

Does Use Tax Violate External Consistency?

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Agenda

- Introduction
- Chris's **Perspective**
- Michael's **Perspective**
- Open Discussion
- Audience Poll

Introduction

- Are there instances where use tax needs to be apportioned to meet the requirement of external consistency?
 - *See* May 7, 2024, Petition for Writ of Certiorari, *Ellingson Drainage, Inc. v. South Dakota Dep't of Revenue*, 3 N.W.3d 417 (2024) (question presented is: “Whether South Dakota’s imposition of an unapportioned use tax on the fair market value of Petitioner’s movable construction equipment – some of which was used in South Dakota for one day – violates the fair apportionment requirement of the Commerce Clause”)
 - The Petition for Cert was denied on October 7, 2024

Use Tax & External Consistency

- This topic can be broken down into two questions:
 1. What is a use tax?
 2. What does the Commerce Clause require for a tax to be fairly apportioned?

What is a use tax?

- On May 15, 1944, *McLeod v. J.E. Dilworth*, 322 US 327 and *General Trading Co. v. State Tax Comm'n*, 322 US 335 were both decided
 - In *Dilworth*, the Arkansas Gross Receipts Act imposed a retail sales tax on sales made by a Tennessee vendor that were consummated in Tennessee for the delivery of goods in Arkansas. “For Arkansas to impose a tax on such transaction would be to project its powers beyond its boundaries and to tax an interstate transaction.”
 - In *General Trading Co.*, the Iowa Use Tax Law imposed a tax on property bought from the taxpayer and sent by it from Minnesota to purchasers in Iowa for use and enjoyment there. “The tax is what it professes to be- a non-discriminatory excise laid on all personal property consumed in Iowa... The exaction is made against the ultimate consumer- the Iowa resident who is paying taxes to sustain his own state government.”

What is a use tax?

- “It is suggested, however, that Arkansas could have levied a tax of the same amount on the use of these goods in Arkansas by the Arkansas buyers, and that such a use tax would not exceed the limits upon state power derived from the United States Constitution. Whatever might be the fate of such a tax were it before us, the not too short answer is that Arkansas has chosen not to impose such a use tax... A sales and a use tax in many instances may bring about the same result. But they are different in conception, are assessments upon different transactions, and the interlacings of the two legislative authorities within our federation may have to justify themselves on different constitutional grounds.” *Dilworth*

What is a use tax?

- “Though sales and use taxes may secure the same revenues and serve complementary purposes, they are, as we have indicated, taxes on different transactions and for different opportunities afforded by a State.”
- Is it constitutionally relevant that the use tax is designed as a complementary tax to the sales tax from a policy perspective?

The Commerce Clause

- 4 Prongs of *Complete Auto*
 - A Mississippi tax on the privilege of doing business in Mississippi did not violate the Commerce Clause when it is applied to an interstate activity (here the transportation by motor carrier in Mississippi to Mississippi dealers of cars manufactured outside the state):
 - With a substantial nexus with the taxing state;
 - Is fairly apportioned;
 - Does not discriminate against interstate commerce; and
 - Is fairly related to the services provided by the State.
 - Upon which prong does external consistency depend?

The Commerce Clause

- Fair Apportionment

- Courts determine whether a tax is fairly apportioned by examining whether it is internally and externally consistent:
 - The simpler of these two inquiries- internal consistency- asks if the approach employed by a taxing state were applied by every jurisdiction, whether more than 100% of income or a transaction would be taxed.
 - External consistency “asks whether the State has taxed only that portion of the revenues from interstate activity which reasonably reflects the in-state component of the activity being taxed.” *Goldberg v. Sweet*, 488 U.S. 252 (1989) (citing *Container Corp. of America v. FTB*, 463 US 159 (1983)).
- In *Goldberg*, a telecommunications tax withstood scrutiny despite being assessed on the gross charge of an interstate call that triggered simultaneous activity in several states

The Commerce Clause

- Fair Apportionment

- “It should not be overlooked, moreover, that the external consistency test is essentially a practical inquiry. In previous cases we have endorsed apportionment formulas based upon the miles a bus, train, or truck traveled within the taxing State. But those cases all dealt with the movement of large physical objects over identifiable routes, where it was practicable to keep track of the distance actually traveled within the taxing State. See, e.g. *Central Greyhound*, 334 US at 663... (‘There is no dispute as to feasibility in apportioning this tax’)[.]” *Goldberg*.

