1-1983

Federalism and state taxation of multistate enterprises

Howard HUNTER
Singapore Management University, howardhunter@smu.edu.sg

Published in Emory Law Journal, 1983 January, Volume 32, Pages 89-133

FEDERALISM AND STATE TAXATION OF MULTISTATE ENTERPRISES

by
Howard O. Hunter*

I. INTRODUCTION

This article began to develop in my mind during the fall of 1981 when I read the Supreme Court's opinion in *Commonwealth Edison Co. v. Montana*,[1] as I was preparing notes for my first year constitutional law class. I was trying to determine how best to present to novices the sometimes dry and often confusing materials on the Commerce Clause, and *Commonwealth Edison*, at first blush, seemed to be a good case to use with *National League of Cities v. Usery*[2] to discuss the scope of permissible federal action under the Commerce Clause and the concomitant limitations on state action also imposed by that clause.

In *National League of Cities* the Court, for the first time in forty years,[3] overruled an act of Congress because it went beyond the powers granted to Congress by the Commerce Clause. This suggested a modest judicial revival of federalism as a governing structural theory, and the case did draw a ragged line attempting to define the outer limits of national regulatory power.[4] The impact of *National League of Cities* was softened by the Court's decision a few years later in *Hodel v. Virginia Surface Mining & Reclamation Association*,[5] which limited its applicability.[6] Even

---

* Professor of Law, Emory University; Visiting Professor of Law, University of Virginia 1982-83; B.A., 1968, J.D., 1971, Yale University. I thank the Emory University School of Law for a grant which supported the research for this article and Granvette Mathews of the Emory Law School Class of 1983 whose work as my research assistant was both speedy and gracious.

[1] 453 U.S. 609 (1981).

[2] 426 U.S. 833 (1976).

[3] The last such decision was in Carter v. Carter Coal Co., 298 U.S. 238 (1936) (provisions of the Bituminous Coal Conservation Act of 1935 imposing an excise tax and controlling wages, hours, and working conditions were beyond the powers of Congress).

[4] Professor Tribe found the *National League of Cities* decision to be a natural development from a series of cases decided during the preceding several years that had consistently expressed solicitude for local and state autonomy. L. TRIBE, AMERICAN CONSTITUTIONAL LAW § 5-22, at 309 (1978).

[5] 452 U.S. 264 (1981).

so, the Court had attempted to draw some line and to reaffirm the notion of a union of sovereigns in which the national government is *primus inter pares*, but in which the national powers cannot be employed in disregard of individual state sovereignty.

The *Commonwealth Edison* case presented the Court with the opportunity to review the limitations of the Commerce Clause in a somewhat trickier context. The case involved a Montana severance tax on coal mined in that state. The tax was alleged to have imposed an unreasonable burden on interstate commerce because virtually all the coal mined in Montana was shipped to other states. Congress had not acted directly in the area, and so the Court was faced with an archetypical dormant Commerce Clause issue. Did Montana's tax so interfere with the free flow of commerce that it intruded into an area of exclusive federal concern by impeding the ability of Congress to respond to matters within its plenary powers? This issue has plagued the Court in one form or another for more than a century and a quarter,[7] and the Court has never developed a clearly articulated policy for the resolution of the problem.[8] The Montana tax was upheld, and the *Commonwealth Edison* opinion seemed to suggest that the Court might finally be reaching a consensus about the limits of state taxation powers.

As I was preparing my class notes, I decided that *National League of Cities* and *Commonwealth Edison*, despite serious problems with the opinions in both cases, would serve reasonably well as guides to an understanding of the relationship between Commerce Clause concerns and federalism concerns. This article was intended to be a short commentary on what looked like a mi-

---

[6] In *National League of Cities* the Court invalidated the 1974 minimum wage and maximum hour amendments to the Fair Labor Standards Act, 29 U.S.C. § 203(d), (s)(5), (x) (Supp. IV 1974), as applied to state and municipal employees. 426 U.S. at 852. The Court said that by regulating states as employers the law regulated states as states in violation of the Tenth Amendment. *Id.* at 845. *Hodel* involved a challenge to the Surface Mining Control and Reclamation Act of 1977, 30 U.S.C. §§ 1201-1328 (Supp. III 1979), which was said to interfere with the ability of states to engage in zoning and land use planning, thus interfering with states' rights to control the basic property laws of their respective jurisdictions. 452 U.S. at 275-76.

[7] *See* Cooley v. Board of Wardens, 53 U.S. (12 How.) 299 (1851).

[8] There have been scholarly attempts to fill the void. *See, e.g.*, Tushnet, *Rethinking the Dormant Commerce Clause*, 1979 WIS. L. REV. 125.

nor trend toward a somewhat less expansive reading of the Commerce Clause with a few lurches in one direction or the other. But then the Court intervened, as it sometimes does, and decided two cases at the end of the 1982 term[9] that threw this neat little comment into disarray. Instead of a series of cases leading awkwardly toward some more comprehensible theory of dormant Commerce Clause jurisprudence and perhaps toward greater recognition of state roles in the federal system, the members of the Court revealed themselves to be as uncertain as ever about the proper role of federalism values in Commerce Clause cases.

Although *National League of Cities* forms a necessary backdrop to an understanding of what the Court seems to be doing in recent Commerce Clause cases, the focus of this article is on questions raised by state actions taken in the absence of congressional action. More narrowly, the main subject of discussion revolves around state taxation. There are a host of dormant Commerce Clause and federalism questions raised by various state regulatory statutes, but tax laws sharpen the perspective because they most particularly involve the exercise of sovereignty by a state. Generally, in taxation cases the Court is not faced with the fundamental question of whether a state has a power to act at all. In fact, in an opinion rendered during the 1982 term[10] the Court expressly held that the power to tax is an inherent attribute of sovereignty. Thus, state taxation cases provide an excellent opportunity to examine the relative weights that are given to the values of state sovereignty and national consistency, and can, if one is able to muddle through them, provide some clues to the Court's position on basic federalism questions.

In cases involving state regulation of interstate activities through means other than taxation, the Court has been less solicitous of state sovereignty as a fundamental value.[11] Whether this is because

---

[9] Asarco Inc. v. Idaho State Tax Comm'n, 102 S. Ct. 3103 (1982); F.W. Woolworth Co. v. Taxation & Revenue Dep't, 102 S. Ct. 3128 (1982).

[10] Merrion v. Jicarilla Apache Tribe, 455 U.S. 130 (1982). For a discussion of *Jicarilla* see *infra* notes 85-107 and accompanying text.

[11] *See, e.g.*, Kassel v. Consolidated Freightways Corp., 450 U.S. 662 (1981); Lewis v. B.T. Inv. Managers, 447 U.S. 27 (1980); Hughes v. Oklahoma, 441 U.S. 322 (1979); City of Philadelphia v. New Jersey, 437 U.S. 617 (1978); Raymond Motor Transp. v. Rice, 434 U.S.

taxation more clearly involves an exercise of inherent sovereignty

---

429 (1978); Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333 (1977). By contrast, Professor Eule in a recent, thoughtful article on the dormant Commerce Clause found it to be useful to avoid, for the most part, state taxation cases. Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L.J. 425, 479 (1982).

The trucking cases are illustrative of the lengths to which the Supreme Court has gone in reviewing state regulatory schemes. Twenty-three years ago the Court invalidated an Illinois statute which required the use of contoured mudguards, as opposed to straight ones, on large trucks. Illinois said that the regulation was justified by safety considerations. The Court, after reviewing the facts, determined that the increase in safety was minimal in contrast to the additional costs imposed on interstate transportation. Bibb v. Navajo Freight Lines, 359 U.S. 520 (1959). In *Bibb* the Court not only undertook an extensive factual review of the controversy, it also judged Illinois by the actions of *other* states. Illinois was the only state to have required contoured mudguards; therefore, the Court concluded that Illinois had to bear a substantially greater burden of proof. 359 U.S. at 528-30. This, of course, left open the possibility that the standard would become that of the lowest common denominator.

In the *Raymond Motor Transportation* case, the Court struck down a Wisconsin statute barring trucks longer than fifty-five feet from its highways. This, in effect, prohibited the use of double-rig trailers which are popular in the West and Midwest. The Wisconsin scheme was replete with exceptions and in several instances clearly favored intrastate operators. Although the Court engaged in another review of safety factors, the facially discriminatory features of the statute were what spelled its doom, a point particularly noted by the four who joined a concurring opinion. 434 U.S. at 450 (Blackmun, J., concurring, joined by the Chief Justice and Justices Brennan and Rehnquist).

In *Kassel*, decided the same year as *Commonwealth Edison*, the Court struck down an Iowa law prohibiting double-rig trailers. The Iowa law did not suffer from the defects of facial discrimination, although there was some concern about latent protectionism. The Court again engaged in a lengthy factual analysis and noted, as in *Bibb*, that Iowa was out of line with other midwestern states. (It was in line, however, with seventeen southern and eastern states.) In dissent, Justice Rehnquist noted:

> Whenever a State enacts more stringent safety measures than its neighbors, in an area which affects commerce, the safety law will have the incidental effect of deflecting interstate commerce to the neighboring States. Indeed, the safety and protectionist motives cannot be separated: The whole purpose of safety regulation of vehicles is to *protect* the State from unsafe vehicles. If a neighboring State chooses *not* to protect its citizens from the danger discerned by the enacting State, that is its business, but the enacting State should not be penalized when the vehicles it considers unsafe travel through the neighboring state.

450 U.S. at 705-06 (Rehnquist, J., dissenting).

Although the result in *Kassel* might well have been predicted from the analysis employed in *Bibb*, the uncertainty that surrounds trucking regulation cases by reason of the Court's extensive factual reviews has prompted Professor Gunther to ask, "In light of Bibb, Raymond, and, now, Kassel, what *is* the modern standard of review of state highway regulations challenged under the commerce clause?" G. GUNTHER, CASES AND MATERIALS ON CONSTITUTIONAL LAW 19 (Supp. 1981). What is clear is that the rhetoric about deference to state legislative decisionmaking often seems to be just that, while the Court engages in its own attempts to insure the existence of a free trade market among the states. In reality, deci-

or because the Court is not certain of its own underlying theories is difficult to determine. The Court's own tendency to separate these broad categories makes for a natural division in an article such as this. The question whether such a separation is justified would be a good topic for another study.

This article briefly reviews the history of Commerce Clause challenges to state tax laws in Section II, and then in Sections III and IV examines *Commonwealth Edison* and *Merrion v. Jicarilla Apache Tribe*[12] in some detail. Both are severance tax cases in which the tax was upheld because the Court recognized the need to protect state sovereignty in *Commonwealth Edison* and tribal sovereignty in *Jicarilla Apache Tribe*. Section V examines the competing interests at play in such cases and concludes that on balance, the arguments in favor of the local tax are stronger and more consistent with the structure of federalism. Section VI looks at two 1982 state income tax cases[13] that substitute a due process analysis for one based on the Commerce Clause. The Court's choice of analysis raises questions regarding congressional power to act in the future that would not have been raised if the income tax cases had been subjected to Commerce Clause analysis.

