A Constitutional Rethink: *Complete Auto* & *Moorman*

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Complete Auto Transit v. Brady, 430 U.S. 274 (1977)

- Background:
  - Michigan motor carrier company transported vehicles shipped into Mississippi via rail from in-state railheads to in-state dealerships on a contract basis
  - Mississippi imposed a gross receipts tax on its income for the privilege of doing business in the state
  - Taxpayer challenged the imposition of tax, arguing a per se violation of the Commerce Clause
    - Argued that under *Spector Motor Service, Inc. v. O'Connor*, a tax imposed on business operations conducted as part of interstate commerce is automatically in violation of the U.S. Constitution
    - In *Spector*, the Court looked only to whether the incidence of a tax imposed on an activity in interstate commerce was on the "privilege of doing business" and disregarded any practical effects of the tax
  - Taxpayer only argued this per se constitutional violation without raising any other issues
- Holding:
  - The U.S. Supreme Court rejected the idea that interstate commerce "should enjoy a sort of 'free trade' immunity from state taxation"
    - Overruled the *Spector* decision and the principal that "a state tax on the 'privilege of doing business' is per se unconstitutional when it is applied to interstate commerce"
    - Affirmed application of the tax since the per se Constitutional challenge was the only issue raised

Complete Auto Transit v. Brady, 430 U.S. 274 (1977)

- Analysis:
  - Court recognized that the courts had upheld taxes on interstate commerce not imposed on the "privilege of doing busines" in the state
  - Rejected the *Spector* approach as merely a "trap for the unwary draftsman" that "has no relationship to economic realities"
  - Instead, the Court recognized that a series of cases looking to "not the formal language of the tax statute, but its practical effect" had established a new Commerce Clause analytical framework
  - This analytical framework for evaluating a tax for a Commerce Clause violation has come to be known as the *Complete Auto* four-pronged analysis of whether:
    - Substantial nexus exists between the taxpayer and the taxing state;
    - A tax is fairly apportioned;
    - A tax discriminates against interstate commerce; and
    - A tax is fairly related to services provided by the state

Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978)

- Background:
  - Taxpayer, an Illinois company selling animal feed into Iowa, challenged Iowa's use of a single sales factor (SFF) formula for the apportionment of income earned in interstate commerce
  - 20 percent of taxpayer's sales arose in Iowa, but majority of payroll and property were in Illinois
  - Argued SSF apportionment violated both the Due Process and Commerce Clause because it resulted in extraterritorial taxation and in double taxation of income from conflicting state formulas
- Holding:
  - The U.S. Supreme court upheld the use of SSF apportionment for corporate income tax purposes
    - No evidence proffered showing a arbitrary result caused by SSF for Due Process purposes
      - "Despite … imprecision, the Court has refused to impose strict constitutional restraints on a State's selection of a particular formula."
      - Due Process challenges may succeed where the taxpayer shows "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, or has 'led to a grossly distorted result.'"
    - Speculative concerns of double taxation not sufficient for Court to override Iowa's chosen approach under the Commerce Clause and instead prescribe a uniform apportionment method
      - Court embraced fact that "some risk of duplicative taxation exists whenever the States in which a corporation does business do not follow identical rules for the division of income"
      - Prevention of duplicative taxation "would require national uniform rules for the division of income," which while supporting the Commerce Clause, would "require a policy decision based on political and economic considerations that vary from State to State."

Subsequent applications of *Complete Auto*

- *Am. Trucking Associations, Inc. v. Scheiner*, 483 U.S. 266 (1987)
  - Applied the *Complete Auto* Commerce Clause analysis to a Pennsylvania flat tax on trucking in the state, finding the tax violated the fair apportionment prong. In making its ruling, the Court emphasized the *Complete Auto* analysis applies to facially neutral flat taxes that would previously have been upheld under a more formalistic analysis.

- *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)
  - Applied the *Complete Auto* Commerce Clause test to determine that while a taxpayer's contacts may be sufficient to support imposition of a tax under the Due Process Clause, those connections may not be sufficient under the Commerce Clause. In its analysis, the Court established a bright-line physical presence requirement under the nexus prong of the *Complete Auto* test.

- *Comptroller of Treasury v. Wynne*, 312 Mich. App. 394 (2015)
  - Determined Maryland personal income tax regime of offering credit for taxes paid to other jurisdictions against state personal income tax but not a county component violated the Commerce Clause because it failed the *Complete Auto* fair apportionment prong due to a lack of internal consistency.

- *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018)
  - Upheld the application of sales tax collection obligations on out-of-state sellers under the Commerce Clause, rejecting the *Quill* bright-line nexus test in favor of a "sensitive, case-by-case analysis of purposes and effects" for purposes of *Complete Auto* Commerce Clause analysis.

Subsequent applications of *Moorman*

- *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983)
  - Upheld as constitutional the California worldwide unitary combined reporting regime.
  - Cited *Moorman* for Commerce Clause fair apportionment external consistency analysis and the proposition that an apportionment method that may result in the taxation of income sourced outside the state is not automatically unconstitutional, but may be challenged if the method leads to grossly distorted results.

