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Constitutional Law—Business and Occupation Tax—Constitutionality

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CONSTITUTIONAL LAW

Business and Occupation Tax—Constitutionality. The Washington court denied the claim of General Motors[1] that the Washington Business and Occupation Tax[2] violated the due process and commerce clauses as applied to its interstate business of wholesaling new cars. The Tax Commission had determined that the activities of General Motors within the state subjected the corporation to this tax on its gross receipts.

The main appeal involved the activities of the Portland, Oregon "zone office,"[3] part of the Chevrolet, Pontiac and Oldsmobile divisions which were divided countrywide into "regions," "zones" and "districts." The Portland "zone office" supervised the activities of the "district managers," who contacted the retail dealers in Washington. These "district managers" combined promotional and employee training activities with their liason functions. They normally resided in the district, but never had an office. Although the "district manager" might advise the dealer about his purchase of cars, the orders for new cars were sent directly to the Portland "zone office," where they were accepted and filled, f.o.b. the factory.

The cross appeal by General Motors contested the taxation of sales allocated to the Seattle branch office of the Portland "zone office." This branch office performed expediting functions for the sales of Chevrolet in the northern counties of Washington. Only receipts from

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ington court in *Yiatchos* used state rather than federal law to protect the wife's interest. (To say that the prescription of federal fraud is *dictum*—see p. 117—is erroneous since it was necessary for the Court to spell out the reasons for remanding vice reversing and thus further necessary to describe what law controlled the "fraud exception.") Although the Note cogently argues for preservation of state law it fails to mention the federal interest in the bonds which is served by rejecting the "convenience theory." A more serious shortcoming however is the conceptual approach, *i.e.*, that the decision turned on the *wording* of the Treasury regulations (see in particular note 14, p. 116)—or that the court "relied" on *Wissner* to reach the result in *Free*. This of course fails to come to grips with the core of *Free*—the policy decision which the Supreme Court made: How *should* the regulations be construed?

[1] General Motors Corp. v. State Tax Comm'n, 160 Wash. Dec. 867, 376 P.2d 843 (1962). General Motors has appealed this case to the United States Supreme Court under the second clause of 28 U.S.C. § 1257 (1958). The court has not ruled on the appeal at this writing.

[2] RCW 82.04.220 Business and Occupation Tax Imposed. There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

[3] It is interesting to note that General Motors established a new "zone office" in Seattle after the taxing period involved. General Motors has paid the gross receipts tax on sales allocated to this office and has not contested its liability for them. 160 Wash. Dec. at 875, 376 P.2d at 848 (1962).

the sale of cars processed through this branch office were held constitutionally taxable by the trial court.

The state also levied a tax on the Parts Division of General Motors. This division operated a warehouse in Portland to supply parts to dealers. The orders for these parts also came directly from the dealers in Washington.

The state levied a gross receipts tax on these divisions on the theory that the activities of the "district managers" brought the business within the state. General Motors argued that this activity was not enough to give the state due process jurisdiction to levy the tax. Further, even if there was jurisdiction to tax, the gross recipts tax was invalid as a "direct burden" on interstate commerce.

Probably the first step in testing a state tax is to characterize it. Prior Washington cases have stated that the tax here involved is an "excise tax upon every person for the privilege of doing business in this state."[4] It is essential to note that the tax is levied on gross receipts, a kind of tax recognized as similar to a sales tax in its ultimate effect on interstate commerce.[5] Thus the constitutional principles applied to state sales taxes can serve as guides for analyzing the vulnerability of interstate commerce to a gross receipts tax.

