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DePaul Law Review

Volume 14
Issue 1 *Fall-Winter 1964*

Article 19

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Recommended Citation
Dennis Carlin, *Constitutional Law - Taxation - Interstate Commerce - Congressional Stop-Gap Legislation and State Taxation of Income from Order-Taking in Interstate Commerce*, 14 DePaul L. Rev. 195 (1964)
Available at: https://via.library.depaul.edu/law-review/vol14/iss1/19

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CONSTITUTIONAL LAW–TAXATION–INTERSTATE COMMERCE–CONGRESSIONAL STOP-GAP LEGISLATION AND STATE TAXATION OF INCOME FROM ORDER-TAKING IN INTERSTATE COMMERCE

The International Shoe Company, a Delaware Corporation, has its principal place of business in St. Louis, Missouri. During the period in question, the plaintiff sent its salesmen into Louisiana to solicit orders for shoes. These orders were forwarded to St. Louis, the home office, for acceptance or rejection. If the orders were accepted the merchandise was shipped into Louisiana from outside the state. No office, warehouse or any other place of business in Louisiana is maintained by International Shoe Company. During the fiscal years ended November, 1959 and 1960, the Collector of Revenue (Cocreham) levied a tax on the net income of the plaintiff, which the plaintiff paid under protest. Subsequently, the International Shoe Company brought this suit against the Collector of Revenue to recover the state income taxes paid. In the District Court of Louisiana, a judgement was entered for the International Shoe Company from which the Collector appealed. The Supreme Court of Louisiana affirmed the opinion of the lower court. *International Shoe Company v. Cocreham*, 164 So. 2d 314 (La. 1964).[1]

Congress and its plenary power to regulate interstate commerce is the salient issue in this case and will be the major subject of this case note. State taxation of income derived from interstate commerce continues to be an important question. Is such a tax an inordinate burden on the free flow of trade between the states and thus a violation of the Commerce Clause?[2] To fully appreciate and understand the treatment the United States Courts afford this issue, it is necessary to mention briefly its development.

The United States Supreme Court differentiates between a state tax levied against an interstate business for the privilege of doing business in the state, sometimes referred to as a *gross receipts* or *excise tax*, and a state

[1] 164 So. 2d 314 (La. 1964), n. 3: "In this court briefs by amici curiae have been filed on behalf of the Collector by the attorneys general of 19 states. These states are Alaska, Arizona, Arkansas, Colorado, Georgia, Hawaii, Kansas, Kentucky, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, New Hampshire, North Dakota, Oregon, Pennsylvania, South Dakota, and Washington. Other amici curiae briefs have been filed on behalf of plaintiff by forty nation-wide trade associations representing 71,105 multistate merchandisers and seventeen state manufacturers' associations."

[2] U.S. CONST. art. 1, § 9, clause 3; "The Congress shall have the Power ... To regulate commerce ... among the several States."

tax levied on the income earned within the state from interstate operations. Where the business is solely from interstate commerce, the Supreme Court has held the *excise* or *gross receipts tax* to be a direct or undue burden on the free flow of trade and thus a violation of the Commerce Clause.[3] This position is most clearly stated in *Spector Motor Service Inc. v. O'Conner.*[4] The excise tax charged here was measured by net income and the rates and incidents of the tax were the same as if the tax were applied as a net income tax. However, the tax was not placed on the net income, rather it was imposed directly on Spector Motor Service, a wholly interstate business, as an excise tax. The Supreme Court considers this to be taxation assessed directly on interstate commerce and thus oppressive.

A state tax on the income earned from interstate business, on the other hand, has been considered an indirect effect on interstate commerce and thus valid.[5] Such taxation is received much more favorably since the tax is levied on the net income of a business after the interstate transactions have ceased.[6] Therefore, the income tax is not an exaction on interstate transactions but rather on the end results produced by them. Furthermore, this type of income tax is considered to be less prohibitive than an excise or gross receipts tax because it only occurs if the interstate transactions are profitable.[7]

The *Northwestern-Stockham*[8] decision in 1959 marks the initiation of the controversy culminating in the *International Shoe Company* case. It

[3] *Cf.* Eastern Tennessee & Western North Carolina Transp. Co. v. Currie, 248 N.C. 560, 104 S.E.2d 403 (1958); *aff'd per curiam* at 359 U.S. 28 (1959). See also Wisconsin v. J. C. Penney Co., 311 U.S. 435 (1940); Adams Mfg. Co. v. Storen, 304 U.S. 307 (1937); Cheney Bros. Co. v. Massachusetts, 246 U.S. 147 (1917); and Alpha Portland Cement Co. v. Massachusetts, 268 U.S. 203 (1924).