- *W. R. Grace & Co. v. Comm'r of Revenue*, 378 Mass. 577 (1979)
  - Upheld Massachusetts taxation of a Connecticut company's gains from the sale of an interest in another company.
  - Cited *Moorman* in holding that the court would not require an alternative apportionment method where a taxpayer failed to prove by clear and cogent evidence that income attributed to the Commonwealth was out of all appropriate proportion to the business transacted there or led to a grossly distorted result.

- *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358 (1991)
  - Upheld the constitutionality of Michigan's single business tax three-factor apportionment formula, applying the *Moorman* external consistency analysis to the SBT for the proposition that states have wide latitude in the selection of an apportionment formula unless a taxpayer can prove by clear and cogent evidence that the state's apportionment regime provides a distorted result.

- *Comptroller of Treasury v. Wynne*, 312 Mich. App. 394 (2015)
  - Determined Maryland personal income tax regime of offering credit for taxes paid to other jurisdictions against state personal income tax but not a county component violated the Commerce Clause because it failed the *Complete Auto* fair apportionment prong due to a lack of internal consistency.
  - Relied on *Moorman* for internal consistency analysis and concept that state choices in tax regimes can constitutionally result in multiple taxation of the same income.

The Court's Reliance on *Complete Auto*

- *Complete Auto* has been cited in forty-five United States Supreme Court opinions.
- The Court regularly cited *Complete Auto* up until the late 1990's. Since 1997, the Court has only cited *Complete Auto* in five opinions, most recently in *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018).

The Dormant Commerce Clause

- The dormant (or negative) Commerce Clause is not found in the text of the United States Constitution.
- The dormant Commerce Clause doctrine is one of implied restraints on permissible state action to prevent economic protectionism.
- Critics and Skeptics:
  - Two justices (Justices Scalia and Thomas) have openly questioned the validity of the dormant Commerce Clause in dissenting opinions. *See Comptroller of Treasury of Maryland v. Wynne*, 575 U.S. 542 (2015).
  - Justice Gorsuch has also expressed skepticism as to the application of the dormant Commerce Clause. *See Tennessee Wine & Spirits Retailers Ass'n v. Thomas*, 139 S. Ct. 2449 (2019).

Implication of *New Hampshire v. Massachusetts*

- A Massachusetts regulation allowed the state to source and tax income of nonresidents who would normally be working in Massachusetts but were instead telecommuting.
- New Hampshire claimed the regulation failed the *Complete Auto* test and taxed value outside Massachusetts' borders.
- The Supreme Court denied New Hampshire's motion for leave to file the bills of complaint.
- Will more state's follow the lead of Massachusetts?

"Stormin' *Moorman*" Follows "Kill *Quill*"

- Single Sales Factor apportionment formula is unconstitutional
  - *Moorman*'s antiquated analysis does not hold up to a more nuanced, modern Commerce Clause analysis

- Discrimination —*Complete Auto* 3rd Prong
  - *Bacchus Imports*

- Fair Apportionment —*Complete Auto* 2nd Prong
  - *Mobil Oil, Exxon, Container, Hans Rees, Norfolk & Western*

Single Sales Factor Discriminates Against Interstate Commerce

- Our nation's political union is grounded on economic union, a nationwide economic free trade zone
  —*The Federalist Papers*

- Discrimination invalidates a tax statute if discrimination is:
  - facial or
  - intended or
  - effected —*Bacchus Imports* (US`84)

- California example:
  - *Intent*: Prop 39 marketing: shift $1B taxes to multistate businesses
  - *Effect*: Tax doubled for multistate businesses with no in-state property or payroll; unchanged for Calif-only companies

Fair Apportionment "External Consistency" Analysis

- As-Applied Quantitative Rationality—*Hans' Rees* (US`31)—is not the end of modern External Consistency ("rational relationship") analysis

- "Rational Relationship" analysis has 3 elements, each with 2 facets:
  - Subject
    - person/ corporation —*Exxon v WI* (US`80)
    - statutory formula —*Container* (US'83)
  - Method
    - as-applied (taxpayer's facts) —*Hans' Rees*
    - facial (language of statute) —*Norfolk & Western* (US`68)
  - Characteristics
    - quantitative (math) —*Hans' Rees*
    - qualitative (economic reality) —*Container*, *Microsoft*(CA'06)

The Benchmark: Three-Factor Formula & Economic Science

- 3-Factor Formula is "benchmark against which other apportionment formulas are judged … because payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated." —*Container* (US'83)

- Corporate Income Tax is imposed on value of business activity
  - Economics identifies measurable / situsable proxies for business activity using the "intersection of supply & demand" —Mazerov (CBPP`05)

  - Supply = production = labor (payroll) & capital (property)
  - Demand = consumption = market (sales)

Application—SSF Fails "Facial Qualitative Rationality" Test

- Irrationality of "Blue Eye Formula"
  - quantitatively: may be grossly under, over, or satisfy *Hans' Rees*
  - qualitatively: can never satisfy *Container* economic reality test
- Irrationality of Single Sales Factor
  - SSF tells just half the story (demand without supply)
  - on its face, SSF qualitatively fails as a proxy for business activity, whether or not it coincidentally gets close for a particular taxpayer
- SSF is unconstitutional; *Moorman* should be overturned

Conclusion

[Joe, as moderator, ties it all together]