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Taxation--A New Era in Taxing Interstate Income

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Having concluded that section 315 conferred immunity, the majority held that state libel laws have been pre-empted insofar as they might conflict with that immunity:

> We have not hesitated to abrogate state law where satisfied that its enforcement would stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. Here petitioner is asking us to attribute to section 315 a meaning which would either frustrate the underlying purposes for which it was enacted, or alternatively impose unreasonable burdens on the parties governed by that legislation.[16]

It is upon the issue of pre-emption that Mr. Justice Frankfurter most strongly dissented. He argued that Congress has not expressly conferred immunity upon broadcasters under section 315, and that in the absence of a clear pronouncement, there is not sufficient conflict between state and federal law to warrant the abrogation of state libel laws in this area.

The obvious conflict which results when both the federal and state governments attempt to regulate identical subjects does not manifest itself here;[17] but, it is certainly an example of state law interfering with the accomplishment of valid Congressional objectives.[18] That the power over interstate commerce includes the right to regulate broadcasting is well established.[19] That Congress, in the exercise of that power, could grant immunity to broadcasters is not denied. The clear conflict between state libel laws and the policy of section 315 necessitated a determination that the libel laws had been pre-empted. In making this determination, the Court has acted reasonably in view of the legislative history and the clearly announced purpose of section 315.

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TAXATION — A NEW ERA IN TAXING INTERSTATE INCOME

Northwestern States Portland Cement Company v. State of Minnesota came to the Supreme Court of the United States[1] on appeal from the Supreme Court of Minnesota,[2] which court had upheld the assessment by the State of Minnesota of income taxes for the years 1933-1948 against appellant, an Iowa corporation engaged in the manufacture and sale of cement, with its plant in Mason City, Iowa.[3]

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16. 360 U.S. 525, 535 (1959).

17. For the classic example of this type of conflict, see Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824).

18. See Minnesota Rate Cases, 230 U.S. 352 (1913).

19. National Broadcasting Co. v. United States, 319 U.S. 190 (1943); Federal Radio Commission v. Nelson, 289 U.S. 266 (1933).

Appellant's business in Minnesota consisted of the regular and systematic solicitation of orders for the sale of its products, each order being subject to acceptance, filling, and delivery from the plant in Mason City. Appellant leased a sales office in Minneapolis, Minnesota, which was under the supervision of a manager who performed sales functions. A salesman and a secretary also occupied the three-room office. Two additional salesmen used it as a clearing house. No bank account was kept in Minnesota by appellant, no real estate was owned there, nor was any merchandise warehoused there. Further, all sales were made on a delivered price basis from appellant's plant in Mason City, and all orders taken in Minnesota were transmitted daily to Mason City for approval and acknowledgement, which was forwarded directly to the purchaser.

Because no income tax returns were filed with the state by the appellant, assessments, aggregating some $102,000, were made by the commissioner of taxation. The Supreme Court of the United States said, in affirming this assessment:

> . . . net income from *exclusively* interstate operations of a foreign corporation may be subjected to state taxation, provided the levy is not discriminatory and is properly apportioned to local activities within the taxing state forming *sufficient nexus* to support the same.[4] (Emphasis added.)

Mr. Justice Clark, who delivered the opinion of the Court, described the setting for this momentous decision as one which has grown up because of Congress' failure to regulate taxation of interstate commerce and because of the states' persistent desire to get some measure of return for the benefits they have afforded such commerce. Further, he noted that the judicial application of constitutional principles to specific state statutes in this area allowed much room for controversy, and that this Court alone has handed down some three hundred opinions on the subject.

The Court, in the majority opinion, after an examination of several of the earlier cases on the particular subject presented, came to the conclusion that it has consistently upheld state net income taxes of general application which were applied so as to reach that portion of the profits of interstate business enterprises fairly allocable to activities within the state's borders, and that they were doing no more

1. 358 U.S. 450 (1959), decided with *Williams v. Stockham Valves & Fittings, Inc.*, on certiorari from the Supreme Court of Georgia, 213 Ga. 713, 101 S.E.2d 197 (1957), because of the similiarity of facts and issues involved.