The Washington court was quite elaborate in its argument that the state had due process jurisdiction to impose the tax. Preoccupation with due process seems to miss the primary issue. As Mr. Justice Rutledge has stated, "the great difficulty in allocating taxing power as a matter of due process between the state of origin and the state of market arises from the fact that each state, considered without reference to the other, always has a sufficiently substantial relation in fact and in tax benefit conferred to the interstate transaction to sustain an exertion of its taxing power, a fact not always recognized."[6]

It must be readily admitted, however, that some decisions of the

[4] Gwin, White & Prince, Inc. v. Henneford, 193 Wash. 451, 454, 75 P.2d 1017, 1018 (1938), *rev'd* 305 U.S. 434 (1939); Puget Sound Stevedoring v. State Tax Comm'n, 189 Wash. 131, 135, 63 P.2d 532, 533 (1937) *modified*, 302 U.S. 250 (1937). In *General Motors*, the court states that the tax "is imposed upon business activity within the state," *supra* note 1, at 882, 376 P.2d at 852. The Supreme Court normally adopts the characterizations given a state tax by the courts of that state. See, *e.g.*, Crew Levick Co. v. Pennsylvania, 245 U.S. 292 (1917).

[5] International Harvester Co. v. Dep't of Treasury, 322 U.S. 340 (1944); Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938). Hartman, *State Taxation of Corporate Income From a Multistate Business*, 13 VAND. L. REV. 21, 102 (1959); Comment, 54 COLUM. L. REV. 261, 267 (1954); Comment, 75 HARV. L. REV. 953, 1022 (1962). *But see* Norton Co. v. Dep't of Revenue, 340 U.S. 534, 537, (1951) (distinguishing a sales tax as falling on the buyer and a gross receipts tax as falling on the vendor).

[6] International Harvester Co. v. Dep't of Treasury, 322 U.S. 340, 357 (1944) (concurring opinion).

United States Supreme Court have been based entirely upon due process concepts. *McLeod v. Dilworth Co.*[7] is a notable example. The court denied Arkansas the right to impose a sales tax on transactions solicited by traveling salesmen, where acceptance and delivery were allocated to the home office of the corporation in Tennessee. The divided court held that "for Arkansas to impose a tax on such transactions would be to project its powers beyond its boundaries and to tax an interstate transaction."[8] The United States Supreme Court could reverse the *General Motors* decision simply on its similarity to *McLeod v. Dilworth Co.* But analysis under the commerce clause would seem preferable since the Court would then have to determine the effect of the tax upon interstate commerce.

There are at least two[9] current theories on the perplexing question of how much the commerce clause[10] protects interstate transactions from state taxation. Regardless of which theory predominates, the United States Supreme Court will probably reverse the Washington decision allowing taxation of the gross receipts on General Motors' interstate transactions. An exception may be allowed for the sales expedited through the Seattle branch office.

The classical theory regards a gross receipts tax *on* an interstate transaction as a constitutionally prohibited "direct burden" on interstate commerce.[11] But the court has allowed gross receipts taxes where

[7] 322 U.S. 327 (1944).

[8] *Id.* at 330.

[9] Mr. Justice Black has advocated a third theory that has not been accepted by the court. He maintains that only state taxes which discriminate against interstate commerce may be struck down under the commerce clause. See his dissent in Adams Mfg. Co. v. Storen, 304 U.S. 307, 327 (1938). For a brief and clear discussion of the three differing views of "undue burden" see Hellerstein, *The Power of Congress to Restrict State Taxation of Interstate Commerce*, 12 J. TAXATION 302, 303 (1960).

[10] U.S. CONST. art. 1, § 8, cl. 3.