Finally, Section VII concludes that the structural organization of the federal system is an important value that the Court has inadequately expressed.[14] The structure of governmental organization contemplates a compromise between a supreme national government of strictly limited powers and states with considerable sovereignty. Federalism is still a key to the American system in that it provides a framework of competition, a mechanism for experimentation, and a means for the recognition of social and cultural group

---

sions such as *Kassel, Raymond,* and *Bibb* have the effect of protecting the interstate trucking industry while doing little to further a clearer understanding of the proper balance among governments. *Cf.* Choper, *The Scope of National Power Vis-a-Vis the States: The Dispensability of Judicial Review,* 86 YALE L.J. 1552, 1587 n.194 (1977).

[12] 102 S. Ct. 894 (1982).

[13] Asarco Inc. v. Idaho State Tax Comm'n, 102 S. Ct. 3103 (1982); F.W. Woolworth Co. v. Taxation & Revenue Dep't, 102 S. Ct. 3128 (1982).

[14] The identification of structure as important is far from novel. For instance, I find myself in agreement with much of what Professor Nagel wrote in a recent article about *National League of Cities.* See, Nagel, *Federalism as a Fundamental Value: National League of Cities in Perspective,* 1981 SUP. CT. REV. 81.

differences. In recent years, there have been cases in which the Court has been groping toward an understanding of the dormant Commerce Clause that would give substantial support to the values of federalism by allowing maximum state action subject to control by the political branches of the national government. The two 1982 tax apportionment cases, however, exemplify the continuing vitality of the individual rights paradigm in constitutional adjudication. The Court's readiness to pursue an individual rights argument in cases that could lend themselves to structural analysis suggests that the idea of structure as a value is far from an accepted commonplace.

II. State Taxation and Interstate Commerce—A Brief Background

Despite the absence of explicit structural separations in the Constitution between state and federal taxing powers, the national and state governments have worked out an informal but rather well-ordered separation in their methods of taxation.[15] The federal government relies heavily on forms of income taxation.[16] States and their political subdivisions tend to rely heavily on ad valorem taxes, sales taxes, and use taxes. Of course there are many overlapping areas of taxation, and a change in national law may sometimes have profound ramifications for state tax policy,[17] but there has developed a remarkable degree of mutual respect for each sovereign's principal sources of revenue.

Nonetheless, a tax imposed by a state or local government on an item or service that crosses state lines raises a prima facie issue of state interference in a province of exclusive federal concern. Most Commerce Clause challenges to state taxes have relied upon the dormant Commerce Clause. When Congress has the power to act

---

[15] *See generally* Dam, *The American Fiscal Constitution*, 44 U. Chi. L. Rev. 271 (1977).

[16] Excise taxes, estate taxes, gift taxes, and miscellaneous other imposts and duties, although not insubstantial, total only a fraction of the sums raised through personal and corporate taxes on income.

[17] Some states follow the federal pattern of deductions, credits, and the like to simplify their forms and their auditing procedures. Everytime there is a federal change, however, the state has to change or face problems in its taxing mechanism.

but has not acted, does the state tax trespass upon an exclusively federal matter, or is it an exercise of concurrent sovereignty? If the latter, does the exercise of concurrent sovereignty effectively preclude or unduly interfere with the potential exercise of congressional power? The difficulties of analysis relevant to these questions are evident in a review of the many cases in which judges have attempted to formulate responses. Justice Frankfurter stated the judicial frustrations well in a 1946 opinion:

> The history of this problem is spread over hundreds of volumes of our Reports. To attempt to harmonize all that has been said in the past would neither clarify what has gone before nor guide the future. Suffice it to say that especially in this field opinions must be read in the setting of the particular cases and as the product of preoccupation with their special facts.[18]

In an apparent attempt to slice through complexity and to substitute a simple, straightforward test, courts adopted and long followed what came to be known as the "Formal Rule."[19] The thrust of the Formal Rule was that a state may not impose a tax on any activity or process viewed by the Court as a part of interstate commerce. Courts still had to determine what constituted interstate commerce, but as the Commerce Clause was read to justify more and more exercises of congressional regulatory power,[20] the activities that could be said to be a part of interstate commerce tended to grow in number. The Court applied the Formal Rule to state taxation statutes whether or not there were any discriminatory effects of the tax at issue.[21] The application of the Formal Rule had

---

[18] Freeman v. Hewit, 329 U.S. 249, 252 (1946). *See also* Dam, *supra* note 15, at 285.

[19] Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951); Freeman v. Hewit, 329 U.S. 249 (1946). The *Spector* test was labeled the "Formal Rule" by Professor William B. Lockhart. Lockhart, *A Revolution in State Taxation of Commerce*? 65 MINN. L. REV. 1025, 1026 (1981) [hereinafter cited as *A Revolution*]. *See also* Lockhart, *The Sales Tax in Interstate Commerce*, 52 HARV. L. REV. 617 (1939) [hereinafter cited as *The Sales Tax*].

[20] *See, e.g.*, Perez v. United States, 402 U.S. 146 (1971); Katzenbach v. McClung, 379 U.S. 294 (1964); Wickard v. Filburn, 317 U.S. 111 (1942).

[21] *See, e.g.*, Colonial Pipeline Co. v. Traigle, 421 U.S. 100, 101 (1974) (there was no claim that the tax was discriminatory); Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602, 607 (1951) (the tax in question did not discriminate between interstate and intrastate commerce); Freeman v. Hewitt, 329 U.S. 249, 254, 256-57 (1946) (any showing of discrimina-

certain advantages of simplicity and predictability, but it also created anomalies that could not withstand serious policy debate. Multistate companies were able to avoid tax liabilities in many states in which they did business even if their activities within a state were functionally no different from those of an intrastate business that was subject to the tax. On the other hand, a state tax statute that focused on a "local" object, such as tangible property, or one that was artfully drawn to appear to be functionally "local" would often be upheld even though the burden on commerce, measured by the cost of the tax to the enterprise, might have been even greater than the burden resulting from a tax "on" interstate commerce.[22]

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.[23] This is best exemplified by *Complete Auto Transit, Inc. v. Brady*,[24] in which the Supreme Court unanimously sustained the validity of a Mississippi tax on the privilege of doing business in the state. In so doing, the Court expressly overruled *Spector Motor Service v. O'Connor*,[25] in which the Court had used the Formal Rule to find such a privilege tax to be per se unconsti-

---

tion against interstate commerce was unnecessary to the decision). In comparison, where the tax actually discriminates against enterprises engaged in interstate commerce, the Court will invalidate the tax on the ground that it discriminates in violation of the Commerce Clause. *See, e.g.*, Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977); Evco v. Jones, 409 U.S. 91 (1972); Norfolk & W. Ry. Co. v. Missouri State Tax Comm'n, 390 U.S. 317 (1968); McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944); Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940); J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938). The invalidation is consistent both with the goal of avoiding economic Balkanization and with the application of the Equal Protection Clause of the Fourteenth Amendment.

[22] *A Revolution, supra* note 19, at 1033. According to Lockhart:

> The Court never explained why a tax "on" interstate commerce threatened commerce any more than a tax in the same amount, measured the same way, imposed on a taxable subject. Nor did it attempt to explain why the same pragmatic standards and other considerations used by the court to protect interstate commerce from unfair burdens of taxes not subject to the Formal Rule could not also suffice to protect against unfair burdens from taxes "on" interstate commerce itself.

Id.

[23] The more recent formulations suggest a greater scrutiny of underlying facts. Whether they will in fact apply more to substance than to form remains to be seen. *See infra* notes 53-84 and accompanying text.

[24] 430 U.S. 274 (1977).

[25] 340 U.S. 602 (1951).

tutional. In *Complete Auto* the Court said that a state tax should be subjected to four tests: (1) Does the taxpayer's business activity have a significant nexus with the state? (2) Does the tax discriminate against interstate commerce? (3) Is the tax fairly apportioned? (4) Is the tax unrelated to services provided by the state?[26]

The *Complete Auto* decision has met with generally favorable comment from scholars,[27] although there may be doubts about the ability of judges to undertake some of the complex inquiries that seem to be compelled by the decision.[28] On the whole a test that is based in functional reality seems to present a more balanced approach to the problem than one that is based simply on a rule that amounts to little more than a truism. Unfortunately, it is not altogether clear that the Supreme Court will apply the *Complete Auto* test any less mechanically than it applied the Formal Rule.[29]

The question of state taxation versus free interstate commerce does present one of the continuing problems of American structural constitutional law. On the one hand, there is a strong national interest in the free flow of trade regardless of state boundaries. There may be disagreement about the extent to which the Framers were interested in the creation of a free national market,[30] but clearly the Framers were concerned about the possibility of having too many different sovereigns regulating commerce. This is reflected in the specific constitutional prohibition of state imposts and duties on foreign trade,[31] in the language of the Commerce Clause,[32] and in limitations on the federal power to raise trade barriers among the states.[33] At the same time, however, the Constitution expressly contemplates a national government of limited pow-

---

[26] 430 U.S. at 279. *Complete Auto* was reaffirmed the following year in Department of Revenue v. Association of Washington Stevedoring Cos., 435 U.S. 734 (1978), in which the Court upheld another privilege tax.

[27] *See, e.g.*, L. TRIBE, *supra* note 4, § 6-14, at 345; *A Revolution, supra* note 19, at 1043-44; Schwartz, *Commerce, the States, and the Burger Court*, 74 NW. U.L. REV. 409, 431, 438 (1979).

[28] *See infra* notes 69-77 and accompanying text.

[29] *See infra* notes 47-55 and accompanying text.

[30] *See* Eule, *supra* note 11, at 429-35.

[31] U.S. CONST. art. I, § 10.

[32] *Id.* at § 8.

[33] *Id.* at § 9.

ers in respect of the states as well as in respect of individuals, and the concept of a free market among the states is one implied from the negative restraints of the document rather than from an express statement.[34] The relationship among fifty states, each possessed of substantial sovereignty, and one central sovereign with ultimate supremacy in the event of a conflict, is one of continuing tension at a structural level, which, if properly managed, can help to sustain the integrity of all the participants. Tax statutes provide an intriguing field of inquiry because they can raise direct conflicts between locally made political decisions and national economic concerns in a context that involves express exercises of sovereignty. Surely the intent of the Commerce Clause is to prevent each separate state from taxing an enterprise so that its cumulative tax burden becomes confiscatory.[35] Surely the Commerce Clause also prevents the wholesale exportation of tax liabilities to the benefit of in-state residents.[36] But the Commerce Clause cannot be used as a cloak to shield enterprises from sharing in the costs of maintaining a civilized society.[37]

For the time being, courts must handle such issues under the rubric of the dormant Commerce Clause. Congress may well have the power to regulate taxation affecting interstate commerce.[38] It

---

[34] *See, e.g.*, H.P. Hood & Sons v. DuMond, 336 U.S. 525 (1949); Baldwin v. Seelig, 294 U.S. 511 (1935); Cooley v. Board of Wardens, 53 U.S. (12 How.) 299 (1851).

[35] This problem has been addressed in part by federal legislation, 15 U.S.C. §§ 381-384 (1976), and by the Multistate Tax Compact which was found to be constitutional in U.S. Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452 (1978) (the purposes of the Multistate Tax Compact were: "(1) facilitating proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes; (2) promoting uniformity and compatibility in state tax systems; (3) facilitating taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; and (4) avoiding duplicative taxation." 434 U.S. at 456.).

