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State and Local Taxation of Interstate and Foreign Commerce: The Second Best Solution

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STATE AND LOCAL TAXATION OF INTERSTATE
AND FOREIGN COMMERCE: THE SECOND BEST
SOLUTION

KATHRYN L. MOORE†

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I. INTRODUCTION

Our current system of state and local taxation of interstate and foreign commerce, simply put, is a mess. First, the mere number of jurisdictions that may impose taxes is seemingly limitless: each of the fifty states, plus the District of Columbia, may impose its own set of taxes. In addition, each state may authorize local government units within the state, such as counties, municipalities, townships, and special districts, to assess and collect taxes. For example, in 1994, well over 6,000 separate jurisdictions were authorized to impose sales taxes.¹

Second, the states may impose a wide variety of taxes and may authorize their local jurisdictions to impose such taxes. For example, states may impose individual income taxes, corporation income taxes, general sales taxes, property taxes, estate taxes, and a

¹. I ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, SIGNIFICANT FEATURES OF FISCAL FEDERALISM 95-96 (Table 27) (1995).
wide variety of excise taxes, such as gasoline, cigarette, and alcoholic beverage taxes. Each taxing jurisdiction has the power to define independently the tax base and to specify the other rules applicable to each tax.

Finally, the United States Supreme Court's attempts to regulate the area have created substantial uncertainty and confusion. Relying principally on the negative implications of the Commerce Clause, often called the dormant Commerce Clause,2 the Court, on more than one occasion, has described its decisions in this area as a "quagmire."3

This Article will address the role the Court's dormant Commerce Clause jurisprudence should play in resolving the many problems raised by state and local taxation of interstate and foreign commerce. Ideally, the Court should mandate more uniformity. It should not require that states and local jurisdictions apply a single, uniform tax to interstate and foreign commerce. However, it should order that the states and local jurisdictions apply uniform rules to define the tax base and apply uniform rules to allocate that base among the states with respect to each tax affecting interstate and foreign commerce.

Unfortunately, the Court is not institutionally competent to dictate that solution. If uniformity is to be achieved, it must be through the voluntary efforts of the states or through federal legislation. In recent years, some advances toward uniformity have


Northwestern was also quoted in a number of U.S. Supreme Court minority opinions. See, e.g., West Lynn Creamery, Inc. v. Healy, 114 S. Ct. 2205, 2220 (1994) (Scalia, J., concurring); American Trucking Ass'ns v. Smith, 496 U.S. 167, 202 (1990); Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue, 483 U.S. 232, 259 (1987) (Scalia, J., concurring in part, dissenting in part).
been made, but more uniformity is needed.

This Article will also address the role the Court should play in the absence of uniformity, the second best solution. The proposed role is based on a refined version of an approach to state tax dormant Commerce Clause jurisprudence developed by Justice Scalia over a period of years. According to that vision, the Court should only strike down a state or local taxing statute if: (1) the statute facially discriminates against interstate or foreign commerce; or (2) the statute is indistinguishable from a statute the Court has previously stricken.

Although this approach is not perfect, it has the potential to compensate for some of the imperfections in the current system of state and local taxation. First, it could eliminate those state taxing statutes that create the most egregious drags on our national economy while providing greater certainty and stability in an area of the law in desperate need of certainty and stability. Second, it could encourage legislation providing for uniformity, and such legislation may be the only feasible means for achieving uniformity.

Part two of this Article explains why uniformity is the best solution to the problems raised by state and local taxation of interstate and foreign commerce. Part three then provides a brief history of the Court’s state tax dormant Commerce Clause jurisprudence and explains why the Court is institutionally
incapable of mandating uniformity, the first best solution.

Part four discusses the current status of the Court’s state tax dormant Commerce Clause jurisprudence. That discussion reveals that the Court’s current state tax dormant Commerce Clause jurisprudence, while perhaps improved from earlier jurisprudence, remains extraordinarily uncertain and unstable. It also illustrates that uniformity in taxation would eliminate most, if not all, of that uncertainty.

Part five of the Article describes how the Court should interpret the dormant Commerce Clause as applied to state and local taxation of interstate and foreign commerce. It begins by explaining the origins of second best solutions. It then describes the proposed second best solution and its history. It concludes by explaining why the proposed approach is in fact the second best.

II. UNIFORMITY: THE OPTIMAL SOLUTION TO STATE AND LOCAL TAXATION OF INTERSTATE AND FOREIGN COMMERCE

A brief look at some of the rules for dividing corporate income among the states illustrates the extraordinary complexity of our current system of taxation. Typically, states use one of two

Regulation of State Taxation of Interstate Commerce, 38 N.C. L. REV. 119, 129 (1960) (“An attempt to synthesize all the Supreme Court decisions pertaining to taxation of interstate commerce would be foredoomed by the Court’s inconsistency.”).

Accordingly, this article does not attempt to present an exhaustive history or analysis. For a more comprehensive discussion, see JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION ¶¶ 4.05-07 (2d ed. 1993); PAUL J. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION §§ 2.9-2.16 (1981); Walter Hellerstein, State Taxation of Interstate Business: Perspectives on Two Centuries of Constitutional Adjudication, 41 TAX L. REV. 37, 40-50 (1987) [hereinafter Hellerstein, Perspectives]; David F. Shores, State Taxation of Interstate Commerce – Quiet Revolution or Much Ado About Nothing, 38 TAX L. REV. 127, 129-145 (1982); Noel T. Dowling, Interstate Commerce and State Power, 27 VA. L. REV. 1, 2-19 (1940).

5. For a somewhat more detailed discussion of the complexities in our current system, see DANIEL SHAVIRO, FEDERALISM IN TAXATION: THE CASE FOR GREATER UNIFORMITY 32-38 (1993).
methods to divide income earned by multijurisdictional enterprises. Income that is relatively easy to trace to a particular state is generally allocated, that is, attributed totally to one state.

Most income, however, is difficult to trace to a particular state and is apportioned, that is, divided among the states by use of an apportionment formula.

If the states used uniform allocation and apportionment rules, state taxation of corporate income would be complex but manageable. The states, however, do not use uniform rules. For example, under the Uniform Division of Income for Tax Purposes Act and similar statutes that are in effect in the majority of states, income is apportionable if it is "business income," that is, "income arising from transactions and activity in the regular course of the taxpayer's trade or business." "Nonbusiness income," that is, "all

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6. Charles E. McLure, Jr., The Elusive Incidence of the Corporate Income Tax: The State Case, reprinted in ECONOMIC PERSPECTIVES ON STATE TAXATION OF MULTIJURISDICTIONAL CORPORATIONS 27, 29 (1986). States may also use a third method, separate accounting, to tax income for particular industries. See I HELLERSTEIN & HELLERSTEIN, supra note 4, at § 8.03.

7. For example, states may allocate rents and royalties from real and tangible personal property, patents and copyright royalties, dividends and interest, and capital gains and losses. JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE AND LOCAL TAXATION: CASES AND MATERIALS 418 (5th ed. 1988).

8. The theory behind formula apportionment "is that certain factors or elements of a business will fairly reflect the portion of the measure of the tax allocable to a state." Id. The tax due to the state is the product calculated by multiplying a tax base that includes all apportionable income by an apportionment formula and tax rate. Examples of income subject to apportionment include the operating income of a multistate manufacturer, wholesaler, or retailer. Id. For a more detailed discussion of apportionment formulae, see, e.g., Panel Discussion, State Taxation of Interstate Commerce, 27 TENN. L. REV. 239, 251-57 (1960); Donald K. Barnes, Prerequisites of a Federal Statute Regulating State Taxation of Interstate Commerce, 46 VA. L. REV. 1269, 1275-82 (1960).


11. UDITPA ¶ 1(a).
income other than business income." All states, however, do not conform to the UDITPA model. For example, several states allocate all income from intangibles to the taxpayer's commercial domicile or to the business situs of the intangible while a few states treat all income as apportionable ("net income"). The use of these two "theoretically incommensurate" methods of taxation to the same item of income at the same time necessarily subjects that income to the risk of multiple taxation or permits some of it to escape taxation altogether.

In addition, under UDITPA and similar statutes in effect in most states, a three factor formula, consisting of property, payroll, and receipts, is used to allocate business income among the states. All states, however, do not use a three-factor apportionment formula. More importantly, the states do not all give the same weight to each factor in the formula and do not define all of the factors in the same manner. Again, these variations create

12. Id. § 1(e).
13. Id. §§ 4-8.
18. For example, if the taxpayer's state of domicile allocates all income from intangibles to that state, and the taxpayer does business in other states that apportion such income, the income will be subject to multiple taxation. In contrast, if the taxpayer's state of domicile apportions income from intangibles and the taxpayer does business in another state that allocates all such income to the state of domicile, some of that income will necessarily escape taxation.
20. For example, Iowa and Nebraska use a one-factor sales/receipts formula. I CCH All States Tax Guide ¶ 10-110, at 2582-83.
21. For example, Tennessee gives equal weight to each factor of the formula while Kentucky gives twice as much weight to the sales factor as to the property and payroll factors. Id.
22. Id. at 2584-88. For example, although all states but Louisiana use a
extraordinary compliance burdens for the multijurisdictional taxpayer as well as run the risk of subjecting some income to multiple taxation while permitting other income to escape taxation altogether. 23

The extraordinary diversity in state and local taxation may be attributed to at least two factors. First, there is no single best method of state and local taxation. There are many types of state and local taxes and there is no one theoretically correct way to tax. This is especially true with respect to state taxation of corporate income. There is also some question whether states should tax corporate income in the first place. 24 Moreover, once state taxation of corporate income is accepted, there is no one theoretically correct method for dividing that income among the states. 25

Second, there are wide variations in the size, social make-up, property, resources, and economies of the various states and local jurisdictions. These variations necessarily require states and local jurisdictions to impose different mixes of taxes. For example, a state with abundant natural resources and little tourism must rely more

destination rule to attribute sales to the state of the purchaser, the states do not treat consistently sales to purchasers in states which do not have the power to tax the seller. In such cases, about half of the states use a "throwback" rule to attribute such sales to the state of origin. The other half of the states permit such sales to fall into the "no-man's" land of non-taxation by any state. Id. at 2584-85; see also Hellerstein & Hellerstein, supra note 7, at 485.

23. For a more detailed discussion of the inconsistencies in state taxation of the income of multijurisdictional corporations and the problems raised by these inconsistencies, see Eugene F. Corrigan, Interstate Corporate Income Taxation -- Recent Revolutions and a Modern Response, 29 VAND. L. REV. 423, 429-35 (1976).


25. I Hellerstein & Hellerstein, supra note 4, at ¶ 8.06 n.150. ("The committees of the NTA, which have been the prime movers in developing formulary apportionment for unitary businesses, have long recognized that: 'All methods of apportionment of trading profits are arbitrary...[T]here is no one right rule of apportionment."); Panel Discussion, supra note 8, at 257 ("From an academic standpoint, it does not seem important what formula is adopted as long as it is adopted by all the states and is applied uniformly.").
heavily on severance taxes than hotel taxes for its tax revenue. In
addition, these variations may come into play in creating diversity
of taxing systems if the states or local jurisdictions try to structure
their taxing systems to shift as much of the tax burden as possible
on non-voting outsiders.\footnote{See generally Shaviro, supra note 5, at 20; Walter Hellerstein,
Constitutional Limitations on State Tax Exportation, 1982 AM. BAR FOUND. RESEARCH J. 1, 70-73.}
For example, states with large tourist industries tend to charge higher sales taxes than other states,\footnote{Shaviro, supra note 5, at 20 (citing \textit{John F. Due \\& John L. Mikesell}, \textit{Sales Taxation: State and Local Structure and Administration} 12 (1983)).}
and market states tend to give extra weight to the receipts factor of the
apportionment formula.\footnote{Cf. Panel Discussion, supra note 8, at 258.
Daniel Shaviro identifies six principal arguments in favor of state and
local government autonomy. The first two are described in the text above and
the remaining four are as follows: (1) smaller governments are more responsive
to voters’ preferences than larger governments; (2) “unfettered taxing powers
permit state and local governments to exploit and develop” their resources more
readily; (3) “autonomy has the Madisonian advantage of dividing political
authority and thus reducing its capacity to do great harm”; and (4) “autonomy
promotes experimentation by governments with different kinds of tax rules.”
Shaviro, supra note 5, at 78-94.
Gordon D. Henderson, \textit{What We Can Do About What’s Wrong With the Tax Law}, 49 TAX NOTES 1349, 1352 (1990).}
Daniel Shaviro has described what I believe to be the optimal solution to state and local taxation of interstate and foreign commerce: more uniformity. States and local jurisdictions need not impose a single, uniform tax on interstate and foreign commerce, nor need they impose a single rate for each tax. They should, however, apply uniform rules to define the base for each tax and apply uniform rules to allocate each tax base among the states.\textsuperscript{32}

Few outside academia would dispute that more uniformity is needed in state and local taxation.\textsuperscript{33} Scholars have long recognized this need,\textsuperscript{34} and, as our economy has expanded,\textsuperscript{35} and state and local taxes have increased in amount and scope, state tax administrators,\textsuperscript{36}

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35. The expansion in the interstate and international character of our economy is due, in part, to advances in communications, transportation, and distribution. \textit{See generally} Corrigan, supra note 23, at 424-25.

36. \textit{See NATIONAL CONF. OF STATE TAX LEGISLATURES}, supra, note 29, at 68-103; James W. Wetzler, "\textit{We Need State Taxes}," 7 STATE TAX NOTES 48, 49 (1994) (James W. Wetzler, commissioner of New York State's Department of Taxation and Finance, says "[M]y judgment is that we need greater uniformity than presently exists."); \textit{see also} News Stories, \textit{State Tax System Should Be Restructured, Says MTC's Bucks}, 5 STATE TAX NOTES 48 (1993) ("To compete in
scholars,\textsuperscript{37} and taxpayers\textsuperscript{38} have all become increasingly sensitive to this need.

Some progress has been made toward uniformity. For example, in 1958, the National Conference of Commissioners on Uniform State Laws approved UDITPA.\textsuperscript{39} Twenty-three of the forty-six states, plus the District of Columbia, that impose a corporate income tax\textsuperscript{40} have adopted UDITPA.\textsuperscript{41} In addition, eighteen states, plus the District of Columbia, are full members of the Multistate Tax Compact, and another thirteen states are associate members of that Compact.\textsuperscript{42} Among the Compact's purposes is the promotion of uniformity and compatibility in state tax systems.\textsuperscript{43} To further this end, among others, the Multistate Tax Compact created the Multistate Tax Commission,\textsuperscript{44} which drafted detailed regulations for the allocation and apportionment of income for tax purposes.

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the modern world of interstate and international commerce, state governments must work together to develop uniform tax laws that are both 'equitable and effective,' said Dan Bucks, executive director of the Multistate Tax Commission.\textsuperscript{37}

37. Alice M. Rivlin, Reviving the American Dream: The Economy, the States, and the Federal Government 126-152 (The Brookings Institute 1992); Shavro, supra note 5. But see Fiscal Federalism Expert No Longer Sees Tax Competition as 'The Devil's Work,' 1995 STATE TAX NOTES 206-26 (1995) (Urban Institute senior economist John Shannon "more and more convinced that intergovernmental competition produces more pluses for our federal system than minuses.").

38. The Income Tax Compliance Cost of Big Business (Office of Tax Policy Research, Working Paper No. 93-11, at 14 (1993)) (state and local income tax reform suggested most often by survey of large corporations in the United States was "more uniformity between the state income tax systems and the federal system, and among the state systems.").


40. Only Nevada, Texas, Washington, and Wyoming have no corporate income tax. Id. at 2502-03.

41. Id. at 2579-81. In addition, a number of states have adopted similar taxing structures. See I CCH All States Guide ¶ 10-110.


44. Art. IV, Multistate Tax Compact.
As of December 31, 1994, seventeen states had adopted most or substantially all of the Multistate Tax Commission's regulations.\textsuperscript{45}

Although UDITPA and the Multistate Tax Compact and Commission represent progress toward uniformity, still more uniformity is needed in state and local taxation of interstate and foreign commerce. In theory, this uniformity could be achieved in one of three ways: 1) by congressional action; 2) by the voluntary, joint action of the states; or 3) by the Supreme Court's interpretation of the dormant Commerce Clause. The next part of this Article provides a brief history of the Court's state tax dormant Commerce Clause jurisprudence and explains why the third option is not a viable alternative.

III. A BRIEF HISTORY OF THE COURT'S STATE TAX DORMANT Commerce Clause Jurisprudence and the Court's Understandable Failure to Adopt the Optimal Solution

Article I, Section 8, Clause 3 of the United States Constitution, the Commerce Clause, grants to Congress the "Power . . . [t]o regulate Commerce with foreign Nations and among the several States." Although the clause does not expressly limit the states' power to tax,\textsuperscript{46} the Court has long relied on its negative implications to regulate state and local taxation of interstate and

\textsuperscript{45} I CCH All States Guide \textsuperscript{¶} 10-110, at 2579-81.

\textsuperscript{46} Only two provisions of the Constitution expressly discuss the scope of the states' taxing power: (1) the Import-Export Clause and (2) the duty of tonnage prohibition. The Import-Export Clause, U.S. CONST. art I, § 10, cl. 2, provides:

No State shall, without the Consent of Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Control of the Congress.