[4] 340 U.S. 602 (1951).

[5] Brown-Forman Distillers Corp. v. Collector of Revenue, 234 La. 651, 101 So. 2d 70 (1958); *appeal dismissed* 359 U.S. 28 (1958); West Publishing Co. v. McColgan, 27 Cal. 2d 705, 166 P.2d 861 (1945); *aff'd per curiam* 328 U.S. 823 (1946); Memphis Natural Gas Co. v. Beeler, 315 U.S. 649 (1942); McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940); American Mfg. Co. v. City of St. Louis, 250 U.S. 459 (1919); U.S. Glue Co. v. Town of Oak Creek, 247 U.S. 321 (1918); Peck & Co. v. Lowe, 247 U.S. 165 (1918).

[6] In Smith Kline & French Laboratories v. State Tax Commission, 5 State Tax Cas. § 250-116 (1964), the court states that "The Supreme Court has long recognized that, at some point in the entire framework of our national business intercourse, interstate commerce must cease."

[7] See U.S. Glue Co. v. Town of Oak Creek, 247 U.S. 321, 329 (1918) where the court clearly explains "A tax upon gross receipts affects each transaction in proportion to its magnitude and irrespective of whether it is profitable or otherwise. . . . A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and losses, and the tax cannot be heavy unless the profits are large."

[8] Northwestern State Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959).

is noteworthy that the facts of this case are very similar to those in the *International Shoe Company* case. The Northwestern States Portland Cement Company has its principal place of business in Iowa. It leased an office in Minnesota for its salesmen and a secretary principally for the purpose of securing sales. The salesmen solicited orders and relayed them to the home office in Iowa for acceptance or rejection. If accepted, the goods were shipped directly from Iowa to the customer in Minnesota. The facts of the *Stockham Valves Co.* case are almost identical.[9] Both states levied an apportioned tax on the net income of the respective corporations and the Supreme Court upheld the validity of the taxes by a vote of six to three. The following quotation from the opinion of the court summarizes the significance of the decision:

We conclude that the net income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy *is not discriminatory*[10] *and is properly apportioned to local activities within the taxing State*[11] forming sufficient nexus[12] to support the same.[13]

[9] The two cases, Northwestern States Portland Cement Co. v. Minnesota, and Williams v. Stockham Valves and Fittings Inc. (Ohio), are consolidated in the *Northwestern-Stockham* decision.

[10] Taxes that discriminate against foreign corporations, by giving local business a direct commercial advantage have been held an undue burden on interstate commerce and thus unconstitutional. The question as to whether the Commerce Clause was violated was determined by whether the tax assessed was discriminatory. See Cook, *State Net Income Taxation of Interstate Commerce,* 42 TAXES 512, 518 (1964). Interstate business must pay its fair share of the tax burden in return for the benefits it derives from the state. If local business has an equal burden, the tax cannot be discriminatory. See West Publishing Co. v. McColgan, 27 Cal. 2d 705, 166 P.2d 861 (1945); *aff'd per curiam* 328 U.S. 823 (1945). Unequal taxation will hinder and discourage interstate commerce and will be considered discriminatory taxation, Best & Co. v. Marshall, 311 U.S. 454 (1940).

On the other hand the tax levied can discriminate against local business if the business in interstate commerce is exempt from local taxation. In this case the interstate business is earning income within the state upon which it pays no tax while the local business is earning income within the same state yet, it must pay a tax. See Roland, *Public Law 86-272 Regulation or Raid,* 46 VA. L. REV. 1172 (1960).

In a study by the Special Subcommittee on State Taxation of Interstate Commerce of the House Judiciary Committee, released June 15, 1964, it was determined that there are substantial inequities in the existing tax structures of states among interstate companies and between interstate and intrastate companies. But as a whole interstate companies bore less than their fair share of the tax burden. See, COMMERCE CLEARING HOUSE, INTERSTATE INCOME LAW § 300-90 (1964).

[11] In the Northwestern decision the court would consider the tax valid only if it was apportioned to the income earned from activities within the state. Otherwise the foreign corporation would suffer a multiple tax burden in having more than 100% of its net income subject to a tax, Hellerstein, *An Academician's View of State Taxation of Interstate Commerce,* 16 TAX L. REV. 159 (1961). See also, General Motors Corporation v. Washington, 84 S.Ct. 1564 (1964). Most states that tax net income from interstate commerce have apportionment formulas, but the problem is that each state may have a different type of formula thereby not eliminating the danger of duplication,

The *Spector* decision and the *Northwestern-Stockham* decision remain signally important in determining the validity of state taxes particularly in the distinction drawn. In every situation a tax is burdensome.[14] But only under certain circumstances is it so onerous that the tax will be invalid as demonstrated in these two cases.