[36] *See, e.g.*, Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977) (a New York transfer tax statute taxed securities transactions involving an out-of-state sale more heavily than most transactions involving a sale within the state).

[37] *Cf.* Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 522 (1937) (an Alabama tax on employers to provide unemployment benefits for workers was upheld as a means of distributing the burden of the cost of government).

[38] Hellerstein, *State Taxation Under the Commerce Clause: An Historical Perspective*, 29 VAND. L. REV. 335 (1976) [hereinafter cited as *Historical Perspective*]. *See also* P. HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 275-85 (1953); Hellerstein, *State Income Taxation of Multijurisdictional Corporations: Reflections on* Mobil, Exxon, *and H.R. 5076*,

has acted in a small way to regulate multistate taxation,[39] and it has considered further action in the area.[40] Unless Congress does more, courts will have to rely on the restraining power of the dormant Commerce Clause to determine the permissible extent of state taxation. A federal court must decide whether a particular state tax effectively undermines the national economic unit. The judicial role is to be protective of the structural integrity[41] of the federal system by defining the limits of state sovereignty insofar as the production of revenue through taxes is concerned.

III. THE *Commonwealth Edison* Case

Questions of national interests, state sovereignty, and the role of the courts in reconciling conflicts between them were all involved in the 1981 case of *Commonwealth Edison Co. v. Montana*,[42] in which the Court upheld a Montana coal severance tax against arguments that the tax imposed an unfair burden on interstate commerce. The factual background is starkly simple. Crude oil and natural gas prices have greatly increased in the past decade. Middle eastern supply lines are subject to constant political tension and overall world supplies are being rapidly consumed. Among alternative energy sources, nuclear power is often even more expensive in the short term, hydroelectric power is available in limited areas, and solar power is not yet technologically feasible. Coal is one alternative to other fossil fuels that is readily usable in many

---

79 MICH. L. REV. 113 (1980) [hereinafter cited as *Reflections*].

[39] *See* 15 U.S.C. §§ 381-384 (1976).

[40] *See Reflections*, *supra* note 38. *See, e.g., Coal Severance Taxes: Hearings on H.R. 6625, H.R. 6654, and H.R. 7163 Before the Subcomm. on Energy and Power of the House Comm. on Interstate and Foreign Commerce*, 96th Cong., 2d Sess. (1980); *Hearings on Proposals Regarding State Taxation of Interstate Commerce Before the Subcomm. on State Taxation of Interstate Commerce of the Senate Comm. on Finance*, 93rd Cong., 1st Sess. (1973).

[41] On the importance of structure, see Nagel, *supra* note 14. The refusal or inability of Congress to act comprehensively in this area has, however, left an opening into which the Court has moved. *See* Hellerstein, *State Taxation of Interstate Business and the Supreme Court, 1974 Term:* Standard Pressed Steel *and* Colonial Pipeline, 62 VA. L. REV. 149 (1976). Whether the Court *should* have so readily responded to state taxation questions is another matter. *See generally* Fletcher, *The Discretionary Constitution: Institutional Remedies and Judicial Legitimacy*, 91 YALE L.J. 635 (1982).

[42] 453 U.S. 609 (1981).

existing industrial operations, and that is available in enormous quantities within the continental United States. Bituminous coal with a low sulphur content is especially prized because its use creates fewer air pollution problems than other coals. If it can be extracted by strip mining, so much the better, because the costs in human life and health, as well as in dollars, are substantially less than those incurred in deep mining. Montana and other western states, all of which are sparsely populated, have vast reserves of low sulphur bituminous coal ready to be extracted by strip mining techniques for shipment to the population and industrial centers of the United States to ease the artificial pressures imposed by OPEC and all the other uncertainties surrounding the oil market.[43] A central planner might view the coal fields of the West as the answer to the national demand for cheap and secure energy.

Against this background, the Montana legislature imposed a substantial severance tax on all coal extracted from Montana lands.[44] This obviously increased the costs of doing business, costs which eventually were passed on to consumers of Montana coal before it left Montana at a rate based on volume or on contract value. The Montana tax was not significantly different from a typical ad valorem property tax. Severance taxes had even been sus-

---

[43] *See generally* R. NEHRING, B. ZYCHER, & J. WHARTON, COAL DEVELOPMENT AND GOVERNMENT REGULATION IN THE NORTHERN GREAT PLAINS: A PRELIMINARY REPORT (1976); Note, *The Increasing Conflict Between State Coal Severance Taxation and Federal Energy Policy*, 57 TEX. L. REV. 675 (1979).

[44] MONT. CODE ANN. § 15-35-103 (1977) provides:

(1) A severance tax is imposed on each ton of coal produced in the state in accordance with the following schedule:

Heating quality (Btu per pound of coal):	Surface Mining	Underground Mining
Under 7,000	12 cents or 20% of value	5 cents or 3% of value
7,000-8,000	22 cents or 30% of value	8 cents or 4% of value
8,000-9,000	34 cents or 30% of value	10 cents or 4% of value
Over 9,000	40 cents or 30% of value	12 cents or 4% of value

"Value" means the contract sales price.

(2) The formula which yields the greater amount of tax in a particular case shall be used at each point on this schedule.

(3) A person is not liable for any severance tax upon 20,000 tons of the coal he produces in a calendar year.

tained during the lifetime of the Formal Rule.[45] When the tax was challenged, the Montana Supreme Court upheld it as a matter of law without requiring that any evidence be taken, reasoning, in part, that the severance tax attached to a wholly intrastate activity—the removal of coal from the ground—and thus did not implicate the Commerce Clause at all.[46] Approximately ninety percent of the coal mined in Montana and subjected to the severance tax was destined for out-of-state users. The challengers argued that the tax was, in practical effect, a tax on interstate commerce. The tax burden, although applied equally to coal bound for intrastate as well as extrastate use, was almost entirely exported. Purchasers of electricity in New York were paying the taxes that went into the Montana treasury.

The Supreme Court applied the four part *Complete Auto* test,[47] and in an opinion by Justice Marshall,[48] found that the tax did not unduly burden interstate commerce. The first two parts of the *Complete Auto* test were easily satisfied. The nexus of the tax was wholly within Montana,[49] and because it was a one-time tax it did not give rise to any problem of multiple, vexatious taxation.[50] The third question—whether the tax was discriminatory—was also quickly handled. The rate of taxation was based on the amount of coal actually removed from the ground and did not vary with the eventual destination of the coal.[51] Even though the entire lawsuit was based on the fact that the coal was bound for other places, the Court dismissed the point as an "adventitious" consideration.[52]

The fourth part of the *Complete Auto* test received somewhat

---

[45] Hope Natural Gas Co. v. Hall, 274 U.S. 284 (1927); Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923); Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922). The Court reasoned in all these cases that the severance tax was a purely intrastate action.

[46] Commonwealth Edison Co. v. Montana, ___ Mont. ___, 615 P.2d 847, 854 (1980), *aff'd*, 453 U.S. 609 (1981).

[47] 453 U.S. at 617-29.

[48] The majority was comprised of Justice Marshall, the Chief Justice, and Justices Brennan, Stewart, White, and Rehnquist. Justice White filed a separate concurrence. *Id.* at 637. Justice Blackmun, joined by Justices Powell and Stevens, dissented. *Id.* at 638.

[49] *Id.* at 617.

[50] *Id.*

[51] *Id.* at 618.

[52] *Id.*

greater attention. A tax must be "fairly" related to the services provided by the state."[53] The challengers argued that they should be allowed to attempt to prove that the amount of the tax collected was not fairly related to any costs incurred by the state as a result of coal mining. They did not object to the power of Montana to enact some form of severance tax; they simply argued that the *rate* of taxation should be examined in the context of the public costs associated with the mining activities and that this determination could not be made on a motion to dismiss without the creation of a factual record.[54] The Court explicitly rejected this argument. In the Court's language: "This assertion reveals that appellants labor under a misconception about a court's role in cases such as this. The simple fact is that the appropriate level or rate of taxation is essentially a matter for legislative, and not judicial, resolution."[55] This does little more than reduce the fourth part of the *Complete Auto* test to a truism. Practically every enterprise involves some costs to the state in which it operates. The Court seems to be saying that so long as a tax based on the intrastate activities is not confiscatory or discriminatory, it satisfies the "fairly related" test. It is probably true that courts are ill equipped to make the kinds of inquiries that would be required by the close analysis suggested by the applicants in *Commonwealth Edison.* There also may be good arguments that the use of a factual test would involve inappropriate intrusions into the legislative process. Nevertheless, the only conclusion that can be drawn from the case is that virtually any tax can be made to satisfy the "fairly related" test of *Complete Auto.*

Perhaps the most interesting argument advanced by the appellants was that the Montana tax interfered with national energy policies as defined by a variety of federal statutes.[56] The argument puts in bold form the classic conflict of federalism. What is a matter of such national commercial concern that even with due respect

---

[53] 430 U.S. at 279.

[54] 453 U.S. at 620-21.

[55] *Id.* at 627 (footnotes omitted).

[56] *Id.* at 633. Among the laws cited were the Energy Policy and Conservation Act of 1975, 42 U.S.C. §§ 6201-6422 (1976) and the Powerplant and Industrial Fuel Use Act of 1978, 42 U.S.C. §§ 8301-8483 (Supp. III 1979).

for the sovereignty of the various states, state action has to be stricken? In response to the economic disarray that characterized trading relationships among the several states during the time of the Articles of Confederation,[57] Alexander Hamilton wrote that a national power to regulate commerce was one of the essential requisites of a new federal constitution.[58] That being so, and sources of energy being critical to the success of the American industrial enterprise, it is not unreasonable to suggest that local taxes that burden energy production have an effect on the national concern with interstate commerce that may implicate federal policies. Furthermore, the appellants were not forced to rely solely on the negative implications of the dormant Commerce Clause. Congress, before acting, had debated national energy policies at great length.

On the other hand, Montana could—and did—argue with considerable historical justification that any attempt to preempt an exercise of its taxing power (an essential ingredient of sovereignty) must be scrutinized carefully. With the exception of "imposts or duties on imports or exports,"[59] states share a "concurrent and coequal authority" with each other and with the federal government to lay taxes for the production of revenue.[60] In the interpretation of powers that are concurrently exercised, the judicial branch traditionally has been careful to interpret statutes to be consistent with one another.[61] In this instance, the Court tipped the balance in favor of federalism and against a consistent national energy policy that would have limited individual state authority.

Proving once again that reasonable, rational, intelligent, educated men can reach utterly different conclusions from a review of the same evidence, Justice Blackmun wrote a sharp dissent in which Justices Powell and Stevens joined.[62] The split among the Justices can be viewed, in part, as a disagreement about procedure.

---

[57] *See, e.g.*, Fiske, *The Critical Period of American History, 1783-1789*, in THE GOLDEN AGE OF AMERICAN HISTORY 245 (F. Friedel ed. 1959).

[58] THE FEDERALIST No. 22 (A. Hamilton).

[59] U.S. CONST. art. I, § 10.

[60] THE FEDERALIST No. 31 (A. Hamilton).