The duty of tonnage prohibition, U.S. CONST. art. I, § 10, cl. 3, provides that "[n]o State shall, without the Consent of Congress, lay any Duty of Tonnage."
foreign commerce.\textsuperscript{47}

The Court’s dormant Commerce Clause jurisprudence, as applied to state taxation of interstate and foreign commerce,\textsuperscript{48} has followed a long and tortuous path.\textsuperscript{49} Both the Court\textsuperscript{50} and scholars\textsuperscript{51}

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48. Although the dormant Commerce Clause as applied to interstate commerce is sometimes treated differently from the clause as applied to foreign commerce, this article will treat the two interchangeably, unless specifically noted otherwise.

49. Because Commerce Clause challenges to state taxing statutes present different concerns than such challenges to other state regulations, this article will focus primarily on the doctrine as applied to state taxation. See generally Ferdinand P. Schoettle, \textit{Commerce Clause Challenges to State Taxes}, 75 MINN. L. REV. 907, 908 (1991) (“Commerce Clause challenges to state taxes are, in fact, unique.”); Walter Hellerstein, \textit{Commerce Clause Restraints on State Taxation: Purposeful Economic Protectionism and Beyond}, 85 MICH. L. REV. 758, 758 (1987) (noting that most scholars writing about the dormant Commerce Clause have limited their attention to state regulation, as opposed to state taxation of interstate commerce); Donald H. Regan, \textit{The Supreme Court and State Protection: Making Sense of the Dormant Commerce Clause}, 84 MICH. L. REV. 1091, 1182 (1986) (treating transportation and taxation cases separately from other cases).

50. The judicial debate began with the Court’s very first state tax decision under the dormant Commerce Clause, Brown v. Maryland, 25 U.S. (12 Wheat.) 419, 449 (1827) (Thompson, J., dissenting), and continues to this day. See West Lynn Creamery, Inc. v. Healy, 114 S. Ct. 2205, 2218 (1994) (Scalia, J., dissenting). For scholarly discussions of the judicial debate, see generally FELIX FRANKFURTER, \textit{THE COMMERCE CLAUSE UNDER MARSHALL, TANEY AND WAITE} (1937); Dowling, \textit{supra} note 4.

51. For examples of the debate among scholars, see Daniel Shaviro, \textit{State and Local Taxation: The Current Judicial Outlook}, 22 CAP. U. L. REV. 279, 282 (1993) (asserting that the Court has been too lenient in striking down state and local taxes under the dormant Commerce Clause “antidiscrimination standard”); Hellerstein & Hennefeld, \textit{supra} note 34, at 953 (arguing that no state tax should be struck down under the dormant Commerce Clause); Dowling, \textit{supra} note 4, at 20 (contending that the Court should strike down state taxing or regulatory statutes whose “effect upon interstate commerce constitutes an unreasonable

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have long debated the proper role of the Court in regulating state taxation of interstate and foreign commerce in the absence of congressional legislation.

The Court first struck down a state taxing statute for violating the dormant foreign Commerce Clause in 1829.\textsuperscript{52} Almost fifty years later, the Court first struck down a state tax under the dormant interstate Commerce Clause.\textsuperscript{53} These divided opinions, which were the result of a protracted struggle within the Court,\textsuperscript{54} suggested that the Commerce Clause prohibits all state taxation of interstate and foreign commerce.\textsuperscript{55}

Shortly after the Court decided the second of these opinions, the Court began to distinguish between "direct" and "indirect" taxes.\textsuperscript{56} Viewing the former as impermissible "undue burdens" on interstate commerce, the Court struck down such taxes,\textsuperscript{57} while it seemed to view the latter as taxes on "local" activities and thus permissible.\textsuperscript{58} This direct/indirect distinction, in which "[n]ames were made to matter more than mathematics or economics,"\textsuperscript{59} provided the states, taxpayers, and lower courts with little guidance in determining whether a particular taxing statute would violate the dormant Commerce Clause.\textsuperscript{60}

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52. In \textit{Brown}, 25 U.S. (12 Wheat.) at 419, the Court held that a state license tax imposed on importers and wholesalers of foreign goods violated the Import-Export Clause as well as the dormant foreign Commerce Clause.


54. HELLERSTEIN & HELLERSTEIN, supra note 7, at 216.

55. \textit{Id. at} 215-17. \textit{See also} Leloup v. Port of Mobile, 127 U.S. 640, 648 (1888) ("no State has the right to lay a tax on interstate commerce in any form").

56. HARTMAN, supra note 4, at § 2.13.


58. \textit{See, e.g.,} Wiloil Corp. v. Pennsylvania, 294 U.S. 169 (1935); Ozark Pipe Line Corp. v. Monier, 266 U.S. 555 (1925); Postal Telegraph-Cable Co. v. Richmond, 249 U.S. 252 (1919); \textit{see generally} HARTMAN, supra note 4, at § 2.13.


60. \textit{See, e.g.,} Di Santo v. Pennsylvania, 273 U.S. 34, 44 (1927) (Stone, J.,
Dissatisfied with the uncertainty inherent in this formalistic distinction, the Court replaced it with a “multiple taxation doctrine” in 1938. Under that doctrine, the Court would only invalidate a state taxing statute if it believed that the tax subjected interstate commerce to a risk of multiple taxation that intrastate commerce was not required to bear.

The multiple taxation doctrine was short-lived. A mere eight years after its enunciation, the Court rejected the doctrine and once again embraced the formal distinction between direct and indirect taxes. In time, the Court’s jurisprudence resumed its character as nothing more than “a trap for the unwary draftsman.”

Finally, in 1977, in the most recent twist on the state tax dormant Commerce Clause path, the Court once again rejected the formal distinction between “direct” and “indirect” taxes, and adopted a four prong test, known as the Complete Auto test, to determine whether a state tax violates the dormant Commerce Clause. Two years later, the Court extended application of that test to state taxes affecting foreign commerce and added two more prongs to test such taxes.

The incessant changes in the Court’s state tax dormant Commerce Clause jurisprudence may be attributed, in part, to the fact that the jurisprudence is based on Constitutional silence. That silence can be, and has been, interpreted in one of three dissenting) (criticizing the direct/indirect test), overruled, California v. Thompson, 313 U.S. 109, 115-16 (1941).

63. Freeman v. Hewit, 329 U.S. 249 (1946). Today, however, the Court seems to have resurrected the multiple taxation doctrine in the fair apportionment prong of the Complete Auto test. See infra text accompanying notes 108-16.
fundamentally conflicting ways: (1) as preventing the states from taxing interstate commerce at all;66 (2) as permitting all state taxation, so long as it does not conflict with express congressional legislation;67 and (3) as permitting some, but not all, state taxation in the absence of contrary congressional legislation.68

66. The Court adopted this interpretation in some of its early decisions. See, e.g., Leloup v. Port of Mobile, 127 U.S. 640, 648 (1888).

Contrary drafting practices in other sections of the Constitution cast serious doubt on the validity of this interpretation of the silence. For example, Article I, Section 8, clause 11 of the Constitution expressly grants to Congress the power to grant Letters of Marque and Repiral, while Article I, Section 10, clause 1 specifically prohibits the states from granting such letters. Had the drafters viewed an express grant of power to Congress as concurrently prohibiting the states from exercising that power, Article I, Section 10, clause 1 would have been superfluous. Accord Frederick Schauer, *Easy Cases*, 58 S. CAL. L. REV. 399, 401 n.7 (1985); Martin H. Redish & Shane V. Nugent, *The Dormant Commerce Clause and the Constitutional Balance of Federalism*, 1987 DUKE L.J. 569, 585-86. Compare U.S. CONST. art. I, § 8, cl. 4 with U.S. CONST. art. I, § 10, cl. 10.

67. Although a majority of the Court has never interpreted the Commerce Clause in this manner, Justice Scalia apparently would do so if he were faced with interpreting it as a matter of first impression. See, e.g., Tyler Pipe Indus., Inc. v. Washington State Dept of Revenue, 483 U.S. 232, 260-65 (1987) (Scalia, J., dissenting). Accord THOMAS M. COOLEY, *CONSTITUTIONAL LIMITATIONS* 601 (5th ed. 1883) ("The States may unquestionably tax the subjects of commerce; and no necessary conflict with that complete control which is vested in Congress appears until the power is so exercised as to defeat or embarrass the congressional legislation. Where Congress has not acted at all upon the subject, the State taxation cannot be invalid on this ground."); Hellerstein & Hennefeld, *supra* note 34, at 951 ("The provisions in the Constitution relating specifically to state taxation are an indication that except as to foreign commerce, the states were to be left free to tax until their action came into conflict with congressional legislation.").

68. In applying this third, most commonly adopted, approach, the Court may be viewed as interpreting Congress’ silence rather than that of the Constitution. Justice Thomas Reed has suggested the absurdity of this approach:

Now Congress has a wonderful power that only judges and lawyers know about. Congress has a power to keep silent. Congress can regulate interstate commerce just by not doing anything about it. Of course when congress keeps silent, it takes an expert to know what it means. But the judges are experts. They say that congress by keeping silent sometimes means that it is keeping silent and sometimes means that it
The instability may also be attributed to the uncertainty in the debate surrounding the enactment of the Constitution. According to some commentators, that debate indicates that the primary purpose of the Commerce Clause was to prevent the states from regulating commerce among themselves.69 Other commentators dispute this proposition and contend that the debate seems to have rested on the assumption that no negative Commerce Clause existed.70 Finally, others suggest that the framers simply did not have a uniform understanding of the clause in mind.71

While the uncertain underpinnings of the Court’s state tax dormant Commerce Clause jurisprudence do much to explain the shifting and unstable nature of that doctrine, they, alone, do not explain its unsettled, and unsettling, character. The Court’s institutional capabilities play a significant role in explaining the confusion in this area:

is speaking. If congress keeps silent about the interstate commerce that is not national in character and that may just as well be regulated by the states, then congress is silently silent, and the states may regulate. But if Congress keeps silent about the kind of commerce that is national in character and ought to be regulated only by congress, then congress is silently vocal and says that the commerce must be free from state regulation.


71. FRANKFURTER, *supra* note 50, at 12 ("Neither the Philadelphia Convention nor the discussions preceding ratification of its labors generated currents of important thought concerning the process of adjusting [c]ongressional and state authorities. The records disclose no constructive criticisms by the states of the commerce clause as proposed to them."); Steven Brekner-Cooper, *The Commerce Clause: The Case for Judicial Non-Intervention*, 69 OR. L. REV. 895, 905-06 (1990) ("Regardless of one’s views on originalism in constitutional interpretation, it appears that the Framers themselves did not have a specific understanding of the effect of the commerce clause in mind.").
[A] court deals in absolutes, and in this area an absolute decision in either direction is not likely to be satisfactory. A decision to uphold a tax does not mean that serious problems do not confront interstate commerce. It means only that the court considers striking down the tax – the one avenue open to it for alleviating those problems – to be of greater gravity than the problems themselves. Even in this limited function, the court is substantially handicapped by its inability to explore fully the nature, the extent, and the impact of the burdens created.\(^\text{72}\)

As discussed above, the ideal solution to state taxation of interstate and foreign commerce is more uniformity. Yet, selecting a tax base and apportionment rules involves a multitude of complex policy issues, ranging from fairness to compliance costs to efficiency,\(^\text{73}\) which the Court is institutionally incapable of resolving.\(^\text{74}\) On numerous occasions, members of the Court have

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73. See, e.g., American Enterprise Institute Legislative Analyses, Proposals to Regulate State and Local Taxation of Multijurisdictional Corporations, 97th Cong., 1st Sess. 21-50 (1981) (describing fairness, compliance cost, and economic efficiency arguments raised in favor and against three tax bills directed at state and local imposition of income taxes, sales and use taxes, and gross receipts on businesses); Jerome A. Geis, A Sales Tax on Business and Professional Services: Is it Practical Tax Policy?, 7 STATE TAX NOTES 1817 (1994) (discussing economic, equity, administrative, and compliance considerations to be taken into account in enacting a sales tax on business and professional services); Mindy S. Piatoff, Difficulties in Structuring a Sales Tax on Services, 3 STATE TAX NOTES 232 (1992); COMPTROLLER'S REPORT, supra note 33, at 26 ("Decisions such as those covering State taxation of multijurisdictional corporate income are best made by the Congress because they involve broad interrelated policy issues concerning interstate and international commerce.").
74. See COMPTROLLER'S REPORT, supra note 33, at 24; Michael S. Moore, A Natural Law Theory of Interpretation, 58 S. CAL. L. REV. 277, 376 (1985) ("Courts are to decide disputes, not issue edicts. . . . Courts deciding individual cases do not have the information before them (nor the means to get it) to issue rules in the linguistically precise form of a statute. They do not know precisely what the reach of the rule should be when deciding cases."); Mike McGrath & Walter Hellerstein, Reflections on Commonwealth Edison Co. v. Montana, 43 MONT. L.
expressly recognized the Court's institutional limitations. For example, in *Northwestern Portland Cement Co. v. Minnesota*, Justice Frankfurter declared:

[The Court] 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 [it] 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.  

More recently, in *Moorman Manufacturing Co. v. Bair*, the Court stated:

Although the adoption of a uniform code would undeniably advance the policies that underlie the Commerce Clause, it would require a policy decision based on political and

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economic considerations that vary from State to State. The Constitution, however, is neutral with respect to the content of any uniform rule. If division-of-income problems were to be constitutionalized, . . . the prevalent practice would be endorsed as the constitutional rule. This rule would be at best an amalgam of independent state decisions, based on considerations unique to each state. Of most importance, it could not reflect the national interest, because the interests of those States whose policies are subordinated in the quest for uniformity would be excluded from the calculation. 78

Because of the uncertain underpinnings of the Court’s state tax dormant Commerce Clause jurisprudence and the institutional limitations of the Court, the Court’s state dormant Commerce Clause jurisprudence has been unsettled. The next section discusses the Court’s current state tax dormant Commerce Clause jurisprudence in more detail and explains how uniformity would eliminate most, if not all, of that uncertainty.

IV. CONTEMPORARY STATE TAX DOCTRINE: NEITHER UNIFORM NOR CERTAIN

Under the four prong Complete Auto test, the Court will sustain a state taxing statute against a dormant Commerce Clause challenge if the tax (1) is applied to an activity with a substantial nexus to the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to benefits provided by the state. 79

The Complete Auto test arose in a challenge to a state taxing statute affecting interstate commerce. In Japan Line, Ltd. v. County of Los Angeles, 80 the Court extended application of the test to challenges to taxing statutes affecting foreign commerce and

78. Id. at 279-280.
identified two additional issues to be addressed in such cases: (1) does the tax subject foreign commerce to an impermissible risk of multiple taxation; and (2) does the tax prevent the federal government from speaking with one voice. Although the Complete Auto and Japan Line tests may have been an improvement over the Court’s previous indirect/direct distinction, they have left much uncertainty and instability in the law today.

A. Nexus

Prior to 1992, the Complete Auto nexus requirement appeared to be identical to the nexus requirement under the Due Process Clause. In Quill Corp. v. North Dakota, however, the Court

81. Id. at 451.

82. HARTMAN, supra note 4, at § 2.21 (Supp. 1995) (Complete Auto “brought some rationality to commerce clause doctrines into this area”); Tatarowicz, supra note 2, at 105 (describing Complete Auto approach as “more logical and predictable than its predecessors”); William B. Lockhart, A Revolution in State Taxation of Commerce?, 65 MINN. L. REV. 1025, 1025 (1981) (describing Complete Auto as a “potentially revolutionary shift”); Walter Hellerstein, State Taxation and the Supreme Court: Toward a More Unified Approach to Constitutional Adjudication, 75 MICH. L. REV. 1426, 1446-52 (1977) (asserting that Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976), United States v. County of Fresno, 429 U.S. 452 (1977), and Complete Auto suggest a development in the law that should be acknowledged, if not encouraged). But see Shores, supra note 4 (criticizing Complete Auto and cases decided shortly after Complete Auto for lack of coherent analysis).

83. See, e.g., Trinova Corp. v. Michigan Dep’t of Treasury, 498 U.S. 358, 373 (1991) (quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 436-37 (1980)) (“[t]he Complete Auto test, while responsive to Commerce Clause dictates, encompasses as well the Due Process requirement that there be a ‘minimal connection’ between the interstate activities and the taxing State”); Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 165-66 (1983) (quoting Exxon Corp. v. Wisconsin Dep’t of Revenue, 447 U.S. 207, 219-20 (1980), quoting Mobil Oil) (“[t]he Due Process and Commerce Clauses of the Constitution do not allow a State to tax income arising out of interstate activities — even on a proportional basis — unless there is a “minimal connection” or “nexus” between the interstate activities and the taxing State”); Mobil Oil, 445 U.S. at 436-42 (treating nexus as a purely due process issue); see also Quill Corp. v. North Dakota, 504 U.S. 298, 305 (1992) (recognizing that the Court has not always
declared for the first time that the nexus requirement under the Commerce Clause is both different from, and higher than, the requirement under the Due Process Clause.\textsuperscript{85}

The Court’s decision in Quill seemed to be driven by the desire to provide stability and certainty in the law.\textsuperscript{86} The Court, however, did not base its decision solely on stare decisis.\textsuperscript{87} As a result, the decision has created instability and uncertainty.\textsuperscript{88}

\textit{Quill Corporation v. North Dakota: An Answer to the Taxing Problem Surrounding Mail-Order Sales}, 71 TAXES 3, 5 (1993) ("Items one and four in the analysis, which required nexus and benefits for a tax to stand, are classic due process requirements."); Walter Nagel, \textit{The Emergence of a Single Nexus Standard}, 45 TAX NOTES 327, 328 (1989) ("the nexus standards in the Commerce and Due Process clauses are interchangeable"); Tatarowicz, \textit{supra} note 2, at 106 & n.21 (equating \textit{Complete Auto} “substantial nexus” requirement with due process nexus requirement); Paul J. Hartman, \textit{Collection of the Use Tax on Out-of-State Mail-Order Sales}, 39 VAND. L. REV. 993, 1022 (1986) ("Bellas Hess may be primarily a commerce clause case, but a due process clause question also is involved in collection of the use tax from out-of-state sellers.").