The *Northwestern-Stockham* decision in 1959 caused widespread antagonism in interstate business and an agitation for remedial legislation. Businessmen expressed indignation that a corporation whose only function in a state is the solicitation of orders should bear the liability of an income tax. Not many months later, Congress responded with P.L. 86-272[15] which is sometimes referred to as "stopgap" legislation.[16] It specifically exempts foreign corporations from state taxation of net income earned within the

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Cook, *supra* note 10, at 519. For a discussion of apportionment formulas see Cox, *The NCCUSL Uniform Apportionment Formula,* 42 Taxes 530 (1964). However, before a multiple tax burden can become an issue, the taxpayer must demonstrate that the formula used for apportionment caused the income of the foreign corporation to be subject to cumulative tax burdens. Until this was demonstrated, said the court in the Northwestern case, this question would not be decided. In the case of West Publishing Co. v. McColgan, 27 *supra* note 10, at 710, 166 P.2d at 864, the court observed: "Taxation in one state is not an immunization against taxation in other states."

[12] The pertinent part of Section 1 of the 14th Amendment to the United States Constitution reads ". . . nor shall any State deprive any person of life, liberty, or property, without due process of law." Taxpayers in various cases have raised the objection that the State in question is depriving them of "due process" by taxing the income they earned from interstate commerce. These interstate businesses feel that there is not a sufficient relationship or "nexus" between the business and the state to justify the tax. The courts have decided that the final determination of due process lies with them and not the Congress as evidenced in State Board of Insurance v. Todd Shipyards Corp., 370 U.S. 451, 457 (1962) where the court said "Congress of course does not have the final say as to what constitutes due process under the 14th Amendment." Further, the courts in their determination of due process have generally held that the states' protection of interstate business in the market is sufficient to justify a tax. See Cook, *supra* note 10, at 514, 516; West Publishing Co. v. McColgan, 27 Cal. 2d 705, 166 P.2d 861 (1946); *aff'd per curiam,* 328 U.S. 823 (1946); International Shoe Co. v. State of Washington, 326 U.S. 310 (1945); International Shoe Co. v. Fontenot, 236 La. 279, 107 So. 2d 640 (1958); *cert. den.,* 358 U.S. 984 (1959); Underwood Typewriter Co. v. Chamberlin, 254 U.S. 113 (1920).

[13] Northwestern States Portland Cement Company v. Minnesota, 358 U.S. 450, 452 (1959).

[14] Smith, Kline & French Laboratories v. State Tax Commission, 5 State Tax Cas. § 250-116 (1964).

[15] Imposition of Net Income Tax, 15 U.S.C. § 381 (Supp. V, 1963), hereinafter referred to as P.L. 86-272.

[16] See INTERSTATE INCOME LAW *op. cit. supra* note 10, at 11. Congress only intended this law to be a temporary solution and called for a study to be made which was recently released in part. The study merely shows the results of surveys and questionnaires sent to a sample of businessmen. There were no recommendations in this study. The recommendations are expected later.

taxing state if its only activities within the state are the solicitation of orders for sales of tangible personal property.[17] Such orders must be accepted or rejected outside the taxing state. If approved, the orders may be filled by shipment from a point outside the state.[18]

A law negating so many United States Supreme Court rulings is certainly to be tested in the courts. Its first significant examination is the *International Shoe Company* case.

In levying a tax on the net income of International Shoe Company after the passage of P.L. 86-272, the law was clearly violated. Cocreham was fully cognizant of this fact but he intended to test the constitutionality of the statute. He questions the authority of Congress in passing P.L. 86-272 on the basis of its plenary power to regulate interstate commerce. The crux of his objection is based on prior decisions holding a state tax on net income not oppressive to interstate commerce since it is exacted only after interstate transactions have terminated. The Collector contends, therefore, that P.L. 86-272 is unjustifiably restricting certain fundamental, implicit rights of the states reserved to them by the tenth amendment of the Federal Constitution.[19] Counsel for one of the amici curiae further asserts that Congress has forfeited its right to legislate since it has not done so for over one hundred and seventy years. Congress is bound by the

[17] There have been many complaints by critics of this statute that the exemptions are too arbitrary and the important legal terms are not defined clearly. It is felt by these people that too many interstate businesses would change their activities in the state to meet the exemptions in P.L. 86-272 and thus avoid state tax liability. See Roland, *Public Law 86-272 Regulation or Raid,* 46 VA. L. REV. 1172, 1180 (1960). See also Minority Report, U.S. CODE CONG. & AD. NEWS, 86th Congress, 1st Sess., p. 2556, (1959).