[61] *See generally* Chicago & North Western Transp. Co. v. Kalo Brick & Tile Co., 450 U.S. 311 (1981); Note, *A Framework for Preemption Analysis*, 88 YALE L.J. 363 (1978).

[62] 453 U.S. at 638 (Blackmun, J., dissenting).

The trial court had sustained the validity of the tax without receiving any evidence.[63] This result subsequently was affirmed by the Montana and United States Supreme Courts. The dissenters thought at the very least that the complainants raised issues of sufficient complexity to require more careful scrutiny.[64]

This apparent procedural disagreement could not mask the basic disagreement about the interpretation and application of the fourth part[65] of the *Complete Auto* test, because the question whether evidence had to be taken went to the heart of the meaning of the test. In the words of Justice Blackmun:

> The Court's conclusion . . . rests on the premise that the relevant inquiry under the fourth prong of the *Complete Auto Transit* test is simply whether the *measure* of the tax is fixed as a percentage of the value of the coal taken. . . . This interpretation emasculates the fourth prong. No trial will ever be necessary on the issue of fair relationship so long as a State is careful to impose a proportional rather than a flat tax rate; thus, the Court's rule is no less "mechanical" than the approach entertained in *Heisler v. Thomas Colliery Co.*, 260 U.S. 245 (1922), disapproved today . . . . Under the Court's reasoning, any ad valorem tax will satisfy the fourth prong; indeed, the Court implicitly ratifies Montana's contention that it is free to tax this coal at 100% or even 1,000% of value, should it choose to do so. . . . Likewise, the Court's analysis indicates that Montana's severance tax would not run afoul of the Commerce Clause even if it raised sufficient revenue to allow Montana to eliminate all other taxes upon its citizens.[66]

The dissenters were concerned about state "tailoring" of taxes to

---

[63] The figures relied on in the various opinions were included in pleadings and briefs. They are not data which were subjected to standard requirements of evidence nor to cross-examination.

[64] 453 U.S. at 638 (Blackmun, J. dissenting). The dissenters also seemed to be impressed by the increase in the proportion of total state revenues derived from the severance tax from 0.4% in 1972 to about 20% in 1979 with the result that Montana had been able to reduce local property and income taxes. *Id.* at 642.

[65] The dissenters agreed that the first three parts of the test had been satisfied. *Id.* at 644-54.

[66] *Id.* at 645-46 (footnotes omitted).

export costs.[67] In short, they suggested that when a prima facie case of tax exportation is set forth, close scrutiny is necessary under *Complete Auto* to determine whether, indeed, there is some real relationship between the costs attributable to the taxed enterprise and the taxation imposed upon it.[68] Any such inquiry would require a reasonably complex analysis of economic conditions, but Justice Blackmun did not consider such an inquiry to be beyond the level of competence of judges.[69] While it may not be necessary to go so far as to adopt entirely the rather mechanistic application of the test advanced by the majority, there are significant questions raised by Justice Blackmun's suggestion that,

> if the tax singles out this particular interstate activity and charges it with a grossly disproportionate share of the general costs of government, the court must determine whether there is some reasonable basis for the legislative judgment that the tax is necessary to compensate the State for the particular costs imposed by the activity.[70]

This necessarily would involve courts in what could turn out to be extraordinarily complex and extensive hearings on matters that involve delicate policy decisions and value judgments. Such inquiries might also open up the possibility of further challenges to taxes on due process or equal protection grounds. For instance, the same argument could be raised by a wholly intrastate enterprise that considered itself to be facing a tax liability disproportionate to those borne by other kinds of enterprises. The national constitutional interest involved by reason of the nexus with interstate commerce in the Montana case is no greater than the national constitutional interest in prohibiting a state from denying to a citizen the equal protection of the laws—including fair adjustments of tax liabilities.

What kinds of inquiries might have to be made to satisfy the fourth part of the *Complete Auto* test in accordance with the dissenters' opinion? The first, and in this case simplest, question is

---

[67] *Id.* at 650.
[68] *Id.* at 649-51.
[69] *Id.* at 651.
[70] *Id.* at 651-52.

whether the tax is on what is primarily an intrastate or primarily an interstate activity. A severance tax attaches to a purely local undertaking. The application of a strictly geographic kind of test would result in a finding of intrastate taxation, but such an analysis is so cramped and limited that it ultimately makes little sense. Indeed, one of the major criticisms of the Formal Rule was just this sort of mechanistic, unrealistic approach.[71] The parties in the *Commonwealth Edison* case agreed that approximately ninety percent of the coal mined in Montana was destined for out of state markets.[72] The severance tax was no different from any other cost of doing business in the sense that it would be included in the price paid by the ultimate purchasers of the coal, most of whom were outside Montana. Thus, simply noting that the application of the tax is to the *intra*state activity of physical extraction overlooks the fact that the tax is eventually paid by people in other states. On the other hand, the fact that ultimate consumers in other states pay the tax through higher prices for coal does not indicate that the tax is an invalid burden on interstate commerce. If that were so, ad valorem property taxes, income taxes, sales taxes, use taxes, and virtually all state taxes paid by multistate businesses could be subjected to Commerce Clause attacks because they all contribute to the cost base of a product and determine its eventual price. The market realities of the coal industry suggest that the extraterritorial effect of a locally applied tax may be so substantial that it places an *unreasonable* burden on interstate commerce.[73] What is unreasonable is not, unfortunately, self-evident. If the first inquiry leads to a determination that there is a significant extraterritorial effect, then a court applying the Blackmun test would have to determine whether the effect was justifiable. In Justice Blackmun's defense, he was attempting to guide the Court in the direction suggested by its rejection of the Formal Rule in *Complete Auto*. The majority's interpretation of *Complete Auto* in *Common-*

---

[71] *See generally A Revolution, supra* note 19; *The Sales Tax, supra* note 19.

[72] 453 U.S. at 617.

[73] As Professor Dam has pointed out, a state has wide latitude within the structure of the federal constitution to tax goods, services, activities, property, and income within its borders *unless* there are raised questions of "protectionism, extraterritoriality or multiple burdens." Dam, *supra* note 15, at 286.

wealth Edison, while not without merit, amounts to little more than the substitution of one formal rule for another. But in continuing this inquiry, the dissenters' approach swiftly runs into difficulties. If we accept the premise, as the Court has done, that a multistate business may be required to share in the costs of maintaining local and state governments,[74] then a court must try to determine what costs to the state are attributable to the intrastate activities of the enterprise in question. One way would be to look at the size of the activity in terms of gross revenues or number of employees, but that approach again would amount to the substitution of a mechanical test that fails to account for real economic impact. In the case of coal mining, the following kinds of questions could be raised: (1) Are more firemen, policemen, and similar public safety personnel needed? (2) Is there greater demand on water, sewage, and solid waste disposal systems that will require additional capital expenditures, either now or sooner than originally budgeted? (3) Will more workers be attracted to the mining area, thereby causing greater demand for housing, schools, hospitals, and other services? (4) If there is a "boom," is it likely to be long or short term? That is, will new roads, sewers, schools, etc., be used for a period equivalent to their anticipated useful lives or will they be used for a shorter time and then be left as white elephants? (5) What will be the environmental costs in the short term during operations and in the long term after the coal has been extracted?[75] (6) What will happen to the property tax base after it has been depleted of minerals? Other questions no doubt could arise, but these few suggest the flavor of the kinds of issues that would have to be addressed in making a decision about the costs of a particular activity. Left out of the list are any questions about social desirability. What if the people of Montana really do not want coal mining, or only want it if paid enough? If the whole state could be

---

[74] *See, e.g.*, McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940); Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938).

[75] The conflict between state and local interests in environmental protection and the interests of multistate businesses in free trade can be sharp. *See, e.g.*, Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456 (1981); American Can Co. v. Oregon Liquor Control Comm'n, 15 Ore. App. 618, 517 P.2d 691 (1973); Note, *supra* note 43, at 681; Note, *State Environmental Protection Legislation and the Commerce Clause*, 87 HARV. L. REV. 1762 (1974).

zoned to prevent mining or if a law could be passed prohibiting mining, then why not a *tax* that allows mining but only at a high price?[76]

No court is adequately equipped to engage in the kind of analysis that would be required were the foregoing questions presented for review. It is virtually impossible for a court, with its limited resources, to determine with any degree of accuracy the costs to a town, county, or state of a particular industry. About all that can be said is that any industrial activity will bring with it some costs and that it is not unreasonable for that activity (and those who eventually profit from it, be they shareholders or consumers) to share in those costs. A tax may be imposed that is so grossly out of line with any reasonable allocation of costs that it raises a question of fairness, but so long as there also may be questions of social policy, a court ultimately would be faced with the necessity of making a value judgment about the relative utilities of competing policies. Courts do make such decisions, and the dormant Commerce Clause does act as a brake on state policies that intrude into an area reserved for national action, but, as a general proposition, the better part of valor is for courts to be hesitant to make conclusive judgments in such cases.[77]

Furthermore, even if some idea of relative costs can be established, and even if it can be shown that a particular tax is greater than the aliquot share of costs attributable to a certain enterprise,

---

[76] On the use of severance taxes to advance conservation policies, see Whiteside & Gillig, *Coal and Conservation—Tax Policy*, 64 Ky. L.J. 573 (1976).

[77] In a slightly different context, the argument was recently put by one commentator as follows:

> Political bodies and courts respond to different institutional imperatives. They overlap in many ways, and may be equally capable of performing a number of functions, albeit in their characteristic institutional fashions. Devising remedies for constitutional violations in institutional suits, however, is not such a function. Legal standards for devising institutional remedies are absent because the problems they pose are, and inevitably must be, polycentric and non-legal in nature. As a matter of fundamental structure, even where a constitutional violation has been found, a court cannot legitimately resolve such a problem unless the political bodies that ordinarily should do so are in such serious and chronic default that there is realistically no other choice.

Fletcher, *supra* note 41, at 696.

the inquiry is far from complete. There are, to begin with, the generalized, nonspecific costs of a "civilized society."[78] For example, ad valorem property taxes are regularly used for the support of public schools, even though they are paid by property owners who have no children or who use private schools as well as by those who do have children in public schools. Other activities may be determined to have social value or to cause social harm and this determination may be manifested in tax policies. There may be tax breaks granted to certain industries for certain purposes. Deductions and credits abound to encourage or to discourage a myriad of activities. So long as tax policies are not wholly divorced from social policies, one cannot complain, as a matter of constitutional law, unless there is discrimination within a defined class or unless there is discrimination between intra and interstate commerce. Thus, the fact that a coal severance tax imposes a burden on the coal industry that may be disproportionate to the direct costs associated with that industry does not by itself end the inquiry. There would have to be a showing of discriminatory impact on interstate commerce unjustified by local policies based on costs or social values.