85. \textit{Id.} at 325 (White, J., concurring in part and dissenting in part) ("The Court freely acknowledges that there is no authority for this novel interpretation of our cases and that we have never before found, as we do in this case, sufficient contacts for due process purposes but an insufficient nexus under the Commerce Clause.").

86. In its opinion, the Court conceded that “contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today,” \textit{id.} at 311, and expressly referred to the need for stability, \textit{id.} at 317. \textit{See also} Alice J. Davis, \textit{State Jurisdiction to Compel Production of Documents and Witnesses After Quill}, 6 STATE TAX NOTES 1343, 1344 (1994) ("The Court made it clear [in Quill] that the basis for its Commerce Clause decision was its reluctance to overturn National Bellas Hess, supra, and its belief that Commerce Clause issues such as the one presented are better regulated by Congress."); Mark L. Evans, \textit{Some Implications of Allied-Signal and Quill for Business Planning and Litigation}, 2 STATE TAX NOTES 891, 891 (1992) ("The Court in [Quill] . . . predicated its conclusions in large measure on a well-founded aversion to overruling its own prior decisions.").

87. \textit{Cf. Quill}, 504 U.S. at 320 (Scalia, J., concurring) ("I would not revisit the merits of [the Bellas Hess Commerce Clause decision] . . . but would adhere to it on the basis of \textit{stare decisis}.")

88. See Richard H. Kirk, Note, \textit{Supreme Court Refuses to Re-Examine Whether}
Quill involved a challenge to a state statute which imposed use tax collection responsibilities on an out-of-state mail-order house that had neither outlets nor sales representatives in the state. Twenty-five years earlier, in National Bellas Hess, Inc. v. Department of Revenue, the Court had held that an Illinois statute that imposed similar responsibilities violated both the Due Process and Commerce Clauses.

The Court began its analysis in Quill by noting that the Due Process and Commerce Clauses, while similar, impose "distinct limits on the taxing powers of the States." With respect to the Due Process Clause, the Court found that its due process jurisprudence had evolved in the years since Bellas Hess so that due process no longer requires that a mail-order house have a physical presence in the state before the state may require that it collect and pay use tax on goods purchased for use in the state. Instead, the Court held that a state may impose such responsibilities on a seller so long as the seller purposefully directs its commercial activity at the residents of the state.

The Court recognized that its Commerce Clause jurisprudence

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Physical Presence Is a Prerequisite to State Income Tax Jurisdiction: Geoffrey, Inc. v. South Carolina Tax Commission, 48 Tax Law. 271, 286 (1994) ("judicial analysis of due process and the Commerce Clause in the context of interstate business taxation remains muddled"); David F. Shores, State Taxation of Interstate Commerce: Quill, Allied Signal, and a Proposal, 72 Neb. L. Rev. 682, 683 (1993) (Quill is "likely to create more problems than it solves"); Charles Rothfeld, Quill: Confusing the Commerce Clause, 3 State Tax Notes 111, 111 (1992) (Quill's majority opinion "leaves open significant questions about the scope of the Court's holding and ... almost surely will encourage continuing litigation").

89. 386 U.S. 753 (1967).

90. Quill, 504 U.S. at 305. Prior to the Quill decision, commentators had disagreed as to "whether the Bellas Hess decision rested on the Commerce Clause, the Due Process Clause, or both." Jerome R. Hellerstein, The Quill Case: What the States Can Do To Undo the Effects of the Decision, 4 State Tax Notes 273, 273 (1993); Timothy H. Gillis, Note, Collecting the Use Tax on Mail-Order Sales, 79 Geo. L.J. 535, 536 n.10 (1991).

91. Quill, 504 U.S. at 305.

92. Id. at 306-08.
had also evolved in the years since it decided *Bellas Hess*. Nevertheless, it concluded that its Commerce Clause jurisprudence had not evolved to such a degree as to merit overruling that decision. It reaffirmed *Bellas Hess*’ “bright line” rule and held that nexus under the Commerce Clause requires that an out-of-state seller have some physical presence in the state before the state may impose use tax collection responsibilities on that seller.

Yet the Court did not precisely define the physical presence necessary to satisfy the Commerce Clause nexus requirement. Nor did it explain adequately why the Commerce Clause requires a different nexus standard than that required under the Due Process Clause. In addition, the Court left open the question whether the physical presence test applies to other types of state taxes. As a result, the Court’s decision created instability and uncertainty with respect to how the Commerce Clause nexus standard should be

93. *Id.* at 309-10.
94. *Id.* at 314-19.
95. *Id.* at 315 n. 8 (concluding that Quill’s licensing of software in the state failed to constitute “substantial nexus” but declining to define what contacts would in fact constitute “substantial nexus”). *See also* Laura A. Kulwicki, *Continuing State Trends in Nexus Enforcement after Quill: The Struggle To Define “Substantial Nexus,”* 6 STATE TAX NOTES 345, 345 (1994) (“This ‘bright line’ is not quite as bright as it first seems.”); Direct Marketing Association Official Speaks on the Quill Victory at Tax Administrators’ Meeting, 3 STATE TAX NOTES 122, 125 (1992) (“Although the Bellas Hess physical presence test was called a ‘bright line’ test . . . this is a relative term.”).
96. In attempting to differentiate the two nexus requirements, the Court noted that the Commerce Clause nexus requirement is intended to “limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce,” 504 U.S. at 313, while the due process nexus requirement is designed to ensure “the fundamental fairness of governmental activity” with respect to individual defendants. *Id.* at 312. Those concerns explain why the Commerce Clause requires fair apportionment and non-discrimination while the Due Process Clause does not. Those concerns do not, however, explain why the Commerce Clause requires a higher nexus standard. Shores, *supra* note 88, at 695.
97. *Quill*, 504 U.S. at 314 (“[W]e have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes.”).
defined\(^{98}\) and whether the higher standard should apply to different types of taxes\(^{99}\) and different duties related to use tax collection.\(^{100}\)

Had the states defined their use tax bases in a uniform manner,

98. See Kulwicki, \textit{supra} note 95, at 346-47 (discussing pending litigation regarding meaning of the substantial nexus requirement); see also \textit{Quill}, 504 U.S. at 330-31 (White, J., dissenting) (predicting that decision would result in flurry of litigation over meaning of “physical presence”); Rothfeld, \textit{supra} note 88, at 114 (taxpayers and taxing officials will not be able to determine adequacy of physical presence “because it is not based on any real principle”). Compare Michael C. Hamersley, Note, \textit{Will the Bellas Hess Physical Presence Requirement Continue to Protect Out-of-State Mail-Order Retailers from State Use Taxes in the Quill Era? Quill Corp. v. North Dakota}, 46 \textit{TAX LAW.} 515, 521-23 (1993) (contending that \textit{Quill} requires “substantial physical presence”) with Alice J. Davis, \textit{How Much Is Too Little? Defining De Minimis Substantial Nexus}, 7 \textit{STATE TAX NOTES} 1983, 1985-86 (1994) (criticizing recent New York decisions which relied on Hamersley’s note in finding that \textit{Quill}’s nexus requirement demands “substantial physical presence”).


100. For example, Ohio has enacted legislation requiring out-of-state sellers with no physical presence in the state to keep records of its sales in the state and make those records available for inspection by the state tax commissioner. \textit{OHIO REV. CODE ANN.} §§ 5741.01(H), 5741.15 (Anderson 1996); see Christine T. Mesirow & Mark A. Engel, \textit{What Hath Quill Wrought? Ohio’s New Nexus Provisions}, 7 \textit{CAP. U. OHIO TAX REV.} 2 (1993), \textit{reprinted in} 6 \textit{STATE TAX NOTES} 1207 (1994) (questioning constitutionality of such legislation); Davis, \textit{supra} note 86, at 1345 (defending constitutionality of such legislation).
the Quill problem would likely never have arisen. In explaining why the North Dakota statute risked unduly burdening interstate commerce, the Court noted that not only did North Dakota impose use tax collection responsibilities on a vendor who advertises in the state at least three times in a year, but “[w]hat is more significant, similar obligations might be imposed by the Nation’s 6,000-plus taxing jurisdictions.” If all state and local jurisdictions defined their use tax bases in a uniform manner, that collection responsibility would not have been as significant a burden. The Court, however, could not, and did not, attempt to resolve the problem by mandating uniform use legislation. Instead, the Court made it clear that Congress could resolve the problem by legislation.

B. Fair Apportionment

The second prong of the Complete Auto test requires that the tax be fairly apportioned to the taxpayers’ activities in the taxing state. Unlike the Commerce Clause nexus requirement, which, until Quill, appeared to have been firmly rooted in the Court’s due process jurisprudence, the Court has long evaluated state tax apportionment formulae under both the dormant Commerce

101. Quill, 504 U.S. at 313 n.6.
102. Id. at 318. As discussed in supra note 90, according to some commentators, Bellas Hess was based on both due process and Commerce Clause limitations. To the extent that it was based on the Due Process Clause, Congress may not have had authority to legislate in the area prior to Quill because there is some question whether Congress has the power to authorize state taxation that violates due process limitations. Compare Walter Hellerstein, State Taxation of Corporate Income from Intangibles: Allied-Signal and Beyond, 48 TAX L. REV. 739, 800 n.344 (1993) (asserting that this issue raises a serious question) with William Cohen, Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma, 35 STAN. L. REV. 387, 398-400 (1983) (arguing that Congress has such power).
104. See Quill, 504 U.S. at 326-27 (White, J., dissenting) (discussing due process origins of Complete Auto nexus requirement).
105. See supra note 8 and accompanying text.
Clause and the Due Process Clause. Nevertheless, the precise purpose of the Commerce Clause fair apportionment requirement is not entirely clear.

Commentators have suggested that the requirement’s purpose is to protect against multiple taxation and the Court’s most recent decision addressing the issue lends considerable support to this view. Nevertheless, in other decisions, the Court has suggested that the discrimination prong protects against multiple taxation, and in Japan Line, the Court found it necessary to add


108. See, for example, Regan, supra note 37, at 1186 (fair apportionment requirement best viewed as deriving solely from the Commerce Clause).

109. See, for example, In re Levy, 118 U.S. 383, 385 (1886) (describing the fair apportionment requirement as “the lineal descendant of Western Live Stock’s”) prohibition of multiple taxation”).

110. For example, in Exxon Corp. v. Wisconsin Dep’t of Revenue, 447 U.S. 207 (1980), the Court began its Commerce Clause discussion by reciting the four
a separate multiple taxation prong to test challenges to state taxes affecting foreign commerce.\textsuperscript{112}

Whatever the purpose behind the fair apportionment requirement, the Court has made it clear that it does not always forbid multiple taxation in fact, at least in the context of income taxation. For instance, in \textit{Container Corp. v. Franchise Tax Board},\textsuperscript{113} the taxpayer challenged California’s application of its world-wide combined reporting method of taxation to income received by the taxpayer’s subsidiaries operating abroad. The taxpayer contended that California’s method of taxation impermissibly subjected it to multiple taxation because it conflicted with the internationally accepted “arm’s length” separate accounting method of taxation.

prong Complete Auto test. \textit{Id.} at 227-28. It quickly disposed of the first, second, and fourth prongs, \textit{id.} at 228, and then discussed multiple taxation at length. Although the Court did not expressly label its multiple taxation discussion a discrimination discussion, it appears that it viewed it as such because the Court had already disposed of the other three prongs before it even began to discuss multiple taxation. \textit{Id.} at 227-30. See also Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 443 (1980) (Court rejects taxpayer’s assertion that tax subjects interstate business to burden of multiple taxation that intrastate business does not share, but does not reject taxpayer’s characterization of that issue as one of discrimination); cf. Amy Hamilton, \textit{Legal Minds Weigh in on High Court’s Jefferson Lines Ruling}, 8 \textit{STATE TAX NOTES} 1630, 1631 (1995) (“several times the U.S. Supreme Court has, from [MTC Deputy Counsel Paul Mines’] point of view, confused fair apportionment and nondiscrimination”).

The Court’s extension of the internal consistency doctrine to the discrimination prong, see infra text accompanying notes 199-208, is also consistent with the view that the discrimination prong protects against multiple taxation.


112. \textit{Id.} at 446-48. In \textit{Itel Containers Int’l Corp. v. Huddleston}, 507 U.S. 60 (1993), however, the Court suggested that the fair apportionment requirement would protect against multiple taxation unless the international norm were a tax other than a fairly apportioned tax. \textit{Id.} at 74-75 (“Absent a conflict with a ‘consistent international practice [or] . . . federal policy,’ . . . the careful apportionment of a state tax on business transactions conducted within state borders does not create the substantial risk of international multiple taxation that implicates foreign commerce clause concerns.”) (quoting \textit{Container Corp. v. Franchise Tax Bd.}, 463 U.S. 159, 190 (1983)).

Assuming that the taxpayer was subjected to multiple taxation in fact, the Court nevertheless found that California’s method of taxation satisfied the fair apportionment requirement.

In that case, the Court developed a two-fold inquiry to determine whether an apportionment formula is fair. Under this inquiry, the Court asks: (1) whether the formula has “internal consistency,” that is, whether the formula, if applied in every jurisdiction, would result in “no more than all of the unitary business’ income being taxed,” and (2) whether the formula has “external consistency,” that is, whether the formula actually reflects a “reasonable sense of how income is generated.”

The internal consistency test, in the fair apportionment context, is unexceptional and does little more than serve as a check against blatant multiple taxation in theory. The test, however, has been extended to the discrimination prong of the Complete Auto test and has created great uncertainty in the law as there applied.

For the first time, the Court devoted significant attention to the external consistency test in Oklahoma Tax Commission v. Jefferson Lines, Inc. There, a bus line challenged an Oklahoma sales tax

114. Id. at 187 & n.22
115. Id. at 169.
116. Id.
117. Hellerstein, supra note 99, at 139.
118. See infra notes 142-48 and accompanying text.
119. 115 S. Ct. 1331 (1995). The external consistency test appears to overlap considerably with the fourth prong of the Complete Auto test, discussed infra part IV.D. For example, in Trinova Corp. v. Michigan Dep’t of Treasury, 498 U.S. 359 (1991), the Court declared that an apportionment formula would only fail the external consistency if “the income attributed to the State is in fact ‘out of all appropriate proportions to the business transacted . . . in that State’ . . . or has ‘led to a grossly distorted result.’” Id. at 380 (quoting Hans Rees’ Sons, Inc. v. State of North Carolina, 283 U.S. 123, 135 (1935), and Norfolk & Western R. Co. v. Missouri State Tax Comm’n, 390 U.S. 317, 326 (1968)). The Court used almost identical language to describe the fourth prong in Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981): “Beyond [the] threshold requirement [of substantial nexus], the fourth prong of the Complete Auto Transit test imposes the additional limitation that the measure of the tax must be reasonably related to the extent of the contact.” Id. at 626.
imposed on the full price of a bus ticket for travel originating in Oklahoma and ending outside the state. In determining whether the tax violated the external consistency requirement, the Court asked whether the tax raised the risk of actual multiple taxation.

Distinguishing the sales tax at issue from income and gross receipts taxes, the Jefferson Lines Court held that the tax did not violate the external consistency test because no other state could impose a sales tax on the transaction: "The taxable event comprises agreement, payment, and delivery of some of the services in the taxing State; no other State can claim to be the site of the same combination." While the Court's decision has been praised for "not upset[ting] the appletcart of state taxation," the decision raises questions about state taxation of interstate services such as advertising, architecture, data processing, and engineering, where the situs of the sale is less clear.

As discussed above, in *Moorman Manufacturing Co. v. Bair*, the Court expressly held that the Commerce Clause does not require that states impose a uniform apportionment formula. In subsequent cases, the Court has made it clear that Congress can impose uniform rules under the exercise of its Commerce Clause power, but that the Court will not do so under the dormant Commerce Clause. If states were to impose uniform

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120. 115 S. Ct. at 1335.
121. *Id.* at 1341-43.
122. *Id.* at 1339, 1340-41.
123. *Id.* at 1341.
126. *See supra* text accompanying notes 77-78.
128. *Id.* at 279-80.
129. *Barclays Bank PLC v. Franchise Tax Bd.*, 114 S. Ct. 2268, 2286 (1994) ("[W]e leave it to Congress – whose voice, in this area, is the Nation's – to evaluate whether the national interest is best served by tax uniformity, or state autonomy."); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 448-49
apportionment rules, either by voluntary agreement or by congressional mandate, the risk of multiple taxation would be eliminated and the Court would no longer need to analyze taxes under the fair apportionment prong of the Complete Auto test.\textsuperscript{130}

C. Discrimination

The third prong of the Complete Auto test requires that the tax not discriminate against interstate commerce.\textsuperscript{131} The discrimination prong may be viewed as a type of uniformity requirement: it does not require that all states tax interstate and foreign commerce in a uniform manner, but it does demand that each state treat in-state taxpayers and out-of-state taxpayers similarly. This requirement is “more firmly entrenched and consistently applied than any other [doctrine the Court] has enunciated in this field.”\textsuperscript{132} Yet the “standard has an almost excruciating vagueness and inconsistency

(1980) (declining to mandate uniform state taxation of foreign dividends where Congress has not enacted legislation requiring such treatment).