The Commerce Clause

- Does a credit resolve any fair apportionment concerns?
 - *D.H. Holmes Co. v. McNamara*, 486 US 24 (1988)- Louisiana’s use tax on catalogs was fairly apportioned because it “provide[d] a credit against its use tax for sales taxes that have been paid in other states... Similarly, Louisiana imposed its use tax only on the 82% of the catalogs distributed in-state; it did not attempt to tax that portion of the catalogs that went to out-of-state customers”
- What about mobile property?
 - *Ellingson* may be a case of first impression for use tax. But see *Norfolk and Western Railway Co. v. State Tax Comm’n*, 390 US 317 (1968) (A state will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the peculiarities of a given enterprise, to project the taxing power of the state plainly beyond its border.)
 - How do we reconcile *Jefferson Lines* and *Central Greyhound*?

The Commerce Clause

- And a final reminder not to forget the “venerable maxim”:
De minimis non curat lex (“the law cares not for trifles”)
Dep’t of Rev. v. Wrigley, 505 US 214 (1992)

Background – nature of a use tax

- The enactment of state use tax statutes date back to the time of the enactment of sales tax statutes, i.e., the early 1930's
- Use tax statutes were intended to remove the incentive for in-state persons to make out-of-state purchases resulting in (1) loss of business to in-state merchants and (2) loss of state sales tax revenue more generally
- Supreme Court has stated that a use tax is “complimentary” or “compensatory” with respect to sales tax
- A use tax is typically imposed upon the in-state “storage, use or other consumption” of property purchased outside the state where the out-of-state purchase was not subject to tax

Background – constitutionality of use taxes

- The imposition of a use tax does not violate the Commerce Clause even though the sale itself is made in another state
- “The tax upon the use after the property is at rest is not so measured or conditioned as to hamper the transactions of interstate commerce or discriminate against them.” *Henneford et al., v. Silas Mason Co., Inc.*, 300 U.S. 577 (1937)
- Similar to the constitutional analysis applied to a sales tax imposed upon moveable property. *See McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33 (1940)
- As in the case of a use tax, “[t]he ultimate burden of the [sales] tax, both in form and in substance, is laid upon the buyer for consumption,” *see id.* at 43
- But “full consumption or use of the purchased goods within the taxing State has never been a condition for taxing a sale of those goods.” *Jefferson Lines*, 514 U.S. at 191

Background – external consistency & corporate income tax

- Applied in the context of corporate income tax dating back over a hundred years. *See Underwood Typewriter v. Chamberlain*, 254 U.S. 113 (1920)
- To meet “external consistency,” the state “factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.” *See Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983)
- The Constitution does not “invalidate an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing State [but] we will strike down the application of an apportionment formula if the taxpayer can prove by clear and cogent evidence that the income attributed to the State is in fact out of all appropriate proportions to the business transacted in that State.” *Id.* at 169-170.

Jefferson Lines: external consistency & sales tax

- *Jefferson Lines* considers external consistency claim that a state should be limited to imposing sales tax only on the apportioned value of a purchased multistate bus ticket that represents the miles of the journey to be traveled in that state
- Court rejects taxpayer's claim, upholds the tax; notes the tax reaches "only the activity taking place within the taxing State, that is, the sale of the service"
- Court recognizes that in general property subject to sales tax may be moveable and in fact subsequently moved
- "We have ... consistently approved taxation of sales without any division of the tax base among different States, and have instead held such taxes properly measurable by the gross charge for the purchase, regardless of any activity outside the taxing jurisdiction that might have preceded the sale or might occur in the future," 514 U.S. at 179

