TAX LAW REVIEW

VOLUME FIFTY ONE NUMBER ONE

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51 Tax Law Review 47-114 (Fall, 1995)

Walter Hellerstein
Michael J. McIntyre
Richard D. Pomp

New York University School of Law

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Walter Hellerstein,* Michael J. McIntyre** And Richard D. Pomp***

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* Professor of Law, University of Georgia.

** Professor of Law, Wayne State University.

*** Alva P. Loiselle Professor of Law, University of Connecticut.

The authors would like to thank Paull Mines and Rick Kay for their helpful comments on an earlier draft of this Article.

I. Introduction

The Supreme Court's 1977 decision in *Complete Auto Transit, Inc. v. Brady*[1] signaled a paradigmatic shift in the Court's approach to state tax adjudication under the dormant Commerce Clause.[2] In [*49] *Complete Auto*, the Court repudiated the

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[1] 430 U.S. 274 (1977).

[2] See David A. Barrett, Constitutional Limitations on Discriminatory State Tax Laws, 2 N.Y.U. Inst. on State and Local Tax'n and Conf. on Property Tax'n 1.03[2], at 1-15 (1983) (*Complete Auto* is "a bell wether decision marking a shift away from adjudicating the constitutionality of tax measures by labels and to the use of practically oriented economic analysis."), cited in Philip M. Tatarowicz & Rebecca F. Mims-Velarde, An Analytical Approach to State Tax Discrimination Under the Commerce Clause, 39 Vand. L. Rev. 879, 897 n.79 (1986); Paul J. Hartman, Federal Limitations on State and Local Taxation 88 (1981) ("After decades of distinctions based upon insubstantial and pointless formalism, in 1977 the Court cut the Gordian knot in *Complete Auto*."); Jerome R. Hellerstein & Walter Hellerstein, State and Local Taxation 258 (5th ed. 1988) ("*Complete Auto* . . . has emerged as the starting point for much of modern Commerce Clause analysis of State taxes."); Howard O. Hunter, Federalism and State Taxation of Multistate Enterprises, 32 Emory L.J. 89, 96 (1983) (*Complete Auto* reveals that "the Formal Rule has now been largely cast aside in favor of an approach that is apparently intended to focus more on function and less on form"); Michael Jenkins

formalistic school of interpretation that once had governed Commerce Clause analysis of state taxation because it bore "no relationship to economic realities."[3] In its place, the Court embraced a decisional framework that "considered not the formal language of the tax statute but rather its practical effect."[4] In furtherance of this objective, the Court suggested a four-part test to guide the constitutional analysis of state taxation of interstate commerce.[5]

The Court subsequently characterized its contemporary approach to Commerce Clause adjudication in the state tax field as a "consistent and rational method of inquiry [focusing on] the practical effect of a challenged tax.'"[6] This approach has "moved toward a standard of permissibility of state taxation based upon its actual effect rather than its legal terminology.'"[7] Over the two decades following *Complete Auto*, the Court has faithfully reaffirmed its central themes: Commerce Clause challenges to state taxes are to be resolved on the basis of the "practical or economic effect of the tax";[8] decisions should be grounded in "economic realities";[9] and the analysis should eschew "magic words or labels,"[10] "avoid formalism"[11] and reflect pragmatism.[12] In implementing these views, the Court has invoked *Complete*

& Paul Hribernick, State Taxation of Interstate Commerce: "It Is a Question of Power," 42 La. L. Rev. 951 (1982) (*Complete Auto* ended period of "'[d]octrinal disarray' . . . [in] adjudications of state taxes imposed on interstate commerce" and marked beginning of "a quiet revolution in Commerce Clause decisions."); William B. Lockhart, A Revolution in State Taxation of Commerce?, 65 Minn. L. Rev. 1025, 1026 (1981) ("The Supreme Court shook the foundations [underlying the current law] for the first time in 1977 with *Complete Auto*...."); Tatarowicz & Mims-Velarde, supra, at 897 ("The1977 *Complete Auto Transit* decision marked a break-through in state tax adjudication under the commerce clause."). Indeed, several Justices have held up *Complete Auto* as a benchmark against which major developments in other areas of the law are to be compared. American Trucking Ass'ns, Inc. v. Smith, 496 U.S. 167, 216 (1990) (Stevens, J. dissenting) ("a string of subsequent decisions the preceding five Terms had effected a sea change in election law no less substantial than this Court's decision[] in *Complete Auto Transit*...effected with respect to the understanding of the Commerce Clause.") (footnote omitted).

[3] *Complete Auto*, 430 U.S. at 279.

[4] Id.

[5] Under this test, a tax affecting interstate commerce will be sustained under the Commerce Clause "when the tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." Id.

[6] 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, 443 (1980)).

[7] American Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266, 295 (1987) (quoting *Complete Auto*, 430 U.S. at 281).

[8] Goldberg v. Sweet, 488 U.S. 252, 262 (1989).

[9] American Trucking, 483 U.S. at 295 (quoting *Complete Auto*, 430 U.S. at 279).

[10] Quill Corp. v. North Dakota, 504 U.S. 298, 310 (1992) (quoting Railway Express Agency, Inc. v. Virginia, 358 U.S. 434, 441 (1959)).

[11] Trinova Corp. v. Michigan Dep't of Treasury, 498 U.S. 358, 373 (1991).

[12] See *Quill*, 504 U.S. at 310.

Auto's four-part test in most subsequent Commerce Clause challenges to state taxation.[13] [*50]

The Court may appear to have retreated from these teachings in a case decided in 1995. In *Oklahoma Tax Commission v. Jefferson Lines, Inc.*,[14] the Court upheld an Oklahoma sales tax on the full sales price of bus tickets for interstate trips.[15] At the same time, the Court reaffirmed *Central Greyhound Lines, Inc. v. Mealey*,[16] which struck down a New York gross receipts tax on the full sales price of bus tickets for interstate trips.[17] *Jefferson Lines* and *Central Greyhound* are essentially identical from an economic standpoint, and Justice Breyer, writing in dissent, accused the majority of elevating form over substance and ignoring economic reality.[18] If Justice Breyer's criticisms are well taken, they could mean that the Court has jettisoned the basic doctrine of *Complete Auto* and has come to one more turning point in its historically unstable analysis of state taxes under the dormant Commerce Clause.

Jefferson Lines may indeed be a pivotal case, but not for the reasons suggested by the dissent. The case is significant because the Court has recognized explicitly for the first time that the application of *Complete Auto's* Commerce Clause criteria can—and should—depend to a critical extent on the nature of the tax under scrutiny, a position that runs counter to the assumed universality of the *Complete Auto* standard that underlies the Court's earlier opinions.[19]

As explained below, the Court's new tax-by-tax approach is notable for many reasons, not the least of which is its implications concerning the role of economic

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[13] See, e.g., Barclays Bank PLC v. Franchise Tax Bd., 114 S. Ct. 2268, 2276-77 (1994); *Quill*, 504 U.S. at 311-13; *Trinova*, 498 U.S. at 372; Amerada Hess Corp. v. Director, Div. of Taxation, New Jersey Dep't of Treasury, 490 U.S. 66, 72 (1989); Goldberg v. Sweet, 488 U.S. 252, 258-60 (1989); D.H. Holmes Co. v. McNamara, 486 U.S. 24, 30 (1988); *American Trucking*, 483 U.S. at 291; Wardair Can. Inc. v. Florida Dep't of Revenue, 477 U.S. 1, 8 (1986); Commonwealth Edison Co. v. Montana, 453 U.S. 609, 617 (1981); Maryland v. Louisiana, 451 U.S. 725, 754 (1981); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 443 (1980); Department of Revenue v. Association of Wash. Stevedoring Cos., 435 U.S. 734, 745 (1978). But see West Lynn Creamery, Inc. v. Healy, 114 S. Ct. 2205 (1994); Kraft General Foods, Inc. v. Iowa, 505 U.S. 71 (1992); New Energy Co. v. Limbach, 486 U.S. 269 (1988); Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984); Armco, Inc. v. Hardesty, 467 U.S. 638 (1984) (all dormant Commerce Clause cases in which the four-prong test of *Complete Auto* played little or no role).

[14] 115 S. Ct. 1331 (1995).

[15] Justice Souter wrote the Court's opinion, which was joined by Chief Justice Rehnquist and Justices Stevens, Kennedy and Ginsburg. Justice Scalia concurred in the judgment and wrote a separate opinion, which was joined by Justice Thomas.

[16] 334 U.S. 653 (1948).

[17] See *Jefferson Lines*, 115 S. Ct. at 1340-41.

[18] See id. at 1346-48. Justice O'Connor joined in the dissent.

[19] See, e.g., D.H. Holmes Co. v. McNamara, 486 U.S. 24, 30 (1988) ("This four-part formulation has. . . been used to evaluate the validity of state taxes vis-a-vis the Commerce Clause in a number of contexts." (citations omitted)).

analysis in resolving Commerce Clause issues. Justice Breyer was certainly correct in observing that the economic effects of the Oklahoma and New York taxes, as they applied to transportation services, were identical. If the case should have turned on that economic equivalence, Justice Breyer should be applauded. But we should hold our applause. Although economic considerations [*51] clearly have an important role to play in Commerce Clause adjudication of state tax cases, the establishment of uniform constitutional rules for economically equivalent exactions is not the only goal of Commerce Clause analysis of state taxation, as the Court correctly concluded in *Jefferson Lines*.

Despite reaching a proper result, *Jefferson Lines* is significantly flawed in its reasoning. The Court fails to ground its opinion in the normative and structural considerations that would have responded fully to Justice Breyer's critique. Instead, it appears to have engaged in the type of ad hoc decisionmaking that has substantially reduced the predictive power of its dormant Commerce Clause jurisprudence and has weakened the claims of that jurisprudence to legitimacy. Consequently, the Court did nothing to mollify the critics of its dormant Commerce Clause doctrine who, like Justice Scalia, "look forward to the day when *Complete Auto* will take its rightful place . . . among the other useless and discarded tools of our negative-Commerce-Clause jurisprudence."[20]

This Article analyzes *Jefferson Lines* and its implications for Commerce Clause adjudication of state taxation. Section II examines the Court's opinion in *Jefferson Lines*, discusses the flaws in the Court's analysis and presents a better justification for the result reached in that case. Section III considers the opinion's ramifications for the existing pattern of state sales and gross receipts taxation and, in particular, for state taxation of services. Section IV takes a broader look at *Jefferson Lines*' impact on the Court's Commerce Clause jurisprudence in state tax cases.

II. *Jefferson Lines*

A. The Facts and Proceedings Below

The facts of the case were simple and undisputed. Oklahoma imposes a tax on the retail sale in the state of most tangible personal property and selected services.[21] The purchaser of the taxable goods or services pays the tax to the seller, who collects the tax and remits it to the state.[22] Among the services subject to tax in Oklahoma was "transportation for hire."[23] [*52]

[20] *Jefferson Lines*, 115 S. Ct. at 1346 (Scalia, J., concurring).

[21] Okla. Stat. tit. 68, 1350-1369 (1981 & Supp. 1995).

[22] Id. 1361 (Supp. 1995).

[23] During the years at issue (1988-1990), Oklahoma's statute "levied upon all sales . . . an excise tax of four percent (4%) of the gross receipts or gross proceeds of each sale of the following . . . (C) Transportation for hire to persons by common carrier." Id. 1354(1) (Supp. 1988) (amended 1990).

Jefferson Lines, Inc. was a Minnesota corporation that provided bus services in Oklahoma. Despite its statutory obligation to collect and remit a tax on all sales in Oklahoma of transportation for hire, regardless of where the trip began or ended, Jefferson collected and remitted taxes only for tickets it sold in Oklahoma for bus travel that originated and terminated in the state. It collected no taxes on sales of tickets in Oklahoma for bus travel from Oklahoma to other states.[24]

After Jefferson filed for bankruptcy, the Oklahoma Tax Commission sought payment in bankruptcy court for unpaid taxes due on Jefferson's receipts from sales in Oklahoma of tickets for travel originating in Oklahoma and terminating in other states.[25] Jefferson resisted the claim on the ground that the tax violated the Commerce Clause proscription against taxes that are not fairly apportioned to the taxpayer's activities in the taxing state.[26] In Jefferson's view, Oklahoma's tax offended the fair apportionment requirement because it was measured by the full purchase price of the bus ticket, even though a portion of the price was attributable to transportation services rendered in other states.[27] Jefferson also maintained that the tax ran afoul of the related Commerce Clause prohibition against multiple taxation because other states through which Jefferson's buses traveled could impose levies measured by the same receipts that Oklahoma sought to tax upon the sale of the bus ticket.[28]

The bankruptcy court, the district court,[29] and the United States Court of Appeals for the Eighth Circuit[30] agreed with Jefferson. As Judge Arnold explained for the court of appeals, a state tax on interstate commerce must be "fairly apportioned";[31] the fair apportionment [*53] requirement demands that a state "tax[] only that portion of the revenues from the interstate activity which reasonably

[24] We understand that Jefferson adopted this pricing strategy because its competitors were not collecting the sales tax under similar circumstances. Accordingly, the decision not to collect the sales tax on interstate trips was motivated more by business than by tax considerations.

[25] Even though tickets that Jefferson may have sold in Oklahoma for bus services wholly outside the state or for bus services originating outside the state and terminating in Oklahoma literally fell within the terms of the statute, the Commission did not seek to recover taxes with respect to such sales. See *Jefferson Lines*, 115 S. Ct. at 1335 n.2. Consequently, the validity of a tax on such sales was not before the Court. It is, however, considered in note 330. We understand that in other cases Oklahoma has assessed a sales tax on all tickets sold and paid for in Oklahoma, even though none of the travel occurred there.

[26] See Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

[27] See *Jefferson Lines*, 115 S. Ct. at 1335. Under Jefferson's theory of the case, it should have collected an apportioned share of the tax on tickets that originated in Oklahoma and terminated elsewhere or that originated elsewhere and terminated in Oklahoma.

[28] See id.

[29] See id. at 1335 (referring to unreported opinions of the bankruptcy and district courts).

[30] In re Jefferson Lines, Inc., 15 F.3d 90 (8th Cir. 1994), rev'd sub nom., Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. 1331 (1995).

[31] Id. at 91 (quoting *Complete Auto*, 430 U.S. at 279).

reflects the in-state component of the activity being taxed";[32] the Oklahoma tax failed this test because it was imposed on the unapportioned gross receipts from the sale of interstate transportation services, a substantial portion of which were performed outside of Oklahoma;[33] the state's argument that the Oklahoma levy taxed "only the purchase of the ticket, and not the use of the ticket, ignores the fact that the real value of the ticket is the right to ride a bus";[34] to accept this argument "would elevate form over substance" and "ignore economic realities";[35] and the case is indistinguishable from *Central Greyhound Lines, Inc. v. Mealy*,[36] in which the Court struck down a tax on an interstate bus company measured by its unapportioned receipts from tickets sold in New York, even though the receipts reflected payment for transportation services performed partially outside of New York.[37]

B. The Supreme Court's Opinion

1. Pragmatism and Economic Reality: An Overview

Jefferson Lines presented the Court with an uncomfortable dilemma. As we noted at the outset of this Article, the signal characteristic of the Court's contemporary Commerce Clause opinions is their commitment to a jurisprudence based on pragmatism and economic reality. These two criteria typically reinforce one another, with the pragmatic outcome likewise being the outcome that makes economic sense.[38] [*54]

In *Jefferson Lines*, however, considerations of pragmatism and economic reality diverged.[39] From a practical standpoint, Oklahoma's levy closely resembled the

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32 Id. at 92 (quoting Goldberg v. Sweet, 488 U.S. 252, 262 (1989)).

33 See id. at 93.

34 Id.

35 Id.

36 334 U.S. 653 (1948).

37 *In re Jefferson Lines, Inc.*, 15 F.3d at 92-93.

38 See, e.g., D.H. Holmes Co. v. McNamara, 486 U.S. 24, 31, 33 (1988) (sustaining state's power to impose use tax on catalogs shipped from outside the state to local retailer's in-state customers because of retailer's substantial in-state "economic presence," and deeming it "largely irrelevant" for Commerce Clause purposes whether catalogs were still "in the stream of interstate commerce"); American Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266, 286 (1987) (invalidating flat highway use tax as applied to out-of-state trucks because practical effect of tax was to impose higher per mile economic burden on interstate than on intrastate trucking activity). But see Quill Corp. v. North Dakota, 504 U.S. 298, 317-18 (1992) (reaffirming admittedly formalistic physical presence standard with respect to obligation of out-of-state mail-order seller to collect use taxes, even though such a standard makes little economic sense, because of pragmatic considerations, including reliance interests).

39 Although the Court's decision was based on a preference for pragmatism, the result reached also can be defended on economic grounds. A decision for the taxpayer almost certainly would have resulted in the undertaxation of interstate transportation services, thereby creating an economically

"garden-variety sales tax" on tangible personal property that the Court had "perennially sustained, even though levied on goods that have traveled in interstate commerce to the point of sale or that will move across state lines thereafter."[40] Just as a state may impose a tax on the local sale of goods measured by their full sales price even though the price reflects value added outside the state, so it might seem that a state may impose a tax on the local sale of services measured by their full sales price even though the price reflects value added outside the state.[41]

From the standpoint of economic reality, however, there is no meaningful distinction between a tax imposed on the retail sale of interstate transportation services, measured by the unapportioned gross receipts from the sale of such services, and a tax imposed on the business of providing interstate transportation services, measured by the unapportioned gross receipts from the sale of such services.[42] The [*55] Court already had condemned a levy of the latter description

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inefficient bias against in-state transportation. See text accompanying notes 185-201.

[40] *Jefferson Lines*, 115 S. Ct. at 1344.

[41] From a normative perspective, events preceding the sale should be distinguished from events subsequent to the sale. Events preceding the sale, such as the value added by out-of-state manufacturing, or the cost of transporting the goods to the state of sale, are a proper measure of the consumption that is purchased and thus should be included within an ideal sales tax base. Events subsequent to the sale, however, such as the out-of-state portion of a bus trip, do not represent consumption in the taxing state and arguably should be excluded from the base of an ideal sales tax. See generally Richard D. Pomp & Oliver Oldman, A Normative Inquiry into the Base of a Retail Sales Tax: Casual Sales, Used Goods, and Trade Ins, 43 Nat'l Tax J. 427 (1990).

[42] Whether the legal incidence of a tax falls on the buyer or the seller will not determine its economic incidence, that is, the ultimate distribution of its burden. See generally Walter Hellerstein, Complementary Taxes as a Defense to Unconstitutional State Tax Discrimination, 39 Tax Law. 405, 438-41 (1986) (discussing economics of tax incidence), on which the balance of this footnote is largely based. Many factors determine who bears the economic burden of a tax. Elasticities of supply and demand, that is, the sensitivity of supply and demand to a change in price, are among the most significant. For example, if demand is relatively elastic—if an increase in the price of the service induces a relatively larger decrease in the demand for it—a tax on the service is likely to be borne by service providers rather than by consumers of the service. Assuming that consumers are unwilling to pay more than $100 for a bus ticket from Tulsa to Dallas, a 5% tax on bus tickets will not affect the after-tax price of the bus ticket to consumers, which will remain at $100. Instead, the bus line will have to reduce its price to a little over $95, and it will absorb the economic burden of the tax. On the other hand, if the demand is relatively inelastic—if an increase in the price of the service induces a comparatively smaller decrease in the demand for it—a tax on the service is likely to be borne by its consumers rather than by service providers. Assuming that consumers will not alter their pattern of purchasing bus tickets even in the face of a price increase, a 5% tax on bus tickets selling for $100 will increase the price of the ticket to $105, thereby requiring the purchaser to absorb the tax. The providers of interstate bus services in Oklahoma apparently thought they were facing very price elastic demand curves. See note 24.

The critical lesson to be drawn from these elementary principles of tax incidence analysis is that it makes no difference from the standpoint of the economic impact of a tax whether the tax is imposed on the purchaser or the seller, or on the "sales price" of interstate transportation services as distinguished from the "gross receipts" from the business of selling transportation services. In each as incompatible with the Commerce Clause in *Central Greyhound Lines, Inc. v. Mealey*.[43] If "economic realities"[44] rather than "magic words or labels"[45] were to govern the analysis, approval of the levy because it was denominated a retail sales tax rather than a business gross receipts tax would be difficult to justify.

2. *Fair Apportionment and the Sales Taxation of Goods*

The Court confronted the disquieting choice of pragmatism versus economic reality in addressing the "difficult question"[46] of fair apportionment,[47] which lay at the heart of the Court's opinion. On the one [*56] hand, the Court could maintain a pragmatic, but formalistic, approach to the application of the fair apportionment criterion to sales taxes by sustaining a levy on the full price of an interstate bus ticket. On the other hand, it could endorse an economically appealing but administratively problematic requirement of dividing the base of a sales tax on interstate transportation services. In adopting the former position, the Court cast new light on the meaning of the fair apportionment requirement.

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case, the economic incidence of the tax depends on such factors as elasticity of supply and demand, whether there are viable, untaxed substitutes for the taxed services, the industrial structure of the market and the applicable time frame, and the like. The economic incidence of the tax will not depend on who is denominated as the "taxpayer" or on whether the receipts are taxed in the hands of seller or the buyer.