Justice Blackmun's argument follows logically from the language of *Complete Auto.* Nevertheless, his approach would necessitate judicial inquiry into issues that generally are beyond the technical competence of courts and that involve courts in the kind of fact finding and policy determinations that often are better left to the legislative branches. In the absence of extensive factual inquiries, the Blackmun analysis easily could fall prey to problems of arbitrariness. There is little that is more susceptible to unpredictability than courts applying a complicated test to issues of great factual complexity in situations involving evidentiary presentations of widely differing quality.[79]

---

[78] *See* Exxon Corp. v. Department of Revenue, 447 U.S. 207, 228 (1980) (taxation of the income of a corporation doing business in several states must be fairly related to services provided by the taxing state, "which include police and fire protection, the benefit of a trained work force, and 'the advantages of a civilized society.'" (quoting Japan Line v. County of Los Angeles, 441 U.S. 434, 445 (1979)).

[79] Judicial incompetence in the area of income apportionment has long been recognized. *See* Hellerstein, *supra* note 41, at 188-92. That did not prevent the Court from entering the

Justice White's short concurrence was the most sensitive to the serious institutional concerns suggested by *Commonwealth Edison.*[80] Although this opinion was a brief two paragraphs, it contained the essence of dormant Commerce Clause cases. Congress can act to establish policies with respect to energy resource development. It may even have the power to develop policies that limit state action in matters such as land planning, which have traditionally been of local concern, if the national consequences are of sufficient moment.[81] But Congress has *not* acted and the purpose of the Court in applying the dormant Commerce Clause is to delineate those areas that are totally closed to state regulation whether or not Congress ever acts. In the absence of Congressional preemption, the Court can act only as a restraining power that defines the limits of state sovereignty within the federal union.[82]

Justice White's concurrence puts the *Commonwealth Edison* decision in perspective as essentially a federalism case. There may be serious arguments addressed to the majority's rather technical dismissal of the appellants' arguments. The *Complete Auto* test seems to require at least minimal factual inquiry that would preclude such a summary disposition of the case. There may be good reasons for avoiding the kind of complex factual analysis that would seem to be demanded by the dissenters' reading of *Complete Auto.* On the other hand, the majority in *Commonwealth Edison* did seem to contemplate a review akin to that used in state regulation, as opposed to taxation, cases.[83] The manner in which the majority disposed of the appellants' case suggests the substitu-

---

fray in 1982. See *infra* notes 120-40 and accompanying text.

[80] 453 U.S. at 637 (White, J., concurring).

[81] *See* Hodel v. Virginia Surface Mining & Reclamation Ass'n, 452 U.S. 264 (1981).

[82] [T]he institutional nature of a judicial tribunal and the constitutional inability of the Supreme Court under the Commerce Clause to do more than restrain undue state tax burdens on interstate commerce make the Court inherently incapable of dealing adequately with the complex problems posed by state and local taxation of multistate enterprises.

Historical Perspective, supra note 38, at 339 (citing P. HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 275-85 (1953)).

[83] 453 U.S. at 615. As examples of decisions involving state regulation see Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951); H.P. Hood & Sons v. DuMond, 336 U.S. 525 (1949); cases cited *supra* note 11.

tion of simply another magical incantation for the one disapproved in *Complete Auto*. Be that as it may, *Commonwealth Edison* did indicate that the Court was somewhat more attuned to federalism issues, a development that should not have been surprising after the same Court had decided *National League of Cities v. Usery*.[84] Even the dissenters did not conclude that Montana had overstepped its bounds. They simply thought that the appellants should have a chance to prove their case.

IV. THE *Jicarilla Apache* CASE

The Court's concern with definitions of sovereignty, which are essential to the full development of federalist theory, was particularly apparent in the 1982 case of *Merrion v. Jicarilla Apache Tribe*.[85] That case involved a tax imposed by an Indian tribe on the severance of natural gas and oil from its reservation. Undoubtedly Indian tribes are not states, and they were not participants in the original constitutional process. Nevertheless, they are quasi-independent sovereignties existing within and under the protection of the United States. They have treaties with the federal government just as sovereign nations do. The Court's conception that the relationship between the federal government and the Indian tribes is one of relative respect as among sovereigns is relevant to more traditional federalism issues.

The Jicarilla Apaches live on a reservation in northwestern New Mexico that was set aside as tribal trust property by an 1887 Executive Order.[86] The Tribe is organized pursuant to the Indian Reorganization Act of 1934[87] and has a constitution that has been approved by the Secretary of the Interior.[88] Pursuant to the Tribe's

---

[84] 426 U.S. 833 (1976). Even so, *National League of Cities* remains the only recent case in which the Court struck down an act of Congress as being beyond the national powers contained in the Commerce Clause, and the Court has invalidated several recent exercises of state regulatory power on dormant Commerce Clause grounds. *See supra* note 11 and cases cited therein. However, the Court has also held that a state could refuse to allow interstate sales of cement from state owned plants in order to favor domestic purchasers. Reeves, Inc. v. Stake, 447 U.S. 429 (1980).

[85] 455 U.S. 130 (1982).

[86] *Id.* at 133.

[87] 25 U.S.C. §§ 461-492 (1976 & Supp. IV 1980).

[88] 455 U.S. at 134.

constitution, the tribal council "may levy and collect taxes and fees on tribal members, and may enact ordinances, subject to approval by the Secretary of the Interior, to impose taxes and fees on non-members of the tribe doing business on the reservation."[89] For some time the tribal council has leased the mineral rights to substantial portions of its land, and in 1976 the tribal council, with the approval of the Secretary of the Interior, imposed a severance tax on oil and gas production from tribal land.[90] Thus the Tribe received royalties from the mineral leases plus severance taxes. The lessees were also subject to a New Mexico severance tax.[91]

The Indian severance tax was challenged on two grounds: first, that the Tribe did not have the power to impose the tax; and second, that the tax violated the Commerce Clause. The Supreme Court upheld the tax against both challenges, with Justice Marshall writing the majority opinion as he had in *Commonwealth Edison.* There were, however, several shifts on the Court. Justices Blackmun and Powell, who had dissented in the earlier case, joined the majority while the Chief Justice and Justice Rehnquist, who had been in the *Commonwealth Edison* majority, joined the dissenting opinion of Justice Stevens.

The Court found the power of taxation to be an essential attribute of sovereignty "because it is a necessary instrument of self-government and territorial management."[92] The status of an Indian tribe was analogized to that of a state in that the latter is entitled to collect royalties as well as severance taxes.[93] More importantly, the majority rejected the argument relied upon by the dissenters that the power to tax is a function of the power to exclude.[94] Rather, the power to tax, according to the Court, derives

---

[89] JICARILLA APACHE TRIBE CONST. art. XI, § 1, *quoted in* 455 U.S. at 135.

[90] 455 U.S. at 135-36.

[91] 25 U.S.C. section 398c (1976) permits state taxation of mineral production on Indian Reservations.

[92] 455 U.S. at 137. The Court also relied upon its decision in Washington v. Confederated Tribes of the Colville Indian Reservation, 447 U.S. 134 (1980), in which the Court said: "[t]he power to tax transactions occurring on trust lands and significantly involving a tribe or its members is a fundamental attribute of sovereignty which the tribes retain unless divested of it by federal law or necessary implication of their dependent status." *Id.* at 152.

[93] 455 U.S. at 138.

[94] *Id.* at 141-44.

simply from the fact of sovereignty. The Court did not say that the power to tax is unfettered, but it did establish a clear precedent that the attribute of sovereignty alone creates a taxing power. Although a state does not have a general power of exclusion because all citizens are free to travel,[95] a state may have the power to exclude a certain product[96] or to prohibit certain uses of property.[97] But if the *Jicarilla Apache* case means what it says, then whether or not a state has the power to exclude a product or an activity should not determine the extent of a state's power of taxation.

The other line of argument against the Jicarilla Apache tax was similar to that advanced against the Montana coal severance tax. It was said to violate the " 'negative implications' of the Commerce Clause because it taxes an activity that is an integral part of the flow of commerce, discriminates against interstate commerce, and imposes a multiple burden on interstate commerce."[98] The majority decided first that the dormant Commerce Clause was inapplicable because Congress in fact had acted specifically on the subject. Therefore, the problem was to attempt to reconcile the Indian action with federal statutes. The Court's inquiry was at an end because Congress had directly addressed the kind of question posed in this case and because the severance tax was enacted in accordance with and pursuant to specifically granted authority.[99]

---

[95] *See, e.g.*, Edwards v. California, 314 U.S. 160 (1941) (a California statute making it a misdemeanor for anyone knowingly to bring or assist in bringing into the state a nonresident indigent person held invalid).

[96] A state can exclude alcoholic beverages, for instance. *See* U.S. CONST. amend. XXI, § 2.

[97] *See, e.g.*, Agins v. City of Tiburon, 447 U.S. 255 (1980) (upheld zoning ordinance limiting development of land); Young v. American Mini Theatres, 427 U.S. 50 (1976) (upheld Detroit zoning ordinance regulating the location of adult theatres); Goldblatt v. Town of Hempstead, 369 U.S. 590 (1962) (upheld ordinance regulating dredging and pit excavation on property); Village of Euclid v. Ambler Realty Co., 272 U.S. 365 (1926) (upheld zoning ordinance restricting location of industries).

[98] 455 U.S. at 152-53.

[99] In the words of the Court:

> Once Congress acts, courts are not free to review state taxes or other regulations under the dormant Commerce Clause. When Congress has struck the balance it deems appropriate, the courts are no longer needed to prevent States from burdening commerce, and it matters not that the courts would invalidate the state tax or regulation under the Commerce Clause in the absence of congressional action.

Although they were unnecessary to the decision and therefore are nothing more than dictum, statements by the majority indicate that the tax also would be valid under the *Complete Auto* test. The major challenge to the tax was based upon the third part of the test—that the tax discriminated against interstate commerce because oil and gas used by lessees or received by the Tribe as in-kind royalty payments was not subject to the tax. The Court rejected the argument because all that would be necessary to avoid the problem would be some "administrative makework."[100]

In the section discussing the possible application of the *Complete Auto* test to the Jicarilla Apaches, the majority opinion included a footnote that could have significant implications for future state tax cases.[101] In the Supreme Court the petitioners made no attempt to challenge the tax on the basis of the fourth prong of the *Complete Auto* test, the provision that was at the heart of the dispute in the *Commonwealth Edison* case. At the trial the Tribe had attempted to present evidence showing that it provided services sufficient to meet the "fairly related" test, but the petitioners objected that such evidence was irrelevant, and the trial court sustained the objection.[102] On appeal, the court of appeals ruled that the failure of the petitioners to build (or permit the building of) a factual foundation on this issue meant that "there was no basis on which to find that the tax was not fairly related to the services provided by the Tribe."[103] The petitioners thus were left in a bit of a quandary, although one partly of their own making. A fair reading of the *Commonwealth Edison* majority opinion was that the "fairly related" test was one of law that could be determined without a factual record, although this conclusion was disputed by the three dissenters who quite reasonably felt that the nature of the test was essentially factual. It is not surprising, therefore, that the petitioners chose to limit their attack at the trial to matters of law, although the services provided by the Indian Tribe were probably

---

Id. at 154.

[100] *Id.* at 158.

[101] *Id.* at 157 n.23.

[102] The district court held that the tax was illegal. Merrion v. Jicarilla Apache Tribe, No. 77-292 (D.N.M. Dec. 29, 1977).