130. The states would also have to adopt uniform allocation rules to eliminate completely the risk of multiple taxation. As discussed at supra note 18, if a specific type of income is taxed by allocation by one state while at the same time another state taxes it is taxed by apportionment, the income is necessarily subject to the risk of multiple taxation or the risk that some of the income will escape taxation altogether. In Mobil Oil, 445 U.S. at 444-45, the Court recognized that these two types of taxation were “theoretically incommensurate” and that if taxation by allocation were constitutionally preferred to taxation by apportionment, taxation by apportionment could not be sustained. The Court, however, found no adequate justification for that preference. Id. The Court left open the question whether, as a constitutional matter, taxation by allocation must yield to taxation by apportionment. Id. at 445.


132. Hellerstein, Perspectives, supra note 4, at 46. See also Boston Stock Exch. v. State Tax Comm’n, 429 U.S. 318, 329 (1977) (describing as a “fundamental principle” of the Court’s dormant Commerce Clause jurisprudence that “[n]o State, consistent with the Commerce Clause, may ‘impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business’”) (quoting Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 457 (1959)).
in practice.”133 “The concept of discrimination is not self-defining, and the Court has never precisely delineated the scope of the doctrine.”134

First, the Court does not limit its review to the face of a taxing statute. Instead, it polices against taxes that discriminate in operation135 as well as those that discriminate on their face. While determining whether a particular tax discriminates on its face is generally a relatively straightforward exercise,136 determining whether a taxing statute discriminates in operation has frequently

133. SHAVIRO, supra note 5, at 48.
134. Hellerstein, Perspectives, supra note 4, at 60.
135. The Court first referred to this principle in Robbins v. Shelby County Taxing Dist., 120 U.S. 489, 498 (1887), and it has been a recurring theme throughout the Court’s opinions. Hellerstein, Perspectives, supra note 4, at 46. See also Hellerstein, supra note 74, at 345 (“Historically, the Court has been zealous to strike down under the commerce clause state taxes that discriminate against interstate commerce, no matter how artfully drawn to disguise the discrimination.”).
136. See, e.g., New Energy Co. v. Limbach, 486 U.S. 269 (1988) (unanimous Court holds that an Ohio statute that expressly provides credit only for ethanol produced in Ohio or a state which grants reciprocal credit discriminates against interstate commerce in violation of dormant Commerce Clause); Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) (majority holds that Hawaiian excise tax exempting certain locally produced alcoholic beverages discriminates against interstate commerce in violation of the dormant Commerce Clause; dissenting justices skeptical that taxpayers can prove harm but do not dispute finding that tax facially discriminates against interstate commerce); Westinghouse Elec. Corp. v. Tully, 466 U.S. 388 (1984) (unanimous Court holds that New York income tax provision that expressly provides credit only for products shipped from New York discriminates against interstate commerce in violation of the dormant Commerce Clause); see also Philip M. Tatarowicz & Rebecca F. Mims-Velarde, An Analytical Approach to State Tax Discrimination Under the Commerce Clause, 39 VAND. L. REV. 879, 902 (1986) (“In these cases [of facial discrimination], it is not difficult for the taxpayer to meet its burden of proof.”).

Of course, not all claims of facial discrimination result in unanimous opinions. See, e.g., Kraft Gen. Foods, Inc. v. Iowa Dep’t of Revenue and Fin., 505 U.S. 71 (1992) (majority holds that Iowa statute which includes “foreign subsidiary dividends” in Iowa tax base while excluding “domestic subsidiary dividends” from that base discriminates against foreign commerce in violation of dormant foreign Commerce Clause).
proven to be an elusive task.\textsuperscript{137}

Second, the Court does not always limit its inquiry to a single tax. Under the complementary tax doctrine, the Court will uphold an apparently discriminatory taxing statute if other complementary or compensating taxes equalize the tax burden imposed by the tax at issue.\textsuperscript{138} Although the Court first invoked the doctrine in 1869,\textsuperscript{139} the Court has yet to develop a clear and consistent approach to the doctrine and has left many questions regarding application of the doctrine unanswered.\textsuperscript{140}

Finally, in recent years, the Court has compounded the uncertainty in this area by extending application of the internal consistency doctrine to its discrimination analysis. As discussed above,\textsuperscript{141} the Court developed the internal consistency test as a means of determining whether an apportionment formula is fair.\textsuperscript{142} The test asks whether the formula, "if applied by every jurisdiction, . . . would result in no more than all of the unitary business' income being taxed.\textsuperscript{143}

In \textit{Armco, Inc. v. Hardesty},\textsuperscript{144} the Court extended application of the doctrine to determine whether a taxing statute facially

\begin{itemize}
\item 137. For example, compare the divided opinions filed in Goldberg v. Sweet, 488 U.S. 252 (1989); American Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266 (1987); Nippert v. City of Richmond, 327 U.S. 416 (1946). \textit{See also} HARTMAN, \textit{supra} note 4, at § 2.19 ("[O]nce the question goes beyond the tax that is patently discriminatory on its face, much room for controversy about hidden discrimination exists."); Tatarowicz & Mims-Velarde, \textit{supra} note 136, at 902 ("The more difficult cases involve facially neutral statutes that nonetheless have a discriminatory effect on interstate commerce.").
\item 138. \textit{See}, e.g., Associated Indus. v. Lohman, 114 S. Ct. 1815 (1994) (statewide use tax of 1.5% is valid compensating tax for local sales taxes that equal or exceed 1.5%).
\item 139. Hinson v. Lott, 75 U.S. (8 Wall.) 148 (1869).
\item 141. \textit{See supra} text accompanying notes 113-16.
\item 143. \textit{Id}.
\item 144. 467 U.S. 638 (1984).
\end{itemize}
discriminates against interstate commerce. In *American Trucking Ass’ns, Inc. v. Scheiner*, the Court further extended application of the doctrine to strike down a facially nondiscriminatory tax. Noting that the majority’s opinion required the Court to overrule directly at least three decisions, Justice O’Connor vigorously opposed extension of the doctrine.

Adoption of uniform rules to define all state tax bases and allocate those bases among the states would eliminate the problems raised under the discrimination prong. Admittedly, states might “still accomplish a measure of perceived or actual tax exportation” in choosing their tax rates. Nevertheless, the Court in *Commonwealth Edison Co. v. Montana* made it clear that this is

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145. In *Armco*, the taxpayer contended that a West Virginia wholesale gross receipts tax facially discriminated against interstate commerce because local manufacturers were exempt from the tax. The state defended the wholesale tax as a complementary tax offsetting the higher manufacturing tax imposed on local manufacturers. Rejecting the state’s characterization of the manufacturing tax as a compensating tax, the Court nonetheless noted that, even if the two taxes were considered together, the wholesale tax would still discriminate against interstate commerce because the taxing scheme, if applied by every taxing jurisdiction, would result in a heavier burden being imposed on interstate commerce than on purely intrastate commerce. *Id.* at 644-45.


147. *Id.* at 284-87.

148. *Id.* at 298-303. Justice Scalia, joined by Chief Justice Rehnquist, separately dissented. *Id.* at 303-06.

Walter Hellerstein has roundly criticized the decision for unnecessarily casting doubt on a number of other state taxes. Hellerstein, *supra* note 99, at 154-63 (arguing that *Scheiner* puts in jeopardy any unapportioned state or local tax on a multistate business, such as a tax for the privilege of engaging in business activity in the state, an annual business license tax, or a professional licensing fee). See also Richard B. Collins, *Justice Scalia and the Elusive Idea of Discrimination Against Interstate Commerce*, 20 N.M. L. REV. 555, 583 (1990) (appearance of the internal consistency test in discrimination opinions compounds confusion regarding the definition of discrimination). But see Shaviro, *supra* note 51, at 283 (describing the internal consistency test, in the discrimination context, as an “important new test”).

149. SHAVIRO, *supra* note 5, at 106.

not a risk against which the discrimination prong protects.\footnote{Id. at 618-19 (holding that the discrimination prong does not protect out-of-state consumers from high tax rates as long as state imposes the same rates on in-state consumers).}

\textit{D. Fair Relation}

The fourth prong of the \textit{Complete Auto} test requires that the tax be “fairly related to the services provided by the State.”\footnote{Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).} Like the first two prongs of the \textit{Complete Auto} test, this prong overlaps with the Court’s due process jurisprudence.\footnote{See, e.g., Trinova Corp. v. Michigan Dep’t of Treas., 498 U.S. 358, 373 (1991) (“The \textit{Complete Auto} test, while responsive to Commerce Clause dictates, encompasses as well the due process requirement that there be . . . a rational relationship between the income attributed to the State and the intrastate values of the enterprise) (internal quotation omitted); Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 165-66 (1983) (“The Due Process and Commerce Clauses of the Constitution do not allow a State to tax income arising out of interstate activities – even on a proportional basis – unless there is . . . a rational relationship between the income attributed to the State and the intrastate values of the enterprise.”) (internal quotations omitted); \textit{see also} Cain, \textit{supra} note 83, at 5 (“Items one and four in the analysis, which required nexus and benefits for a tax to stand, are classic due process requirements.”); Sedler, \textit{supra} note 107, at 912-13 (due process source of \textit{Complete Auto}’s fair relation requirement).} In addition, it appears to overlap with \textit{Container}’s fair apportionment external consistency requirement.\footnote{See \textit{supra} note 119.} Nevertheless, it is not entirely clear what content, if any, this prong contains, for the Court has yet to strike down a state tax based solely on this prong of the \textit{Complete Auto} test.\footnote{Rarely has the Court struck down state taxes based on the seemingly analogous requirement under the Due Process Clause that a tax be fairly related to services provided by the state. See Norfolk & Western Ry. v. Missouri State Tax Comm’n, 390 U.S. 317 (1968); Hans Rees’ Sons v. North Carolina, 283 U.S. 123 (1931).}

In \textit{Goldberg v. Sweet},\footnote{488 U.S. 252 (1989).} the Court stated that the purpose of the prong is “to ensure that a state’s tax burden is not placed upon
persons who do not benefit from services provided by the state.”

In Commonwealth Edison Co. v. Montana, the Court suggested that the prong will impose no barrier whatsoever to any proportional tax. The Court in American Trucking Ass'ns v. Scheiner, however, suggested that it may have some bite in determining the validity of flat taxes.

If all states were to impose uniform tax bases and apportionment rules, presumably the rules would be drafted to ensure that each state be attributed a share of tax that is fairly related to the services it provides. Thus, the imposition of uniform tax bases and apportionment rules would resolve any problems under the fair relation prong.

E. Multiple Taxation/Speaking with One Voice

In Japan Line, Ltd. v. County of Los Angeles, the Court relied on two additional considerations to strike down under the dormant

157. Id. at 266-67.
159. Id. at 645 (Blackmun, J., dissenting). See also McGrath & Hellerstein, supra note 74, at 171 (“It is difficult to argue with Justice Blackmun’s conclusion.”).

In Commonwealth Edison, the taxpayers contended that a severance tax levied by Montana on coal mined in the state violated the fair relation prong of the Complete Auto test. Declining to review the rate of the tax, the Court described the relevant inquiry as whether the measure of the tax is reasonably related to the extent of the taxpayer’s contact with the state “since it is the activities or presence of the taxpayer in the State that may properly be made to bear a ‘just share of state tax burden.’” 453 U.S. at 626 (quoting Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938)). Because the severance tax was measured as a percentage of the value of the coal mined, the Court found that it was in “proper proportion” to the taxpayers’ activities within the state and upheld the tax. Id. at 626.

161. There, the Court found the flat taxes distinguishable from the tax in Commonwealth Edison because “the amount of Pennsylvania’s marker and axle taxes owed by a trucker does not vary directly with miles traveled or with some other proxy for value obtained from the State.” Id. at 291.
foreign Commerce Clause a fairly apportioned, nondiscriminatory property tax imposed on foreign-owned cargo containers used exclusively in foreign commerce: (1) the risk of multiple taxation, and (2) the requirement that the federal government speak with one voice. In the years since Japan Line, the Court has continued to pay lip service to the need to take these considerations into account when evaluating a challenge to a state tax affecting foreign commerce. Yet the Court has never again relied on either of these considerations to strike down a state tax affecting foreign commerce, and its analysis in the post-Japan Line cases has weakened the considerations so that they seem to have little substance left to them. Moreover, in recent dictum, the Court questioned the theoretical need for Japan Line's extra protection of foreign commerce.

163. Id. at 451.
165. The Court relied on the discrimination prong of the Complete Auto test and did not even address Japan Line's two supplemental considerations to strike down an Iowa taxing statute in Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Fin., 505 U.S. 71 (1992), the only case since Japan Line to strike down a state tax affecting foreign commerce.
166. See Harriet Hanlon, California Tax Conference Looks at High Court Rulings, Barclays Fallout, 7 STATE TAX NOTES 1268, 1269 (1994) (Professor Pomp notes at California Tax Policy Conference that Barclays "signals the death of the Foreign Commerce Clause"); Charles Rothfeld, Viewpoint, From Japan Line to Barclays: The Rise and Fall of the Foreign Commerce Clause, 7 STATE TAX NOTES 367 (1994) (arguing that not much is left of Japan Line's two prongs after Barclay's); Gregory A. Viggiano, Itel and the Strengthening of States' Tax Power, 4 STATE TAX NOTES 912, 917 (1993) ("Itel seriously erodes both parts of the Japan Line test").
167. The Court stated:
We do note, however, that Tennessee's compliance with the Complete Auto test has relevance to our conclusion that the state tax meets those inquiries unique to the foreign commerce clause. That the tax is a fair measure of the State's contacts with a given commercial transaction in all four aspects of the Complete Auto test confirms both the State's
1. Multiple Taxation

In *Japan Line*, the Court suggested that the dormant foreign Commerce Clause may prohibit absolutely any degree of multiple taxation in international commerce.168 Yet less than a year after deciding the case, the Court began to dilute that requirement,169 and by 1983, expressly disclaimed that *Japan Line* set forth an absolute prohibition on multiple taxation in the foreign commerce context.170

In *Container Corp. v. Franchise Tax Board*, the Court declared that “[a]lthough double taxation in the foreign commerce context deserves to receive close scrutiny, that scrutiny must take into

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168. Specifically, the Court said, “Even a slight overlapping of tax – a problem that might be deemed *de minimis* in a domestic context – assumes importance when sensitive matters of foreign relations and national sovereignty are concerned.” *Japan Line*, Ltd. v. County of Los Angeles, 441 U.S. 434, 456 (1979).

169. In *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), Mobil, a New York corporation, challenged Vermont’s inclusion of dividend income it received from subsidiaries and affiliates operating abroad in its apportionable tax base. Although New York did not tax the dividend income Mobil received from its subsidiaries and affiliates operating abroad, Mobil contended that the Vermont taxing scheme created an impermissible risk of multiple taxation because New York had the power to tax that dividend income in full. *Id.* at 433. The Court declared that Mobil’s argument underestimated the Court’s ability to correct excessive taxation: “A discriminatory effect on foreign commerce as a result of multiple state taxation is just as detectable and corrigeable as a similar effect on commerce among the States. Accordingly, we see no reason why the standard for identifying impermissible discrimination should differ in the two instances.” *Id.* at 447. The Court’s inability to protect completely against multiple taxation in the interstate commerce context, *see Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 278-80 (1978), combined with its failure to distinguish the risk of multiple taxation in *Mobil* from the risk of multiple taxation in the purely intrastate context suggested that “*de minimis*” multiple taxation of foreign commerce may be permissible.

account the context in which the double taxation takes place and the alternatives reasonably available to the taxing State.” 171 The Court described the alternatives available to the state in that case as (1) abstaining from taxing the taxpayer’s income at all or (2) adopting some version of the “arm’s length” separate accounting method of taxation. 172 The Court thought the “obvious unfairness [of the first alternative] require[d] no elaboration,” 173 despite the fact that the Court had previously held in Japan Line that the dormant foreign Commerce Clause forbade California from imposing any property tax in that case. 174 The Court dismissed the second alternative because it would not guarantee an end to double taxation. After Container, it is not clear against what risk of multiple taxation, if any, the Japan Line multiple taxation prong now protects.

As discussed above, 175 the imposition of uniform tax bases and apportionment rules would eliminate the risk of multiple state taxation. To the extent, however, that a foreign country were to tax without apportionment, as Japan did in Japan Line, uniform tax bases and apportionment rules would not eliminate the risk of multiple taxation. In such cases, that risk could only be eliminated if states abstained from taxing at all.

2. Speaking with One Voice

The Container Court also appeared to enervate Japan Line’s “one voice” requirement. The Court explained that a state tax “will violate the ‘one voice’ standard if it either implicates foreign policy

171. Id.
172. Id. at 190.
173. Id.
174. Id. at 189-90. The Container Court believed that prohibiting California from taxing the containers in Japan Line was “by no means unfair, because the rule did no more than reflect consistent international practice and express federal policy.” Id. at 190. Yet the “arm’s length” method of taxation, which the Container Court did not require California to adopt, also represented the international norm. Id. at 191 & n.28.
175. See supra note 130 and accompanying text.
issues which must be left to the Federal Government or violates a clear federal directive."\textsuperscript{176} In analyzing the first element, the Court described "the most obvious foreign policy implication" as the threat of retaliation by the nation's trading partners against the nation as a whole, but doubted its ability to directly assess the risk.\textsuperscript{177} Describing the second element as "essentially a species of pre-emption analysis,"\textsuperscript{178} the Court suggested that the "clear federal directive"\textsuperscript{179} inquiry is little more than a Supremacy Clause analysis.

