Ch. IX. Constitutional Issues in State Tax

A. Rethink the Subject

1. Needless Confusion

Litigious state taxpayers routinely claim violations of the Constitution of the United States. State tax practitioners often say that any state tax dispute worth its salt has a federal constitutional issue. Therefore state tax controversies are on an entirely different footing than federal tax controversies, which seldom involve the Constitution (despite the eight chapters above).

And yet few provisions of the Constitution directly address the subject of state taxation; those that do are extremely vague or address subjects rarely of interest (e.g., tonnage and exports). Nevertheless, railroads and other early multistate business litigants against state and local taxes routinely claimed protection under the Equal Protection, Due Process and Commerce Clauses, at a minimum, plus several other even less likely provisions. As a result, the Supreme Court has effectively made up the constitutional limits on state taxes in hundreds of opinions over two centuries. Anyone concerned about the Supreme Court being too activist might be troubled by its state tax opinions.

That over-abundance of Supreme Court opinions is dwarfed by the much larger set of state court opinions. But there are not many lower federal court opinions because state tax litigants usually could not get into lower federal courts and so most of the cases came up to the Supreme Court of the United States directly from state supreme courts.
It seems that every railroad, ship line, bus line, telegraph company and oil company disputed every state and local tax touching them in the post-Civil War period, through the middle of the 20th Century. They frequently lost, sometimes because state courts tended to be very protective of local revenues when attacked by nonresident nontaxpayers. And the state courts also may have been insensitive to federal constitutional limits on state taxation, particularly when the U.S. Supreme Court was making them up and changing them as it went along.

This combination of factors produced an amazing volume of Supreme Court opinions on state taxation, because up to 1988 the Supreme Court was obliged to hear appeals as of right from state supreme courts that upheld their state and local taxes against federal constitutional objections. In addition state taxpayers were not precluded by statute from pursuing state tax claims in federal trial courts until 1937. As a result of the appeal right and exercise of equity jurisdiction, many constitutional disputes over state tax laws were eligible for review by the Supreme Court and it decided hundreds of such cases. Not only are the rulings numerous, but the Court’s opinions often spend a lot of words batting down spurious constitutional claims. The resulting welter of Supreme Court writings still did not make clear what the law was (or is).

This chapter continues the general approach of this book that the opinions that matter most on state tax constitutional issues are those of the Supreme Court, both for the usual reasons—they are authoritative and ubiquitous, and all lower courts must work from them—and because the Supreme Court has mostly made the law up in this field. That limitation makes it easier to attempt to restate the constitutional law of state taxation in hornbook fashion, because the numerous state court opinions can be ignored (a luxury not enjoyed by general state tax law treatises).

Also the hornbook approach does not try to wrestle a synthesis out of every set of opinions addressing a subject. Sometimes there is no synthesis. Sometimes a synthesis would be a guess or an argument. Instead, the aim is to report what the Supreme Court has held; a grouping of decisions does not always fit together as neatly as a law review article would hope to show. Sometimes this Chapter

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1 See Eugene Stern and Robert L. Gressman, Supreme Court Practice: Jurisdiction, Procedure, Arguing and Briefing Techniques, Forms, Statutes, Rules for Practice in the Supreme Court of the United States, sec. 3-4 (3d ed.) (for prior jurisdictional rule); 28 U.S.C. § 1257 now provides only certiorari jurisdiction to review state court rulings. In contrast, the United States had a right of appeal to the Supreme Court from a lower federal court ruling that a federal statute, including a tax provision was unconstitutional. Stern and Gressman, at sec. 2.5. The first case attacking a state tax on constitutional grounds proved the value of giving the losing taxpayer an absolute right to appeal to the Supreme Court, because the Maryland courts saw nothing wrong with taxing the Bank of the United States. McCulloch v. Maryland, 17 U.S. 316 (1819). The early jurisdictional statute provided for a writ of error when the state statute was upheld and a writ of certiorari when it was voided under the constitution. See Dahnke-Walker Milling Co. v. Bondurant, 257 U.S. 282 (1921).