In addition, laws requiring the shifting of the tax to the consumer, along with its separate statement on the bill, cannot themselves determine the economic incidence of a tax. As Professors John Due and John Mikesell observe, "no law can actually compel shifting of a tax, because retailers are free to reduce the price net of the tax and to show the tax separately, thus complying with the act and yet, in fact, absorbing the tax." John F. Due & John L. Mikesell, Sales Taxation: State and Local Structure and Administration 31 (2d ed. 1994). Nevertheless, provisions in retail sales tax statutes for shifting "are significant in promoting uniformity of treatment of the tax by competing retailers. If the law provides for shifting, retailers feel more confident that their competitors will shift and, in turn, will be more inclined to do so themselves." Id.

[43] 334 U.S. 653 (1948).

[44] American Trucking Ass'ns, Inc. v. Sheiner, 483 U.S. 266, 295 (1987) (quoting Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)).

[45] Quill Corp. v. North Dakota, 504 U.S. 298, 310 (1992) (quoting Railway Express Agency, Inc. v. Virginia, 358 U.S. 434, 441 (1959)).

[46] *Jefferson Lines*, 115 S. Ct. at 1338.

[47] Before turning to the apportionment issue, the Court first reviewed the historical evolution of its Commerce Clause doctrine, which culminated in *Complete Auto*'s now familiar four-part test for evaluating the constitutionality of state taxes under the Commerce Clause. The Court summarily disposed of the nexus question, finding "nexus' aplenty" because "Oklahoma is where the ticket is purchased, and the service originates there." Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. 1331 1338 (1995) (citing D.H. Holmes Co. v. McNamara, 486 U.S. 24, 33 (1988)). The Court's statement in *Jefferson Lines* that "it has long been settled that a sale of tangible goods has a sufficient nexus to the State in which the sale is consummated," 115 S. Ct. at 1338, does not state the applicable constitutional doctrine regarding the collection of a use tax. See Quill Corp. v. North Dakota, 504 U.S. 298, 306 (1992).

The Court observed that, in recent years, it had been evaluating state taxes for conformity with the fair apportionment requirement of *Complete Auto* by applying the internal and external consistency tests.[48] A tax is internally consistent if "the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear."[49] The Oklahoma tax easily met this test because if "every State were to impose a tax identical to Oklahoma's, that is, a tax on ticket sales within the State for travel originating there, no sale would be subject to more than one State's tax."[50]

The more troublesome—and critical—issue for the Court was whether the tax satisfied the external consistency test. "External consistency . . . looks not to the logical consequences of cloning, but to the economic justification for the State's claim upon the value taxed, to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State."[51] In explicating this requirement, the Court acknowledged that the very term "apportionment" tends to suggest a division of the tax base, and that apportionment controversies involving income taxation of interstate business "have often centered around specific formulas for slicing a taxable pie among several States in which the taxpayer's activities contributed to taxable value."[52] With regard to the application of the fair apportionment requirement to sales taxes, however, the Court observed that "we have *had* to set a different course."[53]

The Court attributed its unwillingness to require a division of the sales tax base to the nature of the levy as it commonly is understood. "A sale of goods is most readily viewed as a discrete event facilitated [*57] by the laws and amenities of the place of sale, and the transaction itself does not readily reveal the extent to which completed or anticipated interstate activity affects the value on which a buyer is taxed."[54] Accordingly, because division of the sales tax base did not appear practicable, the Court had "consistently approved taxation of sales without any division of the tax base among different States, and had 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."[55]

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[48] See *Jefferson Lines*, 115 S. Ct. at 1338.

[49] Id.; see generally Walter Hellerstein, Is "Internal Consistency" Foolish?: Reflections on an Emerging Commerce Clause Restraint on State Taxation, 87 Mich. L. Rev. 138 (1988) [hereinafter Internal Consistency].

[50] *Jefferson Lines*, 115 S. Ct. at 1338.

[51] Id.

[52] Id. at 1339.

[53] Id. (emphasis added).

[54] Id.

[55] Id. (citing McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940) (sustaining sales tax on unapportioned sales price of coal shipped from outside the state); Wardair Can. Inc. v.

In taking this approach, however, the Court still had to address the concern that sales taxes on interstate transactions might undermine "the central purpose'"[56] of the fair apportionment requirement; namely, to "ensure that each State taxes only its fair share of an interstate transaction,'"[57] thereby avoiding "multiple taxation."[58] In the Court's eyes, the essential nature of a sales tax made this objective self-executing: "The very conception of the common sales tax on goods, operating on the transfer of ownership and possession at a particular time and place, insulated the buyer from any threat of further taxation of the transaction."[59] The Court concluded that "in light of [the] settled treatment of taxes on sales of *goods* . . . it is fair to say that because the taxable event of the consummated sale of *goods* has been found to be properly treated as unique, an internally consistent, conventional sales tax has long been held to be externally consistent as well."[60] [*58]

Although the Court was in error in suggesting that sales taxes intrinsically are immune from the risk of multiple taxation on the theory that taxable sales are "consummated"[61] only in one state,[62] the Court's ultimate judgment regarding the

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Florida Dep't of Revenue, 477 U.S. 1 (1986) (sustaining sales tax on unapportioned sales price of airplane fuel to be consumed in international commerce); State Tax Comm'n of Utah v. Pacific States Cast Iron Pipe Co., 372 U.S. 605 (1963) (per curiam) (sustaining sales tax on unapportioned sales price of cast iron pipe to be shipped outside the state immediately after sale)). Normatively, the Court should not have equated activity preceding the sale with activity occurring subsequent to the sale. See note 41.

[56] *Jefferson Lines*, 115 S. Ct. at 1338 (quoting Goldberg v. Sweet, 488 U.S. 252, 260 (1989)).

[57] Id.

[58] Id. As the Court noted, the prohibition on multiple taxation descends from Western Life Stock v. Bureau of Revenue, 303 U.S. 250 (1938), and "is threatened whenever one State's act of overreaching combines with the possibility that another State will claim its fair share of the value taxed: the portion of value by which one State exceeded its fair share would be taxed again by a State properly laying claim to it." *Jefferson Lines*, 115 S. Ct. at 1338.

[59] Id. at 1339. The Court repeated this point several times, observing that it had "found a sufficient safeguard against the risk of impermissible multiple taxation of a sale in the fact that it was consummated in only one State," id., and that "the taxable event of the consummated sale of goods has been found to be properly treated as unique." Id. at 1340.

[60] Id. at 1340 (emphasis added).

[61] See note 59.

[62] Contrary to the Court's assumption, most state sales taxes are imposed on the transfer of ownership or possession of tangible personal property, not on the transfer of ownership *and* possession. See, e.g., Fla. Stat. ch. 212.02(15) (1995) (taxable sale defined as "any transfer of title or possession, or both); Mass. Ann. Laws ch. 64H, 1 (Law. Co-op. 1996) (defining taxable sale as "any transfer of title or possession or both"); N.Y. Tax Law 1101(b)(5) (McKinney Supp. 1995) (taxable sale defined as "any transfer of title or possession or both"). Consequently, when title is transferred in the seller's state but possession is transferred in the purchaser's state, a purchaser is exposed to the risk that the sale will be taxable in both states. For this reason, a statute imposing a sales tax on the transfer of ownership or possession may be suspect under the internal consistency doctrine if other provisions of the sales tax statute do not eliminate the risk of multiple taxation. See text accompanying note 49.

risk of multiple taxation was basically sound.[63] Its treatment of the external consistency issue, however, was less than rigorous in the context of a tax on interstate transportation services.[64]

3. *Fair Apportionment and the Sales Taxation of Services*

Even though a sales tax on goods might be externally consistent, the Court recognized that a similar conclusion did not necessarily follow with respect to Oklahoma's levy on an interstate transportation service. Nevertheless, the Court found that a "sale of services can ordinarily be treated as a local state event just as readily as a sale of tangible goods can be located solely within the State of delivery."[65] The Court was unwilling to abandon its longstanding "pragmatic" approach to sales taxation of interstate transactions merely because the sale in question involved transportation services rather than goods. Just as it could identify a single "taxable event" where a sale of goods [*59] was "consummated,"[66] and thus a single state that could tax, without apportionment, the full sales price, even though the transaction may have had connections with other states, it could do the same thing for a sale of bus tickets representing the right to transportation services.

Indeed, the Court pointed to cases in which it had sustained taxes measured by the unapportioned receipts from the sale of services based on the existence of a "wholly local" "taxable event."[67] Thus, in *Western Live Stock v. Bureau of Revenue*,[68] it had approved a levy measured by the unapportioned receipts from the sale of services performed in the taxing state, even though the contract for performance of the services was entered into across state lines with out-of-state customers and even

[63] Despite the theoretical risk of multiple taxation to which interstate commerce could be exposed under many state sales taxes, see note 62, most states, in fact, exempt from tax sales of goods for out-of-state delivery, even when title passes within the state. See, e.g., Mass. Ann. Laws ch. 64H, 6(b) (Law. Co-op. 1996) (exempting from sales tax any sale of tangible personal property to purchaser outside of the state); see also Due & Mikesell, note 42, at 271; 2 Jerome R. Hellerstein & Walter Hellerstein, State Taxation P 18.02[1] (1992) [hereinafter State Taxation]. They do so presumably to accommodate local merchants who wish to attract the business of out-of-state purchasers. The widespread exemption of sales to out-of-state purchasers also may have reflected early doubts about the constitutionality of imposing a sales tax on an interstate sale. See Richard D. Pomp, Determining the Boundaries of a Post-Bellas Hess World, 44 Nat'l Tax J. 237 (1991). As a practical matter, then, a purchaser in *State A* who purchases goods from a seller in *State B* ordinarily will not be subject to *State B*'s sales tax, unless the purchaser comes into *State B* to pick up the goods. See id. In that event, of course, *State A* has no power to impose a tax on the sale, because transfer of neither ownership nor possession occurs in *State A*.

[64] See Subsection II.B.5.

[65] *Jefferson Lines*, 115 S. Ct. at 1340.

[66] Id.

[67] Id.

[68] 303 U.S. 250 (1938).

though out-of-state activities contributed to the value of the services.[69] Similarly, in *Department of Treasury v. Ingram-Richardson Mfg. Co.*,[70] it had upheld an exaction measured by the unapportioned receipts from the sale of services performed within the state upon tangible personal property obtained from and delivered to out-of-state customers.[71]

These cases bolstered the Court's position that a pragmatic approach had governed its adjudication of the constitutionality of taxes measured by the unapportioned receipts from sales of services, as well as goods, provided the sale could be identified with a unique "local state event."[72] Interstate activity was essential to the value of the services in *Western Live Stock* and to performance of the services in *Ingram-Richardson*. Nevertheless, in both cases, "sales with at least partial performance in the taxing State justified that State's taxation of the transaction's entire gross receipts."[73]

Invocation of these precedents, however, came at a high analytical cost. The Court's reliance on *Western Live Stock* and *Ingram-Richardson* undercut the basic distinction on which its opinion in *Jefferson Lines* ultimately was to rest, namely, that consumer sales taxes are different in nature from business gross receipts taxes because the former are imposed on buyers and the latter are imposed on sellers. Both *Western Live Stock* and *Ingram Richardson* involved gross receipts taxes imposed on the seller—the former, a New Mexico tax on [*60] engaging in specified business activities measured by the gross receipts from the business,[74] the latter, an Indiana tax on the gross income derived from engaging in business activity in the state.[75] The Court acknowledged as much, noting that the receipts in these cases were taxed "in the hands of the seller."[76] Yet, it sought to dismiss the significance of this fact by alluding to the "analogy sometimes drawn between sales and

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[69] The tax was measured by the unapportioned receipts from the sale of advertising space to out-of-state advertisers in a journal published within the state but circulated within and without the state.

[70] 313 U.S. 252 (1941).

[71] The tax was measured by the unapportioned receipts from enameling services performed within state on stove and refrigerator parts furnished by out-of-state customers.

[72] *Jefferson Lines*, 115 S. Ct. at 1340.

[73] Id.

[74] N.M. Laws of 1934, 201, ch. 7, quoted in Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 251-52 (1938). In its present form, the New Mexico gross receipts tax is described properly as a retail sales tax. See Section III.A.

[75] Ind. Acts of 1933, ch. 50, 2, cited in Ingram-Richardson, 313 U.S. at 253. The Indiana tax is not imposed on gross income, as that term is defined for federal purposes. For federal income tax purposes, gross income from property is defined as "gains derived from dealings in property." IRC 61(a)(3). In determining gross income, the taxpayer is allowed a deduction for any basis in the property. Reg. 1.61-6. The Indiana gross income tax does not allow a similar deduction. For a further discussion of the Indiana gross income tax and the New Mexico gross receipts tax, see text accompanying notes 233-55.

[76] *Jefferson Lines*, 115 S. Ct. at 1340.

gross receipts taxes"[77] and then concluding that "there would be no reason to suppose that a different apportionment would be feasible or required when the tax falls not on the seller but on the buyer."[78]

4. Sales Taxes Versus Gross Receipts Taxes

The Court reached the defining moment of its opinion when it was forced to distinguish the result with that reached in *Central Greyhound*.[79] At that point, it returned to the very distinction it had just obscured, namely that a sales tax is different in a constitutionally significant way from a gross receipts tax. The fundamental problem for the Court was how to square its approval of an unapportioned tax on receipts from the sale of interstate transportation services with its decision in *Central Greyhound*, which had flatly held that such receipts must be apportioned. The Court's problem was made no easier by its concession that "the similarity of *Central Greyhound* to this case is . . . striking";[80] or by its failure to take issue with the court of appeals' "assumption that the economic significance of a gross receipts tax is indistinguishable from a tax on sales";[81] or by its recognition that "the two cases involve the identical services, and apportionment by mileage per State is equally feasible in each."[82]

Because the Court made no attempt to distinguish the tax on transportation services in *Jefferson Lines* from the tax on the similar services [*61] in *Central Greyhound* on the basis of economic substance, its conclusion that they were constitutionally distinguishable rested unequivocally on legal form. Specifically, the Court made the choice of the nominal taxpayer in the two cases the basis for distinguishing them, asserting that "the two diverge crucially in the identity of the taxpayers and the consequent opportunities that are understood to exist for multiple taxation of the same taxpayer."[83] The Court tied *Central Greyhound*'s requirement that the gross receipts from the sale of interstate transportation must be apportioned to "the Court's express understanding that the seller-taxpayer was exposed to taxation by New Jersey and Pennsylvania on portions of the same receipts that New York was taxing in their entirety."[84] Accordingly, the Court "understood the gross receipts tax to be simply a variety of a tax on income, which

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[77] Id.
[78] Id.
[79] See Central Greyhound Lines, Inc. v. Mealey, 334 U.S. 653 (1948).
[80] *Jefferson Lines*, 115 S. Ct. at 1340.
[81] Id.
[82] Id. at 1341.
[83] Id.
[84] Id. (emphasis added).

was required to be apportioned to reflect the location of the various interstate activities by which it was earned."[85]

In *Jefferson Lines*, by contrast, the Court found it dispositive that "the tax falls on the buyer of the services, who is no more subject to double taxation on the sale of these services than the buyer of goods would be."[86] The formal "taxable event," which, in the Court's eyes, obviated any requirement of apportionment, "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."[87] By making the choice of the nominal taxpayer the central issue in *Jefferson Lines*, the Court was heading for trouble, as we explain below.[88]

The source of the Court's trouble can be traced to what looked like an innocent effort to define "sales" and "gross receipts" taxes. The Court declared at the outset of its opinion that:

> We follow standard usage, under which gross receipts taxes are on the gross receipts from the sales payable by the seller, in contrast to sales taxes, which are also levied on the gross receipts from sales but are payable by the buyer (although they are collected by the seller and remitted to the taxing entity).[89]

The definition, however, was less than complete. More importantly, it was unable to carry the constitutional weight that it ultimately was [*62] forced to bear—a reminder, perhaps, of the force of Ayn Rand's observation that "the truth or falsehood of all man's conclusions, inferences, thought and knowledge rests on the truth or falsehood of his definitions."[90]

5. *Fair Apportionment, Administrative Considerations and External Consistency*

The fact that Oklahoma feasibly *could have* satisfied the fair apportionment requirement by dividing Oklahoma's sales tax base on a mileage or other basis did not alter the Court's conclusion that Oklahoma was not required to do so.[91] Re

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[85] Id.

[86] Id. (emphasis added).

[87] Id.

[88] See Section II.C.

[89] *Jefferson Lines*, 115 S. Ct. at 1335 n.3.

[90] Ayn Rand, Introduction to Objectivist Epistemology 49 (1967).

[91] In Goldberg v. Sweet, 488 U.S. 252, 264-65 (1989), the Court had relied in part on the "insurmountable administrative and technological barriers" of dividing the tax base on a geographic basis as the predicate for refusing to require the taxpayer to divide the tax base, and the Court relied instead on other protections against multiple taxation. See id. at 262-65 (relying on existence of credit and lack of nexus in other states). It is also true that those barriers were nonexistent in *Jefferson Lines*.

But in *Goldberg*, there was another reason why the Court had not insisted on true apportionment in the sense of a division of the tax base. The Court considered the tax in *Goldberg* to be essentially a sales tax. "It is assessed on the individual consumer, collected by the retailer, and accompanies the turning to the dominant theme in the opinion—the taxonomy of receipts-based taxes and the constitutional rules that this taxonomy implied—the Court had little difficulty concluding that the Oklahoma levy, like "the garden-variety sales tax" to which the Court analogized it,[92] did not have to be divided among the states like an income tax. Insofar as Oklahoma's levy imputed economic activity occurring outside the state to Oklahoma, it did not do so "in any way substantially different from that imputed by the garden-variety sales tax, which we have perennially sustained, even though levied on goods that have traveled in interstate commerce to the point of sale or that will move across state lines thereafter."[93] Moreover, as the Court already had gone to great lengths to demonstrate, the Oklahoma levy did not "raise any greater threat of multiple taxation than those sales taxes that have passed [*63] muster time and again."[94] Accordingly, the Court could pronounce the Oklahoma tax as "externally consistent," on the theory that it reached "only the activity taking place within the taxing State, that is, the sale of the service," because "longstanding precedent" had endorsed this fiction and the Court saw "no reason to . . . lose the simplicity of our general rule sustaining sales taxes measured by full value."[95]

The Court's conclusion regarding the "external consistency" component of the fair apportionment requirement (that is, that the tax was "fairly attributable to economic activity within the taxing State"[96]) easily can be called into question, however, by considering an alternative, albeit unrealistic, method for Jefferson to have charged for an interstate bus trip. Assume, for example, that Jefferson dispensed with bus tickets and that passengers boarded buses on a first-come, first-serve basis for a trip from Oklahoma to Texas. Imagine that immediately after the bus crossed the Oklahoma/Texas border, it pulled over to the side and the driver collected the fare for the Oklahoma leg of the trip, along with the appropriate Oklahoma sales tax. Then, after the bus reached its Texas destination, assume the driver collected the fare for the Texas leg of the trip as the passengers departed.

Would the Court have upheld an Oklahoma sales tax on the fare collected in Texas for the Texas leg of the trip? We think not. It would be difficult to conceive

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retail purchase of an interstate telephone call." *Goldberg*, 488 U.S. at 262. Thus, "the Tax Act reasonably reflects the way that consumers purchase interstate telephone calls." Id. Consequently, when it came to the "fair apportionment" criterion, the Court had little difficulty in concluding, as it had traditionally concluded with regard to retail sales taxes, that, provided they avoided the risk of multiple taxation, they were "fairly apportioned" in a constitutional sense, even though there was no division of the tax base. Id. at 264 ("the. . . taxing scheme is fairly apportioned, for it provides a credit against its use tax for sales taxes that have been paid in other States'") (quoting D.H. Holmes Co. v. McNamara, 486 U.S. 24, 31 (1988)). The Court's approach in *Goldberg* is entirely consistent with the analytical framework developed in this Article.

[92] *Jefferson Lines*, 115 S. Ct. at 1343.

[93] Id. at 1343-44.

[94] Id. at 1344.

[95] Id.

[96] Id. at 1338.

how an Oklahoma sales tax collected under these circumstances could escape characterization as "reaching beyond that portion of value that is fairly attributable to economic activity [within Oklahoma]."[97] Accordingly, the Court's conclusion in *Jefferson Lines* that "Oklahoma's tax on ticket sales for travel originating in Oklahoma is externally consistent, as reaching only the activity taking place within the taxing State, that is, the sale of the service"[98] seems highly formalistic, at least viewed in a narrow and isolated context.[99]

6. "Successive Taxation" Versus "Multiple Taxation"

Even though the Court had satisfied itself that the Oklahoma levy would not give rise to prohibited "multiple taxation"[100] because no [*64] other state could impose an "identical tax" upon the same "taxable event,"[101] the Court nevertheless expressed concern that the levy might create "a possibility of successive taxation so closely related to the transaction as to indicate potential unfairness of Oklahoma's tax on the full amount of sale."[102] "Successive taxation" is a new term in the Court's tax lexicon,[103] and it is not yet clear whether the Court was merely describing taxes that were temporally sequential or whether it intended to create yet another constitutionally significant category of state taxes. The Court's opinion suggests that some successive taxation is constitutionally tolerable, even though it may expose an interstate enterprise to multiple taxation in a general sense, whereas other successive taxation falls within the Court's bar against multiple taxation. The trick, of course, is to distinguish between the two.