In \textit{Wardair Canada, Inc. v. Florida Department of Revenue},\textsuperscript{180} the Court continued to weaken the "one voice" standard by finding "[b]y negative implication" that Congress had affirmatively acted to permit state taxation of aviation fuel.\textsuperscript{181} Then, in \textit{Itel Containers International Corp. v. Huddleston},\textsuperscript{182} the Court further weakened the prong by interpreting the Customs Convention on Containers in a manner entirely inconsistent with the manner in which the Court had interpreted the same convention in \textit{Japan Line}.

In \textit{Japan Line}, the Court interpreted the convention broadly to prohibit California from imposing an apportioned property tax on cargo containers used in foreign commerce. The Court described the convention as reflecting "a national policy to remove impediments to the use of containers as 'instruments of

\textsuperscript{176} 463 U.S. at 194.
\textsuperscript{177}  Id. "In considering this issue, however, we are faced with a distinct problem. This Court has little competence in determining precisely when foreign nations will be offended by particular acts, and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the States tax as they please. The best that we can do, in the absence of explicit action by Congress, is to attempt to develop objective standards that reflect very general observations about the imperatives of international trade and international relations." \textit{Id}.
\textsuperscript{178}  Id. at 194.
\textsuperscript{179}  \textit{Id}.
\textsuperscript{180}  477 U.S. 1 (1986).
\textsuperscript{181}  \textit{Id}. at 12.
\textsuperscript{182}  507 U.S. 60 (1993).
international traffic,” and found that California’s tax created a risk of retaliation by Japan because California’s tax on Japanese-owned containers, combined with Japan’s abstention from taxing American-owned containers, created “an asymmetry in international maritime taxation operating to Japan’s disadvantage.” The Court concluded by stating, “[i]f other States follow California’s example . . . , foreign-owned containers will be subjected to various degrees of multiple taxation, depending on which American ports they enter. This result, obviously, would make ‘speaking with one voice’ impossible.”

In Itel, the taxpayer carefully tracked this reasoning in order to challenge a Tennessee sales tax imposed on proceeds earned from the delivery of leased cargo containers in Tennessee. Feigning ignorance of the source of this argument, the Court rejected the argument by, among other things, adopting a much narrower interpretation of the convention. The Court did not make any real attempt to reconcile the case with Japan Line, other than to point out that, unlike Japan Line, the United States filed an amicus brief defending the Tennessee tax in Itel.

184. Id.
185. Id.
187. In Itel, the Court framed the taxpayer claim as follows: [I]f other States in this country follow Tennessee’s lead and tax international container leases [while foreign countries currently abstain from taxing those containers], the United States will be unable to speak with one voice in foreign trade because international container leases will be subject to various degrees of domestic taxation. As a consequence, . . . container owners and users will be hit by retaliatory foreign taxes.
188. Id. (“To the extent Itel is arguing that the risk of double taxation violates the one voice test, our response is the same as above: Tennessee’s tax does not create the substantial risk of international multiple taxation that implicates foreign commerce clause concerns.”).
189. Id. Of course, the Court had to admit that the views of the Executive
Finally, in *Barclays Bank PLC v. Franchise Tax Board*, the Court recently indicated that there is no substance left to the “one voice” requirement. That case involved a challenge to the application of California’s worldwide combined reporting method of taxation to a multinational enterprise, a question the Court had expressly left open in *Container*. The *Barclays* Court began its “one voice” analysis by stating that an important premise underlying the Court’s decisions in *Container* and *Wardair* was that Congress may more passively indicate that certain state practices do not “impair federal uniformity in an area where federal uniformity is essential;” it need not convey its intent with the unmistakable clarity required to permit state regulation that discriminates against interstate commerce or otherwise falls short under *Complete Auto* inspection.

Then, in applying the standard, the Court suggested that nothing less than a finding of express congressional action prohibiting state taxation would establish that a state tax violates the “one voice” requirement.

If Congress were to mandate uniform tax bases and apportionment rules, there is no doubt that the speaking with one

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branch were “by no means dispositive,” *id.* (quoting *Container*), particularly in light of the fact that the Court had disregarded the views of the Solicitor General in *Wardair*.

192. *Barclays*, 114 S. Ct. at 2282-83 (citation omitted).
193. *Id.* at 2283. The Court found no “specific indications of congressional intent” to bar California’s application of its worldwide combined method to foreign multinationals because (1) Congress could have enacted legislation to overrule *Container* but had failed to do so; (2) Congress had considered numerous bills that would have prohibited California’s method of taxation but had never enacted any of them; and (3) the history of Senate action on the United States/United Kingdom tax treaty suggested that Congress implicitly permitted California’s worldwide combined reporting method of taxation. *Id.* at 2283-84.
voice prong would be satisfied. Congress would have spoken with one voice in announcing those rules. If the rules were adopted by voluntary cooperative state action, they should still satisfy that prong because (1) there is little left of the one voice prong; (2) by adopting uniform rules, the states, if not the federal government, would be speaking with one voice; and (3) uniform rules would not seem to raise as great a risk of retaliation as would separate rules applied by each state.

F. Summary of Current State Tax Doctrine

Currently, the Court applies a four prong test to determine whether a state or local taxing statute violates the dormant interstate Commerce Clause. Under that four prong test, the Court will sustain a state taxing statute against a dormant Commerce Clause challenge if the tax (1) is applied to an activity with a substantial nexus to the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to services provided by the state.\(^{194}\) The Court applies the same four prong test, plus two additional prongs, to test state and local taxing statutes affecting foreign commerce. The two prongs ask whether (1) the tax subjects foreign commerce to an impermissible risk of multiple taxation, and (2) the tax prevents the federal government from speaking with one voice.\(^{195}\) Although describing each of these prongs is a relatively straightforward exercise, the Court’s application of the prongs has been, as demonstrated above, “shot through with uneasy juxtapositions and outright contradictions.”\(^{196}\)

V. HOW THE COURT SHOULD INTERPRET THE STATE TAX DORMANT COMMERCE CLAUSE

If the Court were to mandate uniform state tax bases and

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196. SHAVERO, supra note 5, at 56.
apportionment rules, it would resolve most, if not all, of the problems raised in state and local taxation of interstate and foreign commerce. Unfortunately, the Court is not institutionally competent to adopt that solution. Accordingly, this section will discuss the second best solution, the manner in which the Court should interpret the dormant Commerce Clause, as applied to state and local taxing statutes, in light of its inability to mandate the optimal solution.

A. The Second Best Solution

1. The Idea of the Second Best in Economics and Law

The idea of a second best solution has its roots in economics:

The first fundamental theorem of welfare economics is that when the economy meets the stringent requirements of complete and perfectly competitive markets, the market equilibrium will be Pareto optimal. If these stringent requirements are not met, however, correcting a single market imperfection may not enhance welfare. The theory of the second best attempts to evaluate how one might try to maximize welfare in the face of market imperfections.¹⁹⁷

At least one commentator has extended application of this theory to the law.¹⁹⁸ As applied to the law, the theory recognizes the imperfections in the current state of the law and tries to compensate for those weaknesses. It does not ask that the Court disregard the law as it has developed over the years, but rather attempts to offset existing imperfections in the law.

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¹⁹⁸. See id.; see also NEIL K. KOMESAR, IMPERFECT ALTERNATIVES (1994) (recognizing that all institutions suffer from imperfections and advocating comparative institutional analysis).
2. Justice Scalia’s Original Articulation of the Second Best Solution

Over a period of years, Justice Scalia developed a unique approach to state tax dormant Commerce Clause cases. According to that theory, the Court should strike down a state taxing statute under the dormant Commerce Clause if (1) the statute facially discriminates against interstate commerce, or (2) the statute is indistinguishable from a statute the Court previously struck down.\textsuperscript{199}

Justice Scalia introduced the first prong of his test in the first state tax dormant Commerce Clause cases in which he participated.\textsuperscript{200} In the first of those opinions, he vehemently criticized the Court’s state tax dormant Commerce Clause jurisprudence and suggested that were he to interpret the clause as a matter of first impression, he would confer no “negative” implications whatsoever on it.\textsuperscript{201} In the second of those opinions, however, he expressed a willingness to strike down facially discriminatory taxing statutes.\textsuperscript{202}

In both opinions, Justice Scalia made it clear that he would apply a very narrow approach to determine whether a taxing statute facially discriminates. First, in \textit{Tyler Pipe Industries, Inc. v. Washington State Department of Revenue},\textsuperscript{203} Justice Scalia announced that he was unwilling to extend the internal consistency doctrine to


\textsuperscript{201} \textit{Tyler Pipe}, 483 U.S. at 259-65.

\textsuperscript{202} \textit{Scheiner}, 483 U.S. at 304. In \textit{Tyler Pipe}, he indicated that the Court’s power to strike down such statutes arises under the Privileges and Immunities Clause rather than the Commerce Clause. \textit{Tyler Pipe}, 483 U.S. at 265.

\textsuperscript{203} 483 U.S. 232 (1987).
determine whether a taxing statute facially discriminates.\textsuperscript{204} The statute in that case required both local and out-of-state manufacturers to pay a wholesale tax on in-state sales. In addition, it provided local manufacturers with an exemption from the manufacturing tax for the portion of the manufacturers' output that was subject to the wholesale tax. Out-of-state manufacturers were not subject to the local manufacturing tax.\textsuperscript{205} The majority conceded that the tax "ha[d] the advantage of appearing nondiscriminatory."\textsuperscript{206} Nevertheless, by extending application of the internal consistency doctrine, the majority concluded that the taxing scheme was facially discriminatory because, if every jurisdiction were to apply the same taxing scheme, the taxing scheme, on its face, would subject interstate commerce to a greater tax burden than purely intrastate commerce.\textsuperscript{207} Justice Scalia vigorously disputed this extension of the doctrine.\textsuperscript{208}

In \textit{American Trucking Ass'ns, Inc. v. Scheiner},\textsuperscript{209} Justice Scalia declared that he would not go beyond the face of the taxing statute at issue to determine whether it facially discriminates.\textsuperscript{210} In that case, the taxpayer argued that a flat axle tax, imposed on all trucks used in Pennsylvania, whether registered in the state or elsewhere, facially discriminated against interstate commerce because at the time that the flat tax was introduced, registration fees for Pennsylvania-based trucks were, for all practical purposes, reduced by an amount equal to the axle tax.\textsuperscript{211} The majority did not need to reach that issue because it found that the axle tax discriminated in operation against interstate commerce.\textsuperscript{212} Justice Scalia, however, considered and rejected the argument. "To determine the facially

\textsuperscript{204} Id. at 250-259.
\textsuperscript{205} Id. at 235.
\textsuperscript{206} Id. at 248 (quoting General Motors Corp. v. Washington, 377 U.S. 436, 460 (1964) (Goldberg, J., dissenting)).
\textsuperscript{207} Id. at 247-48.
\textsuperscript{208} Id. at 256-60.
\textsuperscript{209} 483 U.S. 266 (1987).
\textsuperscript{210} Id. at 304.
\textsuperscript{211} Id. at 273-75.
\textsuperscript{212} Id. at 286.
discriminatory character of a tax not on the basis of the tax alone, but on the basis of the structure of a State's tax code, is to extend our case law into a new field, and one in which principled distinctions become impossible.\footnote{213}

By joining in the majority opinion in \textit{Associated Industries v. Lohman},\footnote{214} however, Justice Scalia indicated that he would apply the complementary tax doctrine, and thus go beyond the face of a taxing statute to uphold a statute against a discrimination challenge. In that case, the taxpayer challenged a uniform, statewide use tax imposed on goods bought outside the state and stored, used, or consumed inside the state.\footnote{215} Although the use tax in \textit{Lohman} was only imposed on goods purchased outside the state, the Court did not strike it down as discriminatory for that reason. Instead, under the complementary tax doctrine, the Court took into account local sales taxes for which the use tax was designed to compensate in order to determine whether the use tax discriminated.\footnote{216} Those local sales taxes varied from jurisdiction to jurisdiction, and the Court held that the use tax discriminated against interstate commerce only in those localities in which the local sales tax was less than the use tax.\footnote{217}

Justice Scalia first suggested the second prong of his test in \textit{Quill Corp. v. North Dakota}.\footnote{218} There, as discussed above,\footnote{219} the Court faced a challenge to a use tax statute that was like the use tax statute that the Court struck down twenty five years earlier in \textit{National Bellas Hess, Inc. v. Department of Revenue}.\footnote{220} Justice Scalia joined in the majority's judgment that \textit{Bellas Hess'} Commerce Clause holding should not be overruled, but declared that he would adhere to it on the basis of stare decisis rather than revisit its merits as the majority

\begin{footnotes}
\footnote{213} \textit{Id.} at 305.
\footnote{214} 114 S. Ct. 1815 (1994).
\footnote{215} \textit{Id.} at 1818-19.
\footnote{216} \textit{Id.} at 1820-21.
\footnote{217} \textit{Id.} at 1824.
\footnote{218} 504 U.S. 298 (1992).
\footnote{219} See \textit{supra} part IV.A.
\footnote{220} 386 U.S. 753 (1967).
\end{footnotes}
had.\textsuperscript{221}

Justice Scalia announced his two prong test for the first time in \textit{Itel Containers International Corp. v. Huddleston.}\textsuperscript{222} There, a lessor challenged a Tennessee sales tax imposed on cargo containers used exclusively in international trade.\textsuperscript{223} In announcing the test, Justice Scalia made no effort to give the term “indistinguishable statute” any content. As the Court had already addressed “the validity of a state [property] tax affecting cargo containers used in international trade”\textsuperscript{224} in \textit{Japan Line, Ltd. v. County of Los Angeles,}\textsuperscript{225} Justice Scalia could have compared and contrasted the sales and property taxes to establish the meaning of indistinguishable taxes. Justice Scalia, however, declined to do so. Instead, he appeared to assume that they were clearly distinguishable.

A year later, Justice Scalia reaffirmed his two prong test in \textit{West Lynn Creamery, Inc. v. Healy}\textsuperscript{226} and \textit{Barclays Bank PLC v. Franchise Tax Board.}\textsuperscript{227} Yet, in neither of those cases did Justice Scalia flesh out the meaning of “indistinguishable statutes,” nor did he identify objective factors to determine when one tax is distinguishable from another.\textsuperscript{228}

\begin{itemize}
\item \textsuperscript{221} \textit{Quill}, 504 U.S. at 320. \textit{See also} \textit{American Trucking Ass’ns, Inc. v. Smith}, 496 U.S. 167, 200-05 (1990) (Scalia, J., dissenting) (Scalia votes to apply \textit{Scheiner} prospectively in the interest of protecting settled expectations).
\item \textsuperscript{222} 507 U.S. 60 (1993).
\item \textsuperscript{223} Id. at 63.
\item \textsuperscript{224} Id. at 62.
\item \textsuperscript{225} 441 U.S. 434 (1979).
\item \textsuperscript{226} 114 S. Ct. 2205 (1994).
\item \textsuperscript{227} 114 S. Ct. 2268 (1994).
\item \textsuperscript{228} \textit{Barclays Bank} did not actually present Justice Scalia with much of an opportunity to flesh out the meaning of “indistinguishable” statutes. In that case, the taxpayer challenged California’s income-based corporate franchise tax as applied to foreign-based multinationals. \textit{Id.} at 2271-72. Rather than relying on a case in which the Court had stricken an indistinguishable taxing statute, the taxpayer argued that the case should be distinguished from \textit{Container Corp. v. Franchise Tax Bd.}, 463 U.S. 159 (1983), where the Court had \textit{upheld} the California tax as applied to a domestic-based multinational. 114 S. Ct. at 2279.
\item \textit{West Lynn Creamery}, in contrast, did afford Justice Scalia an opportunity to provide content to the term “indistinguishable” statutes. In that case, milk dealers
\end{itemize}
challenged a Massachusetts milk pricing order that was assessed on all milk sold in the state, wherever produced, and distributed solely to Massachusetts dairy farmers. In a sweeping opinion that cast doubt on the constitutionality of all subsidies, the majority held that the pricing order discriminated against interstate commerce in violation of the dormant Commerce Clause.

Justice Scalia criticized the majority’s opinion for calling into doubt many state laws previously permissible under the dormant Commerce Clause, and applied the second prong of his test to strike down the tax. *Id.* at 2220-21. Justice Scalia noted that the state could have used at least four different means to produce the economic effect of the Massachusetts scheme:

(1) a discriminatory tax upon the industry, imposing a higher liability on out-of-state members than on their in-state competitors; (2) a tax upon the industry that is nondiscriminatory in its assessment, but that has an “exemption” or “credit” for in-state members; (3) a nondiscriminatory tax upon the industry, the revenues from which are placed into a segregated fund, which fund is disbursted as “rebates” or “subsidies” to in-state members of the industry (the situation at issue in this case); and (4) with or without nondiscriminatory taxation of the industry, a subsidy for the in-state members of the industry, funded from the State’s general revenues.

*Id.* at 2220.

Citing, without discussing, a number of the Court’s earlier decisions, Justice Scalia declared that the first two methods were clearly prohibited by the Court’s precedents, while the fourth “is so far removed from what [the Court has] hitherto held to be unconstitutional, that prohibiting it must be regarded as an extension of our negative-Commerce-Clause jurisprudence.” *Id.* Justice Scalia described the question of whether the third methodology should fail as close. He nevertheless concluded that “it would not be a principled point at which to disembark from the negative-Commerce-Clause train” because the only difference between the second and third methodologies is that under the second, “money is taken and returned rather than simply left with the favored in-state taxpayer in the first place.” *Id.* at 2220-21. In contrast, Justice Scalia found significant the difference between the third and fourth methodologies as: “The difference between assisting in-state industry through discriminatory taxation, and assisting in-state industry by other means.” *Id.* at 2221.