2 The Tax Injunction Act was adopted at 50 Stat. 738 (1937).
does attempt a synthesis, but not in all cases, else it would be the length of 200 law review articles.

The principal stumbling block, even with this constricted approach to constitutional state tax issues, is that the Court’s views have shifted over time on several key issues, to a far greater degree than the Court’s usual pace of departing from stare decisis. These shifts include (1) away from a formalistic refusal to allow any tax on “interstate commerce,” which also meant deciding when interstate commerce “ended”; (2) away from the view that states could charge foreign corporations any amount for admission to doing business in the state; (3) away from finding indirect taxation of the federal and state governments through taxing private parties claiming intergovernmental immunity; (4) away from approving flat taxes on persons engaged in interstate commerce, such as flat vehicle taxes; and (5) the Court has adjusted its views on when imports and exports are deemed to be taxed.

As a result many of the Court’s earlier opinions on state taxation are obsolete, making research in the area treacherous. Many writers attempt to deal with the layers of precedent by recounting the history of every current holding, back through all of its predecessors. Although fascinating, that method can be an impediment to knowing what the law is.

Writers have mostly addressed state tax constitutional issues as issues of interstate commerce because the majority of the Supreme Court’s state tax opinions have been sought by interstate businesses not wanting to pay taxes. Also writers have tended to categorize the issues in terms of the common state taxes and the particular attacks on them. Thomas M. Cooley popularized the notion in the 19th Century that constitutions exist to limit and not grant state powers, in taxation and otherwise. His Constitutional Limitations treatise identified the two subjects to be protected by constitutions: persons and property. Cooley observed that the assumed territorial limits on taxation could be satisfied if either the person or the property were in the state, and identified the vexing ambiguity of locating personal property with its owner or where it was found. However, increasingly state taxes were triggered by transactions rather than persons or property.

These differing approaches of commentators illustrate the difficulty of organizing the subject. State taxation is not mostly about the Commerce Clause. It should not be viewed as a scramble of states to escape many limitations. It may

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3 An interesting source for annotations explaining the history of the constitutional tax provisions is Constitution Annotated in the Library of Congress’ online Constitution section. See also Walter Nagel and Timothy B. Dyk, Leading U.S. Supreme Court State Tax Cases (BNA 1995).

4 E.g., Paul J. Hartman, State Taxation of Interstate Commerce (1953).

5 E.g., Jerome R. Hellerstein, State and Local Taxation: Cases and Materials (1952) (see table of contents and introduction).

6 Thomas M. Cooley, Treatise on the Constitutional Limitations Which Rest upon the Legislative Power of the States of the American Union (5th ed.).

7 Thomas M. Cooley, Treatise on the Law of Taxation, including the Law of Local Assessments 56 (2d ed.).
be triggered by transactions, but the transactions do not pay tax, people and property do. Focusing on categories of tax types like gross receipts taxes and franchise taxes is the wrong focus, as those categories do not relate to persons, property and transactions or the underlying constitutional limitations.

The constitutional limits on state taxation should not be so hard to understand. And yet state tax experts tend to want to lead you through recitations of Supreme Court opinions from decades and sometimes centuries ago, and explain where the Court went wrong, and how this nuance means that, and what the law should be, as stated in some mid-level state appellate court. They also routinely criticize outmoded Supreme Court decisions that the Court has not overruled. And such information and views can be valuable.

However, this book is based on the premise that we should be able to know what the Supreme Court has said the constitutional rules are today for state taxation. Therefore this chapter only mentions Supreme Court opinions that the Court has not overruled and that are not clearly within the several swaths of decisions that are no longer viable; for example it ignores most of the cases addressing taxation of national banks and many of the early Commerce Clause rulings. Chapter II.C addresses the intergovernmental immunity decisions.