In theory, the line between constitutionally valid and invalid successive taxes is one that separates those levies which spawn multiple taxation as a result of the "accidental incident of interstate commerce being subject to two different taxing jurisdictions'"[104] from those that do so as a result of some identifiable "structural evil."[105] As an example of the former, the Court offered a hypothetical apportioned gross receipts tax imposed by Texas on a bus line's receipts from the Texas portion of travel from Oklahoma City to Dallas coupled with an Oklahoma sales tax on the sale of the ticket for such travel. The Court viewed such "multiple taxation,"

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[97] Id.

[98] Id. at 1344.

[99] For a defense of the Court's holding that the Oklahoma tax was externally consistent, see Subsections II.C.3. & 4.

[100] *Jefferson Lines*, 115 S. Ct. at 1341.

[101] Id. ("agreement, payment, and delivery of some of the services in the taxing State").

[102] Id. (question mark omitted).

[103] Research reveals that the Court never before has used that phrase in a state tax opinion—or, indeed, in any other opinion.

[104] *Jefferson Lines*, 115 S. Ct. at 1342 (quoting William B. Lockhart, Gross Receipts Taxes on Interstate Transportation and Communication, 57 Harv. L. Rev. 40, 75 (1943)).

[105] Id.

assuming the taxation were so characterized, as no different from the taxation of "coal for which the producer may be taxed first at point of severance by Montana and [for which] the customer may later be taxed upon its purchase in New York."[106]

The multiple taxation in the Court's hypothetical is plainly adventitious and is not tied structurally to the interstate character of the business or the transaction. This may be shown in two ways. First, if a [*65] single state imposed both a gross receipts tax and a retail sales tax on transportation services, intrastate transportation would be subject to the same "multiple taxation" to which interstate taxation is exposed in the example given. Hence, there is no ineluctable connection between the multiple taxation and interstate commerce. Rather, the two levels of taxation represent a simple case of what tax analysts ordinarily would characterize as "concurrent taxation," which may occur within or across jurisdictional boundaries.

Second, such "successive taxes" could result as easily in undertaxation as in overtaxation of interstate commerce by comparison to the taxation of intrastate commerce. For example, assume *State A* imposed a gross receipts tax on sellers but no sales tax on purchasers, while *State B* imposed a sales tax on purchasers but no gross receipts tax on sellers. A sale by a seller in *State A* to a purchaser in *State B* would attract two taxes, but a sale by a seller in *State B* to a purchaser in *State A* would attract no taxes. In each case, there would be one tax (either a gross receipts tax or a sales tax) on the wholly intrastate transaction. This type of discrepancy is simply the price the United States pays for federalism. It does not arise from any "fault," in a constitutional sense, of any state's taxing regime.[107]

As for successive taxes that cannot withstand constitutional scrutiny, the Court only hinted at their existence in a tantalizing footnote that explored the constitutionally required relationship among gross receipts, sales and use taxes.[108]

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[106] Id. Once the Court rejected *Central Greyhound* as the controlling precedent, thereby acknowledging that gross receipts taxes were not equivalent to retail sales taxes, the conclusion that no impermissible "successive taxation" resulted was unsurprising. If gross receipts taxes are recognized as being distinct from retail sales taxes, the Court's hypothetical could be restated in the context of any two separate taxes. For example, no one would suspect any impermissible "successive taxation" if Texas were to levy its corporate income tax (that is, its earned surplus tax) on an apportioned share of the bus line's profits while Oklahoma levied a sales tax on the sale of tickets. Yet, that hypothetical is the functional equivalent of the Court's hypothetical.

[107] See Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 U.S. 232, 258-59 (1987) (Scalia, J., concurring and dissenting); Moorman Mfg. Co. v. Bair, 437 U.S. 267, 277 (1978).

[108] See *Jefferson Lines*, 115 S. Ct. at 1342 n.6. Every state that imposes a tax on "sales" consummated in the state likewise imposes a tax on the "use" of tangible personal property (and sometimes of services) purchased outside the state for use within the state. See Due & Mikesell, note 42, at 245-48, 250. States enacted use taxes to deal with a troublesome gap in the sales tax structure they encountered when they first adopted sales taxes during the 1930's. The gap was attributable to the constitutional strictures prohibiting states from taxing sales consummated outside their borders or in interstate commerce. See, e.g., McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944); Sonneborn Bros. v. Cureton, 262 U.S. 506, 515 (1923). The gap created two concerns. First,

The Court did so by elaborating on [*66] the restraints that would limit Texas if it imposed the apportioned gross receipts tax the Court had hypothesized on a bus line providing service between Oklahoma City and Dallas, and, at the same time, sought to impose related successive taxes. The Court observed that if Texas imposed a sales tax on transportation services, along with the posited gross receipts tax on the same services, but

> chose to limit the burden of successive taxes attributable to the same transaction by combining an apportioned gross receipts tax with a credit for sales taxes paid to Texas, . . . it would have to give equal treatment to service into Texas purchased subject to a sales tax in another State, which it could do by granting a credit for sales taxes paid to any State.[109]

In other words, if Texas wished to remove the burden of successive taxation resulting from two transactions that occurred within the state's borders, it likewise must remove the burden of successive taxation resulting from the same two transactions when one of them crossed state lines.

Although unremarkable, the Court's observation helps end speculation regarding the question of whether a state must provide a credit against its use tax for sales taxes paid to other states. Its observation is unremarkable because a credit limited only to in-state sales would run counter to numerous Supreme Court decisions.[110]

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states feared the loss of business that local merchants would suffer when prospective purchasers made out-of-state or interstate purchases to avoid local sales tax liability. Second, states feared the loss of revenue they would incur as a result of the diversion of sales to nontax states. To deal with this potential loss of business and revenue, states enacted "compensating" use taxes that were "complementary" to their pre-existing sales tax.

Compensating use taxes are generally functionally equivalent to sales taxes. They are typically levied on the storage, use or consumption in the state of tangible personal property and selected services that have not been subjected already to sales tax. See 2 Hellerstein & Hellerstein, State Taxation, note 63, P 16.01. The use tax imposes an exaction equal in amount to the sales tax that would have been imposed on the sale in question if the sale had occurred within the state's taxing jurisdiction. For example, if the property has been subjected to sales tax in a jurisdiction with a tax rate lower than that adopted by the taxing state, the state generally imposes a use tax at a rate that accounts for the difference. The state overcomes the constitutional hurdle of taxing an out-of-state or interstate sale by imposing a tax on a subject within its taxing power—the use, storage or consumption of property or services within the state. In principle, then, an in-state consumer stands to gain nothing by making an out-of-state or interstate purchase free of sales tax because he ultimately will be saddled with an identical use tax when the property is brought into the taxing state. In practice, the critical question facing the taxing state is often whether it can require the out-of-state vendor to collect the use tax concededly due from the in-state consumer. See, e.g., Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (prohibiting state from requiring out-of-state mail-order house with neither retail outlets nor sales representatives in state to collect and pay use tax on goods purchased for use there).

[109] *Jefferson Lines*, 115 S. Ct. at 1342 n.6 (citations omitted).

[110] See, e.g., Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 U.S. 232 (1987) (invalidating gross receipts tax due to existence of wholesalers' exemption limited to in-state manufacturers); Westinghouse Elec. Corp. v. Tully, 466 U.S. 388 (1984) (invalidating income tax

Analytically, the Court could have disposed of this issue without any reference to successive taxes. The Court's treatment of the issue nevertheless makes a valuable contribution because the Court in the past has danced around the question whether a state that imposes a use tax—which applies only to purchases that have not been subjected to the [*67] state's own sales tax[111]—must provide a credit for other states' sales taxes,[112] and *Jefferson Lines* ought to put an end to this controversy.[113] To be sure, the Court might have articulated the problem more artfully[114] and in the body of the opinion rather than in a footnote. Nevertheless, the Court's strong statements tying its approval of state taxing schemes to the provision of a such a credit,[115] and expressing its disapproval of state taxing schemes that fail to provide

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credit limited to income derived from in-state activity); Maryland v. Louisiana, 451 U.S. 725 (1981) (invalidating use tax because of credits limited to in-state taxpayers).

[111] See note 108; see also *Jefferson Lines*, 115 S. Ct. at 1343.

[112] See, e.g., Williams v. Vermont, 472 U.S. 14, 21-22 (1985); Southern Pac. Co. v. Gallagher, 306 U.S. 167, 172 (1939); Henneford v. Silas Mason Co., 300 U.S. 577, 587 (1937) (each finding it unnecessary to rule on credit issue given factual posture of the case at hand). Some observers, however, including one of the co-authors of this Article, believe that the requirement of an offsetting credit already was apparent from the Court's earlier opinions. See Hellerstein, Internal Consistency, note 49, at 159-61.

[113] If, contrary to existing practice, a state chose to levy both a sales tax and a use tax on goods or services purchased for in-state use, without crediting one against the other, it would not have to treat out-of-state purchases any differently. See note 125.

[114] The Court introduced the question whether states must give credits for taxes imposed by other states as follows: "Although we have not held that a State imposing an apportioned gross receipts tax that grants a credit for sales taxes paid in-state must also extend such a credit to sales taxes paid out-of-state, ..." *Jefferson Lines*, 115 S. Ct. at 1342 n.6. (citing Associated Indus. v. Lohman, 114 S. Ct. 1815, 1819, and nn. 1 & 2 (1994); Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 76-77 (1963) (Brennan, J., concurring); *Silas Mason*, 300 U.S. at 587; *Williams*, 472 U.S. at 21-22). In fact, the Court has never confronted such a case, although it is the one that it hypothesized in addressing the restraints imposed on the states in imposing (and granting credits for) so-called successive taxes. See text accompanying notes 105-06. The factual situation reflected in the precedents cited by the Court, and the one to which almost all attention regarding the constitutional necessity of granting credits is directed, is whether a state must grant a credit against its use tax for sales taxes paid to other states. See cases cited in note 112. Moreover, as noted above, states typically do not grant "credits" against their use tax for sales taxes paid on in-state sales. Instead, the use tax is simply inapplicable to the use of goods or services on which sales tax has been paid. See discussion in note 108. Cf. *Jefferson Lines*, 115 S. Ct. at 1343. Of course, the effect is the same as if a credit were granted against the use tax liability for the sales tax paid on the in-state sale.

[115] The Court declared that "equality of treatment of interstate and intrastate activity has been the common theme among the paired (or "compensating') tax schemes that have passed constitutional muster." *Jefferson Lines*, 115 S. Ct. at 1342 n.6 (citations omitted). It also noted that, in upholding taxing schemes providing credits for taxes on in-state transactions, it had "often pointed to the concomitant credit provisions for taxes paid out-of-state as supporting our conclusion that a particular tax passed muster because it treated out-of-state and in-state taxpayers alike." Id. (citations omitted).

for such a credit,[116] should lay to rest any doubt that credits against use taxes (or other taxes that effectively apply only to transactions having some connection to interstate commerce) are constitutionally required,[117] [*68] especially if subsequent cases view these comments as essential to the Court's holding.

In the end, what the Court seems to have done in distinguishing constitutional from unconstitutional successive taxes is to subject them to an "internal consistency" analysis or a discrimination analysis, although it did not put it in either of those ways.[118] As the Court articulated the internal consistency doctrine in *Jefferson Lines*, "internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear."[119] If one relaxes the requirement that the analysis applies to the imposition of "a tax" identical to "the one" in question to embrace "a taxing scheme" identical to the "scheme" in question, it provides a basis for identifying those successive taxes that are likely to pass muster and those that are likely to be found wanting.

For example, if every state were to impose the successive tax regime hypothesized by the Court, in which Texas imposed both an apportioned gross receipts tax on the Texas portion of transportation services and a sales tax on the purchase of a bus ticket in Texas, interstate commerce and intrastate commerce would be treated the same. Thus, if the price of a ticket between El Paso and Houston and between El Paso and Tulsa each cost $100, the El Paso-Houston journey would generate $100 of taxable gross receipts for the bus company in Texas and $100 of taxable sales. The El Paso-Tulsa journey likewise would generate $100 of taxable gross receipts for the bus company, but they would be divided between Texas and Oklahoma based on the relative apportionment percentage of each state. Similarly, the El Paso-Tulsa ticket would generate $100 of taxable sales in the state in which the ticket was purchased.

By contrast, if every state were to impose successive taxes in which a credit was given for one of the in-state successive taxes but not for the out-of-state successive tax on the same transaction, the resulting violation of the internal consistency principle would be self-evident. For example, if every state imposed a use tax, but gave a credit for in-state but not out-of-state sales taxes, interstate commerce

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[116] The Court observed that it had "never upheld a tax in the face of a substantiated charge that it provided credits for the taxpayer's payment of in-state taxes but failed to extend such a credit to out-of-state taxes." Id. Interestingly, however, the Court did not mention that it has never been confronted with such a case.

[117] See, e.g., id. at 1343 (observing that under Commerce Clause requirements, use tax "presumably . . . would not apply when another State's sales tax had previously been paid, or would apply subject to credit for such payment").

[118] See text accompanying notes 49-50 for the Court's disposition of the internal consistency issue it thought was raised by the case.

[119] *Jefferson Lines*, 115 S. Ct. at 1338.

plainly would be saddled with a tax burden greater than that imposed on intrastate commerce. The enterprise that purchased its property or services in the same state in which it used them would pay but a single tax on the purchase of the goods or services. The enterprise that purchased its property or services in one state and used them in an [*69] other, however, would be subject both to a sales tax in the state of purchase and use tax in the state of use.[120]

When it came to determining whether Oklahoma's sales tax raised the specter of unconstitutional successive taxation, the Court had little difficulty concluding that the levy passed muster. For reasons already alluded to above,[121] the Court perceived no risk of undue successive taxation if other states were to impose gross receipts taxes on transportation services. In large part, of course, the Court's confidence was attributable to the dormant Commerce Clause restraints that governed the imposition of such a tax—it had to be fairly apportioned; it had to be internally consistent;[122] and it had to provide credits for out-of-state taxes similar to those it granted for in-state taxes.

Nor did the Court perceive any risk of successive taxation if other states were to impose consumption taxes on the purchaser of a bus ticket. The Court already had explained that only Oklahoma could impose a "sales" tax on the purchase of the ticket—at least under the Court's limiting assumptions as to a state's power to impose such a tax.[123] If a state were to impose a "use" tax on the consumption of transportation services,[124] there likewise would be no risk of successive taxation that put any special burden on interstate commerce because, under the Commerce Clause restraints the Court already had described, such a tax would apply only if no sales tax had been paid to another state or, alternatively, the tax would be subject to a credit for any sales tax that did apply.[125] The Court also took comfort in the

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[120] The Court's treatment of the successive taxation issue also could be viewed as a straightforward discrimination analysis. All of the taxes cited in note 110, for example, were struck down on the grounds that they discriminated against interstate commerce. Of course, the Court has recognized that the internal consistency doctrine implements the discrimination requirement of the *Complete Auto* Commerce Clause test just as it implements the *Complete Auto*'s fair apportionment requirement. See, e.g., American Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266, 284-86 (1987); Tyler Pipe Indus., Inc. v. Department of Revenue, 483 U.S. 232, 240-48, 251 (1987); Armco, Inc. v. Hardesty, 467 U.S. 638, 642-46 (1984).

[121] See text accompanying notes 100-09.

[122] Among other things, this meant that any such tax would have to apply to in-state and interstate journeys alike. See *Jefferson Lines*, 115 S. Ct. at 1342 n.6.

[123] See text accompanying note 87 (defining sale as "agreement, payment, and delivery of some of the services in the taxing State"). But see note 62 and Subsection III.C.2.

[124] See note 108 (describing use taxes).

[125] See *Jefferson Lines*, 115 S. Ct. at 1343. This assumes that the "use" tax in question was designed to complement the state's sales tax on the purchase of transportation services. Under this assumption, the abatement of the use tax when a sales tax had been paid within the state, but not when it had been paid in another state, would offend the requirement of "equality of treatment of interstate and intrastate activity," as well as the internal consistency principle. Id. at 1342 n.6; see

[*70] virtually universal practice of states that impose use taxes of providing credits for similar taxes paid to other states.[126]

The fact that Oklahoma granted no credit against its *sales tax* for related taxes paid elsewhere was therefore beside the point because it could reasonably "rely upon use-taxing States to do so."[127] The Court nevertheless recognized that if, contrary to its earlier assumption,[128] states other than Oklahoma could tax the sale of the services at issue, a credit or other mechanism effectively confining the sales tax to a single state likely would be required.[129] But this did not disturb its conclusion that Oklahoma's levy created no risk of unconstitutional successive taxation.

7. *Discrimination and Fair Relation*

Although the Court devoted most of its opinion in *Jefferson Lines* to the fair apportionment issue, it also addressed the other three prongs of its four-prong test for adjudicating the validity of state taxes under the Commerce Clause—substantial nexus, nondiscrimination and fair relation between the tax and services provided by

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also text accompanying notes 118-20. If a state imposed both a sales tax and use tax on the local purchase and use of transportation services, however, it surely would be free to impose a use tax on the in-state use of transportation services purchased elsewhere. Such double taxation of the consumption of transportation services might be regarded as excessive, but it would not offend any constitutional prohibition against successive taxation.

[126] See *Jefferson Lines*, 115 S. Ct. at 1343 (citing 2 Hellerstein & Hellerstein, State Taxation, note 63, P 18.08).

[127] *Jefferson Lines*, 115 S. Ct. at 1343.

[128] See text accompanying note 123.

[129] *Jefferson Lines*, 115 S. Ct. at 1343 (citing Goldberg v. Sweet, 488 U.S. 252 (1989)). In *Goldberg*, the Court sustained the Illinois Telecommunications Excise Tax, which was imposed on the "act or privilege" of "originating" or "receiving" interstate telecommunications in the state at the rate of 5% of the gross charge for the telecommunications. Ill. Rev. Stat., ch. 120, P 2004, 4 (1987), quoted in *Goldberg*, 488 U.S. at 256 n.5. If this had been all there was to the statute, it plainly would have created a risk of multiple taxation, since the sale of the telephone call could be taxed by the state of origin and by the state of destination. See *Goldberg*, 488 U.S. at 263. Two additional factors reduced the risk of multiple taxation to the point of constitutional insignificance, however. First, pursuant to the language of the statute, the tax applied only to calls charged to an Illinois service address, which the Court understood to mean the address where the telephone equipment was located. See id. at 256 n.6. Second, in order to prevent "actual multi-state taxation,'" the statute provided a credit to any taxpayer upon proof that the taxpayer had paid a tax to another state on the same telephone call that triggered the Illinois tax. Id. at 256. Hence, even though *Goldberg* presented the possibility of "simultaneous sales taxes," see *Jefferson Lines*, 115 S. Ct. at 1343, imposed by different states that could lead to multiple taxation, the Illinois scheme, by limiting the tax to calls charged to an in-state service address and by providing a credit, "operates to avoid actual multiple taxation." *Goldberg*, 488 U.S. at 264.

the state.[130] The nexus issue was considered above.[131] The other two issues are considered below.

The gravamen of the taxpayer's discrimination claim was that Oklahoma effectively imposed a higher per mile tax on Oklahoma [*71] travel associated with interstate journeys than with Oklahoma travel associated with intrastate journeys. The discrimination allegedly resulted from the fact that dividing Oklahoma sales taxes by in-state miles to be traveled would produce a higher figure on average for interstate than for intrastate journeys, since the former would include the tax on the purchase price fairly attributable to out-of-state transportation. The taxpayer's claim rested largely on the Court's decision in *American Trucking Associations, Inc. v. Scheiner*,[132] where the Court had struck down a flat tax on trucks for the privilege of using Pennsylvania's roads. The Court had reasoned that the tax discriminated against interstate commerce by imposing a cost per mile upon out-of-state trucks far exceeding the cost per mile borne by local trucks that generally traveled more miles on Pennsylvania roads but paid no more than interstate trucks for that privilege.[133]

In rejecting the analogy between Scheiner and *Jefferson Lines*, the Court in *Jefferson Lines* returned to the dominant theme of its opinion—the classification of taxes and the consequences of such classification for constitutional analysis. Because Oklahoma's levy was a tax on a transaction—the taxable event was the sale of the service[134]—it was that event, and that event alone, by which the allegedly discriminatory character of the levy was to be judged. So viewed, the Oklahoma tax was nondiscriminatory because it taxed all "purchases of the services equally for intrastate and interstate purchases"[135] since "all buyers pay tax at the same rate on the value of their purchases."[136] By the same token, since the tax was not a levy on the underlying transportation services nor, like the Pennsylvania tax at issue in *Scheiner*, a tax on the privilege of using the state's roads, miles traveled within the state "simply are not a relevant proxy for the benefit conferred upon the parties to a sales transaction."[137]

In short, formalism carried the day with regard to the discrimination issue raised by *Jefferson Lines*, just as it carried the day with regard to the fair apportionment issue. By focusing exclusively on the formal subject of the tax—the sale of the ticket—rather than the substance of what was sold—the sale of transportation

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[130] See note 5.