Yet, Justice Scalia provided little guidance in determining when other taxing statutes should be considered indistinguishable. He did not list any objective factors relevant to such a determination or explain in any comprehensive way how to determine whether one tax is distinguishable from another. In fact, he expressly rejected one objective factor, interest group participation in the political process, as a reason for reaching his decision that the statute was indistinguishable from those previously stricken. *Id.*
3. Justice Scalia’s Apparent Rejection of His Two Prong Test

Recently, in Oklahoma Tax Commission v. Jefferson Lines, Inc., Justice Scalia appeared to abandon the second prong of his test. In that case, a bus company challenged an Oklahoma sales tax imposed on the full price of a bus ticket purchased in the state for travel originating inside the state and ending outside of the state. In support of its position that the tax should be stricken, the bus line cited the Court’s decision in Central Greyhound Lines, Inc. v. Mealey, where the Court struck down an unapportioned gross receipts tax imposed on a bus line engaged in interstate commerce as violative of the dormant Commerce Clause. Both the majority and the dissent in Jefferson Lines expressly grappled with the issue of whether the gross receipts tax in Central Greyhound was distinguishable from the sales tax in Jefferson Lines. The majority found the two taxes distinguishable, while the dissent based its entire opinion on the fact that it found them indistinguishable.

Justice Scalia, in contrast, ignored the issue and, without discussion, apparently rejected the second prong of his test. He declared,

I agree with the Court’s conclusion that Oklahoma’s sales tax does not facially discriminate against interstate commerce. That seems to me the most we can demand to certify compliance with the “negative Commerce Clause” – which is “negative” not only because it negates state regulation of commerce, but also because it does not appear in the Constitution.

230. Id. at 1335.
231. 334 U.S. 653 (1948).
233. Id. at 1346 (citations omitted).
4. Proposed Modification to Justice Scalia’s Two Prong Test

Although Justice Scalia appears to have abandoned his two prong test, I do not believe that it should be entirely disregarded. Rather, I believe that a modified version of the two prong test has the potential to be the second best solution to the problems raised by state and local taxation of interstate and foreign commerce.

a. Facial Discrimination Prong

As discussed above, the substantial instability and uncertainty arising from the Court’s practice of policing against discriminatory state taxing statutes may be attributed to three factors. First, the Court does not limit its review to the face of a taxing statute, but also asks whether the statute discriminates “in operation.” Second, it has the extended application of the internal consistency doctrine to determine whether a taxing statute discriminates on its face or in operation, and thus has cast doubt on the validity of a number of flat taxes. Finally, the Court applies a complementary tax doctrine of uncertain parameters to determine whether a facially discriminatory taxing statute may be saved.

The facial discrimination prong of Justice Scalia’s test, as originally formulated and applied, eliminates the first two sources of confusion. By definition, it eliminates the first cause of confusion because it limits review to the face of the taxing statute. It eradicates the second root of uncertainty in practice because Justice Scalia has declined to apply the internal consistency doctrine to determine whether a taxing statute discriminates.

The facial discrimination prong could also eliminate the third source of confusion if it were to be modified in its application to the complementary tax doctrine. Currently, the Court applies a three prong test to determine whether a facially discriminatory tax

234. See supra text accompanying notes 135-43.
may be saved as a complementary or compensating tax.\textsuperscript{236} First, the Court requires that “the [intrastate tax] burden for which the State is attempting to compensate”\textsuperscript{237} be identified. Second, the Court demands that the tax on interstate commerce be shown to approximate – but not to exceed – the tax on intrastate commerce.\textsuperscript{238} Finally, the Court requires that the interstate and intrastate taxes be imposed on “substantially equivalent’ events: that is, they must be sufficiently similar in substance to serve as mutually exclusive ‘prox[ies]’ for each other.”\textsuperscript{239} Like the four prongs of the Complete Auto test, the three prongs of the complementary tax doctrine are easy to state, but are “often no mean feat”\textsuperscript{240} to apply.

Professor Walter Hellerstein, in his article addressing the Court’s complementary tax doctrine, alluded to a modification that could vastly simplify the doctrine.\textsuperscript{241} Pursuant to this modification,\textsuperscript{242} only “functionally equivalent” taxes, that is, “taxes . . . [imposing] identical burdens on identical transactions,”\textsuperscript{243}
should qualify as complementary or compensating taxes. If the two
are equivalent, then the facially discriminatory tax should be saved.
If they are not equivalent, then the Court should strike down the
facially discriminatory taxing statute.

Sales and use taxes are the paradigmatic functionally equivalent
taxes. When the states first implemented sales taxes, the dormant
Commerce Clause was interpreted to prohibit states from imposing
such taxes on interstate sales or sales completed outside the State.\footnote{See, e.g., McLeod v. J.E. Dilworth Co., 322 U.S. 327, 330 (1944).}
Thus, the states designed use taxes to tax indirectly that which they
could not tax directly. Typically, use taxes are imposed on the use,
storage, or other consumption in the state of tangible personal
property that has not already been subjected to a sales tax, which
results in the imposition of a burden equal in amount to the sales
tax that would have been imposed if the sale took place inside the
taxing state.\footnote{Of course, if a sales tax and use tax are not imposed on the same tax base,
they will not constitute functionally equivalent taxes. See Halliburton Oil Well
Cementing Co. v. Reily, 373 U.S. 64 (1963).} Other taxes that "impose identical burdens on
identical transactions" would also qualify, though few other taxes
are expected to satisfy this narrow requirement.\footnote{See State of Washington, Dep't of Fisheries v. DeWatto Fish Co., 674
of Fisheries, 466 U.S. 953 (1984), presents that rare case in which taxes other than
sales and use taxes may qualify as functionally equivalent taxes. In that case, the
State imposed two taxes. The first tax, a privilege fee, was imposed on the
"original receiver" of fish, defined as the processor or dealer who first receives
fish within the State's jurisdiction. The second tax, a fish sales tax equal to one-
half of the privilege fee, was imposed on the seller of fish to an original receiver.
The original receiver was required to collect the sales tax from the seller and was
permitted a credit against the privilege tax for any sales tax so collected as well
as for any other fish taxes paid in another state. Id. at 660. Although the privilege
fee appears facially discriminatory because the original receiver pays a higher
privilege tax on out-of-state purchases of fish than on in-state purchases, the tax
should be saved under the reconstituted complementary tax doctrine because the
privilege tax levied on the purchase of out-of-state fish is equivalent to the
privilege and sales taxes levied on the purchase of in-state fish. If the original
receiver purchases fish from a seller subject to the sales tax, then the original
receiver remits to the State an amount equal to one privilege fee, half of which}
Fulton Corp. v. Faulkner\textsuperscript{247} presents the perfect opportunity to apply the modified facial discrimination prong. In that case, the taxpayer challenged the constitutionality of an intangible personal property tax that North Carolina levied on shares of stock owned by state residents. The tax was based on the fair market value of the stock of the issuing corporation but was not imposed uniformly on the full fair market value of all such stock. Instead, a deduction was allowed based on the percentage of business the issuing corporation did in North Carolina.\textsuperscript{248} Thus, a taxpayer owning stock in a corporation that did no business in North Carolina would be subject to an intangibles tax on 100\% of the fair market value of that stock, while no intangibles tax would be imposed on the ownership of stock in a corporation that earned 100\% of its income in North Carolina. In between those two extremes, an intangibles tax would be imposed on the ownership of stock in a corporation that did some, but not all, of its business in North Carolina, based on the percentage of business the issuing corporation did outside of North Carolina.\textsuperscript{249}

The state conceded that the intangibles tax was facially discriminatory but argued that the compensatory tax doctrine saved the tax.\textsuperscript{250} Specifically, the State argued that the intangible personal property tax imposed on the owner of a stock compensated for the state's inability to impose income tax on the issuing corporation to the extent that the issuing corporation did business outside the

\textsuperscript{247} 116 S. Ct. 848 (1996).
\textsuperscript{248} Id. at 852.
\textsuperscript{249} Id.
\textsuperscript{250} Id. at 855.
There is no doubt that the two taxes do not satisfy the modified complementary tax doctrine proposed above. Only taxes that are "functionally equivalent," that is, taxes that impose identical burdens on identical transactions, qualify as complementary or compensating taxes. The income and intangibles taxes at issue are imposed on entirely different transactions or events. The income tax is imposed on income earned in the state, while the intangibles tax is imposed on the ownership of property in the state. One need go no further to determine that the two taxes are not functionally equivalent and thus are not complementary taxes.252

Darnell v. Indiana253 might appear to present a greater challenge to the proposed modification of the complementary tax doctrine. Application of the modified doctrine to the facts of that case, however, illustrates the simplicity of the proposal. Like Fulton, Darnell involved a property tax imposed on the ownership of shares of stock where the tax was not imposed uniformly on all shares of stock. Unlike Fulton, however, the state in Darnell sought to offset the intangibles tax with a state tax on property owned by the issuing corporation, rather than a state income tax imposed on the issuing corporation.254 The Court in Darnell held that the intangibles tax did not discriminate against foreign corporations that were not subject to property tax in the state:

The only difference of treatment disclosed by the record that concerns the defendants is that the State taxes the

251. Id.
252. The Court also found that the two taxes did not satisfy the Court's compensatory tax doctrine. Id. at 856. Resolution of the issue under the Court's doctrine, however, was less certain. In fact, the North Carolina Court of Appeals applied the Court's three-prong test to reject the State's claim that the two taxes satisfied that doctrine. Fulton Corp. v. Justus, 430 S.E.2d 494, 498-99 (N.C. Ct. App. 1993). Moreover, the Court's application of the test provided little guidance as to how the doctrine should apply in future cases, other than to suggest that few taxes other than sales and use taxes will satisfy the doctrine.
254. Id. at 397-98.
property of domestic corporations and the stock of foreign ones in similar cases. That this is consistent with substantial equality notwithstanding the technical differences was decided in *Kidd v. Alabama*.

Although the Court upheld the taxing scheme in *Darnell*, the scheme would not satisfy the modified complementary tax doctrine. As noted above, in order to qualify as complementary or compensating taxes under the proposal, two taxes must impose identical burdens on identical transactions. The value of a corporation's property is but one factor in determining the value of its stock. Thus, a tax imposed on the ownership of property held by a corporation does not impose a burden identical to that imposed by a tax on the ownership of stock in that corporation.

These cases illustrate that the facial discrimination prong, as modified above, has the potential to improve dramatically the current state of the law governing state and local taxation of interstate commerce by eliminating much of the uncertainty present in the Court's current practice of deciding discriminatory state taxing statutes.

*b. Indistinguishable Statute Prong*

The second prong of Justice Scalia's test also has the potential to remedy much of the instability and uncertainty in this area of the law by providing a relatively clear and certain rule: the Court should uphold a state taxing statute unless it "is indistinguishable from a type of law previously held unconstitutional by this

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255. *Id.* at 398. In *Darnell*, the state only permitted taxpayers to offset state property taxes paid by domestic corporations. The Court admitted that the taxing scheme's failure to make allowance for foreign corporations that paid tax on property owned in the state raised a serious question. Nevertheless, the Court did not decide that issue because the taxpayer's challenge did not involve those facts. *Id.*

256. In *Fulton*, the Court declared that the taxing scheme would not stand under its current compensatory tax doctrine either. *Fulton*, 116 S. Ct. at 855-60.
Court.\textsuperscript{257} Of course, this prong cannot provide absolute certainty and stability. In general, determining whether one law is distinguishable from another is no simple task.\textsuperscript{258} Furthermore, determining whether the Court has previously stricken an indistinguishable statute in this area of the law, replete with conflicting precedents,\textsuperscript{259} is even more difficult. Nevertheless, the second prong has the potential to provide more certainty and stability than currently exists in the law.

In order to provide this stability and certainty, the Court should apply the prong in a narrow fashion. First, in determining whether two taxes are distinguishable, it should ask whether they are functionally equivalent, as narrowly defined above. If the taxes are not functionally equivalent, they should be distinguishable. Second, the Court should take the parties’ expectations into account in determining whether taxes are functionally equivalent. To the extent possible, the Court should announce clear and certain rules that further stability and uphold parties’ expectations when applying the prong.

\textit{Itek Containers International Corp. v. Huddleston}\textsuperscript{260} presents the best illustration of how application of the second prong could

\begin{footnotesize}
\bibitem{258} See generally David Lyons, \textit{Formal Justice and Judicial Precedent}, 38 \textit{VAND. L. REV.} 495, 501 (1985) (discussing the inevitability of conflicting precedents in the law); Moore, \textit{supra} note 74, at 367 (“The legal realist view of precedent, while much more faithful to our practices, is woefully incomplete in its ability to determine what the holding of any case actually is. Saying that the holding of a case is the decision of that case on its facts does not help in the least in probing the level of generality at which those facts are to be described, or which facts are material. By any such conception of the holding, there are as many holdings to any case as there are descriptions of its facts. . . .”).
\bibitem{259} West Lynn Creamery, Inc. v. Healy, 114 S. Ct. 2205, 2220 (1994) (Scalia, J., concurring) (“Applying this approach – or at least the second part of it – is not always easy, since once one gets beyond facial discrimination our negative-Clauses jurisprudence becomes (and long has been) a ‘quagmire.’”) (quoting Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959)).
\bibitem{260} 507 U.S. 60 (1993).
\end{footnotesize}
eliminate some of the uncertainty and instability in the law. There, the lessor challenged a Tennessee sales tax imposed on cargo containers used exclusively in international trade.261 Fourteen years earlier, in *Japan Line, Ltd. v. County of Los Angeles*,262 the Court had struck down an apportioned property tax imposed on cargo containers used exclusively in international trade.263 Deciding the case under the Court second prong would have been clear and simple. Sales and property taxes are not functionally equivalent. Property taxes are imposed on the ownership of property, while sales taxes are imposed on the consumption of property. The two taxes do not impose identical burdens on identical transactions. Accordingly, the two taxes are distinguishable, and there would be no ground to strike the sales tax in *Itel* under the second prong.

The Court did uphold the tax in *Itel*, but not under the second prong. Instead, the Court applied the *Japan Line* test in an uneasy manner that left open questions about the continued validity of the test.264 Had the Court decided *Itel* under the second prong, its decision would have been clear, simple, and left no uncertainties.

Application of the second prong to *Oklahoma Tax Commission v. Jefferson Lines, Inc.*265 also illustrates how the test could eliminate some of the confusion in the current law. In *Jefferson Lines*, as discussed above, a bus company challenged an Oklahoma sales tax imposed on the full price of a bus ticket purchased in the state for travel originating inside and ending outside of the state.266 More than forty-five years before, in *Central Greyhound Lines, Inc. v. Mealy*,267 the Court had stricken as violative of the dormant Commerce Clause an unapportioned gross receipts tax imposed on a bus line engaged in interstate commerce. Both the majority and the dissent in *Jefferson Lines* expressly grappled with the issue of

261. *Id.* at 63.
263. *Id.* at 451-54.
266. *Id.* at 1335.
whether the gross receipts tax in *Central Greyhound* was distinguishable from the sales tax in *Jefferson Lines*. The majority held that the taxes were distinguishable because they were imposed on the buyer of the services. Viewing that distinction as purely formal, the dissent found the taxes indistinguishable.

At first blush, the gross receipts tax in *Central Greyhound* appears indistinguishable from the sales tax in *Jefferson Lines*. From an economic standpoint, the two taxes appear identical. Upon closer reflection, however, it becomes clear that the two taxes are distinguishable. While functionally equivalent taxes are almost always economically equivalent, economically equivalent taxes need not be functionally equivalent. Functionally equivalent taxes are narrowly defined as those taxes that impose identical burdens on identical transactions. Sales and gross receipts taxes do not impose identical burdens on identical transactions. They are structurally different taxes that impose different burdens on similar transactions. As Professor Pomp has explained, a “sales tax falls on consumption, is generally collected from the consumer, is typically separately stated, and is excluded from the tax base, and a seller may not advertise that it will pay the tax for the purchaser.” In other words, a sales tax is imposed on a tax-exclusive base. A gross

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268. Justice Scalia, in contrast, as discussed above, disregarded the issue and seemingly rejected the second prong of his test. See *supra* text accompanying note 233.

269. 115 S. Ct. at 1340-41.

270. *Id.* at 1348.


273. *See supra* notes 241-46 and accompanying text.

receipts tax, in contrast, is imposed on a tax inclusive base on business activity, not consumption.\textsuperscript{275}

Had the Court decided the case under the second prong, it would be clear that the apportionment requirement does not apply to sales taxes. There would be no lingering doubts or uncertainties. The Court, however, did not rely on the second prong to reach its decision. Instead, it applied the four prong \textit{Complete Auto} test. The Court's application of that test, particularly the fair apportionment's external consistency requirement, created uncertainty as to how that requirement should apply to sales taxes where the situs of the sale is not as clear as it was in \textit{Jefferson Lines}\.\textsuperscript{276}

\textit{Quill Corp. v. North Dakota}\textsuperscript{277} illustrates both the difficulties with and potential of the second prong. In \textit{Quill}, the petitioner challenged a statute that imposed use tax collection responsibilities on an out-of-state mail order seller that had neither outlets nor sales representatives in the state.\textsuperscript{278} Twenty-five years earlier, in \textit{National Bellas Hess, Inc. v. Department of Revenue},\textsuperscript{279} the Court drew a "sharp distinction ... between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more

\textsuperscript{275} See also Amy Hamilton, \textit{Interstate Dimensions of Sales Tax Dissected at APT-NTA Seminar}, 96 \textit{STATE TAX NOTES} 28-36 (Feb. 9, 1996) (Professor Walter Hellerstein asserts that Court should have specified structural difference between gross receipts and sales tax rather than person on whom tax is imposed in \textit{Jefferson Lines}).