This book mentions many of the Court’s older state tax rulings that are still viable, but which may not appear in the major treatises due to the way those books accreted their citations over relatively recent times. It leaves to the reader the fascinating project of reading the tea leaves and figuring out which way the Court might go based on concurrences and dissents. It eschews detailed analysis of the “reasoning” in newer opinions of the Court, which often obscures the holdings. In other words, this is a practitioner’s hornbook chapter on state tax constitutional issues.

So the “subjects” of state taxation must be identified for purposes of organizing this chapter. The approach chosen here uses the inevitable basic moving parts of any such analysis but rearranges them as explained below. It does not attempt to do several tasks undertaken by treatises on state taxation. It does not explore the inner workings of various types of state taxes. It does not address procedural issues, except as they have constitutional relevance. It is not concerned with state constitutional or interpretational issues. It only addresses currently relevant federal constitutional issues in state taxation. Of course it treats local taxation as part of state taxation.

Finally, the proliferation of state tax constitutional rulings of the Supreme Court reflects more on the desire of mostly large corporations not to pay state tax than on the lawlessness of state legislators. Justice Frankfurter expressed this caution in an opinion reversing a state supreme court’s ruling that its own state tax violated the federal constitution:

> Ambiguous intimations of general phrases in opinions torn from the significance of concrete circumstances, or even occasional deviations over a long course of years, not unnatural in view of the confusing complexities of tax problems, do not alter the limited nature of the function of this Court when state taxes come before it. At best, the responsibility for devising just and pro-
ductive sources of revenue challenges the wit of legislators. Nothing can be less helpful than for courts to go beyond the extremely limited restrictions that the Constitution places upon the states and to inject themselves in a merely negative way into the delicate processes of fiscal policy-making. We must be on guard against imprisoning the taxing power of the states within formulas that are not compelled by the Constitution but merely represent judicial generalizations exceeding the concrete circumstances which they profess to summarize.  

Other Chapters of this book also address subjects addressed here that affect federal taxation, and will be cross referenced.

2. Jurisdiction Versus Other Issues

The Due Process Clause controls jurisdiction of both state courts and state tax collectors over persons and property. The Commerce Clause in effect controls state jurisdiction to tax some persons and property because it enforces a constitutional preclusion of state discrimination against interstate commerce. Discrimination against interstate commerce can look like a type of violation of the Equal Protection Clause and many opinions have addressed both claims as one. Therefore the Commerce Clause sits in both the discrimination zone (with the Equal Protection Clause and sometimes the Privileges and Immunities Clause) and the jurisdiction zone (with the Due Process Clause). That duality substantially contributes to confusion in writings on state taxation and even in the Court’s opinions.

A solution to the confusion is to treat the Due Process Clause and the Commerce Clause as the only jurisdictional limits on state taxation, and to separately treat the Equal Protection Clause as one of a large group of what this Chapter calls “recurring issues,” involving constitutional limitations that also may preclude state taxation of a particular subject that the state has jurisdiction to tax. The recurring issues are addressed separately below. They include some components of Due Process Clause and Commerce Clause issues, e.g., what is commerce, to keep those peripheral issues out of the jurisdictional analysis towards the end of this Chapter. There the Chapter addresses jurisdiction to tax in various fact patterns, with emphasis on Due Process and then Commerce Clause limits on state taxing jurisdiction.

The Due Process Clause did not become applicable to the states until the adoption of the 14th Amendment in 1868. Earlier opinions addressing state jurisdiction to tax were based on the common law conception of taxing power, or upon the Commerce Clause, but commonly are cited as in the line of Due Process authorities.

Most opinions discussing taxing jurisdiction use the term nexus. Nexus generally means no more than connection of some sort. It is the “sort” that is important, rather than the connection. The Supreme Court rarely used the term before using it in 1940 in a state tax opinion. The state imposed a special tax on foreign

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