Jefferson Lines further analysis

- *Jefferson Lines* notes that states with sales taxes also invariably impose use taxes, but notes that sales tax laws provide a credit to the state of purchase, so a purchaser “would be free from multiple taxation”
 - Court acknowledges that apportionment is required with respect to multistate income, but notes that, in those cases, absent apportionment, there would be a threat of double taxation
- *Jefferson Lines* also observes the Court is deferential to the states regarding sourcing/apportionment tax methods and that the apportionment of sales transactions would often be administratively challenging

Goldberg v. Sweet: external consistency & sales tax

- *Goldberg v. Sweet* rejects claim that an unapportioned sales tax imposed on interstate telephone calls – where a similar tax could be imposed by two different states, i.e., at the location of the service address and the billing address – violates external consistency
- “In sum, we hold that the Tax Act is fairly apportioned. Its economic effect is like that of a sales tax, the risk of multiple taxation is low, and actual multiple taxation is precluded by the credit provision. Moreover, we conclude that mileage or some other geographic division of individual telephone calls would be infeasible.” *Goldberg v. Sweet*, 488 U.S. at 264.

D.H. Holmes v. McNamara: external consistency & use tax

- *D.H. Holmes Co. v. McNamara*, 486 U.S. 24 (1988) rejects claim that an unapportioned use tax imposed on the distribution of mail order catalogs to customers within the state violates external consistency where the catalogs are designed and printed outside the state
- “We have no doubt that the [fair apportionment prong] of *Complete Auto* is satisfied ... The Louisiana taxing scheme is fairly apportioned, for it provides a credit against its use tax for sales taxes that have been paid in other states.” *Id.* at 31

Select state supreme court precedent...

- *Miller v. Comm’r*, 359 N.W.2d 620, 621-622 (Minn. 1985) (“courts of other jurisdictions have consistently held that any exercise of right or power incidental to ownership within the state constitutes a use sufficient to impose full use tax liability even when the property is located and used within the state for only brief periods of the year”) (citing cases)
- *General Motors Corp. v. City of Denver*, 990 P.2d 59, 72 (Col. 1999) (“the external consistency requirement does not require that sales and use taxes be apportioned based on the length of time tangible property remains in the taxing jurisdiction”)

Select state supreme court precedent...

- *General Motors v. City of Denver*, 990 P.2d at 72-73 (“use taxes are externally consistent if the contested tax contains a credit that operates to eliminate multiple taxation” – “[t]his rule holds true regardless of how long the property remains in the taxing jurisdiction”)
- *Whitcomb Constr. Corp. v. Comm’r of Taxes*, 479 A.2d 164, 168 (Vt. 1998) (“The Commerce Clause does not require apportionment in addition to a tax credit. The rule of *Complete Auto* ... requiring a tax on interstate commerce to be fairly apportioned is satisfied [where the] the state has provided a credit in lieu of apportionment.”)

Is the issue ultimately legislative?

- Several state courts have specifically said so. *See, e.g., Ellingson*, 3 N.W. 3d. at 426 (“The challenge Ellingson seeks is not a judicial one, but rather one better suited to the formulation of public policy by the legislature.”); *Whitcomb*, 479 A.2d. at 168 (“The Vermont legislature has chosen not to incorporate apportionment within the use tax scheme. This Court, therefore, is without power to impose such a requirement.”).
- *Cf. National Pork Producers Council v. Ross*, 143 S. Ct. 1142, 1165 (2023) (“Preventing state officials from enforcing a democratically adopted state law in the name of the dormant Commerce Clause is a matter of extreme delicacy, something courts should do only where the infraction is clear.”)

Would SCOTUS intervene?

- Court seems to have largely abandoned review of external consistency constitutional claims. *See, e.g., Vectren Infrastructure Servs. Corp. v. Dep't of Treasury*, 999 N.W.2d 748 (Minn. 2023), *cert. denied*, 144 S. Ct. 427 (2023).
 - The standard was last evaluated by the Court in *Jefferson Lines* in 1994
- *See also National Pork Producers*, 143 S. Ct. at 1153 (“In its modern cases, this Court has said that the Commerce Clause prohibits the enforcement of state laws driven by ... economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.”)

Audience Poll

- Are there instances where use tax needs to be apportioned to meet the requirement of external consistency?
 - A) Yes
 - B) No