[131] See note 47.

[132] 483 U.S. 266 (1987).

[133] See id. at 286.

[134] See *Jefferson Lines*, 115 S. Ct. at 1345.

[135] Id.

[136] Id. (citations omitted).

[137] Id.

services, the Court rendered constitutionally irrelevant the interstate character of the services sold and stripped the taxpayer's discrimination argument of its force. Because Oklahoma was taxing only "the freedom of purchase'"[138] under [*72] the Court's view, and it taxed the exercise of that freedom in a nondiscriminatory manner, the Court could dismiss as immaterial what was being purchased, including "the potential for interstate movement after the sale."[139]

The fourth prong of the Court's Commerce Clause test requires that a tax be "fairly related to the services provided by the State."[140] The taxpayer contended that the Oklahoma tax failed to meet this standard because the ticket purchaser's benefits from the taxing state occur only during the portion of the journey that takes place in Oklahoma, even though the tax is imposed on the full purchase price for the journey. The Court disposed of this contention in short order, which has been characteristic of its approach to fourth prong arguments,[141] observing that the "fairly related" test "requires no detailed accounting of the services provided to the taxpayer on account of the activity being taxed."[142] Moreover, given the fundamental premise that informed its opinion from beginning to end, namely, that "the tax falls on the sale that takes place wholly inside Oklahoma,"[143] there could be no quarrel with the conclusion that the tax was fairly related to that activity.

8. The Dissent: Pragmatism and Economic Reality Redux

By comparison to the Court's tortuous and, at times, opaque opinion sustaining Oklahoma's sales tax as a pragmatic, if formalistic, solution to the problem raised by *Jefferson Lines*, Justice Breyer's dissent is a model of simplicity and clarity. According to Justice Breyer, *Jefferson Lines* and *Central Greyhound*[144] were, for all relevant purposes, "identical."[145] In both cases, the taxes were imposed upon interstate bus transportation, they were measured by gross receipts and were unapportioned. For the same reason that the Court condemned the levy at issue in *Central Greyhound*, Justice Breyer would have condemned the levy at issue in *Jefferson Lines*; namely, that it imposed an unapportioned tax on the gross receipts from interstate commerce—receipts to which other states could lay a legitimate

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[138] Id. (citing McLeod v. J.E. Dilworth Co., 322 U.S. 327, 330 (1944)).
[139] Id. (citing Wardair Can. Inc. v. Florida Dep't of Revenue, 477 U.S. 1 (1986)).
[140] Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).
[141] See, e.g., Goldberg v. Sweet, 488 U.S. 252, 266-67 (1989).
[142] *Jefferson Lines*, 115 S. Ct. at 1345.
[143] Id. at 1346.
[144] Central Greyhound Lines, Inc. v. Mealey, 334 U.S. 653 (1948); see text accompanying notes 16-17.
[145] *Jefferson Lines*, 115 S. Ct. at 1346.

fiscal claim. "This being so," the Court in *Central Greyhound* had concluded:[146] [*73]

> To allow New York to impose a tax on the gross receipts for the entire mileage . . would subject interstate commerce to the unfair burden of being taxed as to portions of its revenue by States which give protection to those portions, as well as to a State which does not.[147]

Justice Breyer saw no reason why the same conclusion should not follow in *Jefferson Lines*.[148]

While the Court was driven in large part by the pragmatic goal of establishing "a uniform rule governing taxation on the occasion of what is generally understood as a sales transaction,'" which compelled it to place substantial constitutional weight on "identifying the taxpayer in categorizing the tax,"[149] Justice Breyer's first priority was a rule that made economic sense. He was plainly right in his observation that "to suggest that the tax here is constitutional simply because it lends itself to recharacterizing the taxable event as a "sale' is to ignore economic reality."[150] He also was on firm ground in accusing the Court of relying on "formal" rather than "practical" distinctions in sustaining the levy,[151] which runs against the grain of the Court's contemporary Commerce Clause jurisprudence. Whether he was right in his ultimate conclusion, however, is a question to which we now turn.

C. Notes for a Revised Opinion

1. Introduction

The disagreement between the majority and the dissent in *Jefferson Lines* centered around two competing paradigms. The majority analogized Oklahoma's tax to a retail sales tax on tangible personal property, and its opinion disposed of the controversy under the rules the Court has developed for adjudicating the validity of such levies. The dissent, on the other hand, analogized Oklahoma's tax to a gross receipts tax on transportation services, and its opinion would have disposed of the controversy under the analysis the Court had articulated in *Central Greyhound*. Unfortunately, the majority does not provide a convincing rationale for treating

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[146] *Central Greyhound*, 334 U.S. at 662.

[147] See *Jefferson Lines*, 115 S. Ct. at 1348 (Breyer, J., dissenting).

[148] Id. at 1344 n.7.

[149] Id. at 1348; see also text accompanying notes 80-88.

[150] Id. at 1347-48. The majority of the Court upholding the tax essentially entered a nolo plea to the charge. It noted that the "dissenting opinion rightly counsels against the adoption of purely formalistic distinctions," but pointed out that "economic equivalence alone has . . . not been (and should not be) the touchstone of commerce clause jurisprudence" and that the "significance of the taxpayer's identity is . . . central" to the Court's analysis of the constitutionality of sales taxes. Id. at 1344 n.7.

[151] See 1 All States Tax Guide (RIA) P 250 (1995).

Oklahoma's tax on transportation [*74] services like a garden-variety sales tax. This Section offers that rationale.

Although both sales taxes and gross receipts taxes are similar insofar as they share a common measure (gross receipts), there is a fundamental distinction between the two levies. In a nutshell, a sales tax is intended to tax the ultimate consumer of goods and services whereas a gross receipts tax is intended to tax business activity, and the respective structures of these two levies reflect these differing goals. The following Subsection provides an overview of the sales and gross receipts taxes currently in use by the states and discusses that distinction.

The subsequent Subsection considers whether the distinction between sales taxes and gross receipts taxes should have constitutional significance. That Subsection contends that sales taxes, because of their fundamental design features, are far less likely than gross receipts taxes to present risks of multiple taxation or overreaching. For that reason, the Court was correct in not requiring sales taxes to be apportioned under the "fairly apportioned" prong of *Complete Auto*. More specifically, the Court's conclusion that the Oklahoma levy was externally consistent is an acceptable legal conclusion, even if it is not a satisfying description of the economic reality of the transaction at issue.

The focus of the fairly apportioned requirement has been on the elimination of undue risks of overtaxation. A sound dormant Commerce Clause jurisprudence, however, would not diminish state tax power to the point that undertaxation was nearly inevitable. We argue below that a decision for the taxpayer in *Jefferson Lines* would have led almost inevitably to the undertaxation of transportation services and, by implication, of many other services as well.

2. *Design Features of Sales and Gross Receipts Taxes*

a. *Sales Taxes*

Forty-five states and the District of Columbia impose a general retail sales tax, today's most significant source of state tax revenue.[152] In principle, a retail sales tax is a single-stage levy on consumer expenditures, that is, it applies only to final sales for personal use and consumption.[153] Accordingly, in an ideal retail sales tax, business inputs would be excluded from the tax base. Although no state has [*75] adopted a theoretically pure retail sales tax,[154] all states have provisions that are designed to achieve its purposes.

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[152] Roughly one-third of state tax collections are attributable to general sales taxes. See Due & Mikesell, note 42, at 1.

[153] See id. at 16.

[154] See Walter Hellerstein, Florida's Sales Tax on Services, 41 Nat'l Tax J. 1, 8 (1988) [hereinafter Sales Tax].

Virtually every state excludes sales for resale from the retail sales tax base.[155] Similarly, sales of ingredients or components of property produced for sale commonly are excluded from the retail sales tax.[156] These types of exclusions typically require that the business input retain its physical form as it moves through the production process. Other provisions reflect the broader view that all business inputs should be excluded from the retail sales tax base, even though such costs cannot be tied directly to the item ultimately sold or some component part of that item. Exclusions or exemptions for purchases of machinery and equipment used to produce tangible personal property for sale are illustrative of these sorts of provisions.[157]

State retail sales taxes [hereinafter simply state sales taxes] share a number of administrative features, which reflect, and, in some cases, are intended to further, the underlying philosophy of the tax as a levy imposed on the purchaser's use or consumption of the item sold, with the tax burden resting on the consumer.[158] To make it more likely that the economic incidence of the tax is borne by the consumer,[159] state sales taxes typically are stated separately, and all states but Arizona prohibit vendors from advertising that they will absorb the tax.[160] Further, the tax itself is excluded from the base of the tax. In addition, sales taxes are collected from the purchaser by the seller and [*76] are imposed on a transaction-by-transaction basis. These features effectuate the understanding that the sales tax is a discrete charge, apart from the price of an item, that is paid for by the consumer and collected by the vendor.

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[155] See 2 Hellerstein & Hellerstein, State Taxation, note 63, P 14.01.

[156] See id.

[157] See id. Despite the theoretical premise that the retail sales tax is a single-stage levy on consumer expenditures, and despite the existence of statutory provisions that exclude intermediate purchases in the economic process from the retail sales tax, business inputs, in fact, make up a healthy portion of most states' sales tax bases. Indeed, a nationwide study concluded that business inputs as a share of the sales tax base averaged 40% for 45 states and the District of Columbia. See Raymond J. Ring, Jr., The Proportion of Consumers' and Producers' Goods in the General Sales Tax, 42 Nat'l Tax J. 167, 175 (1989). Typical taxable business inputs are those in which the business is deemed to be the ultimate consumer of the particular item purchased, even though the cost of the item will likely constitute part of the price of the product that the producer sells. For example, transportation equipment, office furniture, advertising catalogs and supplies purchased by manufacturers and other businesses usually are taxable under state sales taxes. Yet, the cost of these items is likely to be reflected in the final cost of the products the business sells. Consequently, these items effectively are subjected to a second tax, assuming the products sold by the business are taxable.

[158] See Due & Mikesell, note 42, at 16, 30.

[159] See note 42.

[160] See Due & Mikesell, note 42, at 30. These provisions, of course, cannot repeal the laws of supply and demand but only can encourage the vendor to shift the tax to the consumer. See note 42. A vendor always can undercut the purpose of these provisions by reducing the base price of an item to offset the amount of the sales tax. See id.

Although state sales taxes display significant common features and generally operate in a uniform manner, they nevertheless may be subdivided into three categories—vendor taxes, consumer taxes and hybrid taxes.[161] Vendor taxes are sales taxes whose legal incidence rests on the vendor (for example, for the privilege of making retail sales), and the vendor therefore has primary legal responsibility for paying the tax.[162] Illinois, for example, imposes a "Retailers' Occupation Tax" on "persons engaged in the business of selling at retail tangible personal property,"[163] measured by the "gross receipts" from such sales "made in the course of business."[164]

Consumer taxes are sales taxes imposed upon the retail "sale" of property or services, and they are measured by the sales price of the goods or services.[165] The measure of consumer taxes (sales price to the buyer) therefore may be contrasted—at least in a formal sense—with the measure of vendor taxes (gross receipts of the seller). Hybrid taxes contain features of both vendor and consumer levies.[166] Of the 45 states that impose sales taxes, 13 impose vendor taxes, 17 impose consumer taxes and 15 impose hybrid taxes.[167] Notwithstanding the foregoing variations among state sales taxes, they all operate in essentially the same manner as levies intended and designed to fall on consumers (even when denominated as vendor taxes). As we explain below, vendor sales taxes have certain features that sometimes may cause them to be confused with gross receipts taxes. [*77]

Sales taxes commonly employ a uniform rate that applies to nearly all taxable transactions.[168] Well over 75% of the states have a rate falling between 4 and 6.5%.[169]

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[161] See Due & Mikesell, note 42, at 28-29.

[162] See id.

[163] 35 Ill. Comp. Stat. Ann. 120/2 (West 1996).

[164] Id. 120/2-10.

[165] See Due & Mikesell, note 42, at 29.

[166] See id.

[167] See id. at 28-29. There are some legal variations among vendor, consumer and hybrid taxes with regard to the common administrative features of sales taxes. See id. at 28-31. Consumer tax states have mandatory shifting provisions—for example, the tax must be shifted to the consumer; some vendor states, such as Arizona and New Mexico, do not. See id. at 30. Consumer states require separate statement of the tax; some vendor states do not. Consumer states prescribe brackets for collection; some vendor states do not. Except for the vendor-tax state of Arizona, however, all states prohibit retailers from advertising that they will absorb the tax. See id. In practice, shifting and separate statement of sales taxes occurs in largely the same manner and to largely the same extent whether or not such shifting or separate statement is required legally. See id. at 30-31.

[168] See id. at 52. Rates lower than the basic rate sometimes apply to motor vehicles, selected business inputs, mobile homes and manufactured homes. See id. at 52-53.

[169] See id. at 45.

b. Gross Receipts Taxes

In contrast to retail sales taxes, some states, and many municipalities,[170] impose gross receipts taxes, known in many foreign countries as turnover taxes.[171] Unlike a retail sales tax, which is designed to tax the ultimate consumer, a gross receipts tax is intended to tax business activity, as measured by gross receipts, gross proceeds or gross income. Because no reason exists to reach only the "final sale" of goods or services, gross receipts taxes typically incorporate none of the exclusions or exemptions found in a sales tax, such as the sale for resale exemption, the exemption for ingredient or component parts of products to be sold at retail or the exemption for manufacturers' purchases.[172]

In contrast to sales taxes, gross receipts tax statutes do not require that the tax be stated separately, and the tax itself is not deductible from the tax base. Because there is no intent that the tax be borne by ultimate consumers, jurisdictions imposing gross receipts taxes do not require the seller to collect the tax from the purchaser, nor do they forbid the seller from advertising that it will absorb the tax. Moreover, gross receipts taxes are not collected on a transaction-by-transaction basis; instead, they are calculated and paid at regular intervals. In addition, gross receipts tax rates generally are much lower than the rates of retail sales taxes, and they frequently use multiple rates (for example, for different business activities), a rare phenomenon in retail sales tax statutes.[173]

In short, even though a sales tax and a gross receipts tax both may be measured by the same receipts, as was true of both the Oklahoma tax in *Jefferson Lines* and the New York tax in *Central Greyhound*, they reflect "sharp differences in intent."[174] That they have different [*78] purposes and functions is revealed by the fact that states with gross receipts taxes almost always impose retail sales taxes as well.[175]

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[170] See John T. Piper & Catherine A. Eggen, General Principles of Gross Receipts Taxes, Tax Mgmt. Portfolio (BNA) 1610:0011 ns. 68, 69, 1610:6104-04.

[171] The People's Republic of China, for example, at one time, had a turnover tax that would have been familiar to American state tax practitioners. For a discussion of the Chinese gross receipts tax, see Richard D. Pomp, Timothy A. Gelatt & Stanley S. Surrey, The Evolving Tax System of the People's Republic of China, 16 Tex. Int'l L.J. 11, 16-40 (1981).

[172] Piper & Eggen, note 170, at 1610:0001.

[173] Id. passim; see text accompanying notes 219-73.

[174] Due & Mikesell, note 42, at 17. As the authors observe:

> It is clear that the firms are expected to shift the sales tax to purchasers; it is presumably the intent of the gross receipts taxes that these rest upon the owners of the business—though in fact, as business expenses, they are likely to be shifted forward as well, but in an imprecise pattern.

Id.

[175] The States of Indiana, Tennessee and Washington, for example, impose both gross receipts taxes and retail sales taxes. See text accompanying notes 219-22, 231-32 and 235-36.

3. *Apportionment in the Context of Sales and Gross Receipts Taxes*

As the foregoing discussion of retail sales taxes and gross receipts taxes suggests, the weakness in the Court's analysis in *Jefferson Lines* was not that it elevated legal form over economic substance. The Court candidly adopted this course for reasons that, in the sales tax context, outweigh the countervailing considerations that can be marshalled in favor of strict adherence to a Commerce Clause doctrine rooted in "economic reality."[176] Rather, the weakness in the Court's analysis is that it adopted the wrong taxonomy for classifying levies that do (and do not) require true apportionment.

The distinction between taxes that require apportionment and those that do not should not rest on whether the tax formally falls on the seller or the buyer, notwithstanding the Court's position to the contrary. As noted above, many retail sales taxes formally are imposed on the seller, but they should be viewed as sales taxes nevertheless rather than gross receipts taxes. This characterization reflects the way the legislature has framed them: They generally apply only to final sales and not to sales for resale; they are separately stated; they are imposed on a transaction-by-transaction basis; they are collected by the seller from the purchaser; and the seller may not claim that it is absorbing the tax. In other words, the legislature intended them to be consumption taxes, to be borne by the buyer, and not as measures of business activity, to be borne by the business.[177] While the suggested line between sales taxes and gross receipts taxes may not always be bright,[178] it is nevertheless a more meaningful line than the one the Court drew in *Jefferson Lines*, and it is one that is implicit in the development of the applicable rules on apportionment.[179]

Both sales and gross receipts taxes are theoretically capable of being apportioned. Administrative considerations, however, make it [*79] much more likely that the former rather than the latter can be apportioned in practice. Because of these administrative differences, the dormant Commerce Clause rules for each type of tax have evolved quite differently, and properly so.

In the case of a sales tax, state practice can be explained by the operating rule of thumb that consumption takes place in the state in which the goods are delivered. Because a sales tax is intended to tax consumption, the state of delivery rather than the state of origin is the state that levies a sales tax (or the functional equivalent—a use tax[180]). For example, a person buying a product from a local store pays that state's sales tax, regardless of whether the goods were shipped in from

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[176] See text accompanying notes 144-50 (discussing Justice Breyer's dissent, which made such a case).

[177] See text accompanying notes 151-60.

[178] See Section III.A. for further consideration of this problem.

[179] We elaborate on this point below. See Section III.B.

[180] See note 108.

outside the state. Similarly, goods purchased directly from an out-of-state vendor typically are not taxed by the state of origin but are subject to use tax in the state of delivery. In either case, the fact that the goods subsequently may be consumed in another state does not limit the right of the state of delivery to levy a consumption tax on the full amount of the sales price, without any type of apportionment. On the assumption that the goods will be consumed in the state in which they are delivered, a consumption tax levied on the transaction will be fairly apportioned because all of the consumption is deemed to occur in the taxing state.

Suppose, however, that consumption actually occurs in more than one state. For example, suppose that while *T* is a resident of *State A*, *T* purchases a car and uses it for one-half of its useful life in *State A*. Assume that *T* then moves to *State B*, where she consumes the remaining one-half of the car's useful life. Theoretically, *T* should receive a refund from *State A* for that part of the sales tax paid on the value of the car that will not be consumed in *State A*. Similarly,[181] *State B* should be allowed to tax *T* only on the consumption of the car that will occur in *State B*. In this manner, the sales tax effectively would be apportioned to the amount of consumption occurring in each state.

Instead of this administratively cumbersome system, however, the rules that have evolved for sales taxation of tangible property implement a second-best approach in which *State B* levies a use tax, with a credit for the sales tax paid to *State A*.[182] It is simply more convenient to allow *State A* to collect and keep the entire sales tax than it is to [*80] apportion it in a more precise way. Moreover, this second-best approach approximates the ideal pattern of apportionment that would exist if all states had nearly identical sales taxes and if, for every taxable product that leaves the state, an identical one enters.

This pattern of sales and use taxation arose in the context of sales of tangible personal property. The sale of tangible personal property can differ from the sale of services—or at least transportation services—in a fundamental respect. When tangible personal property is sold, it is difficult to determine where its consumption will occur.[183] By contrast, when the transportation services in *Jefferson Lines* were

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[181] See generally Pomp & Oldman, note 41, at 427.

[182] See, e.g., General Trading Co. v. State Tax Comm'n, 322 U.S. 335 (1944); McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944). Although the Court has never held explicitly that a state levying a use tax as a complement to its sales tax must provide a credit for sales or use taxes levied by other states, its precedents strongly implied the existence of such a requirement, and Jefferson Lines should help end debate over this issue. See text accompanying notes 110-17.

[183] To be sure, some situations can be imagined in which the nature of the goods purchased will suggest that consumption will occur outside the state, for example, skis purchased in Florida, surfboards purchased in Nebraska or the purchase of fuel by an airplane known to be leaving the United States. See Wardair Can. Inc. v. Florida Dep't of Revenue, 477 U.S. 1 (1986). To let these exceptional examples drive the analysis, however, would allow the tail to wag the dog.

sold, there was no comparable difficulty in determining where their consumption would occur because the ticket itself indicated the place of consumption.

Despite the possibility of apportioning Oklahoma's sales tax on transportation services without encountering the administrative difficulties that one ordinarily would face in seeking to apportion a sales tax on goods,[184] the Court nevertheless adhered to the general rules it had developed for a sale of goods. In effect, the Court decided to maintain and, arguably, to extend the second-best world of apportionment for sales taxes by treating the sale of transportation services as a subset of the more general rules governing a sale of goods rather than using the case as a vehicle for creating a special tax regime involving true apportionment for certain types of services.