[11] Philadelphia & So. S.S. Co. v. Pennsylvania, 122 U.S. 326 (1887) reasons that since a state could not tax the transportation of an interstate common carrier, it could not tax the gross receipts as this would also be a regulation of interstate commerce. Galveston, H. & S.A. Ry. v. Texas, 210 U.S. 217 (1908) applied the same reasoning to invalidate a gross receipts tax on a domestic railroad. Crew Levick Co. v. Pennsylvania, 245 U.S. 292 (1917) invalidated a tax on gross receipts of sales made in the state to foreign customers as a tax *on* such commerce and therefore a regulation of that commerce. Puget Sound Stevedoring Co. v. State Tax Comm'n, 302 U.S. 250 (1937) struck down the Washington gross receipts tax on the business of longshoring as a tax *on* interstate commerce but allowed the tax on the receipts of the firm from supplying longshoremen to ships since this was a "local business." Joseph v. Carter & Weeks Stevedoring Co., 330 U.S. 422 (1947) followed the *Puget Sound* case. For an excellent discussion of the evolution of the "indirect-direct burden" theory see Hartman, *State Taxation of Interstate Commerce: A Survey and An Appraisal*, 46 VA. L. REV. 1051, 1065 (1960). Professor Hartman traces the *"direct burden"* theory to Mr. Chief Justice Marshall in Brown v. Maryland, 25 U.S. (12 Wheat.) 419 (1827) where the court struck down a state license fee on the business of importing as a prohibited duty on imports and an attempted regulation of the commerce. The "indirect burden" part of the theory is related to the "Cooley Compromise" made in Cooley v.

the *subject* of the tax is "localized" to the taxing state[12] or where the tax is imposed "in lieu" of local property taxes.[13] In these situations "gross receipts" are only the *measure* of the taxes, which are allowed because they are only "indirect burdens" on interstate commerce. Thus, under the classical theory, a state can avoid the prohibition by making the *subject* of the tax "local," *i.e.*, by using interstate "gross proceeds" as a *measure* for the "local" tax.

If the court applies the classical test to the transactions in the *General Motors*, case, it will probably rule the tax invalid. Since these are definitely interstate contracts or sales, it appears that the tax is "on" interstate commerce since there are no incidents which can be classified as "local" to bring the tax within the "indirect burden" category. Perhaps the sales expedited through the Seattle office will be found to be "local." Otherwise the tax will fall as a "direct burden."

The other major commerce clause theory was introduced by Mr. Justice Stone in *Western Live Stock*[14] where he explained his view that interstate commerce should bear its cost of state protection, but that it should not be subjected to the risk of "cumulative burdens not imposed on local commerce." This theory played a dominant role in the *Berwind-White*[15] case, where a New York City sales tax was upheld as applied to the sale of Pennslyvania coal delivered by a New York branch office. While Mr. Justice Stone paid homage to the "indirect burdens" theory in the *Berwind-White* case, he relied on the concept of "multiple burdens."[16] Since both the sale and delivery had taken place

Board of Wardens, 53 U.S. (12 How.) 298 (1851), which allowed state regulation of certain local incidents of interstate commerce which do not require a uniform national rule. For a short summary agreeing with this analysis, see Hellerstein, *supra* note 9, at 302.

[12] Banker Bros. Co. v. Pennsylvania, 222 U.S. 210 (1911) allowed a gross receipts tax on a car dealer who sent customers' orders to an out-of-state manufacturer. The Court found sufficient local activity by the dealer to localize the sale within the state. Dep't of Treasury v. Wood Preserving Corp., 313 U.S. 62 (1941) allowed a gross receipts tax on an out-of-state buyer who immediately resold to another who in turn immediately shipped the goods out of state. The court held the sale was localized to the taxing state. *Accord*, International Harvester Co. v. Dep't of Treasury, 322 U.S. 340, (1944). For the facts see note 25 *infra*.

[13] Illinois Central R.R. v. Minnesota, 309 U.S. 157 (1940). Here the court upheld the application of a gross receipts tax on the business of renting railway cars used in the state "in lieu" of a property tax that could have been levied against the cars. In Railway Express Agency v. Virginia, 358 U.S. 434 (1959), the court upheld a "franchise tax" imposed on express companies "in lieu" of property taxes where the measure of the tax was gross receipts allocated to the state.

[14] Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938). Here the court upheld a state tax on the gross receipts from out-of-state purchasers of advertising space in a magazine that circulated in interstate commerce.

[15] McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940).

