imposed in violation of the Commerce Clause . . . . We cannot make a detailed inquiry into the incidence of diverse economic burdens in order to determine the extent to which such burdens conflict with the necessities of national economic life. Neither can we devise appropriate standards for dividing up national revenue on the basis of more or less abstract principles of constitutional law, which cannot be responsive to the subtleties of the interrelated economies of Nation and State.
>
> The problem calls for solution by devising a congressional policy. Congress alone can provide for a full and thorough canvassing of the multitudinous and intricate factors which compose the problem of the taxing freedom of the States and the needed limits on such state taxing power. Congressional committees can make studies and give the claims of individual States adequate hearing before the ultimate legislative formulation of policy is made by the representatives of all the States. The solution to these problems ought not to rest on the self-serving determination of the States of what they are entitled to out of the Nation's resources. Congress alone can formulate policies founded upon economic realities, perhaps to be applied to the myriad situation involved by a properly constituted and duly informed administrative agency.[44]

Although it appears that Congress has realized the need for uniform standards in this area, such standards are needed now more than ever before. *Complete Auto Transit* has indicated this need.

Prior to *Complete Auto Transit*, Congress made several attempts to pass an Interstate Taxation Act which were unsuccessful. Pursuant to Public Law 86-272, a House special subcommittee held hearings on proposed legislation in 1966.[45] In 1968[46] and 1969,[47] the House passed bills dealing with the subject but both proposals died in the Senate because of pressure from state revenuers. In an effort to head off

---

salesmen and refusing to differentiate between full-time employees and independent contractors because the difference was "without constitutional significance."

43. S. REP. No. 87, 87th Cong., 1st Sess. 2 (1961), *reprinted in* [1961] U.S. CODE CONG. & AD. NEWS 1548, 1548.

44. 358 U.S. at 476-477 (Frankfurter, J., dissenting). *See also* McCarroll v. Dixie Greyhound Lines, Inc., 309 U.S. 176, 188-89 (1940) (Black, Douglas, & Frankfurter, JJ., dissenting).

45. *Hearings on H.R. 11798 Before the Special Subcomm. on State Taxation of Interstate Commerce of the House Comm. on the Judiciary*, 89th Cong., 2d Sess. 1 (1966).

46. H.R. 2158, 90th Cong., 2d Sess., 114 CONG. REC. 14432-33 (1968).

47. H.R. 7906, 91st Cong., 1st Sess., 115 CONG. REC. 17323 (1969).

unfavorable congressional action, many states adopted the Multistate Tax Compact.[48]

Most recently the Senate started at the place where the House left off: a Senate subcommittee held hearings[49] in 1973 not only on a proposed Interstate Taxation Act, but also on congressional authorization of the Multistate Tax Compact. In 1975 a bill on an Interstate Taxation Act[50] was introduced in the Senate, as "another of several recent congressional attempts to create a system that reconciles the states' need for revenue with the federal interest in unimpeded interstate commerce,"[51] but it was not adopted.

V. CONCLUSION

It is clear that *Complete Auto Transit* has stripped interstate commerce of much of the protection it once enjoyed from state taxation. If the transportation industry is to be protected in the future, it must find its shield not in the courts, but in Congress. Thus, carriers which are engaged in interstate commerce would be well advised to exert their energies not in the courtroom but in the legislature. Only in this manner can they be assured that they will enjoy continued vitality without the excessive burdens of multistate taxation.

Jean Schmid Ulrich

48. Multistate Tax Compact, *reprinted in* 27 COUNCIL OF STATE GOVERNMENTS, SUGGESTED STATE LEGISLATION C-9 (1968).

49. *Hearings Before the Subcomm. on State Taxation of Interstate Commerce of the Senate Finance Comm.*, 93rd Cong., 1st Sess. 1 (1973).

50. S. 2080, 94th Cong., 1st Sess., 121 CONG. REC. 12210 (1975).

51. Brief for Appellant at 30, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).