[103] 455 U.S. at 157 n.23 (citing 617 F.2d 537, 545 n.4 (10th Cir. 1980)).

so minimal that it might well have been prudent to establish at least some kind of record. As it turned out, however, the petitioners had chosen the wrong tactics because the appeals court ruled that the "fairly related" test would be presumed to have been met by the taxing authority absent any factual evidence to the contrary. The Supreme Court did not disturb this portion of the lower court's opinion. The long and short of all this seems to be that *Commonwealth Edison* treats the *Complete Auto* four-part test as a legal standard that can be analyzed without the development of a factual record, but the *Jicarilla Apache* opinion suggests, albeit indirectly by way of a footnote to a portion of the opinion that is dictum, that in the absence of a factual record the tax under challenge will be presumed valid. This presumption can leave a challenger in an almost impossible situation, and since such a result does not really make sense in terms of basic fairness, one only can assume that future litigants will seek to have some judicial clarification. The result in *Jicarilla Apache* does tend to reinforce the notion, however, that the *Commonwealth Edison* interpretation of *Complete Auto* transforms that apparently factual test into one which is largely mechanical.[104]

For purposes of this discussion the most intriguing aspects of the *Jicarilla Apache* case were: (1) the clear, unequivocal recognition by the Court that the exercise of a power of taxation is definitional to a concept of sovereignty and that it exists in a sovereign by reason of the fact of sovereignty and not by reason of the existence of some other power, such as the power to exclude;[105] (2) an implicit

---

[104] The dissent disagreed with the majority's conclusions about the powers available to the Jicarilla Apaches as quasi-sovereigns pursuant to the various statutes and treaties governing their legal existence. 455 U.S. at 184 (Stevens, J., dissenting). Their concern was not with the application of *Complete Auto*, because the essential problem was not one involving the negative restraints of the dormant Commerce Clause.

The majority responded to the petitioners' multiple taxation complaint by saying that it was appropriate only as a dormant Commerce Clause complaint and should be directed at the New Mexico severance tax rather than at that of the Indian Tribe. *Id.* at 158 n.26.

[105] Although the minority opinion did not speak directly to this point, it was not inconsistent with this notion of a sovereign's powers. Rather, the dissenters seemed to have a different theory of sovereignty for Indian tribes. They concluded that the Jicarilla Apaches possessed substantial powers of internal self-governance, but only such powers over nontribal members as were clearly and specifically granted by federal laws or treaties. This approach was justified by reference to the idea of self-governance itself. Nonmembers have

recognition of a value in having multiple sovereignties within the federal system;[106] and (3) deference to the determination of appropriate political actions by a subordinate sovereign at the expense, perhaps, of a national interest in minimizing costs associated with multi-sovereign commercial transactions.[107]

V. Structure and Values

An examination of the values implied by or inherent in the severance tax cases makes possible the development of a matrix for the consideration of the tensions built into the federal system. It also provides the chance to reconsider the relative importance of constitutional structure as a means for the protection of democratic process. Professor Nagel, for instance, has suggested that the Supreme Court's focus on federalism and the structural integrity of the American system in *National League of Cities* was a healthy development whether or not that particular decision was correct.[108] The federal government itself is made up of coequal branches in which competition, checks, and balances provide a structural means for the preservation of the system's health. Federalism carries this structural form to a larger arena and provides a wider variety of opportunities for participation in the political process.

---

little or no voice over tribal decisions; therefore, the absence of an effective political check means that the Tribe has little right to act in ways contrary to the interest of nonmembers. *Id.* at 171-73. That agreement has credence in a discussion of political rights, but the Indian situation is somewhat different. The Jicarilla Apaches may not have a full power of exclusion, but they do own reservation property. The proper analogy—if one exists—is state power over state-owned property, not state regulatory power in general. *See, e.g.*, Reeves, Inc. v. Stake, 447 U.S. 429 (1980).

[106] 455 U.S. at 148.

[107] In the Court's language:

> We find no "clear indications" that Congress has implicitly deprived the Tribe of its power to impose the severance tax. In any event, if there were ambiguity on this point, the doubt would benefit the Tribe, for "[a]mbiguities in federal law have been construed generously in order to comport with . . . traditional notions of sovereignty and with the federal policy of encouraging tribal independence." White Mountain Apache Tribe v. Bracher, 448 U.S. 136, 143-44 (1980). Accordingly, we find that the Federal Government has not divested the Tribe of its inherent authority to tax mining activities on its land, whether this authority derives from the Tribe's power of self-government or from its power to exclude.

455 U.S. at 152.

[108] *See* Nagel, *supra* note 14, at 97-98.

To use the severance tax cases as examples, a tabulation of values supporting or opposing the tax might include:

In opposition to such a tax:

(1) There is a national interest in the development and maintenance of supplies of fuels that are critical to industrial development, home heating, electricity and similar uses, especially in light of the tensions affecting the availability of middle eastern oil supplies.
(2) Taxes on energy supplies add costs that may be severely inflationary because of the national dependence on fossil fuels.
(3) Increased costs of domestic supplies may lead to greater dependence on foreign sources that may affect national security and the direction of foreign policy.
(4) Industrial and population centers do not have adequate supplies of fuels and should not be made to support, through tax revenues, people who happen to live near concentrations of such fuels by reason of an accident of geography.
(5) Such a tax can result in an unreasonable redistribution of wealth.
(6) Those who pay the tax as consumers do not have an effective voice in the political decisions leading up to the tax. This amounts to taxation without representation.
(7) Such a tax can lead to economic Balkanization in an industry that is critical to the maintenance of an integrated national economy.

In support of such a tax the following points might be made:

(1) Taxation, as stated in the *Jicarilla Apache* case, is a fundamental aspect of sovereignty, and the maintenance of state sovereignty is essential to the life and health of the democratic polity.[109]
(2) The tax is a means for resisting a form of domestic colonial exploitation. Persons who live in fuel-poor regions have no claim against persons who live in fuel-rich regions to require the latter to provide them cheap fuel without sharing in the costs associated with extraction and depletion.
(3) A severance tax is like a property tax except that the ob-

[109] *Id.* at 108-09.

ject to which it attaches is continually being depleted. The property subject to the severance tax will disappear and the remaining land, stripped of its minerals, will be of diminished value. The tax is a present hedge against a future loss.

(4) The tax is a cost that should be subject to market demands. Consumers can exercise their political voices by making market decisions.

(5) Conservation policies may be expressed locally through a variety of mechanisms including taxes.

(6) If there is a national concern, it should be expressed through national legislation by Congress so that the various state interests effectively can voice their political concerns in the national debate. The decision should not be made by a court that effectively short-circuits the political process.[110]

---

[110] On this point generally, see Fletcher, *supra* note 41; Rehnquist, *The Notion of a Living Constitution*, 54 TEX. L. REV. 693 (1976). The debate is similar to that surrounding the revival of substantive due process. *See, e.g.*, Ely, *The Wages of Crying Wolf: A Comment on* Roe v. Wade, 82 YALE L.J. 920 (1973); Tribe, *Childhood, Suspect Classifications, and Conclusive Presumptions: Three Linked Riddles*, 39 LAW & CONTEMP. PROBS. 8 (1975); Tribe, *Structural Due Process*, 10 HARV. C.R.-C.L. L. REV. 269 (1975). *Cf.* Heymann & Barzelay, *The Forest and the Trees:* Roe v. Wade *and Its Critics*, 53 B.U.L. REV. 765 (1973).

The debate about the proper scope of judicial review has been going on since Marbury v. Madison, 5 U.S. (1 Cranch) 137 (1803). Recent considerations of the question can be found in, J. CHOPER, JUDICIAL REVIEW AND THE NATIONAL POLITICAL PROCESS (1980) and J. ELY, DEMOCRACY AND DISTRUST (1980). Dean Wellington recently wrote:

> [C]oncern with judicial review is exaggerated if—as is generally the case—the concern focuses on the countermajoritarian nature of the practice. Concern is appropriate, however, if prompted by the apparent finality of constitutional decisions
>
> . . . .
>
> The key to mitigating concern with judicial review is found when one analyzes the concept of finality and relates it to the judicial process. Many constitutional decisions deal with means and not ends. Accordingly, they are often less final than might be supposed. Moreover, because value determinations of either the policy or the principle variety are problematic, judges are apt to make mistakes. But, at least where principles are involved, mistakes can be discovered and mistaken decisions amended by normal judicial processes.

Wellington, *The Nature of Judicial Review*, 91 YALE L.J. 486, 519 (1982) (footnote omitted). I find myself in general agreement with the conclusions reached by Dean Wellington. In the particular context of this article, however, the fundamental question of judicial review or not is not posed. Rather, the central issue is the balance to be accorded various constitutional principles during the process of review. The principle that seems to me to have been shortchanged more often than not is the principle of federalism itself, as manifested through constitutional structure. Giving appropriate weight to the values inherent in that principle may involve judicial deference to the legislative process, but such deference

The first five points in opposition to the tax may be made with respect to almost any state or local tax or regulation that affects interstate commerce. The essential issues are the burden involved, the importance to the national economic health of the item or service taxed, and the extent to which the tax is exported. Courts may be equipped to deal with such issues to some extent. They may, for instance, be able to determine whether or not a tax is discriminatory or whether it attaches to something outside a state's jurisdiction. As *Commonwealth Edison* indicates, however, courts may be reluctant to engage in serious factual inquiries as to the relative degree of exportation or burden. The majority in *Commonwealth Edison* could have done more than apply the *Complete Auto* test mechanically, but the refusal to become deeply involved in the kind of analysis contemplated by Justice Blackmun's dissent was not unreasonable.[111] If there is a sufficient national interest, responsibility for action should lie with Congress. Courts should only act to restrain state enactments that might effectively preclude the opportunity for meaningful national action.[112]

One of the most consistently expressed concerns has been that those who may be most affected by state action that touches upon interstate commerce do not have an opportunity for meaningful participation in the political process.[113] It is certainly true that most of the consumers of electricity produced by Montana coal cannot vote in Montana, but the concern may be overstated. Their

---

results not from concern about the appropriateness of judicial review but from a judicial balancing of various constitutional concerns. There is a secondary, but important, question of technical competence which does go to the appropriateness issue. Competency questions can be raised in a number of judicial review contexts, but they seem especially compelling to me when political bodies have openly debated matters of public concern and have reached an explicit compromise—as in the case of Multistate Tax Compact—or an implicit understanding—as in congressional deference to state mechanisms for the imposition of fair tax burdens on multijurisdictional enterprises.

[111] *See Historical Perspective, supra* note 38, at 347-50.

[112] *See generally* Note, *supra* note 43.