4. Jefferson Lines and the Undertaxation of Interstate Services

One reason that the disposition of the controversy in *Jefferson Lines* makes good sense (and, therefore, good law) is that it eliminated the real problem in that case, which was the possibility of substantial *under*taxation rather than overtaxation of interstate services. Although much of the Court's opinion in *Jefferson Lines* is devoted to the issue of multiple taxation, the more immediate question presented by the case is one of undertaxation—at least if taxing less than 100% of the potential consumption tax base is viewed as undertaxation.[185] [*81]

Consider, for example, a bus ticket purchased in Oklahoma for a trip terminating in Texas. Under current law, Texas, like most other states, would not levy a use tax on this transaction.[186] Consequently, if the Court were to have held that Oklahoma could tax only that portion of the trip that occurs in Oklahoma, and if Texas did not levy a use tax on its portion of the trip, less than the total amount of transportation services would have been taxed. The dilemma in *Jefferson Lines*, although never explicitly stated by either the majority or the dissent, was that if

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[184] For example, an electronic cash register might be programmed to store the percentage of in-state miles for every possible itinerary. That percentage would then determine how much of the ticket price would be subject to sales tax. Alternatively, such information could be made available to ticket agents through company publications.

[185] See text accompanying notes 190-95.

[186] Oklahoma is apparently the only state that has sought to impose a retail sales tax on the sale of an interstate bus ticket. See Brief of the American Bus Association as Amicus Curiae in Support of Respondent at 2, Jefferson Lines, 115 S. Ct. 1331 (1995) (No. 93-1677). Consequently, because use taxes are designed to complement sales taxes, and states (with the exception of Oklahoma) do not impose sales taxes on interstate bus tickets, they likewise do not impose complementary use taxes on the use in the state of transportation services purchased in other states. If sales and complementary use taxes were to be generally imposed on interstate transportation services, Texas would impose a use tax on the use of transportation services in the state, and the potential problems of multiple taxation to which the Court devoted considerable attention in *Jefferson Lines* would be resolved by the crediting requirements it delineated. See text accompanying notes 113-17.

Oklahoma could not tax the full amount of the ticket, including that part attributable to out-of-state travel, interstate transportation would partially escape sales taxation.

In this sense, the dilemma in *Jefferson Lines* was analogous to that in *Goldberg v. Sweet*.[187] *Goldberg* involved an Illinois excise tax on interstate telephone calls originating or terminating in Illinois and billed to a service address in the state.[188] Accordingly, the entire charge for a telephone call from a party in Illinois to a person in Texas is taxed in full by Illinois if the call is charged to a service address in Illinois. Although the Court described the tax as fairly apportioned, this description (but not the ultimate holding in the case) is troubling as a theoretical matter. Allowing Illinois to tax the entire value of an interstate call, in some sense, could be viewed as overreaching by Illinois.

But such theoretical overreaching diminishes as a practical matter because Texas, like other states, does not tax any part of a telephone call that is charged to an Illinois service address. If the Court had struck down the Illinois tax, interstate telephone calls effectively would have been insulated in whole or in part from a sales tax. *Goldberg* and *Jefferson Lines* are similar in this respect because if the Court had struck down the sales tax at issue in either case, or required that it be apportioned, some consumption would have escaped taxation.[189] The risk was not multiple taxation, to which the Court's professed [*82] concern in both *Goldberg* and *Jefferson Lines* was directed, but rather undertaxation.[190]

Arguably, this "undertaxation" might be viewed as no more than the consequence of states choosing not to tax the consumption of interstate telecommunications or transportation services. We would not suggest, for example, that it would be proper for Oklahoma to impose a tax on the income that a bus line derived from its activities in Wyoming merely because Wyoming chooses not to tax income. From

[187] 488 U.S. 252 (1989); see also notes 91 and 129.

[188] See id. at 256.

[189] This assumes, of course, that if *Goldberg* and *Jefferson Lines* had been decided differently, states that do not currently impose sales or use taxes on interstate telecommunications services charged to a service address in another state or on interstate bus services originating elsewhere, as a practical matter, would be unable to change their taxing regimes to capture receipts from such services. For the reasons suggested in the ensuing discussion, we believe that the possibility of states altering their regimes to fill the tax gaps is extremely low. See text accompanying notes 195-202.

[190] One difference between *Jefferson Lines* and *Goldberg* is the feasibility of levying and collecting a use tax. An Oklahoma use tax could be imposed based on the number of miles travelled within the state. See note 184. Moreover, the presence of buses in the state would allow Oklahoma to require the bus company selling the ticket outside the state to collect the Oklahoma use tax. See Quill Corp. v. North Dakota, 504 U.S. 298 (1992). Illinois, on the other hand, would have more difficulty in determining the basis for imposing its use tax. See *Goldberg*, 488 U.S. at 254-55. Furthermore, because of the various ways in which long distance telephone service can be structured, the question whether Illinois could require any entity to collect its use tax is not necessarily resolved by *Goldberg*.

a constitutional standpoint, such taxation would violate the fair apportionment requirement because Oklahoma would be "reaching beyond that portion of value that is fairly attributable to economic activity within the taxing State."[191] A state does not acquire the constitutional power to tax income earned in other states merely because such other states choose not to tax such income.[192] Nor, it might be argued, does a state acquire the constitutional power to tax consumption enjoyed in other states merely because such other states choose not to tax consumption.

But this argument would lose sight of the different source of the undertaxation in the two contexts. In the income tax context, the source of the undertaxation is simply the state's determination not to assert its power to tax income that settled statutory and constitutional principles would assign to it for tax purposes.[193] In the context of [*83] state sales and use taxation of transportation services, by contrast, the source of the undertaxation lies not in a state's failure to assert its power over an established tax base, but rather that states ordinarily would not reach that tax base at all.[194]

The point can be illustrated best by considering the pattern of sales and use taxation that would result if states were to impose theoretically ideal sales and use taxes on transportation services. In such a world, the states would tax only an apportioned share of the price of tickets purchased for trips originating inside the state but terminating outside the state. Similarly, they would impose an apportioned use tax on that portion of trips originating outside the state and passing through or

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191 *Jefferson Lines*, 115 S. Ct. at 1338.

192 Nor, in our judgment, would it be sufficient for a state to defend the constitutionality of its taxation of income earned elsewhere by the provision of a credit against such income. The tax would still fail the Court's fair apportionment criterion. The "second-best" solution that we have described above in the context of consumption taxes has no application to a tax on income, which, as the Court observed in *Jefferson Lines*, is "required to be apportioned to reflect the location of the various interstate activities by which it [is] earned." Id. at 1341.

193 See generally Walter Hellerstein, State Taxation of Corporate Income from Intangibles: *Allied-Signal* and Beyond, 48 Tax L. Rev. 739, 743-55 (1993) [hereinafter Intangibles] (describing statutory and constitutional framework for allocating and apportioning income of multistate taxpayers among states).

194 Although the existing pattern of state legislation does not always determine constitutional principle, see Moorman Mfg. v. Bair, 437 U.S. 267 (1978) (sustaining constitutionality of single-factor sales formula despite widespread adoption of three-factor formula), the Court frequently has looked to existing state practice in determining whether a particular state statute constitutes a burden on interstate commerce. See, e.g., Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520 (1959) (invalidating state mud guard requirement in part because no other state imposed such a requirement). As we suggested, see note 189, we seriously doubt that a different outcome in *Jefferson Lines* would have provoked a change in the existing pattern of state taxation of interstate transportation services. Hence both constitutional principle as well as pragmatic considerations, see notes 195-202, support the Court's determination in *Jefferson Lines*.

terminating in the state.[195] If the existing pattern of sales and use taxation reflected this utopian model, one might contend with some force that the "undertaxation" by one state that chose not to exercise its established power to tax the sale or use of transportation [*84] services in the state should not enlarge the power of other states to tax those services.

But this utopian world bears no resemblance to the real world of sales and use taxation of transportation services. As noted above,[196] in the real world, states do not impose consumption taxes on transportation services originating in other states and, insofar as they impose consumption taxes on transportation at all, they do so on an unapportioned basis in the state of origin. The Court's opinion thus can be read as allowing states like Oklahoma to levy a sales tax on the full price of tickets for trips originating in the state as an implicit quid pro quo for not taxing trips originating elsewhere and terminating within (or passing through) the state. Viewed in this manner, the "overtaxation" of a ticket for a trip occurring only partially in a state offsets the established pattern of "undertaxation" of trips originating outside the state and terminating within (or passing through) the state. Significantly, and in contrast to the situation posited above in which a state's income tax base inexorably would expand with other states' decisions not to tax income, a state is as likely to gain as to lose from the pattern of sales taxation implicitly approved by the Court,

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[195] In a world in which sales and use taxes were levied on an apportioned basis, no credit would be required against the use tax for out-of-state sales taxes. For example, consider a bus trip originating in Texas and terminating in Oklahoma. If Texas were to levy a sales tax only on that portion of the sales price of the ticket attributable to the Texas leg of the trip, there is no reason why Oklahoma would have to provide a credit against its use tax that was imposed only on the Oklahoma leg of the trip. The Oklahoma sales tax and use tax would be apportioned fairly without a credit. The taxes would be internally consistent because if all states had the Oklahoma system no more than 100% of interstate trips would be subject to tax. Only in-state transportation would be taxed by Oklahoma; thus, the taxes would be externally consistent, and no discrimination against interstate trips could result.

In this theoretically ideal world, Oklahoma could provide a credit against its apportioned use tax for its own apportioned sales tax without having to provide a credit for the apportioned Texas sales tax (or that of any other state). A credit for its own sales tax would maintain parity between trips originating in Oklahoma and terminating in Texas (or in any other state) and those originating in Texas (or in any other state) and terminating in Oklahoma. The latter trips would be subject to an apportioned Texas sales tax and an apportioned Oklahoma use tax; without a credit, the former would be subject to both an apportioned Oklahoma sales tax and an apportioned Oklahoma use tax on the Oklahoma leg of the trip and an apportioned Texas use tax on the Texas leg of the trip. The credit against the Oklahoma apportioned use tax for the Oklahoma apportioned sales tax (or vice versa) would ensure that the Oklahoma leg of the trip would be taxed once—and only once. In the real world of unapportioned sales and use taxes, a credit against out-of-state sales taxes is needed to insure parity of treatment between intrastate and interstate commerce. See note 182 and accompanying text.

[196] See note 186.

because it sometimes will be the state in which the trip originates and sometimes the state in which the trip terminates or passes through.[197] [*85]

Although undertaxation of transportation services was the immediate risk in *Jefferson Lines*, undertaxation of many other services also would have been a likely consequence of a decision for the taxpayer in that case. Receipts from such commonly taxable services as equipment repairs, telecommunications, data processing and information services do not lend themselves readily to being apportioned in a workable manner when they are provided or enjoyed across state lines. For receipts from such services, there is really no practical alternative, other than arbitrary rules,[198] to the basic regime that the Court developed for receipts from sales of tangible personal property.

This was the essential lesson of *Goldberg*, where the Court took the initial step towards conforming its treatment of sales taxes on services to sales taxes on goods. While the Court could point to the lack of feasibility of dividing the tax base associated with interstate telecommunications as a reason for tolerating the second-

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[197] Although the full Court has not explicitly embraced these views, Justice Stevens came close to endorsing them in his concurring opinion in *Goldberg*. Justice Stevens first stated the taxpayer's argument, which is essentially identical to the taxpayer's argument in *Jefferson Lines*:

> A call originating and terminating in Illinois that costs $10 is taxed at full value at 5%. A second call, originating in Illinois but terminating in Indiana, costs the same $10 and is taxed at the same full value at the same 5% rate. But while Illinois may properly tax the entire $10 of the first call, it (technically) may tax only that portion of the second call over which it has jurisdiction, namely, the intrastate portion of the call (say, for example, $5). By imposing an identical 50 tax on the two calls, Illinois has imposed a disproportionate economic burden on the interstate call.

Goldberg v. Sweet, 488 U.S. 252, 269 (1989) (Stevens, J., concurring).

The more appropriate response to the taxpayer's claim in *Goldberg*, although it was not the one the Court offered, was that the claim proceeded on a false premise, namely, that the issue should be analyzed solely in terms of calls that Illinois actually sought to tax because they were charged to an Illinois service address. If, instead, the issue were analyzed in terms of the entire universe of calls originating and terminating in Illinois, only about one-half of which Illinois sought to tax, the claim that Illinois was imposing a disproportionate burden on interstate telephone calls evaporates. Justice Stevens, referring to the example set forth above, put it this way:

> Although Illinois taxes the entirety of every call charged to an Illinois number, it does not tax any part of the calls that are received at an Illinois number but charged elsewhere. Thus, although Illinois taxes the entire Illinois-Indiana $10 call, it taxes no part of the reciprocal Indiana-Illinois $10 call. At the 5% rate, Illinois receives 50 from the two calls combined, precisely the amount it receives from one $10 purely intrastate call. By taxing half the relevant universe of interstate calls at full value, Illinois achieves the same economic result as taxing all of those calls at half value would achieve. As a result, interstate phone calls are taxed at a lower effective rate than intrastate calls, and accordingly bear a proportional tax burden.

Id. at 269-70.

[198] For example, interstate telephone calls might be apportioned equally between the state of origination and the state of termination. This is essentially the approach the federal government employs for apportioning income from international telecommunications. See IRC 863(e)(1)(A).

best approach to the fair apportionment question, it was no less important that this approach "reasonably reflects the way that consumers purchase interstate telephone calls."[199] To have insisted on true apportionment of sales taxes in *Jefferson Lines* could have opened up a Pandora's box of disputes over apportionment of sales taxes on services. Rather than turning every sales tax controversy into a dispute over whether apportionment was feasible, the Court wisely stuck with "the common understanding of a sale"[200] in applying the doctrine it developed for sales of goods to sales of transportation services. In the end, then, the Court's decision in *Jefferson Lines* can be viewed as a second-best solution that approximates the pattern of apportionment that would result if all states had identical sales taxes and had reciprocal flows of goods or services. Under these conditions, allowing Oklahoma to tax the full value of goods delivered or services originating in the state is equivalent to Oklahoma taxing only the Oklahoma portion of the outgoing or incoming goods or services that are consumed in the state. In effect, the overtaxation of goods delivered or services originating in Oklahoma but consumed elsewhere is offset by the undertaxation of [*86] goods and services delivered or originating elsewhere and consumed in part in Oklahoma.[201]

Needless to say, not all states have identical sales taxes and there are unlikely to be reciprocal flows of goods and services between states. Moreover, there may be some instances (as in *Jefferson Lines* itself) in which a precise apportionment of in-state consumption could be determined through administratively feasible division-of-tax base methodologies. But these considerations are outweighed by the "value of a uniform rule governing taxation on the occasion of what is generally understood to be a sales transaction"[202] and the avoidance of the legal uncertainty and complexity that recognition of a Commerce Clause right to an apportionment of sales taxes on services surely would have spawned.

III. The Implications of *Jefferson Lines* for State Sales and Gross Receipts Taxation

Jefferson Lines reinforces the pre-existing doctrinal framework for adjudicating the constitutionality of state sales taxes under the Commerce Clause and makes it clear that this framework applies to at least some sales of services as well as to sales of goods. In so holding, the Court rejected the broad contention that states always must provide for a division of the tax base when they are imposing sales taxes on services, just as it rejected a mandatory division of the tax base when states impose a sales tax on tangible personal property. While resolving this issue, the Court's

[199] *Goldberg*, 488 U.S. at 262.
[200] Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. 1331, 1341 (1995).
[201] See text accompanying notes 185-200.
[202] *Jefferson Lines*, 115 S. Ct. at 1344 n.7.

decision raises a number of others that are likely to be the focus of future controversy. It is to those issues that we now turn.

A. Distinguishing "Sales Taxes" from "Gross Receipts Taxes"

In distinguishing those levies whose tax base must be divided among the states to satisfy the Commerce Clause's fair apportionment requirement from those levies whose tax base may be taxed in full by a single state without offending the Commerce Clause, the Court in *Jefferson Lines* drew a line in the sand between "sales taxes" and "gross receipts taxes." The Court treated the former as a levy on a "taxable event"[203] that occurred, or was deemed to occur, wholly within the state, thereby making apportionment of the base unnecessary. The Court treated the latter as "simply a variety of a tax on [*87] income, which was required to be apportioned to reflect the location of the various interstate activities by which it was earned."[204]

1. Establishing the Proper Taxonomy

The critical task in the future will be the proper classification of exactions as sales taxes or gross receipts taxes. At several points in its opinion, the Court suggested that the dispositive distinction between sales taxes and gross receipts taxes is that the former fall on the buyer whereas the latter fall on the seller.[205] As we pointed out above, however, this difference is a largely semantic one that does not reflect the underlying justification for requiring or not requiring that a tax base be apportioned.[206] The true distinction between those levies that ought to be apportioned and those that need not be is whether they are designed as taxes on business activity or as taxes on the consumer of goods or services.[207]

Three factors militate strongly in favor of the more fundamental distinction we offer between sales taxes and gross receipts taxes than that suggested by the Court. First, the distinction corresponds to the justification for relaxing the apportionment rule. Whereas all taxes measured by values reflecting interstate activity theoretically should be divided among the states in which such values are generated, the rules that have developed regarding consumption taxes are not intended to implement a meaningful system of apportionment. Instead, they are intended as a second-best approach that avoids the practical difficulties that frequently would be encountered if a determination actually had to be made of consumption on a state-by-state

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[203] Id. at 1341.
[204] Id.
[205] See id. at 1335 n.3, 1341; see text accompanying notes 177-79.
[206] See Subsection II.C.3.
[207] See text accompanying note 177-79.

basis.[208] No such difficulties are encountered with respect to taxes designed to tax business activity, which easily can be divided among the states by apportionment factors reflecting the locus of the business activity.

Second, the distinction between sales taxes and gross receipts taxes corresponds to real differences between the levies in question. Business activity taxes measured by gross receipts display structural characteristics that are strikingly different from consumption taxes measured by gross receipts.[209] By contrast, consumption taxes with virtually identical structural characteristics may be imposed either on the seller or on the buyer; indeed, the only difference between such [*88] taxes may be the choice of the nominal taxpayer—a choice that typically has little or no economic significance.[210] The Court's distinction therefore fails to serve its intended function and, if applied, could require the apportionment of levies that most observers would classify as sales taxes.

Finally, the suggested distinction is true to the underlying spirit of the Court's decision, even if not to every phrase it uttered in the course of its opinion. The Court, we believe, was struggling towards the very distinction we suggest. Thus, while declaring that sales and gross receipts taxes "diverge crucially in the identity of the taxpayers and the consequent opportunities that are understood to exist for multiple taxation"[211] and relying on a "taxable event"[212] that purportedly could not be repeated by other states,[213] the Court does recognize that it ultimately is talking about a tax on consumption. For example, the Court equates the economic activity associated with the formal taxable event in *Jefferson Lines*, which involves "the receipt of the ticket,"[214] as being in substance "for "consumption""[215] and closely resembling the sales tax on delivery of goods "for consumption.""[216] It further observed that "full "consumption""[217] of purchased goods within the taxing state has never been a condition for taxing the sale of such goods on an unapportioned basis, thus reflecting the Court's understanding of a sales tax as a tax on consumption, even if the consumption taxed was not precisely calibrated to the consumption actually enjoyed in a state. And, by stressing its reliance on the "common

[208] See text accompanying notes 180-84.

[209] See Subsection II.C.2. While there are real distinctions between business activity taxes and consumption taxes, we are not suggesting that there are necessarily differences in economic substance. See text accompanying notes 41-45 and note 42.

[210] See text accompanying note 42.

[211] Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. 1331, 1341 (1995).

[212] Id.

[213] But see note 62.

[214] *Jefferson Lines*, 115 S. Ct. at 1341.

[215] Id.

[216] Id. (quoting McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 58 (1940)).

[217] Id.

understanding of a sale"[218]—an understanding that embraces consumption—the Court provides additional evidence that the essential distinction that underlies its decision is one between a tax on consumption and a tax on business activity, and not between a tax on a buyer and a tax on a seller.

2. Applying the Distinction

If the essential distinction between a gross receipts tax that might have to be apportioned and a sales tax that need not be is whether the levy is imposed on business activity or on the ultimate consumer, the resolution of this issue, in most instances, will be fairly straightforward. [*89] By examining the structural characteristics of the exaction under scrutiny—does it exclude sales of business inputs, is it imposed on a transaction-by-transaction basis, is it separately stated, and the like—one ordinarily will be able to determine whether a tax is a gross receipts tax or a sales tax with little difficulty.

This determination will be obvious in many circumstances because the overwhelming majority of states have retail sales taxes, whose classification is uncontroverted. At the same time, some of these states impose gross receipts taxes on specialized activities, and the nature of these levies is also clear. Tennessee, for example, imposes a 6% retail sales tax[219] while also levying gross receipts taxes on the manufacture or production and sale of soft drinks (1.9%);[220] the furnishing or distribution of gas, water or electricity (3%);[221] and the manufacture of gas or the distribution of manufactured gas or natural gas (1.5%).[222]

Similarly, the panoply of municipal taxes, denominated variously as license taxes, license fees, business taxes, business operations taxes, business and occupation taxes, occupational licenses, business privileges taxes and mercantile license taxes also present no serious classification problems. These levies share the characteristic features of gross receipts taxes and have none of the features of retail sales taxes.[223] Indeed, one of the reasons for the popularity of gross receipts taxes at the local level is their ease of administration,[224] because they rarely incorporate

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[218] Id.