[16] It is important to note that Mr. Justice Stone refused to follow the old "indirect-local" rule that if goods are brought into the state under previous order they cannot be subject to the local sales tax. See Powell, *New Light on Gross Receipts Taxes,* 53

in New York, no other state could subject the transaction to a similar gross receipts tax. Thus there would be no risk of a double tax burden not borne by local business.

The Washington court discussed the "multiple burdens" test, but it seems to have missed the main point. General Motors argued[17] that the Washington statutory scheme operates to subject the corporation to multiple taxation not borne by local manufacturers. Washington manufacturers who also wholesale are given an exemption by the statute.[18] Since General Motors paid a manufacturing tax in Michigan, it suffered double taxation. The court correctly rejected this argument, stating that manufacturing and wholesaling are two different taxing subjects. But the court did not discuss the true "multiple burdens" danger, *i.e.*, possible double taxation of the same incident—the sale. The court agreed that the acceptance of the orders took place in Portland (and indicated that delivery also took place there). This concession, combined with the location of the "zone office" in Portland, gives Oregon an equal if not greater "right" to tax the sale of business measured by gross receipts. This is precisely the risk of "multiple burdens" that concerned Mr. Justice Stone in the *Western Live Stock* and *Berwind-White* cases. It appears that the United States Supreme Court could reverse the Washington court under the "multiple burdens" theory also.

It is difficult to predict which of the two current theories will predominate in the future. Just when the "multiple burdens" test was taking hold, the court handed down the famous *Freeman v. Hewit*[19] decision. This case held that Indiana could not assess the gross receipts of a sale of stock through the New York Stock Exchange. The importance of the case lies in the return to the "direct burden" test. Mr. Justice Frankfurter described the gross receipts tax as "a direct imposition on that very freedom of commercial flow which for more than a hundred and fifty years has been the ward of the Commerce Clause."[20] The protest to the *Freeman* case was very loud in some quarters:

HARV. L. REV. 909, 911, 916 (1940) for an excellent discussion of the evolution of the old rule in Bowman v. Continental Oil Co., 256 U.S. 642 (1921) and Sonneborn Bros. v. Cureton, 262 U.S. 506 (1923).

Other cases using the "multiple burdens" test include Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434 (1939) and Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938). Lip service was paid to the theory in Central Greyhound Lines, Inc. v. Mealey, 334 U.S. 653 (1948) and Joseph v. Carter & Weeks Stevedoring Co., 330 U.S. 422 (1947).

[17] Brief for Respondent, p. 92.

[18] RCW 82.04.440.

[19] 329 U.S. 249 (1946).

[20] *Id.* at 256.

> With all the modesty of omnipotence, the *Freeman* Court jettisoned, as mere "fashions" in judicial writing, the "multiple burdens" doctrine, which had been painstakingly and systematically developed, especially by Justices Stone and Rutledge, in an effort to require interstate commerce to pay its way....
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> The *Freeman v. Hewit* test of constitutionality is essentially a throw back to the discarded pre-Stone Age "direct-indirect" burden test....[21]

While the same result would have been reached under the "multiple burdens" test, the *Freeman* decision refused to follow this newer theory.

Another important decision appearing to follow the "direct burdens" test is the *Norton*[22] case. Illinois levied a gross receipts tax on a Massachusetts corporation operating a retail store in Illinois. The taxes on (1) sales across the counter were not contested. The court upheld the tax on (2) orders routed through the local retail store for acceptance in Massachusetts. The court placed the burden on the corporation to show that these transactions were "dissociated from the local business and interstate in nature."[23] (3) Orders sent directly to the home office by Illinois customers were held to be "clearly interstate in character,"[24] precluding taxation by Illinois.

The *Norton* case has presented a problem to the state courts because of its apparent stress on the presence of a "local office." The Washington court rejected the argument that there must be an office in the taxing state. This appears to be a correct interpretation of *Norton* which emphasized that the Norton Company was doing a *local retail business* in the taxing state (as contrasted to mere solicitation). Thus the test is not whether there is a local office, but whether there is a local business. If the interstate corporation is maintaining a local business, then under *Norton,* it must segregate its local and interstate business to avoid taxation on all the business.