[113] *See, e.g.*, McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940); Robbins v. Shelby County Taxing Dist., 120 U.S. 489, 495 (1887); L. TRIBE, *supra* note 4, § 6-15, at 347; Note, *The Supreme Court, 1980 Term*, 95 HARV. L. REV. 93, 107-09 (1981). In the words of Professor Eule, "[t]he contemporary dangers of state parochialism lie in its eviscération of the democratic process, not in its impairment of free trade." Eule, *supra* note 11, at 428.

voices can be heard through the market and through Congress. If the tax increases the price of coal, there are alternative fuel sources. The market may not work to perfection and there may be a host of reasons why an increase in tax might not bring about an immediate market reaction, but at some point the tax is likely to run into market resistance. Legislatures do not always act rationally, but unless there was a strong interest in conserving the resource that justified a high, inhibitory tax, the legislature would, if rational, reduce the tax to an acceptable market level. In addition, utility companies, consumers (industrial, commercial, and domestic), state utility regulation boards, and other interested groups all have the opportunity and the incentive to lobby in Washington for national legislation to deal with resource development and exploitation.[114] Nor is there anything to prevent local lobbying. The power of affected companies as employers of local residents and as contributors to political campaigns should not be minimized. Finally, hardly any state is self-sufficient. Those that are rich in coal may be poor in water resources.[115] There may be a *quid pro quo* exacted, and certainly if interstate trade wars seem imminent, federal action would be appropriate. The right to vote, although important, is just one means by which political influence can be exercised.

On balance, the arguments in favor of the local tax seem stronger and more consistent with the structure of a federation of sovereigns. There is, nevertheless, implicit in such arguments a

---

[114] A state that is in a monopoly or strongly oligopolistic position may be impervious to external market pressures so long as there is relative inelasticity of demand. If the product at issue is one of national importance, the national political system should work to overcome individual state trade barriers. The critical point for the judiciary comes when a state, impervious to usual market barriers, imposes trade barriers on a product or service of national importance and the political branches of the federal government fail or refuse to act. Is the judicial branch then entitled to constitutionalize the problem, or does the inaction by Congress and the President suggest that the problem is not one of sufficient moment to justify national action? One must bear in mind that what is at issue in Commerce Clause cases of this sort is the protection of one sovereign's interests as against those of another sovereign. Unless the ground rules are changed and the debate shifted to questions of due process or equal protection, the issue of an improper state intrusion into areas of individual liberty simply is not present.

[115] On developing water concerns, see, for example, Quade, *Water Wars Predicted in a Thirsty Nation*, 68 A.B.A. J. 1066 (1982).

tone of parochialism which, if left unchecked, could lead to a form of economic extortion practiced by the few people who live in fuel-rich states against the many people who live in fuel-poor states—a sort of domestic OPEC cartel.[116] Access to energy resources is largely the result of geological happenstance rather than the result of a collective political decision. Since the doctrine of state "ownership" of natural resources no longer applies,[117] there is a legitimate concern about the abuse of happenstance to the economic detriment of citizens of other states.[118] To that extent there is reason to argue that the dormant Commerce Clause may be activated by a statute that seems to amount to a form of protectionism. The line between protectionism and a legitimate exercise of state sovereignty can, however, be very thin. The value of federalism as a mechanism for the assurance of a multiplicity of opportunities for democratic participation should make courts defer to the wisdom of state action absent clear and convincing proof of a burden on interstate commerce that is discriminatory or that effectively stymies national action. That is very much what the Court did in *Commonwealth Edison* and, in a different context, in the *Jicarilla Apache* case. The results in other cases involving dormant Commerce Clause issues have not been as consistent.[119]

VI. THE 1982 INCOME TAX CASES

On June 29, 1982, the Supreme Court issued two decisions upholding taxpayer challenges to the imposition of certain state income taxes. *Asarco Inc. v. Idaho Tax Commission*[120] involved an Idaho tax challenge by a large multistate mining company. *F.W.*

---

[116] This precise problem has been a matter of considerable concern recently to our Canadian neighbors. Oil, coal, and natural gas are found in the sparsely populated western provinces, but the industrial centers and major cities are in Ontario and Quebec. *See* Ballem, *The Energy Crunch and Constitutional Reform*, 57 CAN. B. REV. 740 (1979). Professor Eule has suggested an "outsider impact percentage" to determine the level of disproportionate impact on out-of-state interests. Eule, *supra* note 11, at 460-74.

[117] Hughes v. Oklahoma, 441 U.S. 322 (1979), *overruling* Geer v. Connecticut, 161 U.S. 519 (1896). *See generally* Hellerstein, *Hughes v. Oklahoma: The Court, the Commerce Clause, and State Control of Natural Resources*, 1979 SUP. CT. REV. 51.

[118] Anson & Schenkkan, *Federalism, the Dormant Commerce Clause, and State-Owned Resources*, 59 TEX. L. REV. 71, 92 (1980).

[119] *See supra* note 11.

[120] 102 S. Ct. 3103 (1982).

Woolworth Co. v. Taxation & Revenue Department[121] involved a New Mexico tax challenge by F.W. Woolworth Co. Each taxpayer had its headquarters in another state. The two states sought to tax a proportionate share of total income, including income derived from out-of-state operations, by the use of what is known as the unitary business approach. Under the Uniform Division of Income for Tax Purposes Act[122] and the provisions of the Multistate Tax Compact,[123] the unitary business income of a multistate corporate taxpayer may be apportioned for income taxation among the various states where the corporation does business. This avoids confiscatory taxation while also making multistate enterprises bear some of the costs of the various states in which they do business.

In both cases there were significant technical questions about what constituted "business income" and how a unitary business is to be defined within the meaning of the applicable statutes. The most important aspect of these cases, for the purposes of this discussion, was the reliance of the Court on the Due Process Clause to sustain the taxpayers' positions. In so doing, the Court in both cases emphasized the necessity for an extensive judicial factual inquiry into the question of the "underlying unity or diversity of business enterprise."[124]

Although the facts peculiar to the two businesses were reasonably complex, the general framework was fairly simple. Neither business was headquartered in the taxing state, but each had a substantial local operation. Each received income from a variety of different sources including divisions, subsidiaries, and related companies operating in other states and in foreign countries. New Mexico and Idaho each argued that income from many of these different sources was income of a single enterprise and that the nexus created by the local operation gave each state a right to demand taxes on an allocable portion of the total income. The tax-

---

[121] 102 S. Ct. 3128 (1982).

[122] IDAHO CODE § 63-3027 (Supp. 1982); N.M. STAT. ANN. § 7-4-1 to 7-4-21 (Supp. 1981).

[123] The Compact was sustained against Commerce Clause and Fourteenth Amendment challenges in United States Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452 (1978).

[124] *Woolworth*, 102 S. Ct. at 3135 (quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 440 (1980)).

payers each argued that income from several of the sources could not properly be characterized as that of a single business because of various control factors and that the taxing state did not have sufficient contact with the income from these extraterritorial sources to assert a claim for taxes.

Whatever the merits of the technical arguments about whether or not one business or the other could be properly characterized as a single enterprise, the central legal issue of state authority to tax could be analyzed under either the Commerce or the Due Process Clause. The question really is the same as the one posed by *Commonwealth Edison.* Are the people of one state seeking to impose taxes on the persons of other states over whom the former have no jurisdiction? In due process terms the question is another version of the taxation without representation argument. In Commerce Clause terms the question is whether the tax inhibits the flow of commerce by its extraterritorial effect. The majority chose to use a due process analysis.

Justice Powell wrote the opinions in both *Asarco* and *Woolworth,* in each case for a majority of six.[125] The Supreme Court had recently decided that the major activities of two large petroleum companies, Mobil and Exxon, were integrated into a single business enterprise such that Vermont could tax an allocable portion of Mobil's worldwide income from foreign subsidiaries and affiliates,[126] and that Wisconsin could tax a portion of Exxon's income from nonmarketing activities even though Exxon only engaged in marketing within Wisconsin.[127] In the *Mobil* case Justice Blackmun stated for the majority:

> [We do] not mean to suggest that all dividend income received by corporations operating in interstate commerce is necessarily taxable in each State where that corporation does business. Where the business activities of the dividend payor have *nothing to do* with the activities of the recipient in the taxing State, due process considerations might well preclude

---

[125] The Chief Justice and Justices Brennan, White, Marshall, and Stevens completed the majorities.

[126] Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980).

[127] Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980).

> apportionability, because there would be no underlying unitary business.[128]

Both the *Mobil* and *Exxon* cases left open the possibility that a taxpayer could seek to prove that its business operations were not unitary and that portions of its operations should not be subject to local taxation. The Court found that the taxpayer had met this burden in both of the 1982 cases. Picking up on a statement in the *Mobil* case that if the business activities in question had nothing to do with the state, "due process considerations might well preclude apportionability,"[129] Justice Powell ruled that the New Mexico and Idaho assessments violated the Fourteenth Amendment. Both decisions emphasized that the income in question was derived from sources outside the taxing states and that the taxing states contributed nothing to its creation or protection.

Justice O'Connor wrote a sharp dissent in each case and was joined by Justices Blackmun and Rehnquist.[130] The first paragraph of her dissent in the Idaho case indicates the concern raised by the majority's reliance on the Due Process Clause:

> The Court today declares that the Due Process Clause of the Constitution forbids a State from taxing a proportionate share of the investment income of a nondomiciliary corporation doing business within its borders. In so doing, the Court groundlessly strikes down the eminently reasonable assertion of Idaho's taxing power at issue in this case. Far more dismaying, however, is that the Court's reliance on the Due Process Clause may deprive Congress of the authority necessary to rationalize the joint taxation of interstate commerce by the 50 States.[131]

Justice O'Connor raises two distinct issues, each of which is important to a proper understanding of federalism questions before the Court. First, she criticizes the Court's substitution of its factual analysis for that of the state courts and taxing authorities. That

---

[128] 445 U.S. at 441-42 (emphasis added).

[129] *Id.* at 442.

[130] *Asarco*, 102 S. Ct. at 3117 (O'Connor, J., dissenting); *Woolworth*, 102 S. Ct. at 3140 (O'Connor, J., dissenting).

[131] *Asarco*, 102 S. Ct. at 3117 (O'Connor, J., dissenting).

raises the perennial question of the Court's role in reviewing the factual underpinnings of a state action when a constitutional challenge is raised. The readiness of the Court to engage in a complex review of corporate accounting[132] suggests that this Court is far from relinquishing the power of ultimate factual review in such cases, however ill-equipped the members may be to undertake sophisticated policy reviews. Growing deference to states and to the legislative process may, in other words, be more rhetorical than real. Second, Justice O'Connor's concern with the use of the Due Process Clause illustrates the Court's willingness to employ an individual rights approach to the solution of the problem that is, at heart, more one of structure. This not only creates a dilemma for Congress as Justice O'Connor noted, but it also suggests that the Court has not yet come to terms with the function of the Constitution as a structural, organizational document as well as a shield against state intrusion into areas of individual rights.

There can be little doubt that a tax, federal, state, or local, might violate the Due Process Clause of the Fifth or Fourteenth Amendment. It does not follow, however, that a challenge to a state tax with an extraterritorial impact must be analyzed in terms of the Due Process Clause. The Interstate Commerce Clause almost invariably will be implicated, and that is certainly the case when the challenger is a large, diversified, multistate corporation. Indeed, the four-part *Complete Auto* test for Commerce Clause violations includes both a due process element and an equal protection element.[133] Are there reasons for preferring the use of the Commerce Clause in situations such as these?

The most straightforward reason to eschew a due process decision when a Commerce Clause one is possible is to retain maximum governmental flexibility. As the dissenters correctly pointed out, the due process decision reached by the majority limits the

---

[132] In some respects the Court's members may be better able to deal with accounting problems than with questions of highway safety, but they seem equally willing to tackle both. See *supra* note 11 and cases cited therein.