[219] Tenn. Code Ann. 67-6-101 (Supp. 1994).

[220] Id. 67-4-402.

[221] Id. 67-4-405.

[222] Id.

[223] See Piper & Eggen, note 170, at 1610:0011 ns. 68, 69, 1610:6101-04. The authors list municipalities in the following states as imposing gross receipts taxes: Alabama, California, Georgia, Missouri, Pennsylvania, South Carolina, Virginia and West Virginia. See id.

[224] This feature also explains the popularity of gross receipts taxes in developing countries. See Pomp, et al., note 171, at 16-32.

deductions of any kind, especially not the kinds of deductions found in retail sales taxes, and because they typically are imposed on an unapportioned basis.[225]

The classic state gross receipts tax is Washington's business and occupation tax. Washington imposes a general gross receipts tax on most business activity in the state,[226] in lieu of a corporate income tax.[227] Retailing is taxed at 0.471%; wholesaling and manufacturing are taxed at 0.484%.[228] The law specifically states that the gross receipts tax shall constitute part of the operating overhead of the [*90] business,[229] which is consistent with the legislative intent that the economic incidence of the tax should fall on business.[230] The inclusion in the tax base of the gross receipts tax likewise reflects this intent. In addition to its gross receipts tax, Washington imposes a 6.5% retail sales tax.[231] Accordingly, a retail sale in the state of Washington attracts two taxes—the 0.471% tax that the retailer must pay on its gross receipts for the privilege of doing business in Washington and the 6.5% tax that the purchaser must pay on the sale of product, measured by the same gross receipts. A 6.5% use tax complements the sales tax.[232]

Like Washington, Indiana has a gross receipts tax, which is labeled a "gross income" tax. The gross income tax essentially applies only to subchapter C corporations (or publicly traded partnerships treated as corporations for federal income tax purposes). The tax is creditable against the corporate income tax, and thus it serves as an alternative minimum tax. In effect, corporations pay the higher of a 3.4% corporate income tax[233] or the gross income tax.[234] The rate of the tax is .3% on, among other things, wholesaling and retailing, and 1.2% on other activities and unearned income, such as interest, dividends and capital gains.[235] In addition to its gross income tax, Indiana also imposes a 5% retail sales and use tax.[236]

In contrast to the taxes described above, there are some taxes whose classification as sales taxes or gross receipts taxes may be more difficult. We consider below the taxes of New Mexico, Arizona and Hawaii because of the confusion that surrounds their proper classification.

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[225] As applied to the receipts from interstate business activity, this common feature is constitutionally suspect after *Jefferson Lines*. See Section III.B.

[226] Wash. Rev. Code 82.04.010 (Supp. 1994).

[227] See Due & Mikesell, note 42, at 57.

[228] Wash. Rev. Code 82.04.250, 82.04.270 (Supp. 1995).

[229] Id. 82.04.500 (Supp. 1995).

[230] For a discussion of economic incidence, see note 42.

[231] Wash. Rev. Code 82.08.020 (Supp. 1995).

[232] Id. 82.12.020.

[233] Ind. Code 6-3-2-1(b) (Supp. 1994).

[234] Id. 6-3-3-2.

[235] Id. 6-2.1-2-3. The name gross income tax is somewhat misleading. See note 75.

[236] Ind. Code 6-2.5-2-2, 6-2.5-3-3.

New Mexico is a state often described as having a gross receipts tax, although its levy has all the characteristics of a retail sales tax.[237] The tax is imposed at a rate typical of sales taxes—5%.[238] Moreover, in [*91] common with state sales taxes, New Mexico provides exemptions for a wide range of business inputs, such as the sale of tangible personal property for resale,[239] services for resale,[240] property that becomes an ingredient and component of other manufactured property,[241] tangible personal property to those engaged in the construction business,[242] feed and fertilizers,[243] agricultural-related inputs,[244] mining, milling or oil-related business inputs,[245] processing of components or materials used in manufacturing[246] and so forth. No doubt one source of confusion about the nature of the New Mexico gross receipts tax is that it is imposed on the vendor and not the consumer, which is irrelevant in classifying the levy.[247] Misunderstanding also may arise from the lack of a provision common in retail sales taxes requiring the separate statement of the tax.[248] Retailers in New Mexico, however, routinely separately state the gross receipts tax.[249] Moreover, whether separately stated or not, the New Mexico gross receipts tax is excluded from the base of the tax,[250] which is a characteristic of retail sales taxes.[251]

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[237] Piper & Eggen, note 170, for example, improperly characterize New Mexico's tax as a gross receipts tax rather than as a retail sales tax. As they concede, the Washington Department of Revenue disagrees with this characterization because the New Mexico tax is not creditable against the Washington gross receipts tax; only gross receipts taxes and not retail sales taxes are creditable. See Washington St. Dep't of Revenue Excise Tax Bull. 543.04.19301, cited in Piper & Eggen, note 170, at 1610:0001. The authors also state that "with the exception of Delaware, all states that impose gross receipts taxes also impose retail sales taxes." Id. at 1610:0002. But New Mexico does not have both a gross receipts tax and a sales tax; it has only one major tax measured by gross receipts.

[238] N.M. Stat. Ann. 7-9-4 (Michie 1994).

[239] Id. 7-9-47. This exemption and the others discussed in the text here and in connection with Arizona's transaction privilege tax, see text accompanying notes 256-68, are implemented through a deduction from the taxpayer's gross receipts. A deduction from gross receipts is equivalent to exempting that transaction from tax.

[240] N.M. Stat. Ann. 7-9-48 (Michie 1994).

[241] Id. 7-9-46.

[242] Id. 7-9-51.

[243] Id. 7-9-58.

[244] Id. 7-9-59.

[245] Id. 7-9-65.

[246] Id. 7-9-75.

[247] See text accompanying notes 161-67.

[248] See note 160 and accompanying text.

[249] Telephone interview with Laird Graesser, Chief, Tax Research Office, N.M. Tax'n and Revenue Dep't (Aug. 10, 1995).

[250] N.M. Stat. Ann. 7-9-3(F)(2)(b) (Michie 1993).

[251] See Subsection II.C.2.; Due & Mikesell, note 42, at 30 (incorrectly stating that gross receipts tax has to be separately stated for it to be deductible).

Another possible source of misunderstanding is the breadth of the New Mexico tax, especially in its coverage of services. For historical rather than normative reasons, retail sales taxes apply to a wide spectrum of tangible personal property but a more limited number of services.[252] The New Mexico tax is notable for its broad coverage of services,[253] a feature consistent with both a broad-based retail sales tax and a broad-based gross receipts tax; the New Mexico exemption for services purchased for resale, however, is an indication that the tax [*92] should be viewed as a retail sales tax. Finally, confusion about the proper classification of the New Mexico tax may be explained by its historical roots. The early New Mexico gross receipts tax reached many nonretail sales of both services and tangible personal property.[254] Over time, however, many of the nonretail sales have been excluded from the tax.[255]

Arizona levies what it calls a transaction privilege tax, but that levy is functionally equivalent to a retail sales tax.[256] Exemptions[257] typical of sales taxes are provided for sales for resale,[258] articles incorporated into a fabricated or manufactured product (ingredients and components),[259] machinery or equipment used directly in manufacturing, processing, fabricating, job printing, refining or metallurgical operations,[260] mining equipment or machinery used directly in the process of extracting ores or minerals,[261] tangible property that is a component of a carrier system,[262] new agricultural, horticultural, viticultural or floricultural machinery or

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[252] See Richard D. Pomp, State Tax Reform for the Eighties, 16 Conn. L. Rev. 925, 933-34 (1984); see also text accompanying notes 318-17.

[253] N.M. Stat. Ann. 7-9-3(F) (Michie 1993). The three states with the broadest coverage of services are South Dakota, Hawaii and New Mexico. Due & Mikesell, note 42, at 320.

[254] See Due & Mikesell, note 42, at 55 n.17, 89.

[255] See id. at 55 n.17. Due and Mikesell do not list New Mexico as a state having nonretail elements in its sales tax. See id. at 54-56. New Mexico's taxation of services, however, can reach many nonretail transactions, although this fact does not distinguish it from other retail sales taxes. States typically tax services that are business inputs (for example, nonretail transactions). Id. at 89-97.

[256] Piper and Eggen view the Arizona levy as a gross receipts tax, contrary to the way we and the State of Washington Department of Revenue view the tax. See Piper & Eggen, note 170, at 1610:0002; see also note 237. Piper and Eggen cannot be right in both maintaining that the Arizona levy is a gross receipts tax and in asserting that, with the exception of Delaware, all states that impose gross receipts taxes also impose retail sales taxes, because like New Mexico, Arizona has only one major tax measured by gross receipts.

[257] See note 239.

[258] Ariz. Rev. Stat. 42-1310.01(P)(3) (Supp. 1994).

[259] Ariz. Admin. Code 15-5-122 (Supp. 1994).

[260] Ariz. Rev. Stat. 42-1310.01(B)(1) (Supp. 1994).

[261] Id. 42-1310.01(B)(2).

[262] Id. 42-1310.01(B)(3).

equipment,[263] machinery and equipment used in research and development[264] and the like.

Arizona's transaction privilege tax generally is imposed at a rate of 5%; transient lodging is taxed at 5.5% and mining is taxed at 3.125%.[265] Like New Mexico, Arizona does not require that the tax be separately stated, although that is the practice of retailers.[266] The [*93] gross receipts tax is deductible from the base of the tax,[267] whether or not separately stated.[268]

Hawaii's tax regime is the most difficult to characterize. Hawaii imposes a .5% gross receipts tax (known as the general excise tax) on sales by processors, wholesalers and manufacturers; a gross receipts tax of .15% on insurance commissions and a tax of 4% on services, contracting, interest, royalties, commissions (other than insurance), rentals and retailing.[269] The issue is whether this 4% tax component should be viewed as a retail sales tax appended to a gross receipts tax or as part of Hawaii's more general gross receipts tax. The 4% rate is more consistent with a retail sales tax, but Hawaii also imposes that rate on interest, royalties and rents received from the rental of real property, items normally excluded from retail sales taxes. The excise tax itself is not deductible in calculating the base of the tax, regardless of whether it is separately stated,[270] which is also indicative of a gross receipts tax. Conversely, Hawaii prohibits any retailer from advertising that the tax is not considered as an element in the price to the consumer.[271] Such a provision is more typical of a retail sales tax.[272] Moreover, Hawaii imposes a compensating use tax for tangible personal property purchased outside of Hawaii,[273] which is more characteristic of a retail sales tax than a gross receipts tax.

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[263] Id. 42-1310.01(B)(13).

[264] Id. 42-1310.01(B)(14).

[265] Id. 42-1317(A)(1), (2). A tax on commercial leasing is being phased out. See id.

[266] Telephone Interview with Joel Postal, Administrator, Arizona transaction privilege and use tax (Aug. 23, 1995).

[267] Ariz. Rev. Stat. Ann. 42-1302(A)(1) (Supp. 1994). Due & Mikesell, note 42, at 30, incorrectly report that the Arizona tax is deductible only if quoted separately.

[268] See Subsection II.C.2.

[269] Haw. Rev. Stat. 237-3, -4, -13, -16, -25 (Supp. 1994).

[270] Id. 237-3. Hawaii does not require that the tax be separately stated. Due & Mikesell, note 42, at 30, report, however, that the general practice is to do so.

[271] Haw. Rev. Stat. 237-16(c) (Supp. 1994).

[272] See Subsection II.C.2. The Washington Department of Revenue views the Hawaii levy as a gross receipts tax. See note 237.

[273] Haw. Rev. Stat. 238-2 (Supp. 1994).

B. The Viability of the Court's Earlier Decisions Sustaining Unapportioned Gross Receipts Taxes

At the same time that the Court's opinion in *Jefferson Lines* gives broad approval to the existing pattern of sales taxation of goods and services, it arguably casts doubt upon the constitutionality of some of its decisions approving unapportioned gross receipts taxes on business activity. Of course, the Court did not assert that all unapportioned gross receipts taxes are constitutionally suspect. But if, as the Court suggests in describing the tax at issue in *Central Greyhound*, a "gross receipts tax . . . [is] simply a variety of tax on income, which [is] required to be apportioned to reflect the location of the various interstate [*94] activities by which it [is] earned,"[274] then once a tax has been properly identified as a gross receipts tax on business activity, it should follow that the tax base must be apportioned to reflect interstate values.

As the Court explained in *Jefferson Lines*, the Court in *Central Greyhound* condemned New York's unapportioned gross receipts tax under which "the seller-taxpayer was exposed to taxation by New Jersey and Pennsylvania on portions of the same receipts that New York was taxing in their entirety":[275]

> New York claims the right to tax the gross receipts from transportation which traverses New Jersey and Pennsylvania as well as New York. To say that this commerce is confined to New York is to indulge in pure fiction. To do so, does not eliminate the relation of Pennsylvania and New Jersey to the transactions nor eliminate the benefits which those two States confer upon the portions of the transportation within their borders. Neither their interests nor their responsibilities are evaporated by the verbal device of attributing the entire transportation to New York . . .. Transactions which to such a substantial extent actually take place in New Jersey and Pennsylvania cannot be deemed legally to take place in New York.[276]

Moreover, "by its very nature an unapportioned gross receipts tax makes interstate transportation bear more than a "fair share of the costs of the local government whose protection it enjoys.'"[277]

The Court's analysis in *Central Greyhound* was echoed by Justice Brennan's dissent in *General Motors Corp. v. Washington*,[278] a case involving Washington's

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[274] Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. 1331, 1341 (1995).

[275] Id.

[276] Central Greyhound Lines, Inc. v. Mealey, 334 U.S. 653, 660 (1948).

[277] Id. at 663 (quoting Freeman v. Hewit, 329 U.S. 249, 256 (1946), overruled in part by Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977)).

[278] 377 U.S. 436 (1964), overruled in part by Tyler Pipe Indus. v. Washington State Dep't of Revenue, 483 U.S. 232 (1987).

business and occupation tax.[279] The state taxed all of the gross receipts that General Motors derived from its sales of cars to Washington retailers, notwithstanding that manufacturing and assembly occurred outside the state.[280] As Justice Brennan observed: [*95]

> If commercial activity in more than one State results in a sale in one of them, that State may not claim as all its own the gross receipts to which the activity within its borders has contributed only a part. Such a tax must be apportioned to reflect the business activity within the taxing State.[281]

While the force of the Court's analysis in *Central Greyhound*, as well as Justice Brennan's analysis in his dissenting opinion in *General Motors*, seems irrefutable, the Court in *General Motors*, and in several other cases like it,[282] in fact, has, sustained business activity taxes measured by the unapportioned gross receipts from interstate commerce over constitutional objections that the levies were unfairly apportioned. The Court's rationale for sustaining these levies is that they are imposed on "local activity" and thus do not require apportionment,[283] a view previously rejected in *Central Greyhound*.[284] Thus in *Standard Pressed Steel*, involving the application of Washington's business activities tax to the unapportioned gross receipts from the sales that an out-of-state supplier made to the Boeing Company,[285] the Court declared that "the tax is on the gross receipts from sales made to a local consumer, which may have some impact on commerce . . . Yet . . . is "apportioned exactly to the activities taxed,' all of which are intrastate."[286]

More recently, in *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*,[287] again involving the application of Washington's business activities tax to the unapportioned gross receipts from the sales that an out-of-state manufacturer made to an in-state customer, the Court declared:

> Washington taxes the full value of receipts from in-state wholesaling . . . thus, an out-of-state manufacturer selling in Washington is subject to an unapportioned wholesale tax even though the value of the wholesale transaction is partly attributable to the manufacturing activity carried on in

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[279] See id. at 437.

[280] See id. at 438.

[281] Id. at 451 (Brennan, J., dissenting).

[282] See, e.g., Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. 560, 564 (1975); Field Enters., Inc. v. Washington, 352 U.S. 806 (1956), per curiam mem., 289 P.2d 1010 (Wash. 1955); International Harvester Co. v. Department of Treasury, 322 U.S. 340, 349 (1944).

[283] *General Motors*, 377 U.S. at 447-49; *Standard Pressed Steel*, 419 U.S. at 564; *International Harvester*, 322 U.S. at 349.

[284] See *Central Greyhound*, 334 U.S. at 661-64.

[285] See *Standard Pressed Steel*, 419 U.S. at 561-62.

[286] Id. at 564 (quoting Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434, 440 (1939)).

[287] 483 U.S. 232 (1987).

another State that plainly has jurisdiction to tax that activity. [*96] This apportionment argument rests on the erroneous assumption that through the [business and occupation] tax, Washington is taxing the unitary activity of manufacturing and wholesaling... The activity of wholesaling—whether by an in-state or out-of-state manufacturer—must be viewed as a separate activity conducted wholly within Washington that no other State has jurisdiction to tax.[288]

This analysis is unfaithful to the fair apportionment requirement:[289]

[The] view of wholesaling as a "separate activity" that a state can tax without apportionment because the activity "must be viewed" as occurring "wholly within" the jurisdiction . . .is a retreat into the very formalism that the Court had purportedly abandoned in *Complete Auto Transit*. . . and its progeny. . .

The critical point is that a tax levied upon interstate [business] activity . . . must reflect [only] the portion of the enterprise's activity that is being conducted in the taxing state, and the tax measure must be adjusted accordingly. Otherwise, the state, under the guise of taxing some "local incident" of that interstate activity, would be able to sweep into its tax base gross receipts . . . That other states could include in their tax bases with equal justification by identifying some other "local incident" of that interstate activity. The risk of multiple taxation to which such a regime would expose interstate commerce is plain.[290]

Although the Court's blanket approval of unapportioned gross receipts taxes is unwarranted, there is an explanation for it. First, with [*97] respect to gross receipts taxes on interstate sales activity, the Court has analogized such taxes, even though imposed on business activity, to retail sales and use taxes."[291] Indeed, the Court explicitly recognized "the analogy sometimes drawn between sales and gross

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[288] Id. at 251.

[289] See Hellerstein, Internal Consistency, note 49, at 171-75; Walter Hellerstein, State Taxation of Interstate Business and the Supreme Court, 1974 Term: *Standard Pressed Steel* and *Colonial Pipeline*, 62 Va. L. Rev. 149, 168-76 (1976). The following discussion draws freely from these sources.

[290] Hellerstein, Internal Consistency, note 49, at 172-73 (citing Richard L. Strecker, "Local Incidents" of Interstate Business, 18 Ohio St. L.J. 69 (1957)). The article goes on to say:

This is not to suggest that states may never impose unapportioned taxes on "local" subjects without burdening interstate commerce. They may do so if the tax base has no multistate attributes over which other states may properly assert their taxing authority. Hence there is no need to apportion. . . a gross receipts tax on a local massage parlor. But a tax [on business activity] measured by. . . [gross receipts generated by interstate commerce should not be] immune from the requirement of fair apportionment merely because it is framed as a tax on a distinctly "local" event such as the privilege of engaging in local business.

Hellerstein, Internal Consistency, note 49, at 173 n.191.

[291] See id. at 173 (citing International Harvester Co. v. Department of Treasury, 322 U.S. 340, 348 (1944)).

receipts taxes"[292] in *Jefferson Lines*. For reasons considered at length above, analogizing gross receipts taxes to retail sales taxes indeed would justify a regime in which the former were unapportioned.[293]

> Second, with respect to gross receipts taxes in general, the Court for many years has [embraced] the view that the states could impose excise taxes on manufacturing, producing, and extracting activities measured by the unapportioned gross receipts from those activities. The Court considered these activities to be "local" in nature, and it permitted the states to measure the value of the activities by the gross receipts they generated notwithstanding their intimate connection with interstate activities.[294]

Prior to *Jefferson Lines*, commentators were relegated to the position of criticizing the Court's anomalous approval of unapportioned gross receipts taxes, observing that plausible explanations did not amount to reasoned justifications and that even the precedents on which the Court relied for sustaining such levies lost much of their force upon closer scrutiny.[295] *Jefferson Lines*, however, lends its support to this criticism. By drawing a sharp line between gross receipts taxes and retail sales taxes, and characterizing the gross receipts tax in *Central Greyhound* as akin to an income tax,[296] the Court has called into question some of its earlier decisions that approved unapportioned gross receipts taxes merely because they were imposed on a "local" subject and could be analogized loosely to retail sales taxes. After *Jefferson Lines*, gross receipts taxes on interstate transactions [*98] should not be exempted from the apportionment requirement on the basis of a false analogy to retail sales taxes. Although there occasionally may be some uncertainty as to precisely how the line between gross receipts taxes and retail sales taxes should be drawn,[297] once a levy is properly classified as a gross receipts tax, the arguments in favor of apportionment must be addressed.

Even under the most literal reading of *Jefferson Lines*, which distinguishes gross receipts taxes from sales taxes based on whether the tax falls on the seller or buyer,

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[292] Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. 1331, 1340 (1995).

[293] See text accompanying notes 274-81.

[294] Hellerstein, Internal Consistency, note 49, at 174 (citing the following cases in which the Court found activities to be local in nature: Hope Natural Gas Co. v. Hall, 274 U.S. 284 (1927) (producing); Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922) (extracting); and American Mfg. Co. v. City of St. Louis, 250 U.S. 459 (1919) (manufacturing).