2. 250 Minn. 32, 84 N.W.2d 373 (1957).

3. This tax was levied under section 290.03 of the Minnesota statutes, which imposes an annual tax upon the taxable net income of residents and non-residents alike. One of the four classes taxed is that of "domestic and foreign corporations . . . whose business within this State during the taxable year consists *exclusively* of foreign commerce, interstate commerce, or both." (Emphasis added.)

4. 358 U.S. 450, 452 (1959).

than this in the case before them. In order to more fully understand the decision of the Court, it is necessary to briefly examine some of these earlier cases relied upon by the majority for support of its decision.

The decision in *Peck & Company v. Lowe*[5] was said to "point the way" to the conclusion reached in the *Northwestern* case. In the *Lowe* case the plaintiff was a domestic corporation engaged in buying goods in several states, shipping them to foreign countries, and there selling them. A net income tax was levied by the state of incorporation on plaintiff's net income. The Court held that the tax was not laid on articles in the course of exportation, which would have been a violation of article 1, section 9 of the United States Constitution,[6] but that it was levied after exportation and, at most, effected exportation only indirectly and remotely. By analogy, therefore, it was felt that a state tax on net income derived from interstate commerce was not a tax on interstate commerce itself.

In both *United States Glue Company v. Town of Oak Creek*[7] and *West Publishing Company v. McColgan*,[8] the taxpayers were corporations engaged primarily in selling their products in interstate commerce. The question presented in the *Glue Company* case was whether the general income tax upon the gains and profits of domestic corporations levied by the State of Wisconsin might include in its computation net income derived from the transactions in interstate commerce, without contravening the commerce clause of the constitution.[9] A somewhat different question was presented in the *West Publishing Company* case. There the tax was not imposed by the state of incorporation as in the *Glue Company* case, but rather by one of the states in which interstate sales were made and the question was, therefore, whether such a state could impose a tax on the net income derived from these interstate sales. Both of these questions were affirmatively answered by the Court.

In the *Glue Company* case the Court distinguished between a direct levy, which placed a burden on interstate commerce, and a charge by way of net income derived from profits from interstate commerce; it said that the latter does not have a direct effect on interstate commerce, and that such a tax is but a method of distributing the costs of governmental services. The majority opinion in the *Northwestern* case said, in referring to the *Glue Company* case and other cases

5. 247 U.S. 165 (1918).

6. U.S. CONST. art. 1, § 9 says: "No Tax or Duty shall be laid on Articles exported from any State."

7. 247 U.S. 321 (1918).

8. 328 U.S. 823 (1946).

9. The taxes which were in controversy here were: (1) on income from sales to customers outside the state, the goods having been delivered from the taxpayer's factory, and (2) on income from sales to customers outside the state, the sales having been made by, and goods shipped from, the taxpayer's branches in other states.

cited,[10] that these cases stand for the doctrine that the entire net income of a corporation derived from interstate, as well as intrastate, activities may be apportioned among the states for tax purposes by formuli utilizing intrastate aspects of interstate affairs.

According to the majority opinion in the *Northwestern* case, any doubt as to their position was entirely dispelled in the *West Publishing Company* case, for there it was recognized that income from purely interstate operations may be taxed. Further, the majority said, the fact that office space was given West's solicitors by attorneys, in exchange for use of books that they had on hand for their sales activities, was a mere triviality, and this decision was not based upon such trivial detail.

In their dissenting opinions, Mr. Justice Whittaker and Mr. Justice Frankfurter refuted the contention that the cases relied upon by the Court supported its holding. They felt that in no case prior to this decision was there a total absence of activities within the taxing state severable from the process which constitutes interstate commerce, as there was in the present case.[11] Therefore, they said this decision cannot rest upon these earlier cases but must, if upheld, rest upon a new doctrine. This new ground is the state's power to tax *exclusively* interstate commerce, which, the minority felt, was in direct violation of the Constitution and, therefore, could not be upheld.