[18] The pertinent provisions of this statute (Title I, Section 101):

"Sec. 101. Imposition of minimum standards. (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after [September 14, 1959], a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following: (1) The solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)."

[19] Two provisions of the United States Constitution are applicable here. First, art. I, § 10 prohibits the states from taxing exports; and second, the tenth amendment provides that: "the powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States. . . ." It is contended in International Shoe Co. v. Cocreham, 164 So. 2d 314 (La. 1964) by the defendant that since the States gave up the right to tax exports they impliedly reserved the right to tax all other areas not specifically delegated to the United States by virtue of the tenth amendment.

decisions of the Supreme Court and it cannot now pursue a different course from that sanctioned by that court.

International Shoe Company, on the contrary, argues that Congress by virtue of its plenary power can determine if state taxation is an undue burden or affects the free flow of trade between the states. If Congress decides it is a hindrance, it can suppress such taxation by passing appropriate legislation. Further under the Supremacy Clause,[20] all state legislation conflicting with federal legislation must be struck down.

The Louisiana Supreme Court recognizes the national ramifications of this case and therefore decides to go beyond the Supremacy Clause grounds and deal with the primary issue of the interstate commerce question. Justice McCaleb, in the opinion of the court, agrees with the prior rulings of the United States Supreme Court holding the tax on income from interstate commerce to be a valid state tax.[21] But Justice McCaleb further points out that the circumstances were different when these decisions were rendered. Congress had not yet manifested its will by legislating on the subject of state taxation of interstate commerce, and these decisions recognize this vital point.[22] As to whether or not Congress has the essential right to speak out, the court incisively states:

> Of the many matters presented to the Supreme Court concerning the unconstitutionality of state taxation of activities in interstate commerce, there is none in which the court has ever suggested that Congress has not retained plenary power to regulate the activity by prohibiting the imposition of a state tax when it determines such tax to unduly burden the free flow of such commerce. Indeed, these cases are authority for holding that the Supreme Court has been able to act negatively only because Congress has not heretofore spoken.[23]

Further on in the opinion the court writes:

> . . . when Congress speaks, the right of the judiciary to determine whether the burden is undue or not is foreclosed.[24]

[20] U.S. CONST. art. VI, clause 2, "This Constitution and the Laws of the United States, which shall be made in pursuance thereof . . . shall be the supreme law of the land; and the judges in every State shall be bound thereby. . . ."

[21] The court quoted Roland, *op. cit. supra* note 10, at 1184, where the author declares "There is no real basis to dispute that a tax upon net income derived from interstate commerce is not a tax upon such commerce."

[22] See Transportation Co. v. Parkersburg, 107 U.S. 691 (1882), where the Court said that Congress and not the Judicial branch has the power to regulate interstate commerce. In Michigan-Wisconsin Pipe Line Co. v. Calvert, 347 U.S. 157, 165 (1953), the court said that interstate business is not totally immune from taxation ". . . absent action by Congress." In the *Northwestern-Stockham* decision, *supra* note 8, the court again appears anxious to qualify its decision of allowing the state tax, ". . . the Congress meanwhile not having undertaken to regulate taxation of it" meaning, of course, commerce. See also Freeman v. Hewit, 329 U.S. 249 (1946); United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944); and Northwest Airlines v. Minnesota, 322 U.S. 292 at 303, 304 (1943).

[23] 164 So. 2d at 319.

[24] *Id.* at 320.