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> The cases that eschew apportionment as an impractical (or unworkable) solution to the multiple taxation issues raised by retail sales taxes have little bearing on the question whether general business taxes imposed on interstate sales activity are apportionable. . . . Hence the analogy the Court may have drawn between retail sales taxes and general gross receipts taxes on interstate sales activity is a false one insofar as the apportionment issue is concerned.

Hellerstein, Internal Consistency, note 49, at 174-75.

[296] See *Jefferson Lines*, 115 S. Ct. at 1340-41.

[297] See Subsection II.B.4.

cases like *General Motors*, *Standard Pressed Steel* and *Tyler Pipe* are problematic, because they approved unapportioned gross receipts taxes measured by values reflecting interstate activity, even though the taxes rested squarely on the seller.[298] More generally, it is plain that the Court has sanctioned taxes on unapportioned gross receipts from interstate business activity that could not conceivably be characterized as consumption taxes. After *Jefferson Lines*, the constitutionality of these taxes is suspect.[299]

Regardless of how subsequent cases may view *Jefferson Lines*' implications for gross receipts taxes, the wisdom of requiring apportionment in many situations can be demonstrated by revisiting *Tyler* [*99] *Pipe*.[300] That case concerned Washington's gross receipts tax on, inter alia, manufacturing and wholesaling. Local manufacturer/wholesalers were exempt from the tax on their manufacturing gross receipts (measured by the sales price of the goods) and paid only the wholesaling tax (also measured by the sales price of the goods). Out-of-state manufacturers that wholesaled in Washington also paid only the wholesaling tax.[301]

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[298] See notes 282-88 and accompanying text. We do not hereby mean to suggest that the nexus holdings in these cases are subject to doubt.

[299] For example, under this analysis, the validity of both Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938), and Department of Treasury v. Ingram-Richardson, 313 U.S. 252 (1941), may be questioned. See text accompanying notes 68-78. Both decisions sustained unapportioned gross receipts taxes on interstate business activity, although the successor to the New Mexico tax at issue might not be so characterized today. It is worth observing, however, that even if apportionment had been required in Western Live Stock and *Ingram-Richardson*, the apportionment likely would have had only a minimal effect on the receipts subject to tax because the overwhelming proportion of the taxable activity in those cases occurred in the taxing state, and the risk of multiple taxation was minimal. See notes 69, 71. This likelihood may explain why the Court had little difficulty sustaining the levies. Cf. Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434, 439 (1939) (invalidating unapportioned gross receipts tax on marketing agent for fruit growers making interstate sales because "the tax, measured by the entire volume of the interstate commerce in which appellant participates, is not apportioned to its activities within the state"); J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307, 311 (1938) (invalidating unapportioned gross receipts tax on manufacturer making sales in other states because "the statute as applied to receipts from interstate sales. . . includes in its measure, without apportionment, receipts derived from activities in interstate commerce"). Moreover, under then-existing conceptions of nexus, it is not clear whether other states would have had the power even to subject the taxpayer in *Western Live Stock* and *Ingram-Richardson* to tax, in which case there would have been no right to apportion the tax base.

It might be argued that *Jefferson Lines*, in analogizing the gross receipts tax at issue in *Central Greyhound* to an income tax, was not implying anything about other business activity taxes measured by gross receipts. The internal logic of the Court's opinion, however, and its statements distinguishing gross receipts taxes from sales taxes lend support to the position that all taxes properly characterized as gross receipts taxes must be apportioned.

[300] Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue, 483 U.S. 232 (1987).

[301] See id. at 236.

The Court held that the Washington scheme violated the internal consistency doctrine and was discriminatory.[302] If every state were to adopt the Washington tax regime, the interstate manufacturer/wholesaler would pay a manufacturing tax to the state of manufacture and a wholesaling tax to the state of sale, but the intrastate manufacture/wholesaler would pay only a wholesaling tax.[303] Although the Court chose to analyze the issue using the internal consistency doctrine, it could have reached the same conclusion by holding that the gross receipts tax was not externally consistent. If the Washington taxes were properly apportioned, all of the defects identified by the Court would disappear.

As discussed above, the major weakness in the Washington scheme was that by imposing an unapportioned gross receipts tax on the proceeds from the sale that an out-of-state manufacturer made to an in-state customer, Washington reached out-of-state values.[304] In other words, part of the gross receipts that Washington was taxing as attributable to wholesaling in the state was actually attributable to the value of the goods before they entered Washington. This economic reality is independent of whether "wholesaling . . . must be viewed as a separate activity conducted wholly within Washington that no other State has jurisdiction to tax."[305] Whether any other state can tax wholesaling is irrelevant to the issue of fair apportionment if Washington can overreach by taxing receipts attributable to activities occurring elsewhere, such as out-of-state manufacturing.

The sales proceeds received from the wholesaling of goods in Washington reflects the fair market value of the goods sold, which, in turn, reflects both the manufacturing as well as the wholesaling activities. In the international context, it is commonplace to view the sales proceeds generated by the manufacture of a good outside a taxing jurisdiction and the sale within (or vice versa) as consisting of two parts: one part attributable to the manufacturing activities, as measured by [*100] the value of the goods at the factory, and the other part attributable to the sales activities, as measured by the difference between the actual sales proceeds and the value of the goods at the factory.[306]

In effect, the transaction is bifurcated and viewed as if there were first a constructive sale at the factory in the state of manufacture, followed by the actual sale in the market state. The constructive sales proceeds would be properly taxable under a gross receipts tax on manufacturing imposed by the state of manufacture, and the difference between the constructive sales proceeds and the actual sales proceeds would be properly taxable under a gross receipts tax on wholesaling imposed by the state of sale. In this manner, the gross receipts of the total activity

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[302] See id. at 247-48.

[303] See id. at 246-48.

[304] See text accompanying notes 286-87.

[305] *Tyler Pipe*, 483 U.S. at 251.

[306] See, e.g., Reg. 1.863-3(b)(2)(Ex. 1).

would be apportioned to the respective jurisdictions in which the manufacturing and sales activities took place.

Washington, however, taxed the gross receipts attributable not only to wholesaling, which took place in the state, but also to manufacturing, which took place outside the state.[307] The value of the goods at the time they entered the state became part of the Washington tax base, which would be acceptable under a retail sales tax but is unacceptable under a business activities tax of the type imposed by Washington.[308] A state should not be allowed to parlay a local hook called wholesaling into taxing activities that took place elsewhere.

Approaching *Tyler Pipe* in this manner would have been more in keeping with the spirit and teachings of *Complete Auto* than was the Court's formalistic treatment of the apportionment issue. Requiring that the Washington gross receipts tax be apportioned would have eliminated the discrimination with which the Court was concerned. Apportionment would mean that out-of-state manufacturers that wholesale in Washington would be subject to the gross receipts tax only on that part of the sales proceeds attributable to their sales activities in Washington. They would pay a gross receipts tax in the state of manufacture only on that part of the sales proceeds attributable to their activities in that state. They would be taxable on 100% of their gross receipts, divided between Washington and the state of manufacture.

Intrastate manufacturer/wholesalers also would be treated in the same manner. Conceptually, their gross receipts would be bifurcated into that part attributable to manufacturing and that part attributable to wholesaling. Because both activities occur in-state, and in *Tyler* [*101] *Pipe* were taxed at the same rate, that rate could be applied to the entire gross receipts without bifurcation.[309]

Similarly, Washington manufacturers that wholesale outside the state would be taxable on that part of their proceeds attributable to their Washington activities. They would pay a gross receipts tax to Washington based on a constructive sale at the factory, and a gross receipts tax to the state of sale based on the difference between their actual sales proceeds and the amount of the constructive sale.

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[307] See *Tyler Pipe*, 483 U.S. at 236.

[308] See text accompanying notes 286-88.

[309] No need would exist for a multiple activities exemption because an in-state manufacturer/wholesaler would be taxed only on 100% of its gross receipts. Under the law in effect at the time of *Tyler Pipe*, such an exemption was mandatory because otherwise all of the sales proceeds would have been taxed twice—once as gross receipts from wholesaling and again as gross receipts from manufacturing. See *Tyler Pipe*, 483 U.S. at 245-48. A multiple activities exemption is required to eliminate the double taxation that otherwise results from the lack of apportionment. If the rates on wholesaling and manufacturing are the same, as they were in *Tyler Pipe*, the exemption functions as a credit. Under the approach suggested in the text, no exemption is needed because the sales proceeds would be taxed only once.

By not adequately dealing with the apportionment issue in *Tyler Pipe*, the Court's holding effectively allows Washington to tax an out-of-state manufacturer on all of its sales proceeds because it wholesaled in Washington, and allows the state of manufacture also to tax part or all of those same receipts. Yet, this was the precise evil condemned by the Court in *Central Greyhound*.[310] In *Central Greyhound*, the clash was between New York's unapportioned gross receipts tax and the apportioned gross receipts taxes of other states. In *Tyler Pipe*, the clash was between Washington's unapportioned gross receipts tax and the unapportioned gross receipts tax of any other state having a statute similar to Washington's. An out-of-state manufacturer wholesaling in Washington, for example, could be subject to a tax on 200% of its gross receipts, if the state of manufacture had a tax regime identical to Washington's.[311] *Central Greyhound*, consequently, should have been the relevant precedent for dealing with *Tyler Pipe*.[312]

The neatness with which imposing an apportionment requirement on gross receipts taxes solves *Tyler Pipe*-type issues was easiest to [*102] demonstrate above by assuming that the sales proceeds could be bifurcated conveniently into manufacturing and wholesaling components.[313] The international experience suggests that bifurcation may not always be administratively practicable.[314] Other

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[310] See Central Greyhound Lines, Inc. v. Mealey, 334 U.S. 653, 662-63 (1948).

[311] See *Tyler Pipe*, 483 U.S. at 248-49.

[312] One difference was that the taxpayer in *Central Greyhound* could show that its gross receipts actually were being taxed on an apportioned basis by Pennsylvania whereas the taxpayers in *Tyler Pipe* were not subject to any other state's gross receipts tax. *Central Greyhound*, 334 U.S. at 662-63; *Tyler Pipe*, 483 U.S. at 242, 247. At one time, disagreement existed regarding the weight a court should give to the risk of multiple taxation (*Tyler Pipe*) versus actual multiple taxation (*Central Greyhound*). That disagreement was resolved definitively with the advent of the internal consistency doctrine, which focuses on the risk of multiple taxation that might arise from an improperly apportioned tax, regardless of whether multiple taxation exists in fact.

[313] The proposed solution, in effect, treats the gross receipts tax as a value-added tax and apportions the tax base in accord with the value added in each state. This approach works properly when the gross receipts tax is imposed on the branches of a single corporation because, in that situation, a gross receipts tax operates like a value-added tax. When a gross receipts tax is imposed seriatim on separate companies engaged in the production and sale of goods, the value-added approach works imperfectly because the gross receipts tax in those circumstances imposes multiple levels of taxation on the same value added. Assume, for example, *A*, *B* and *C* are all related corporations engaged in a common enterprise. *State B* produces unfinished goods in *State A* and sells them to *B* for $100. *B* finishes the goods in *State B* and sells them to *C* for $150. *C* then sells the finished goods in the marketplace of *State C* for $200. If each state has a gross receipts tax, the total amount subject to tax would be $450 ($100 + $150 + $200). The total value added, however, is only $200. Under these facts, the proposed method of apportioning the tax base would produce arbitrary results. Indeed, it is unlikely that any principle of apportionment could be uncovered for apportioning an unprincipled tax.

[314] See Michael J. McIntyre, The International Tax Rules of the United States ch. 5 (1996).

approaches, including formulary apportionment,[315] while not as conceptually pure, are nevertheless available as alternatives. [*103]

C. *Sales Taxation of Services After* Jefferson Lines

1. *Sales Taxation of Services*

The retail sales tax in this country has been confined largely to sales of tangible personal property. Although most states tax some services,[316] and some states tax many services,[317] the inclusion of services in the sales tax base remains the exception rather than the rule. The explanation of the limited scope of the sales tax base lies partly in history and partly politics. It does not lie in the dictates of sound fiscal policy, which, in the eyes of most observers, would justify the extension of sales tax to many services, at least if they represent personal consumption (for example, personal automobile repair, residential landscaping, hairdressing).[318]

Despite the states' historical reluctance to extend the sales tax to services, economic and fiscal pressures are pushing them strongly in that direction. The

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[315] See, e.g., Hellerstein, Internal Consistency, note 49, at 175-76. An apportionment formula, of course, could be manipulated to defeat the goal of apportioning the tax base. Suppose, for example, that Washington were to "apportion" its gross receipts tax on interstate wholesaling activity by adopting a single-factor, destination-based sales formula. That would result in precisely the same receipts attribution as prevails under its existing scheme (as sanctioned by *Standard Pressed Steel*, *General Motors* and *Tyler Pipe*) and yet, superficially would appear to be insulated from constitutional attack by Moorman Mfg. Co. v. Bair, 437 U.S. 267, 280-81 (1978) (sustaining Iowa's single-factor, destination-based sales formula for apportioning net income). See text accompanying notes 282-88 (discussing the Court's analysis in *Standard Pressed Steel*, *General Motors* and *Tyler Pipe*). But if an unapportioned gross receipts tax is unconstitutional because it does not "reflect the location of various interstate activities," Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. 1331, 1341 (1995), a formula that produces the same result under all circumstances as an unapportioned gross receipts tax should be suspect. The reason why a single-factor, destination-based sales formula in a gross receipts tax would be constitutionally suspect but not the same formula used in an income tax, can be illustrated by assuming that the value of the goods manufactured outside Washington is equal to the cost of producing them. Consequently, based on separate accounting, all profit on the sale of the goods is attributable to the wholesaling activities that take place in Washington. A single-factor, destination-based sales formula for apportioning income would be consistent with the result reached under separate accounting by assigning all of the income tax base to Washington. By contrast, the gross receipts attributable to the sale of the goods in Washington partially would reflect the value of the manufactured goods outside of the state. Accordingly, a single-factor, destination-based sales formula for apportioning gross receipts would assign all of the tax base to Washington, even though only part of the gross receipts reflects in-state values. Put differently, a constructive sale of the manufactured goods at the out-of-state plant would produce no taxable income in that state because the sales price would be offset by the cost of the goods. But a constructive sale would produce a positive amount of gross receipts that should be excluded from Washington's gross receipts tax on wholesaling.

[316] See Federation of Tax Administrators, Sales Taxation of Services: An Update 2 tbl. 1 (1994).

[317] See id.

[318] See Hellerstein, Sales Tax, note 154, at 7-8.

significant shift in economic activity toward the service sector has had the effect of eroding the sales tax base relative to total consumption expenditures. Thus from 1960 to 1991, the share of personal consumption expenditures for services (excluding housing) increased from 26% to 42%.[319] During the same period, the share of personal consumption expenditures for tangible goods fell from 60% to 44%.[320]

The states have begun to respond to these pressures. Perhaps the most dramatic response was Florida's 1987 sweeping—but ultimately abortive—extension of its sales tax to a broad range of services, including national advertising, construction and legal services.[321] In 1990, Massachusetts likewise enacted—and quickly repealed—a wholesale extension of its sales tax to services.[322] Notwithstanding these high profile failed attempts at base broadening, states, in fact, gradually have been expanding their state sales tax bases to include services.[323] [*104]

During 1990-1992, for example, 28 states added some business services to the sales tax base, while 27 states added some personal services to the sales tax base.[324] While the movement towards expanding the sales tax to services has been incremental, short- and long-term economic and fiscal pressures make it almost inevitable that the movement will continue to grow. And with that movement will come constitutional controversies like those raised by *Jefferson Lines*.

2. *The Implications of* Jefferson Lines *for Sales Taxation of Services*

In *Jefferson Lines*, the Court conformed the treatment of sales taxation of transportation services to the treatment it had accorded sales taxation of tangible personal property. By characterizing the "taxable event" as "agreement, payment,

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319 See National Conf. of State Legislatures & Nat'l Governors' Ass'n, Financing State Government in the 1990s 34 (Ronald Snell ed., 1993).

320 See id. As Harley T. Duncan, a leading state tax administrator, recently observed, "The inexorable shift in consumer expenditures from the purchase of goods to the purchase of services continues to raise concerns about the long-term vitality of state retail sales taxes which traditionally are applied primarily to the sale of tangible personal property." Federation of Tax Administrators, note 316, at i.

321 Florida's experience is chronicled in Hellerstein, Sales Tax, note 318.

322 See Samuel B. Bruskin & Kathleen K. Parker, State Sales Taxes on Services: Massachusetts as a Case Study, 45 Tax Law. 49, 49-50 (1991).

323 See 2 Hellerstein & Hellerstein, State Taxation, note 63, P 12.05.

324 See Federation of Tax Administrators, note 316, at 3. These included such services as building maintenance services, cleaning services, computer programming services, credit reporting services, data processing services, dating services, detective/protective services, extermination services, information services, interior decorating services, landscaping services, limousine services, motor vehicle repair services, photographic services, tax preparation services, storage services, swimming pool cleaning services and telecommunications services (including cellular, customer calling, 900-number, paging and telephone answering). See id. at 5 tbl. 2.

and delivery of some of the services in the taxing State,"[325] the Court believed that it had eliminated the possibility of multiple sales taxation because "no other State can claim to be the site of the same combination."[326]

According to the analytical framework that we have suggested with respect to *Jefferson Lines*, the first issue that a court should address in determining the constitutionality of an unapportioned tax on interstate services is whether that tax is a sales tax or a gross receipts tax. If it is a sales tax, it is subject to the relaxed regime of *Jefferson Lines*, whereas if it is a gross receipts tax, it should be viewed as constitutionally suspect. If the tax on services is a sales tax, the next issue for the court to address is whether "agreement, payment, and delivery" of the services took place in the taxing state. If so, the tax passes constitutional muster.

Not all sales of interstate services can be confined so easily to a single state as those embodied in the sale of bus ticket. For example, a bank based in North Carolina may agree with a data processing firm in Texas to provide data processing services for the bank's branches all over the country. Assuming the "agreement" is reached in a law office in Atlanta, "payment" is made to the data processing firm's account in New York for services performed in Texas and "delivered" to [*105] the bank's branches across the country, where does the "sale" take place? And what is to prevent Georgia from taxing sales of data processing services based on where the agreement for the sale of such services is consummated, while Texas taxes the sale of services performed in the state, at the same time that New York taxes services where payment for the services is made, and the states where the services are delivered all tax the services based on delivery? Questions like these obviously were not resolved by the Court in *Jefferson Lines*.

We believe that the answer to these questions lies, nevertheless, in the conceptual framework established by *Jefferson Lines*. First, nothing in *Jefferson Lines* or the Commerce Clause speaks to the question of how a state must define a taxable sale of services, provided the transaction has a substantial nexus with the taxing state,[327] and, perhaps, provided it comports with "the common understanding of a sale."[328] Surely performance or delivery of services in a state satisfies the substantial nexus criterion. Moreover, since state statutes taxing sales of services rely both on performance and delivery in defining the situs of the sale,[329] both presumably comport with "the common understanding of a sale." Agreement for the sale of services likewise appears to meet the substantial nexus standard, for states presumably have power to tax the making of contracts in the state. It also would

[325] Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. 1331, 1341 (1995).

[326] Id.

[327] See note 47. For purposes of the ensuing discussion in the text, we assume the existence of such nexus.

[328] *Jefferson Lines*, 115 S. Ct. at 1341.

[329] 2 Hellerstein & Hellerstein, State Taxation, note 63, P 18.05.

seem to meet the "common understanding" requirement.[330] Whether mere payment for the services would constitute a sufficient nexus for imposition of a sales tax is a closer question, and defining the locus of a sale in terms of payment alone might not reflect "the common understanding of a sale."[331] [*106]

The point, however, is that the states enjoy considerable freedom in defining the scope of a taxable sale. Although the Court in *Jefferson Lines* construed the taxable event there at issue as embracing "agreement, payment, and delivery of some of the services in the taxing State,"[332] the Court did not state that this definition was constitutionally mandated. To be sure, the Court relied on its construction of the taxable event in *Jefferson Lines* to demonstrate that the Oklahoma levy raised no specter of multiple sales taxation because "no other State can claim to be the site of the same combination."[333] But the Court also acknowledged that other constitutionally acceptable definitions of a sale could give rise to the possibility of "simultaneous sales taxes."[334] In such cases, *Jefferson Lines* plainly implies that the state must provide, at a minimum, some mechanism for limiting or eliminating the possibility of multiple taxation.

Consequently, when the definition of a taxable sale does not itself effectively confine the imposition of a sales tax to a single jurisdiction,[335] the states must take measures to avoid the risk of multiple taxation. In *Jefferson Lines*, the Court was "reassured to some degree" concerning "threatened multiple taxation" "by the provision of a credit in the disputed tax itself for similar taxes placed upon the

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[330] Indeed, most state sales tax statutes consider the transfer of title to tangible personal property as being a taxable incident. See text accompanying note 62. Because this presumably reflects a "common understanding of a sale," *Jefferson Lines*, 115 S. Ct. at 1341, it reinforces the view that the agreement for the sale of services would be a taxable incident, because the place of transfer of title to tangible personal property, if it differs from the place of transfer of possession, is likely to reflect the place where the agreement of the sale occurs. Assuming that the purchase of a bus ticket constitutes an agreement for the sale of services, it suggests that the question the court left open in *Jefferson Lines*—whether Oklahoma could tax the sale of a ticket for bus services originating outside the state and terminating in Oklahoma or occurring wholly outside the state—should be answered in the affirmative. See note 25.