The quandary in the *General Motors* case is whether the transactions can be allocated to a "local business" or whether they are merely "solicitations" falling under the category of "clearly interstate" trans-

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[21] Hartman, *State Taxation of Interstate Commerce: A Survey and An Appraisal,* 46 Va. L. Rev. 1051, 1083 (1960). See Brown, *The Open Economy: Justice Frankfurter and the Position of the Judiciary,* 67 Yale L.J. 219 (1957) where the author traces Mr. Justice Frankfurter's return to "direct burdens" through the theory that the commerce clause created an "area of free trade among the several states." This expression is found in McLeod v. Dilworth, 322 U.S. 327, 330 (1944) and is further developed in Freeman v. Hewit, 329 U.S. 349 (1946).

[22] Norton Co. v. Department of Revenue, 340 U.S. 534 (1951).

[23] *Id.* at 537.

[24] *Id.* at 539.

actions. The Washington court classified the activities of the "district managers" as "local business." Under *Norton,* then, General Motors could avoid taxation only by showing that the transactions were disassociated from the activity of the "district managers." But it can be argued that the "district managers" were merely soliciting "clearly interstate" transactions which would fall within the third category of *Norton.* The "multiple burdens" test would avoid the dilemma since it minimizes the importance of jurisdictional characterizations like "local office" and "local business."

The "multiple burdens" and "direct burdens" theories both have been relied upon in recent decisions of the United States Supreme Court,[25] a fact which indicates that the Court has not yet settled on a consistent theory. The *General Motors* case could provide the court with an opportunity to end the off-tune duet played by these two theories over the last twenty years.

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[25] Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1958), Williams v. Stockham Valve & Fittings, Inc., 358 U.S. 450 (1959) upheld apportioned state net income tax on business doing strictly interstate business. While both theories were mentioned, the decision is primarily grounded on the fact that apportionment precludes multiple burdens. See generally, Hartman, *supra* note 5, at 84, 96; Hellerstein, *supra* note 9, at 302. It should be noted that Mr. Justice Frankfurter dissented in this decision, advocating again the theory that the policy of the commerce clause was to create a "free trade territory." Another striking feature of this case was the rapidity with which it was restricted by Congress. The new legislation, 15 U.S.C.A. § 381 (Supp. 1961), passed under the commerce clause power, prohibited the states from imposing net income taxes on interstate business that merely sent solicitors into the taxing jurisdiction with acceptance and delivery being made outside. Congress could also remedy part of the confusion in the area of gross income and sales taxes by exercising its power in this area.

A recent per curiam decision in State Tax Comm'n v. Pacific States Cast Iron Pipe Co., 83 Sup. Ct. 925 (1963) reversed the Utah supreme court on the authority of International Harvester Co. v. Department of Treasury, 322 U.S. 340 (1944). In the latter case the court upheld the application of the Indiana gross income tax to the following sales of a foreign corporation which had plants and retail stores in Indiana: 1) sales made by out-of-state branches to customers solicited in Indiana who took delivery in Indiana; 2) sales by Indiana branches to out-of-state buyers who took delivery in Indiana, and then transported the goods to another state ; 3) sales by an Indiana branch to Indiana buyers who took delivery outside the state. These taxes were upheld because the transactions were all sufficiently local to separate them from the interstate commerce. The *Pacific States* case involved the application of a sales tax on a foreign corporation selling material at its in-state plant where the title passed to the buyer who was shipping the goods out of state. The Utah court held that the interstate shipment precluded taxation. The United States Supreme Court reversed, allowing the tax because of the similarity to the second kind of transaction in *International Harvester,* as both the sale and delivery were made within the state. While the *Pacific States* per curiam opinion is based on a decision using the "local" test, this does not indicate that the court has abandoned the "multiple burdens" test. We must await a fuller consideration by the court.