The following example illustrates why gross receipts taxes are not functionally equivalent to sales taxes. Suppose a bus line charges $100 for a ticket from Lexington, Kentucky to Gainesville, Florida. If the state imposes a 10\% sales tax, the seller will collect $110 from the customer, remit $10 to the state, and have $100 left. Suppose, in contrast, the bus line collects the same $110 from the customer and the state imposes a 10\% gross receipts tax. The bus line will be required to remit $11 to the state (10\% of $110) and will be left with $99. Thus, a gross receipts tax and sales tax do not impose identical burdens on identical transactions.

\textsuperscript{276} See \textit{supra} text accompanying notes 122-25.
\textsuperscript{277} 504 U.S. 298 (1992).
\textsuperscript{278} \textit{Id.} at 301.
\textsuperscript{279} 386 U.S. 753 (1967).
than communicate with customers in the State by mail or common
carrier.” 280 The Bellas Hess Court struck down the use tax collection
statute as violative of both the Due Process and Commerce
Clauses. 281 In applying the second prong to Quill, there is no doubt
that the Court had stricken down a functionally equivalent tax in
Quill. The taxes in Quill and Bellas Hess were not merely
functionally equivalent, they were identical.

Whether Bellas Hess remained good law at the time the Court
decided Quill, however, was somewhat less clear. Ten years after
Bellas Hess, the Court addressed use tax collection statutes in
National Geographic Society v. California Board of Equalization. 282
In that case, California sought to impose use tax collection
responsibilities on a mail order seller which maintained in the state
two offices, the activities of which were completely unrelated to the
seller’s mail order business. 283 The mail order house argued that the
state did not have nexus because the offices performed no activities
related to the company’s mail order business. 284 The Court rejected
the argument, and in so doing, arguably “politely brush[ed] aside”
the rationale of Bellas Hess. 285 The Court, however, did not
expressly reject Bellas Hess. In fact, the Court expressly described its
opinion as consistent with that decision. 286 Moreover, the Court
cited the case with apparent approval in subsequent opinions. 287

Therefore, Quill raises the issue of how the second prong
should be applied in cases of conflicting precedent. Since the Court
did not expressly overrule Bellas Hess in National Geographic, but
rather expressly described its opinion as consistent with Bellas Hess
and subsequently cited Bellas Hess with apparent approval, Bellas

280. Id. at 758.
281. See supra note 90.
283. Id. at 552-54.
284. Id. at 560.
concurring in part, dissenting in part).
286. National Geographic, 430 U.S. at 559.
Hess should be treated as good law. The underlying purpose of the second prong is to provide certainty and stability in the law. In the interest of certainty and stability, the Court should only treat a precedent as overruled if the Court expressly overrules it, or its reasoning in a subsequent case clearly overrules it.

Thus, it appears that the Court would have reached the same result had it decided Quill under the second prong. But, had the Court decided the case under the second prong, it would have had a responsibility to define more precisely the physical presence requirement. In Quill, the seller had some physical presence—a few floppy diskettes—in the state, yet the Court made no effort to identify how much physical presence is required to satisfy the physical presence requirement.288 As a result, the Court’s decision created uncertainty.

Had the Court decided Quill under the second prong as described, it could have eliminated much of the uncertainty that currently remains in the law. First, it would have been clear that the bright line physical presence test does not extend to taxes that are not functionally equivalent to use taxes. Thus, the physical presence test would not apply to income taxes.289 Second, had the Court clarified the parameters of the physical presence requirement, it would have eliminated uncertainty in the application of the physical presence requirement.

As the preceding discussion shows, application of the second prong will not always be easy. Nevertheless, it has the potential of eliminating much of the uncertainty in the law by focusing attention on the right issues.

5. Restatement of the Second Best Rule

In summary, in the exercise of its dormant Commerce Clause power, the Court should only strike down a state taxing statute if (1) the statute facially discriminates against interstate commerce, or

288. Quill, 504 U.S. at 315 n. 8.
(2) the statute is indistinguishable from a statute the Court has previously stricken.

The Court should apply a narrow approach to determine whether the taxing statute facially discriminates. As a general rule, the Court should only look at the statute at issue to determine whether the tax facially discriminates. The Court may, however, look beyond the statute at issue to determine whether a facially discriminatory statute may be saved as a compensating tax so long as it narrowly limits compensating taxes to functionally equivalent taxes.

In determining whether the Court has stricken an indistinguishable taxing statute in the past, the Court should first ask whether it has stricken a functionally equivalent tax. If the Court has not stricken a functionally equivalent tax, it should uphold the tax at issue. Second, the Court should take the parties’ expectations into account in determining whether it has stricken a functionally equivalent tax. When applying the prong, the Court should make every effort to create clear and certain rules that further stability and uphold the parties’ expectations.

B. Why This Solution is Second Best

Like any theory of the second best, Justice Scalia’s test is not perfect. Nevertheless, like any theory of the second best, it has the potential to compensate for some of the imperfections existing in today’s world of state and local taxation. First, it has the potential of protecting our national economy from those state taxing statutes that create the most egregious drags on our national economy while providing greater certainty and stability in an area of the law hitherto void of certainty and stability. Second, it has the potential of encouraging Congress and/or the states to enact uniform legislation in an area of the law begging for uniformity.
1. Comparative Advantage over Current Doctrine

As Justice Scalia's approach is firmly grounded in the doctrine of stare decisis,\(^{290}\) it should come as no great surprise that the approach has the potential to provide certainty and stability in the law. The traditional goals of stare decisis include promoting certainty, respecting reliance on earlier decisions, and honoring settled expectations.\(^{291}\)

Although certainty and stability are not the only values worthy of recognition, and sometimes those values should yield to change and growth,\(^ {292}\) they are among the most important values in this particular area of the law.\(^ {293}\)

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290. Stare decisis, as discussed in this article, refers to horizontal stare decisis, that is, the rule that a court follow its own prior decisions, not vertical stare decisis, the rule that a lower court follow the decisions of the higher courts in its jurisdiction. Although there is a well-settled rule of vertical stare decisis in this country, there has never been an unbending rule obligating courts to adhere to their own prior precedents. Lawrence C. Marshall, "Let Congress Do It": The Case for an Absolute Rule of Statutory Stare Decisis, 88 Mich. L. Rev. 177, 177 n.1 (1989) (citation omitted).

The Court has created, at least theoretically, a three-tiered hierarchy of horizontal stare decisis. The Court accords the greatest deference to statutory precedents. The court grants common law precedents “a strong presumption of correctness,” but not as strong as that granted to statutory precedents, and accords constitutional precedents the weakest presumption of correctness. William N. Eskridge, Jr., Overruling Statutory Precedents, 76 Geo. L.J. 1361, 1362 (1988); Earl Maltz, The Nature of Precedent, 66 N.C. L. Rev. 367, 388 (1988).


292. See Eskridge, supra note 290, at 1363 (arguing for an “evolutive” approach to statutory stare decisis); Moore, supra note 74, at 372 (“It would be wrong to claim absolute weight for a court’s past interpretations because other values may simply outweigh the rule of law virtues that argue in favor of following precedent. For interpretative cases, as well as common law cases, the absolutist position that a court can never go back on its own interpretation is simply untenable, as virtually all courts today recognize.”); see also Michael S. Gerhardt, The Role of Precedent in Constitutional Decisionmaking and Theory, 60 Geo. Wash. L. Rev. 68 (1991).

First, certainty and stability would facilitate business planning in an area where planning is exceedingly important. The Court itself has recognized that "[c]onsiderations in favor of stare decisis are at their acme in cases involving property and contract rights, where reliance interests are involved." Multijurisdictional taxpayers necessarily take taxes into account in organizing their activities and investing their resources, and investments once made, are not easily changed. The current unstable state of the law creates an unnecessary drag on our economy as multijurisdictional taxpayers attempt to plan their activities in the face of ever-changing law. Second, certainty and stability are the most for which we can hope from the Court. The Court has attempted to regulate state and local taxation of interstate and

concurring) ("the Court as an institution and the legal system as a whole have an immense stake in the stability of our Commerce Clause jurisprudence as it has evolved to this point").


296. The importance of planning and the difficulty of changing investments once made counsel against prospective as well as retroactive changes in the law. Cf. Maltz, supra note 290, at 369 (arguing that certainty and reliance are not justifications for relying on old law if the law is changed prospectively). For the Justices' various views on whether the Court's constitutional decisions may apply on a purely prospective basis, see the Court's sharply divided decision in Harper v. Virginia Dep't of Taxation, 509 U.S. 86 (1993). See also Eric Rakowski, Harper and Its Aftermath, 1 FLA. TAX REV. 445 (1993).

297. Cf. Mark L. Evans, supra note 86, at 892 ("If the Court's heightened sensitivity to the importance of stability in commercial matters is borne out in future decisions, businesses may soon find it easier to plan with reasonable assurance that investment expectations will not be confounded by sudden changes in judicial interpretations."); NATIONAL CONFERENCE OF STATE LEGISLATURES, supra note 29, at 29 ("stability and certainty . . . are of paramount importance to businesses").
foreign commerce for well over a century. It has applied a myriad of approaches, yet none has proven successful. This long history alone amply illustrates the Court’s institutional inability to regulate the area.

Third, unlike most areas of constitutional law, Congress may overrule dormant Commerce Clause decisions simply by enacting contrary legislation. Moreover, not only is Congress institutionally competent to act, but Congress is institutionally suited to draft the comprehensive legislation needed to resolve the plethora of complex issues raised in this area.

Unconfined by “the narrow scope of judicial proceedings” Congress alone can, in the exercise of its plenary constitutional control over interstate commerce, not only consider whether such a tax . . . is consistent with the best interests of our national economy, but can also on the basis of full exploration of the many aspects of a complicated problem devise a national policy fair alike to the States and

298. See supra text accompanying notes 46-65.

Traditionally, the Court accords the weakest presumption of correctness to constitutional precedents because they may only be corrected by constitutional amendment and the difficulty of amending the constitution makes the Court the most effective institution to overrule obsolete constitutional precedents. Eskridge, supra note 290, at 1363; Maltz, supra note 290, at 388. Obviously, this reasoning does not apply to dormant Commerce Clause precedents.

300. Professor Eskridge has described the leave-it-to-the-legislature argument as “fairly lame.” Eskridge, supra note 290, at 1402. While that may be true as a general rule, it is not so here. It does not simply ask Congress to correct the Court’s mistakes but, rather, to do that for which it is better suited.
Finally, certainty and stability in the law would eliminate the waste of the untold dollars that are currently spent on the endless litigation in this area.\textsuperscript{302} That money could then be directed toward more productive investments or toward lobbying Congress and/or the states to enact the uniform laws needed to resolve the problems in this area.\textsuperscript{303}

The first prong of Justice Scalia’s test has the potential to eliminate a great deal of uncertainty in the law by focusing on the language of a particular taxing statute to determine whether it taxes outsiders more heavily than insiders. Determining whether a taxing statute facially discriminates against interstate or foreign commerce is a relatively straightforward task. Only once since Justice Scalia joined the Court have the Justices seriously disputed whether a tax facially discriminates.\textsuperscript{304} “[O]nce the question goes beyond the tax


\textsuperscript{302} David L. Dubrow, New Hampshire/High Court Active, 6 STATE TAX NOTES 1446 (1994) (“the field of state tax litigation promises to be a ‘growth’ industry in coming years”).

\textsuperscript{303} See infra text accompanying notes 333-37.

\textsuperscript{304} Kraft Gen. Foods, Inc. v. Iowa Dep’ t of Revenue and Fin. 505 U.S. 71 (1992). Although Chief Justice Rehnquist dissented from the majority’s opinion
that is patently discriminatory on its face [however], much room for controversy about hidden discrimination exists.\textsuperscript{305} Moreover, the proposed modification to the complementary tax doctrine should also eliminate a great deal of uncertainty in the law.\textsuperscript{306}

Admittedly, Justice Scalia's facial discrimination test is not perfect. First, it does not provide absolute certainty. The mere fact that the Justices did once dispute whether a taxing statute facially discriminates illustrates that reasonable minds may, on occasion, differ on the issue. Second, the test does not protect our national economy from every attempt by a state to shift tax burdens to outsiders and impose competitive burdens on out-of-state enterprises.

Nevertheless, I believe it provides the best balance possible between certainty in the law and elimination of unnecessary drags on the free flow of our economy. Countless scholars have addressed the issue of discrimination, yet none has identified an easily administrable test.\textsuperscript{307} Comprehensive protection against

in Chemical Waste Management, Inc. v. Hunt, 504 U.S. 334 (1992), he did not appear to dispute that the tax at issue in that case was facially discriminatory. \textit{Id.} at 349 ("Nor do I see any significance in the fact that Alabama has chosen to adopt a differential tax rather than an outright ban.").

As discussed in \textit{supra} text accompanying notes 203-08, the Justices also disputed whether a taxing statute facially discriminated in Tyler Pipe Indus. v. Washington State Dep't of Revenue, 483 U.S. 232 (1987). That dispute only arose because the Justices disagreed as to whether the internal consistency doctrine should be applied to determine whether a taxing statute facially discriminates. Had the Justices agreed, as Justice Scalia argued, that the internal consistency doctrine should not be extended to determine whether a taxing statute facially discriminates, there would have been no doubt but that the statute did not facially discriminate. Prior to applying the internal consistency doctrine, the majority conceded that the tax "ha[d] the advantage of appearing nondiscriminatory." \textit{Id.} at 248 (quoting General Motors Corp. v. Washington 377 U.S. 436, 460 (1964)).

\textsuperscript{305} HARTMAN, \textit{supra} note 4, at § 2.19.

\textsuperscript{306} See \textit{supra} text accompanying notes 236-57.

\textsuperscript{307} See also Hellerstein, \textit{supra} note 49, at 763 ("[un]willing to abandon the principle that requiring interstate commerce to pay more than its way discriminates against interstate commerce at least when intrastate commerce generally is not so burdened, even if there is no judicial remedy for that
discrimination simply does not appear administratively possible. I believe that the uncertainty created by any discrimination test that goes beyond the face of a taxing statute simply outweighs the benefits of such protection.\textsuperscript{308}

Like the first prong of Justice Scalia's test, the second prong cannot provide absolute certainty and stability. As discussed above,\textsuperscript{309} given the current state of the law, there are simply too many conflicting precedents for absolute certainty or stability to be possible. Nevertheless, like the first prong, the second prong has the potential to provide considerably more certainty and stability than currently exists.

2. Comparative Advantages over Other Suggested Solutions

As a second best solution, Daniel Shaviro has suggested that the courts invalidate state taxing statutes whenever they violate any of a number of tests. Under the first of these tests, Ferdinand Schoettle's comparative marginal cost test, the Court should strike down a state taxing statute whenever the marginal, rather than total, tax costs imposed on out-of-staters exceeds those on in-staters. Under the second test, the Court's internal consistency test, the Court should strike down a state or local tax if it would result in multiple taxation if all jurisdictions adopted the tax. Under the third "rules of the road" test, the Court should require that states accept particular allocation rules if they have been adopted by most states. Finally, the Court should bar significant attempted tax exportation, whether perceived or actual.\textsuperscript{310}

Although Professor Shaviro's tests have merit, I believe that

\textsuperscript{308} Moreover, although the facial discrimination test may result in some undesirable laws being upheld in the short run, it may increase the likelihood of Congress enacting uniform legislation in the long run. See infra text accompanying note 329.

\textsuperscript{309} See supra text accompanying note 259.

\textsuperscript{310} SHAVIRO, supra note 5, at 112-14.
they are inferior to the modified two prong test because they would create too much uncertainty in the law. In proposing the tests, Professor Shaviro declared that "in comparison with the alternative of no significant judicial review of state and local taxes, these recommendations should improve at the margin the functioning of our integrated national markets."311 Earlier in his book, however, Professor Shaviro admitted that "one still could argue that [a judicial] check is worse than none at all."312

Other scholars have argued that the Court should confer no negative implications whatsoever on the Commerce Clause.313 Had the Court applied such an approach from the outset, state and local taxation of interstate and foreign commerce might not be such a mess today. First, the Court’s jurisprudence would not have created any instability. It would have been clear that all state and local taxing statutes would stand unless they conflicted with express federal legislation to the contrary. Moreover, the absence of judicial review might have encouraged states and/or Congress to have enacted uniform legislation by now.314

Although declining to grant the Commerce Clause any negative implications whatsoever might have been the best solution when the Court first started to review state taxing statutes well over a hundred years ago, it is much too late for such a solution now. "[T]he Court as an institution and the legal system as a whole have an immense stake in the stability of [the Court’s] Commerce Clause jurisprudence as it has evolved to this point."315 Over the years,

311. Id. at 115.
312. Id. at 71. See also Hellerstein, supra note 33, at 226 (the author is "skeptical whether Shaviro’s proposal is more palatable than the disease").
314. If the Court had refused to review state and local taxation, states may have enacted legislation facially discriminating against interstate commerce and creating egregious drags on our national economy. Such statutes may have made the issue of state and local taxation a more salient concern and thus encouraged Congress to enact uniform legislation. See infra text accompanying notes 326-33.
states and taxpayers have relied on the Court to strike down certain taxing statutes.\textsuperscript{316} If the Court were to jettison entirely its state tax dormant Commerce Clause jurisprudence, it would disrupt settled expectations. In addition, it would permit even facially discriminatory taxing statutes, the most obvious and thus unacceptable burdens on our national economy, to stand. The two prong test, in contrast, would strike down the most unacceptable drags on our economy while providing more certainty and stability in the law.