[331] The question is a very real one. Consider, for example, a state tax imposed on the retail sale of a telephone calling card that allowed the purchaser to make long-distance telephone calls of some specified amount. At the time of sale, it is unclear where the telephone services will be performed. May the state of purchase impose an unapportioned tax on the sale of the ticket? If not, the sales almost certainly will be undertaxed. Must the state at least go through the motion of offering a credit for taxes paid to other states? Similar questions may arise with respect to the taxation of the service charge imposed on companies that sell tickets to sports events, concerts and other entertainment activities.

[332] *Jefferson Lines*, 115 S. Ct. at 1341.

[333] Id.

[334] Id. at 1343.

[335] As the definition did in *Jefferson Lines*, but would not in the hypothetical set forth above.

taxpayer by other States."[336] The provision of a credit for sales taxes paid to other states would be a useful step towards insulating a sales tax on services from constitutional attack on the ground that it exposed a taxpayer to multiple taxation.[337] Accordingly, if Texas, North Carolina, Georgia and New York were each to impose a tax on the sale of data processing services hypothesized above, the taxes are likely to survive constitutional scrutiny if they each provided a credit for sales taxes paid to other states.[338] [*107]

Assuming such a credit were provided, the question would remain as to which state would get to retain the tax and which states would grant the credit. This question should be answered in the context of a normative theory that establishes a hierarchy among the states asserting jurisdiction over the consumption tax base. Neither commentators nor the courts have developed such a theory. Pending the development of a conceptual framework, the states should agree on a generally accepted and easily administrable rule. One rule that would satisfy the easy-to-administer criterion is one that would accord priority to whichever state first received payment for the tax legally due. Such a rule would be analogous to the rule adopted by the Multistate Tax Compact for prioritizing claims to use taxes.[339]

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[336] *Jefferson Lines*, 115 S. Ct. at 1343; see text accompanying note 126.

[337] A similar result would be accomplished by excluding from the sales tax base receipts that had been subjected to sales tax in other states. Such an approach, however, does not assure that sales of services are taxed at the highest rate imposed by all jurisdictions seeking to impose a sales tax on the services. With a credit, by contrast, the services ordinarily are taxed at the highest rate because the crediting state typically allows a credit only up to the amount of the tax actually imposed by the other state.

[338] See In re General Elec. Co., [1991-1992 Transfer Binder N.Y.] St. Tax Rep. (CCH) P 400-311, at 46,215 (N.Y. Tax App. Trib. Mar. 5, 1992). The tribunal struck down New York's sales tax as applied to the receipts from an "integrated waste removal service," which involves the service of picking up and delivering waste. The waste in question was picked up in New York and disposed of in Arkansas. Accordingly, there was a risk that both New York and Arkansas could impose a tax on the same integrated waste removal service. The tribunal declared:

> Our facts are similar to the facts in Goldberg in that an activity is occurring in two states and each state has possible jurisdiction to tax the activity. The crucial difference in our present case is that New York does not provide any type of credit for sales tax paid on an integrated removal service which could be taxed by another jurisdiction. For this reason, our case demands an opposite result than that reached by the Court in *Goldberg*.

Id. at 46,220.

[339] Article V, 1 of the Compact provides: "Each purchaser liable for a use tax on tangible personal property shall be entitled to full credit for the combined amount or amounts of legally imposed sales or use taxes paid by him with respect to the same property to another State." Multistate Tax Compact, in 2 Multistate Corporate Income Tax Guide (CCH) P 8,450 (1985).

IV. *Jefferson Lines* and the Future of Commerce Clause Adjudication in State Tax Cases

The implications of *Jefferson Lines* extend beyond its immediate impact on the Commerce Clause doctrine governing sales and gross receipts taxes delineated above. With the ink barely dry on the opinion, it may be premature to speculate on the place it someday will occupy in the historical development of the Court's Commerce Clause jurisprudence. Nevertheless, we believe that *Jefferson Lines* will influence the Court's future approach to state tax cases in three general—and generally constructive—respects. First, it should change the Court's assumptions about the uniform application of the *Complete Auto* standard to Commerce Clause analysis of state taxation. Second, it should enhance the Court's sensitivity to the underlying purposes of the fair apportionment standard. Third, it should disabuse the Court of the notion that economic equivalence is a talisman of Commerce Clause adjudication of state taxes. We consider each of these effects in turn. [*108]

A. The Complete Auto *Standard After* Jefferson Lines

For the past two decades, *Complete Auto* has exerted virtually a mesmerizing force on the Court's state tax opinions in Commerce Clause cases. The Court repeatedly has paid obeisance to *Complete Auto*'s underlying philosophy of economic realism and judicial pragmatism.[340] The Court likewise has subjected most state tax cases to the strictures of *Complete Auto*'s four-prong test.[341] In so doing, the Court has proceeded on the assumption that *Complete Auto*'s broad approach to Commerce Clause adjudication, as well as its specific analytical framework for implementing that approach, had universal and undifferentiated application to all taxes that came before it.

Jefferson Lines undermines this assumption. In *Jefferson Lines*, the Court indisputably allows considerations of form of a tax (as a sales tax or a gross receipts tax) to triumph over "economic realities." Moreover, in applying *Complete Auto*'s requirement that a tax be "fairly apportioned,"[342] the Court finds that requirement satisfied by a tax that cannot reasonably be so described unless words are to be stripped of their ordinary meaning. This is not to suggest that the Court erred in *Jefferson Lines*. As explained at length above, we believe the Court in *Jefferson Lines* got it right, though not exactly for the reasons it offered in defense of its conclusion. The point is that the Court implicitly has recognized that *Complete Auto*'s philosophy and analytical framework no longer can be regarded as a one-size-fits-all

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[340] See Subsection II.B.1.

[341] See note 13.

[342] Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (quoted in Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. 1331, 1337 (1995)).

solution to every state tax case that comes before it. Rather, the *Complete Auto* adjudicative regime must be modified in appropriate cases, at least with regard to the fair apportionment criterion, to reflect important differences in the nature of the tax under review and the context in which it is being imposed.

B. The Purpose and Function of the Fair Apportionment Requirement

In *Jefferson Lines*, the Court held that the fair apportionment requirement could not be equated in all cases with a requirement that the tax base be divided.[343] Instead, the Court recognized that the fair apportionment requirement, which it characterized more loosely as a requirement of "fair share,"[344] embraces core constitutional values that are not fully captured by an invariable rule requiring that an in- [*109] terstate tax base be divided among the states. The core constitutional values reflected in the "fairly apportioned" prong of *Complete Auto* are that states should avoid the creation of barriers to interstate commerce by making reasonable efforts both to eliminate substantial risks of multiple taxation and to limit their tax bases to values to which they have a legitimate claim.[345] While the Court frequently has characterized the fair apportionment requirement as meaning that a tax base be divided, the Court's focus in *Jefferson Lines* properly shifted to the broader concerns embodied in the fair apportionment requirement.

This shift in the Court's focus is a salutary development for several reasons. First, dividing a tax base among the states is simply one mechanism for avoiding multiple taxation; credits are another. Both mechanisms are used by the states, in the context of different taxes, as a means to an end. In constitutional analysis, that end should be articulated explicitly as a goal, which should have priority over a means of achieving that goal. A focus on the factors underlying the fair apportionment requirement encourages an analysis that is sensitive to differences among tax regimes and discourages the shoehorning of these underlying considerations into narrow concerns over the division of a tax base.

Second, dividing a tax base is not always the best method for avoiding a substantial risk of multiple taxation. For example, "slicing a taxable pie among several States in which the taxpayer's activities contributed to taxable value"[346] may be an appropriate response to fair apportionment concerns when all taxing jurisdictions agree—or are constitutionally compelled to acknowledge—that source rather than residence is the appropriate jurisdictional basis for the exercise of tax power. In fact, however, residence, as well as source, is universally recognized as a proper basis for

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[343] See *Jefferson Lines*, 115 S. Ct. at 1339.

[344] Id. at 1338, 1339.

[345] See Hellerstein, Internal Consistency, note 49, at 163-71, 186. The article restates the internal and external consistency tests, first articulated in Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983), to make explicit the goals such tests are intended to further.

[346] *Jefferson Lines*, 115 S. Ct. at 1339.

the exercise of taxing jurisdiction,[347] although the Constitution sometimes requires the state of residence to yield to the state of source when these two predicates for the exercise of tax power create the risk of multiple taxation.[348]

Consequently, when the Constitution does not confine a jurisdiction's power to tax to source-based levies, a narrow preoccupation with "slicing the pie" as meeting the fair apportionment requirement may miss the point entirely. If a jurisdiction asserts its taxing power on a residence basis, multiple taxation may occur no matter how fair [*110] the state's slice determined on a source basis.[349] In such circumstances, the Court must fashion some solution other than division of the tax base if it is to address the problems of multiple taxation raised by the conflict between residence and source taxation.

Third, focusing on the underlying purposes of the fair apportionment requirement is a reminder that a state can eliminate the risk of multiple taxation, yet, at the same time, tax values to which it has no legitimate claim. For example, a statute that taxed nonresident corporations doing business in the state on all of their income, but that provided a credit for taxes paid to other states, would eliminate multiple taxation yet would overreach territorially by taxing out-of-state values. Such a state statute, we assert, should be held to violate the fair apportionment requirement.

C. The Significance of Economic Equivalence in Commerce Clause Adjudication After Jefferson Lines

In his dissent in *Jefferson Lines*, Justice Breyer accuses the majority of returning to the bad old days before *Complete Auto* when states could avoid effective scrutiny of their taxes under the Commerce Clause by labelling their taxes in the approved fashion. For example, earlier Supreme Court decisions prohibited a state from imposing a tax on the "privilege" of doing business, as applied to the net income of an interstate enterprise, but permitted a state to impose an essentially equivalent levy so long as it was labelled a tax on "net income."[350] *Jefferson Lines*, however, is not a case about formalistic labelling. The taxpayer lost in that case because the tax at issue was genuinely a sales tax, not because Oklahoma had merely attached that label to the tax.

Although Justice Breyer was correct in observing that the taxpayers in *Jefferson Lines* and *Central Greyhound* were subjected to functionally equivalent tax

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[347] See Hellerstein, Intangibles, note 193, at 809-11.

[348] See id. at 803-05.

[349] See Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979).

[350] Compare Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602 (1951), with Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959).

burdens,[351] he was dead wrong in giving controlling weight to that equivalency. For the reasons set forth above,[352] sales taxes and gross receipts taxes are fundamentally different taxes with different policy objectives. The fact that, in some respects, a sales tax is functionally equivalent to a constitutionally suspect gross receipts tax does not mean that the sales tax is itself constitutionally suspect.

The argument made by Justice Breyer on behalf of the taxpayer in *Jefferson Lines*—that an unapportioned sales tax on a bus ticket for an [*111] interstate trip is functionally equivalent to an unapportioned gross receipts tax on the business activity of providing interstate transportation services—also could be made to attack an unapportioned tax on personal income. The following example illustrates this point.

Assume that Oklahoma imposes an individual income tax at the flat rate of 5% on income derived within the state. The tax on nonresidents is collected whenever possible through withholding. *T*, a resident of Kansas, works for Jefferson in its Oklahoma ticket office. She is paid a commission of 20% on all bus tickets that she sells, whether or not the tickets are for travel within or without Oklahoma.

During the taxable year, *T* sells $100,000 of tickets and earns commissions of $20,000. Thus, she becomes liable for an income tax of $1,000 (5% of $20,000). Jefferson refuses to withhold the tax on *T*, claiming that, under the Commerce Clause and *Central Greyhound*, she may be taxed only on commissions relating to ticket sales for travel within Oklahoma. In support of its contention, Jefferson correctly points out that the income tax imposed on *T* is functionally equivalent to an unapportioned gross receipts tax of 1% on gross revenue from ticket sales (1% of $100,000 = $1,000).

It is extremely unlikely that a taxpayer could win this case, even before *Jefferson Lines*. In fact, it is highly unlikely that even Justice Breyer would vote to overturn the tax. No court has ever suggested that a state must apportion a tax imposed on income derived by individuals from the performance of services within a state. The taxpayer in the example above has performed the math correctly but has not made an effective legal argument. Indeed, the functional equivalency of the results obtained under the two taxes should be wholly irrelevant to the constitutional status of the income tax at issue.[353]

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[351] See *Jefferson Lines*, 115 S. Ct. at 1346-49 (Breyer, J., dissenting).

[352] See Subsection II.C.2.

[353] Perhaps we are being somewhat unfair to Justice Breyer in criticizing him for his attacks on the Court as being unduly formalistic. After all, the majority in Jefferson Lines did indicate that certain formalistic differences between sales taxes and gross receipts taxes that have no bearing on the nature of the tax at issue, such as, whether it was imposed on the buyer or the seller, were "crucial" in distinguishing the tax in *Jefferson Lines* from the tax in *Central Greyhound*. See *Jefferson Lines*, 115 S. Ct. at 1341. Justice Breyer can be excused for failing to appreciate the unstated analytical underpinnings of the majority's approach.

There are two conclusions to be drawn from the foregoing example. First, as we already have suggested above, it demonstrates the need for flexibility in applying the fair apportionment criterion to different taxes. Different tests should apply to determine whether personal income taxes and gross receipts taxes satisfy the fair apportionment requirement, just as the Court in *Jefferson Lines* discovered the necessity for applying different tests for determining whether sales taxes and gross receipts taxes are fairly apportioned. [*112]

Second, it suggests that Justice Breyer's functional equivalence argument, despite its surface appeal, is deeply flawed. In order to show the equivalence of two taxing schemes, it is necessary to show that the basic structure of the schemes are similar and that they pursue similar objectives.[354] This is the essential step left out of Justice Breyer's analysis.[355] In short, the Court was clearly justified in rejecting "economic equivalence alone . . . [as] the touchstone of commerce clause jurisprudence."[356] In so doing, it paved the way for a more sensible and practical—if superficially less tidy—Commerce Clause doctrine.

V. Conclusion

Over the past century, the Court's dormant Commerce Clause jurisprudence has been the object of much criticism, from commentators and from members of the Court itself. Occasionally, a commentator will claim to have detected a coherent theme to that jurisprudence.[357] The more typical viewpoint, however, is

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[354] Of course, a tax that the state has characterized as an income tax would be constitutionally suspect if it is, in fact, a disguised gross receipts tax. For example, if a state adopted an "income tax" that applied only to income derived from commission sales of bus tickets, it might be evaluated as a gross receipts tax. Such a tax obviously would not have been designed to tax individuals on the basis of their ability to pay—the hallmark of an individual income tax.

[355] The concept of equivalency is an abstraction. Two taxes will always differ in some respects. For example, the New York tax in Central Greyhound and the Oklahoma tax in *Jefferson Lines* were similar in some respects and dissimilar in others. To conclude that they were equivalent, Justice Breyer focused on their similarities and ignored certain crucial differences. Justice Breyer never posited a conceptual framework that would control the basis for determining equivalency, such as which features of the two taxes should be examined and which should be ignored. The lack of an overriding analytical structure allowed Justice Breyer to parade forth the ways in which the taxes were similar without defending why these were the relevant characteristics to compare, or why he ignored the features that made the levies different. Without a conceptual framework, there is a risk that the determination of equivalency will be arbitrary and that two fundamentally different taxes that should be treated differently nevertheless will be treated the same.

[356] *Jefferson Lines*, 115 S. Ct. at 1344 n.7.

[357] See Donald H. Regan, The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause, 84 Mich. L. Rev. 1091 (1986) (contending that "anti-protectionism" principle explains most dormant Commerce Clause cases but conceding that it does not explain cases requiring a tax to be "fairly apportioned"); Robert A. Sedler, The Negative Commerce Clause as a Restriction on State Regulation and Taxation: An Analysis in Terms of Constitutional Structure,

that the Court has engaged in ad hoc decisionmaking, doing "right" by its own lights without benefit of any grand design. One sign of the lack of controlling principles has [*113] been the instability of that jurisprudence, changing with judicial fashions like New England weather.[358]

Over the past two decades, the Court has brought some stability (both real and apparent) to its adjudication of state tax issues under the dormant Commerce Clause through its consistent reliance on the four-prong test set forth in *Complete Auto*. The heart of *Complete Auto* is that economic reality should prevail over legal form. Yet, in *Jefferson Lines*, Justice Breyer accused the Court in a strong, well-written dissent to have elevated form over substance by allowing the constitutionality of a tax on transportation services to turn on whether that tax is labelled a sales tax or a gross receipts tax. To some, *Jefferson Lines* may be considered a retrenchment from the teachings of *Complete Auto*.

This Article defends the Court's treatment of the Oklahoma sales tax on bus services in *Jefferson Lines*, notwithstanding the Court's reaffirmation of the unconstitutionality of the gross receipts tax on bus services in *Central Greyhound*. Although the Court's opinion clearly fails to offer a convincing rationale for distinguishing those cases, we offer one in this Article.

In our view, the Court should not comminute a general sales tax into a series of levies on the various goods and services that constitute the tax base and then subject each of those levies to the *Complete Auto* tests. Instead, it should evaluate the constitutionality of the tax as an integrated whole. If the overall taxing scheme does not create serious risks of multiple taxation and of overreaching by the state, the tax should be upheld. It seems fairly clear under the facts of *Jefferson Lines* that the tax in question did not present such risks. Consequently, the Court's decision to uphold the tax is an appropriate legal conclusion. Many unapportioned gross receipts taxes, including the tax at issue in *Central Greyhound*, do present serious risks of multiple taxation and overreaching. Accordingly, the Court was right to distinguish the New York unapportioned gross receipts tax in that case from the Oklahoma unapportioned sales tax in *Jefferson Lines*.

Jefferson Lines may turn out to have set an important and proper direction for the Court's dormant Commerce Clause jurisprudence. Of course, if the case turns

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31 Wayne L. Rev. 885 (1985) (arguing that "nondiscrimination principle" is only conceptual justification for dormant Commerce Clause that can withstand structural analysis).

[358] There is a sumptuous variety about New England weather that compels the stranger's admiration—and regret. The weather is always doing something there; . . . always getting up new designs and trying them on the people to see how they will go. . . . In the spring I have counted one hundred and thirty-six different kinds of weather inside of four-and-twenty hours.

Mark Twain, The Weather, Address at the New England Society's Seventy-First Annual Dinner, New York City (Dec. 22, 1876), in the Complete Works of Mark Twain: Mark Twain's Speeches 53 (1923).

out to have been only about bus tickets, it [*114] will be insignificant.[359] And if it turns out to have devitalized *Central Greyhound*, it will be a serious step backwards. But if future state tax cases retain and develop the creative tension between the two cases, *Jefferson Lines* may come to be viewed as a landmark case—a case in which the Court properly subordinated economic analysis to legal analysis and set the basic pattern for a restrained role in regulating state efforts to expand the scope of their consumption taxes to include a tax on the consumption of a wide array of services.

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[359] Indeed, if the case turns out to have been exclusively about bus tickets, it not only will be insignificant, it will be irrelevant. Eight months after the Court's decision in Jefferson Lines, Congress passed legislation effectively overruling the decision. In a little publicized provision of the Interstate Commerce Commission Termination Act, Pub. L. 104-88, 109 Stat. 803 (1995), Congress provided as follows:

> A State or political subdivision thereof may not collect or levy a tax, fee, head charge, or other charge on
>
> (1) a passenger traveling in interstate commerce by motor carrier;
>
> (2) the transportation of a passenger traveling in interstate commerce by motor carrier;
>
> (3) the sale of passenger transportation in interstate commerce by motor carrier; or
>
> (4) the gross receipts derived from such transportation.

This stealth legislation was adopted without public hearings and without any input from the states. There is no significant legislative history. It seems clear, nevertheless, that Congress intended to overturn the particular result in *Jefferson Lines*. The legislation, however, goes much further.

Jefferson Lines involved taxes on consumer purchases of bus tickets. Read literally, the legislation preempts not only retail sales taxes on interstate passenger transportation but also "a tax. . . on. . . the gross receipts derived from such transportation." Under this language, an apportioned gross receipts tax imposed on a company providing interstate passenger transportation—the type of levy the Court implicitly approved in *Central Greyhound*—apparently is barred. Indeed, the literal language of the statute would bar a state from imposing any "tax, fee, head charge, or other charge on. . . a passenger traveling in interstate commerce by motor carrier." Thus, all state income taxes imposed on those who have travelled as passengers in interstate commerce by motor carrier arguably are prohibited. To confine its scope, one might read the legislation as limiting the states from imposing taxes on passengers "with respect to" their travel in interstate commerce by motor carrier. But so read, the legislation might not reach the tax in *Jefferson Lines* itself, because the tax, as interpreted by the Court, was imposed not "with respect to" interstate transportation but rather on the freedom to purchase a ticket.