Because Congress failed to legislate until the passage of P.L. 86-272 does not signify forfeiture of the right to do so ". . . for once the power is given it continues as a legislative power and may be exerted at any time . . . Nor does the exertion of judicial power by negative action, . . . create an estoppel against subsequent contrary legislative action."[25]

Since Congress indubitably has the power to regulate interstate commerce it inevitably follows that it has, along with this power, the right to determine whether the burden of a state tax is unduly restrictive to interstate commerce. Upon so finding, Congress then has the inherent right to suppress it.[26] Based on this cogently reasoned opinion, the Louisiana Supreme Court upholds P.L. 86-272.[27]

Only one month later, the *Smith, Kline & French*[28] case was decided in the Oregon Tax Court. Here again, the constitutionality of P.L. 86-272 is assailed but in this decision the court concludes that the Federal Statute is unconstitutional. Mr. Justice Gunnar in his opinion points out that the subject matter of P.L. 86-272 is not interstate commerce. Net income from interstate commerce, he elucidates in his rationale, arises after the commercial transactions have ended and, therefore, is not interstate commerce per se. Therefore, P.L. 86-272, which limits the taxation of this net income, is not concerned with the subject of interstate commerce, but rather with the end results of such commerce. Perhaps then, the plenary power of Congress to regulate interstate commerce has reached a limit. If Congress attempts to surpass this boundary by prohibiting state taxation of interstate commerce its authority must terminate.[29]

[25] *Id.* at 321.

[26] The United States Supreme Court has in various cases allowed Congress the discretion as to what affects interstate commerce, and thus call for Congressional regulation. See Stafford v. Wallace, 258 U.S. 495 (1922); National Labor Relations Board v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1936). In South Carolina State Highway Department v. Barnwell Bros., 303 U.S. 177, 189 (1938), the Court observes that it is a Congressional function and not a Judicial function to determine what is a burden on interstate commerce and what would be appropriate regulation of such a burden even if such regulation required state and local interests to yield a good deal of power to national interests.

[27] In a recent decision P.L. 86-272 was also upheld. See Ciba Pharmaceutical Products, Inc. v. State Tax Commission, Cir. Ct. Cole County Mo., Nov. 28, 1962, *appeal filed* Mo. Sup. Ct. Feb. 3, 1963, 2 Mo. State Tax Rep. (CCH) § 200-384, summarized 2 Mo. State Tax Rep. (CCH) § 200-385.

[28] Smith, Kline & French Laboratories v. State Tax Commission, 5 State Tax Cases § 250-116 (Ore. Tax 1964).

[29] The Court in McGoldrick v. Berind-White Coal Mining Co., 309 U.S. 33, 46, 47 (1940) said that there were taxes that ". . . affect interstate commerce, which nevertheless fall short of the regulation of the commerce which the Constitution leaves to Congress."

Fear of destruction of state sovereignty[30] is the principal motivation in reaching this decision. According to Justice Gunnar, this catastrophe can result if Congress transgresses beyond the confines specifically delegated to it by the Constitution.[31] But his reasoning is faulty when he declares:

> If, as interstate commerce Congress can prohibit a state tax on net income derived from interstate commerce, then, Congress can prohibit all state taxation under its broad power to regulate intrastate affairs affecting interstate commerce.[32]

Justice Gunnar fails to realize that it is not the purpose of Congress in passing P.L. 86-272 to deprive the states of any revenue. It is designed to protect foreign corporations from inequities that have resulted from the variety of tax systems devised in the many states. This certainly does not indicate that Congress has as its objective further legislation that will completely destroy the states' power to tax.

It remains to be seen what direction this interesting controversy will take. With two such sharply conflicting opinions there is a compelling need for resolution and clarification in a higher forum. In addition Congress in its study of the problem, which is still in process, may decide to amend or completely replace P.L. 86-272 thus rendering the ultimate question moot. However, because of the courts' hesitance to interfere with the acknowledged plenary power of Congress to regulate interstate commerce, it is likely that this statute will remain in force unaltered.

Dennis Carlin

[30] Smith, Kline & French Laboratories v. State Tax Commission, 5 State Tax Cases ¶250-116 (Ore. Tax 1964), the Oregon Tax Court writes "Stripped of the power to tax, the Sovereignty of states is a hollow shell."

[31] Mr. Justice Gunnar also makes mention of Mr. Justice Frankfurter's words in Freeman v. Hewit, 329 U.S. 249 (1946), where he points out interstate commerce should be regulated but not at the expense of state sovereignity.

[32] Smith, Kline & French Laboratories v. State Tax Commission, 5 State Tax Cas. ¶250-116 (Ore. Tax 1964).

JURISDICTION—TORTS—APPLICATION OF "SINGLE ACT" STATUTE BY FORUM STATE WHEN ACTUAL DAMAGE OCCURRED IN SISTER STATE

Estwing Manufacturing Company, an Illinois corporation, manufactured hammers marked unbreakable and shipped them, f.o.b. Rockford, Illinois, to the defendant, Walker's Minerals, for subsequent resale. The dealer's purchases were made by mail order using Estwing's catalogue. Plaintiff's