3. Encourages Optimal Solution by Appropriate Institutions

The two prong test not only has the potential to provide the short term benefit of increased stability and certainty in state and local tax law, but it also has the long run potential of encouraging uniform state and local tax legislation. As discussed above,\textsuperscript{317} few outside academia would disagree that more uniformity is needed in state and local tax law. The Supreme Court has repeatedly demonstrated that it is neither capable of, nor interested in, providing uniformity in state and local taxation.\textsuperscript{318} Thus, if there is to be uniformity, it must come from Congress\textsuperscript{319} or from the

\textsuperscript{317} See supra notes 33-38 and accompanying text.
\textsuperscript{318} Barclays Bank PLC v. Franchise Tax Bd., 114 S. Ct. 2268, 2286 (1994) ("[W]e leave it to Congress – whose voice, in this area, is the Nation’s – to evaluate whether the national interest is best served by tax uniformity, or state autonomy."); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 448-49 (1980) (declining to mandate uniform state taxation of foreign dividends where Congress has not enacted legislation requiring such treatment); Moorman Mfg. Co. v. Bair, 437 U.S. 267, 280 (1978) ("It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income. It is to that body, and not this Court, that the Constitution has committed such policy decisions."). See also supra notes 73-78 and accompanying text.

\textsuperscript{319} At this point, there is little doubt but that Congress has the power both to expand and to restrict state power to tax in the affirmative exercise of its Commerce Clause power. See supra authorities cited in note 102. There is some
voluntary acts of the states. 320

Admittedly, adoption of the proposed test would not guarantee that Congress or the states would adopt uniform state and local tax legislation. Some theories of legislation and past history, however, suggest that adoption of the test might increase the likelihood of such legislation. 321

question, however, whether Congress has the power to authorize state taxation that violates due process limitations. See id. Thus, there may be some limitations on Congress’ power to legislate in this area, but such limitations should not prohibit totally more coordination in state taxation. See also SHAVIRO, supra note 5, at 108-11.

320. Scholars and administrators have debated whether Congress or the states are better suited to prescribe uniform rules. For example, at the third annual Business/Government Dialogue on State Tax Uniformity, Andy Schoetle of the Brookings Institute suggested that states seek a legislative resolution to sales and use tax problems while the Executive Director of the Multistate Tax Commission, Dan Bucks, “cautioned that many states would be concerned that Congress is ill-suited to enacting adequate legislation in this area and ‘would botch up the details.’” MTC Heats Interstate Business’ Concerns Over Draft Uniform Sales/Use Tax Act, 1992 DAILY EXECUTIVE REPORT 205 d48. See also SHAVIRO, supra note 5, at 97-108 (recommending that Congress enact uniform state tax legislation); Hellerstein, supra note 33, at 226 (contending that voluntary state efforts are more appropriate means of achieving uniformity than federal legislation); Corrigan, supra note 23, at 438-39 (same). I will not try to resolve this debate as I believe that it is less important who achieves uniformity than that uniformity be achieved in the first place.

321. See also EDWARD H. LEVI, AN INTRODUCTION TO LEGAL REASONING 32 (1948) (“If legislation which is disfavored can be interpreted away from time to time, then it is not to be expected, particularly if controversy is high, that the legislature will ever act. It will always be possible to say that new legislation is not needed because the court in the future will make a more appropriate interpretation. If the court is to have freedom to reinterpret legislation, the result will be to relieve the legislature from pressure.”); Michael P. Healy, The Preemption of State Hazardous and Solid Waste Regulations: The Dormant Commerce Clause Awakens Once More, 43 J. URB. & CONTEMP. L. 177, 211 (1993) (“Judicial restraint also avoids the problem of discouraging political decisionmaking at the federal level.”); Marshall, supra note 290, at 210 (absolute rule of stare decisis would stimulate increased congressional involvement by articulating a clear and unyielding division of responsibility). But see William N. Eskridge, Jr., The Case of the Amorous Defendant: Criticizing Absolute Stare Decisis for Statutory Cases, 88 MICH. L. REV. 2450, 2453-58 (1990) (challenging
First, the law as "equilibrium" model recently offered by Professors Eskridge and Frickey\(^\text{322}\) provides some support for this proposition. Pursuant to this model, Professors Eskridge and Frickey describe law as a state of balance among the branches of government.\(^\text{323}\) At any given time, most legal issues are in a state of stable equilibrium. Technological, social, or economic changes, however, may render an equilibrium unstable, or at least susceptible to movement. At such times, the Court may shift public policy to reflect more closely its own preferences\(^\text{324}\) by "signalling" to Congress its preferences.\(^\text{325}\)

State tax law currently appears to be in an uneasy state of equilibrium. The Court, Congress, and the states all recognize the need for uniformity in state taxation, and that need increases as our economy becomes ever more global. The Court has tried to police the area but has recognized its institutional inability to resolve its most basic problem, lack of uniformity. Congress has debated numerous bills mandating some degree of uniformity in state and local taxation but has enacted few such bills. The states, through voluntary efforts, have made some progress toward uniform legislation, but much disuniformity remains.

By adopting the two prong test, the Court could upset this


\(^{323}\) Id. at 28.

\(^{324}\) Id. at 29.

\(^{325}\) Id. at 39 ("Lawmaking institutions routinely send 'signals' to one another expression of preferences that have no traditionally understood legal 'authority.'") (footnote omitted). Examples of such signals include dicta, language in committee reports, or veto statements.
unsteady equilibrium and send a clear signal\textsuperscript{326} to Congress that the Court recognizes that it is institutionally incapable of resolving the vast problems in this field and that it is time for Congress to apply itself more rigorously. Through dicta, the Court has already signalled to Congress the Court’s desire that Congress act. Congress, however, has not enacted much legislation in response to that dicta. Adopting the test would send a clearer, and perhaps more successful, signal to Congress that it is time for Congress to act.

Second, political science theories that argue that salience plays a role in legislative decisionmaking provide some support for the proposition that adoption of the proposed test might increase the likelihood of Congress legislating in the state and local tax field. For example, according to the “garbage can decisionmaking” theory, Congress will act to make public policy when: (1) a concern is recognized as salient, (2) a well-considered solution is available that is consistent with the drift of public thinking, and (3) the political climate is ripe for change.\textsuperscript{327} According to political scientist David Price, legislative decisionmaking varies according to public salience, the degree of conflict, and presidential involvement.\textsuperscript{328}

Adoption of the test would likely cause the Court to uphold some state taxing statutes that, as a policy matter, should be stricken, and thus cause state taxation to become a more salient concern.\textsuperscript{329} These theories suggest that the increased salience of state taxation would increase the likelihood of Congress legislating in the area. Of course, the theories do not guarantee that Congress would legislate or that Congress would enact uniform legislation. According to the theories, salience plays a role in legislation but is

\textsuperscript{326} Id. at 81-82 (clear statement rules are one of the ways the Court can signal its concerns to Congress). The proposed test would constitute a clear statement rule that the Court will not strike down a state taxing statute unless the statute facially discriminates against interstate or foreign commerce or the Court has already stricken an indistinguishable statute in the past.

\textsuperscript{327} Eskridge, supra note 290, at 1408.


\textsuperscript{329} See supra text accompanying notes 307-09.
not the sole determinative factor. Nevertheless, the fact that adoption of the proposed test would probably increase the salience of state tax law suggests that adoption of the test might increase the likelihood that Congress would legislate in the area.

To some extent, "public choice" theory also provides some support for the proposition. Public choice theory applies economic analysis to public decisionmaking. One of the two strands of public choice analysis focuses on interest groups and claims that they play a critical role in influencing legislation.

Arguably, adoption of the two prong test would cause interest groups to streamline their efforts and lobby more forcefully and effectively for uniform legislation. Currently, interest groups may (1) ask the Court to overrule a particular taxing statute, (2) lobby Congress to change the law, or (3) lobby the states. If the Court were to adopt the suggested test, recourse to the Court would no longer be a viable option and interest groups could focus their lobbying efforts on Congress and/or the states.

Admittedly, adoption of the test would not guarantee that interest groups would argue more forcefully and effectively for uniform legislation. With respect to state taxation, there are a variety of interest groups, and not all would benefit from uniform legislation. For example, after Quill, Senator Bumpers introduced a bill authorizing states and local jurisdictions to require out-of-state

330. For example, Congress might not legislate because it might not find a satisfactory solution to the inevitable conflict raised by selecting uniform rules governing state taxation.


332. The other type of public choice analysis focuses on how decisions are made under social rules. Id. at 283 n.28.

333. Cf. Hamersley, supra note 98, at 527 (recommending that mail-order retailers shift some of their lobbying resources to state and local levels in light of Quill – which suggests that the Supreme Court wants to get out of the business of deciding these cases and will give state supreme courts more autonomy in deciding these cases – but not to abandon entirely congressional lobbying efforts and also to "make attempts to renew negotiations with state and local government officials").
businesses to collect sales taxes on tangible personal property sold in the state. The bill provided for an in-lieu fee rate where local taxes were not uniform. 334 A wide variety of interest groups supported the bill, 335 while a few, powerful, interest groups opposed the bill. 336 The bill was not enacted into law. 337

Finally, past history shows that Congress is most likely to legislate in the state and local tax area in response to Supreme Court cases or to perceived abuses of state tax power, 338 and the states are most likely to enact uniform legislation in response to the threat of federal preemption. For example, Congress enacted the first federal legislation limiting the states’ power to tax interstate commerce, Public Law 86-272, specifically in response to the Court’s decision in Northwestern States Portland Cement Co. v. Minnesota. 339 Public Law 86-272 not only limited the states’ power to tax interstate commerce, but also charged the Committee on the Judiciary of the House and the Committee on Finance of the Senate with making full and complete studies of all matters pertaining to the taxation by the States of income derived within the States from the conduct of business activities which are exclusively in furtherance of interstate commerce or which are a part of

334. S. 1825, 103d Cong., 2d Sess. (1994). Although, as discussed supra text accompanying notes 214-17, the Court struck down Missouri’s attempt to enact a similar in-lieu scheme at the state level in Associated Indus. v. Lohman, 114 S. Ct. 1815 (1994), Congress in the exercise of its affirmative grant of power under the Commerce Clause should have the authority to enact such a scheme.

335. Among the supporters of the bill were the National Governors’ Association, the National Conference of State Legislatures, the National Association of Counties, the National League of Cities, and the U.S. Conference of Mayors. Hearing on Interstate Use Tax Collection: Hearings before the Senate Comm. on Small Business, S. 1825, 103d Cong., 2d Sess. (1994).

336. Among the interest groups opposing the bill were the National Alliance of Senior Citizens, Disabled American Veterans, and Direct Marketing Association. Id.


338. Hellerstein, supra note 33, at 226.

interstate commerce, for the purpose of recommending to the Congress proposed legislation providing uniform standards to be observed by the States in imposing income taxes on income so derived.\(^{340}\)

Shortly after Public Law 86-272 authorized the study, Congress expanded its scope to include "all matters pertaining to the taxation of interstate commerce by the States . . . or any political or taxing subdivision."\(^{341}\) In response to another Supreme Court decision, *Scripto, Inc. v. Carson.*\(^{342}\) Among other things, the report prepared as a result of the study, the Willis Report, recommended that Congress require a uniform apportionment formula.\(^{343}\)

Prior to the Willis Report, the states had considered uniform apportionment rules. In fact, in 1957, the American Bar Association had endorsed a uniform apportionment act.\(^{344}\) Efforts to achieve uniformity, however, were "painfully slow" until Congress enacted Public Law 86-272 and the Willis Report recommended that Congress enact uniform legislation. "To stave off further Federal intervention, the States moved with surprising speed to adopt the NCCUSL Uniform Division of Income for Tax Purposes Act."\(^{345}\) By 1969, twenty-three states had adopted UDITPA.\(^{346}\) States continue to work toward uniformity, but progress has slowed substantially.\(^{347}\)

To the extent that adoption of the proposed test would cause the Court to uphold state taxing statutes that Congress finds

344. In 1916, committees of the National Tax Association began to work on uniform apportionment formulae. Those committees' work met with little visible success for more than half a century. See Studenski, *supra* note 301, at 1145.
345. *Hellerstein & Hellerstein,* *supra* note 7, at 325.
347. For a discussion of the current status of legislation in this area, see *supra* text accompanying notes 39-45.
distasteful, this history shows that Congress might respond to the
Court's adoption of the proposed approach by legislating in the
area. Furthermore, this history further shows that once Congress
elects to legislate in the area, it might enact, or at least threaten to
enact, sweeping uniform legislation. The more likely Congress is to
enact sweeping uniform legislation, the more likely the states are
voluntarily to adopt uniform legislation. 348

Of course, past history does not unequivocally prove that
Congress and/or the states will enact uniform legislation in
response to adoption of the test. As discussed above, 349 Congress has
debated bills in response to the Court's decision in Quill but has yet
to enact any legislation resolving the problems raised by the case.
Moreover, the states have made efforts toward a voluntary
resolution of the problem but have yet to reach an agreement. 350
Nevertheless, adoption of the test might encourage Congress
and/or the states to enact uniform legislation.

Some might question the wisdom of this approach in the
current climate of fiscal federalism or the so-called "devolution
revolution." 351 Such concerns may be allayed in two ways. First,
while the "devolution revolution" might discourage Congress from
enacting comprehensive, uniform state tax legislation in the near
future, it does not absolutely foreclose the possibility of such

348. See also National Conference of State Legislatures, National
(advocating cooperation among the states to forestall federal preemption); State
of First Use' Sales Tax Scheme Will be Hard to Administer, 197 Daily Report for
Executives G-10 (Oct., 10, 1991) ("Ed Faker, Washington Department of
Revenue and member of the [Multistate Tax Commission] Uniformity
Committee, emphasized that it is in the interest of both businesses and states to
develop uniform policies in order to reduce the risk of legislative or judicial
intervention at the federal level.").

349. See supra text accompanying notes 333-37.

350. See, e.g., Catherine Hubbard, States Break Off Negotiations with Direct
Marketers, 4 State Tax Notes 34 (1993); Direct Marketing Ass'n Speaks on the

351. See generally Amy Hamilton, Fiscal Federalism -- The Elusive American
legislation.\textsuperscript{352} Despite the current climate, Congress recently enacted specific legislation limiting the states’ power to tax interstate commerce.\textsuperscript{353} Second, and more importantly, I offer the possibility of comprehensive federal legislation as a long, not short, run result of the proposed test. American history has been marked by an endless struggle between centralists and decentralists attempting to mold federal-state relations.\textsuperscript{354} History thus suggests that, at some time in the future, centralists will again return to power and comprehensive federal legislation will appear more attractive at that time than it does today.

\section*{VI. Conclusion}

Our current system of state and local taxation of interstate and foreign commerce creates an extraordinary burden on our national economy. Unfortunately, the Supreme Court is institutionally incapable of mandating more uniformity in taxation: the optimal solution to the problems created by our current system of taxation. Thus, the most for which we can hope from the Court is a second best solution.

The Court’s current four and six prong tests used to determine the validity of state and local taxing statutes affecting interstate commerce and foreign commerce may be an improvement over the Court’s earlier state tax dormant Commerce Clause jurisprudence. Nevertheless, the Court’s current approach is not the second best solution. Full of “uneasy juxtapositions and outright contradictions,”\textsuperscript{355} it creates too much uncertainty and instability.

\begin{itemize}
\item \textsuperscript{352} Of course, to the extent that such legislation would impose substantial costs on the states, the legislation would have to comply with the Unfunded Mandates Reform Act, Pub. L. No. 104-4, 109 Stat. 48 (1995). To the extent, however, that such legislation would create a net gain, the Unfunded Mandates Reform Act should not present an obstacle to such legislation.
\item \textsuperscript{353} Pub. L. No. 104-95, 109 Stat. 979 (1996) (prohibiting states from imposing income tax on certain “retirement income” of nonresidents).
\item \textsuperscript{354} John Shannon, \textit{Can New Federalism Tax Reformers Clear the High Middle-Class Hurdles?}, 9 STATE TAX NOTES 1141 (1995).
\item \textsuperscript{355} SHAVIRO, supra note 5, at 56.
\end{itemize}
to be second best.

Instead, the second best solution is a modification of an approach Justice Scalia developed and offered over a period of years. According to that vision, the Court should only strike down a state or local taxing statute if: (1) the statute facially discriminates against interstate or foreign commerce, or (2) the statute is indistinguishable from a statute the Court has previously stricken. In applying the first prong, the Court should only look beyond the face of the statute at issue to determine whether a facially discriminatory statute should be saved as a compensating tax. The court should narrowly define compensating taxes as functionally equivalent taxes. In applying the second prong, the Court should first ask whether the Court has ever stricken a functionally equivalent tax. If it has not, then it should uphold the statute. In determining whether the Court has stricken a functionally equivalent tax, the Court should take into account parties’ expectations. When applying the prong, the Court should make every effort to announce clear and certain rules that further stability.

This approach, although imperfect, has two distinct advantages. First, it has the potential to strike down those taxing statutes that create the greatest burdens on our national economy while providing some certainty and stability in an area of the law long racked by uncertainty and instability. Second, it has the potential to encourage Congress and/or the states to enact uniform legislation, the first best solution to state and local taxation of interstate and foreign commerce.