Conclusion

On September 14, 1959, the President signed into law a bill[12] limiting the Supreme Court's ruling in the *Northwestern* case. The "Interstate Income Law," as it is called, limits the states' power to tax income derived from interstate commerce when only nominal activities are carried on within the state.[13] The passage of this law, however, has not ended the controversy. One state has already said that it will contest the new law as being unconstitutional at the earliest op-

10. It should be noted that the statute involved, Deering's Gen. Laws, act 8494a, § 3, contained this statement: "Income from sources within this State includes income from tangible or intangible property or having a situs in this State and income from any *activities* carried on in this State, regardless of whether carried on in intrastate, interstate or foreign commerce." (Emphasis added.)

11. An example of the dissents' reasoning is Mr. Justice Whittaker's comment on the *West Publishing Company* case, "that the findings established the usual criteria which this court has consistently held to constitute the doing of intrastate commerce. California determined and taxed only the amount of that *intrastate* commerce. *It did not tax any interstate commerce.*" 358 U.S. at 468. (Emphasis added.)

12. Senate 2524, Public Law 86-272, 86th Cong., 1st Sess., Sept. 14, 1959.

13. The act (Senate 2524) says that no state shall have the power to impose a net income tax on the income derived within such state from interstate commerce if the only business activity within such state is: "(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. . . ."

portunity,[14] and others have said that the bill will have no effect on the administration of its corporate net income taxes.[15] However, at this date the law remains in effect, and it is, therefore, necessary to evaluate the Supreme Court's decision in the light of the present law.

Certain things seem clear. First, those states that do not at the present time have corporate income taxes[16] will not want to be left behind; consequently they will probably enact appropriate legislation at the earliest possible time. Second, those states which already have such a tax — there are thirty such states — will change their tax provisions to fit the present situation. This will mean that instead of placing a tax on corporations "engaging in business," they will place a tax on all corporations *deriving* any income from sources within the state. And third, virtually all interstate business will be subject to a properly drawn tax. Such a tax is one that is stated to be based upon income derived from sources within the state, where there is a "sufficient nexus," or connection, in the state to support the tax. The crux of the matter then becomes clear: what will constitute a "sufficient nexus"?

Certainly, under the new federal law mere solicitation of orders will not be a "sufficient nexus" to allow the state to impose an income tax on corporations engaged in interstate commerce; some further activity will be needed. Would the using of office space and the advertising of those offices as the company's local address, as in the *West Publishing Company* case, be enough today? Will maintaining incidental motor terminals by a trucking company engaged exclusively in interstate commerce, as in *Spector Motor Service, Incorporated v. O'Connor,*[17] allow the state to impose a properly drawn tax on the income derived from this activity? What about advertising alone; will that be a sufficient connection to impose such a tax?[18] These and many similar situations will call for further court determinations.[19]

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14. The Collector of Revenue for the State of Louisiana has said that that state will challenge the constitutionality of this law at the first opportunity. 22 CORP. J. 283 (1960). Louisiana is the appropriate state to make such a move, since it was the United States Supreme Court's denial of certiorari in two cases — Brown-Forman Distillers Corp. v. Collector of Revenue, 359 U.S. 28 (1959), and International Shoe Co. v. Fontenot, 359 U.S. 984 (1959) — which left in effect decisions of the Louisiana Supreme Court that mere merchandising of orders was enough to make a corporation subject to the state's taxing jurisdiction.

15. The Utah Tax Commission, in commenting on the new federal law (see CCH, Vol. 20, No. 38, State Tax Review 1 [November 21, 1959]), said that the primary purpose of its new corporation income tax law was to impose the tax on certain airline companies and telephone and telegraph companies whose activities are purely interstate in nature, and which companies all have officers and many employees in the state. Therefore, it felt that the state would not be prohibited from imposing the tax.

16. Those states which do not have a corporate income tax are: Florida, *Ohio,* South Dakota, Texas, Washington, West Virginia, and Wyoming.

17. 340 U.S. 602 (1951).

18. It would seem that under the recent Congressional enactment such a tax would be prohibited.

19. Already interesting developments are taking place. The Supreme Court of the United