[133] The nexus, discrimination, and fair apportionment prongs include both due process elements and equal protection elements. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

ability of Congress to take effective remedial action if it is determined that national legislation is necessary to complement the Multistate Tax Compact or otherwise to deal with the problems of multistate taxation or the taxation of income from foreign subsidiaries or affiliates. The Chief Justice concurred "in reliance on the Court's express statement that the Court's holdings do not preclude further Congressional action in this area."[134] The majority seemed to think that no such untoward result would follow because "it is elementary that the 'states . . . are subject to limitations on their taxing powers that do not apply to the federal government.' "[135] The majority's statement does not answer the basic question. Certainly it is true that state and federal taxing powers are not coextensive; both *Commonwealth Edison* and *Complete Auto* recognize that. But the due process decisions reached in the Idaho and New Mexico cases raise two distinctly different issues. First, can Congress enact legislation that would define unitary business income in such a way as to allocate the income in question in these two cases to Idaho or New Mexico? The answer would seem to be no, because the Due Process Clause, acting as a limit on governmental control on individuals, requires as a matter of constitutional law that there be a nexus as defined by the Supreme Court before *any* tax liability could attach. Congress cannot by statute create such a nexus when the Court has found that, for constitutional purposes, there *is* no such nexus. Second, can the federal government tax income from extraterritorial operations without violating the Due Process Clause? The government does so with the imposition of income tax liability on worldwide income of American citizens and businesses.[136] In addition, there are a number of tax treaties with foreign governments that provide for the allocation of income by persons or businesses with income from more than one country. Surely the Supreme Court did not mean to upset this system, but if the Court sets standards of minimum contacts necessary for a state to impose income taxes, then at least a question is raised whether the same standard should apply to the federal government. Otherwise, the Court might be faced with the

---

[134] 102 S. Ct. at 3140 (Burger, C.J., concurring).

[135] *Id.* at 3115 n.23 (quoting *Woolworth*).

[136] I.R.C. § 61 (1976).

anomaly of having one due process standard for states and another for the federal government.[137] That is altogether different from noting that the states and the federal government have different *powers* of taxation. Whatever *powers* may exist are still subject to individual due process limitations.

These problems could have been avoided by the use of the Commerce Clause. If the problem with the Idaho and New Mexico taxes was that they attached to wholly extraterritorial activities, that would seem to present a straightforward dormant Commerce Clause case. In *Commonwealth Edison* the severance tax attached to coal actually mined in Montana. Thus the basic nexus requirement was satisfied. The same was not true of the income tax cases, at least on their faces. The review of the unitary business income concept could just as well have been undertaken to determine whether or not there was sufficient contact to satisfy the *Complete Auto* test. A Commerce Clause result would not have affected Congressional power to act in the future. Granted that there may be due process questions raised by an attempt to engage in extraterritorial taxation, this particular issue (the unitary business apportionment problem) had been roundly debated through the political process and eventually solved by negotiation among the states.[138] Congress apparently approved of this result. The Supreme Court,

---

[137] In the preceding term the Court had suggested that such an anomaly would be impermissible. See Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456 (1981), where Justice Brennan, writing for the majority said:

> A state court may . . . apply a more stringent standard of review as a matter of state law under the State's equivalent to the Equal Protection or Due Process Clauses. . . . But when a state court reviews state legislation challenged as violative of the Fourteenth Amendment, it is not free to impose greater restrictions as a matter of federal constitutional law than this Court has imposed. *Oregon v. Haas*, 420 U.S. 714, 719 (1975).
>
> The standard of review under equal protection rationality analysis—without regard to which branch of the state government has made the legislative judgment—is governed by federal constitutional law, and a state court's application of that standard is fully reviewable in this Court . . . .

449 U.S. at 461 n.6 (citations omitted).

[138] *See Reflections, supra* note 38; Krol, *Taxpayers Balking at Submitting to Audits of Multistate Tax Commission*, 43 J. TAX'N 364 (1975). The Court did nothing to preserve federal sovereignty as against state intrusions. To the contrary, the due process focus of these decisions served the private interests of the taxpayers to the detriment of state and federal sovereignty.

instead of analyzing these two cases in a way that would preserve maximum political flexibility, took an approach that placed the judiciary in the midst of a political debate.

The Court's reliance on the Due Process Clause also reflects a tendency, noted by Professor Nagel,[139] to rely upon an individual rights paradigm rather than a structural approach to constitutional adjudication. Here there was involved no high drama of the individual struggling to assert himself against a powerful government. Rather, there was a simple case (in form if not in fact) that only required a decision about income characterization. The question was largely one of the proper scope of a state's inherent taxing authority. A structural approach would have satisfactorily defined the limits of state sovereignty, would have left unquestioned the power of national sovereignty, and would not have turned a technical economic decision into one of personal, individual rights that brings into question the power of national authority as well. These two cases would have been good opportunities for the Court to employ the dormant Commerce Clause analysis used in both *Complete Auto* and *Commonwealth Edison.* That the Court chose instead to follow the due process line suggests that there is either a reluctance to meet structural arguments head-on or that the Court rarely thinks in those terms. So many decisions of the post-World War II era have involved individual rights questions that the Court's use of the Commerce Clause as a principal focus of analysis in some of the cases discussed in this article may have been more aberrational than indicative of a trend.[140]

---

[139] Nagel, *supra* note 14.

[140] The Court's retreat from its brief forays into a consideration of the values inherent in federalism was also evident in a third decision announced a few days after the Idaho and New Mexico tax cases. Sporhase v. Nebraska, 102 S. Ct. 3456 (1982). In this case the Court invalidated, on Commerce Clause grounds, a Nebraska regulation that permitted the interstate transportation of ground water only to states granting reciprocal rights to withdraw and transport ground water back to Nebraska. This was done in the face of some 37 federal statutes and numerous interstate compacts indicating a congressional deference to state water law and in the face of Nebraska's consistent (intrastate as well as interstate) treatment of ground water as a scarce natural resource to which a landowner has only a limited right of use.

VII. CONCLUSIONS

The debates among the Framers showed a clear concern for the preservation of the autonomy and integrity of the states. The loose alliance created by the Articles of Confederation was evidence of the distrust for a strong central government with its seat in some distant place. Although some of the arguments in favor of a noncohesive alliance may seem quaint to us, they made a great deal more sense in the late eighteenth century when about three million people were scattered far across the country, connected only by uncertain lines of communication. The victory of those who sought a more cohesive union with a national government of some consequence was, in retrospect, quite extraordinary. There may well have developed over time a greater sense of unity and perhaps a national consensus, but there is little doubt that the written Constitution was the catalyst for the creation of a single nation. Provincial rivalries hardly disappeared. The Civil War was a tragic and monumental testament to the vigor of sectionalism. Even so, it was the existence of a strong idea of national unity, evidenced by the Constitution itself, that provided the basis for Lincoln to justify war to maintain the union.

The creation of a national government, its preservation in a bloody war, and the great expansion of the national government in the twentieth century did not eclipse the concern expressed at the end of the eighteenth century for the maintenance of local autonomy.[141] The idea of federalism as incorporated into the Constitution is a magnificent example of effective compromise between competing concerns. A supreme national government, but one of strictly limited powers, was created. The structure of the governmental organization itself contemplated the possibility of considerable state sovereignty and of large differences among the states. It is indeed remarkable, for instance, that the union survived and prospered as long as it did with a sectional disagreement on the fundamental question of human slavery. That alone was a testa-

---

[141] Although one noted commentator proclaimed the death of federalism, P. KURLAND, POLITICS, THE CONSTITUTION AND THE WARREN COURT 96 (1970), his comments were a bit premature. *See, e.g.*, L. TRIBE, *supra* note 4, § 2-3, at 17.

ment to the inherent flexibility of the system.[142]

Granted that the Constitution's organizational structure was the result of a compromise devised to create a useful national government, why is or should federalism—as a value—be important to us today? Doesn't it create the risk of a revival of state legislation aimed at limiting individual liberties? Isn't there a reasonable concern that a multitude of state economic regulations, each individually acceptable, may in the sum create an economic Balkanization? Has not the federal government been the most earnest protector of individual rights and liberties? Although these questions certainly are debatable, one can answer them all in the affirmative and still argue that federalism is a core value in the American system and is a significant contributor to the preservation of a stable, democratic process.

There are two major functions of federalism, the importance of each varying with time and circumstances. First, the federal system provides a framework of competition. The structure of the national government itself is dependent in part on structural tensions and competition. Federalism does the same on a grander scale. The national Constitution keeps matters from getting out of hand, but the virtues of healthy competition can be seen in the efforts of states to outdo one another in advancing various political and economic interests. By having fifty-one centers of self-interested institutions, there is created a liveliness that adds to the whole. If they are all in good health, they can balance each other in ways that prevent undue concentrations of power and maximize political participation. Second, federalism provides a mechanism for experimentation and for the recognition of social and cultural group differences. There are few nations in the world that are as heterogeneous in make-up as the United States. Federalism provides a built-in organizational structure for the recognition and protection of that heterogeneity in a way that would be much more

---

[142] Justice Rehnquist has argued that the nation might have postponed the inevitable conflict over slavery somewhat longer, or perhaps even worked out a series of compromises short of full scale war, had the Supreme Court not imposed a national standard in the *Dred Scott* case that undercut legislative attempts at political compromise. Rehnquist, *supra* note 110, at 699-702.

difficult with a single, unified governmental structure. Professor Emerson has argued that one of the functions of the First Amendment is to be a "safety valve." Tensions that might be held in check until explosive can be released through free speech.[143] Federalism provides a national "safety valve" structure by providing alternative means for the operation of the democratic process.

A danger in deciding cases on constitutional grounds is that issues that are susceptible of local treatment may become nationalized without any significant political debate. There are obvious issues that should be handled at a national level. It seems clear to me, for instance, that *Plessy v. Ferguson*[144] was wrong and that *Brown v. Board of Education*[145] was right. Yet there are many cases that raise constitutional questions, but that may be handled better through the legislative process of a state in order to protect the long-term institutional, structural stability of the system.

In *Commonwealth Edison, Jicarilla Apache,* and some of the other cases discussed in this article, the Supreme Court seemed to be groping toward an understanding of the dormant Commerce Clause that would give substantial support to the values of federalism by allowing maximum state action subject to control by the political branches of the national government. One may quarrel with the specifics of Court-created tests for Commerce Clause analysis and with the Court's application of those tests. Nevertheless, embodied in those tests was a recognition, however muddled, of the need to defend state sovereignty as well as individual rights and national sovereignty. But then the Court simply ignored this line of thinking in the 1982 Idaho and New Mexico tax apportionment cases, and employed reasoning that not only nationalized the issue but did it in such a way as to limit the power of even the national political branches to operate. A state interpretation of a relatively arcane (although important) corporate organization and accounting concept was transformed into a matter of individual (or at least corporate) right as against government, be it local, state, or federal. This was done in two cases that seemed to cry out for dor-

---

[143] T. EMERSON, THE SYSTEM OF FREEDOM OF EXPRESSION 7 (1970).
[144] 163 U.S. 537 (1896).
[145] 347 U.S. 483 (1954).

mant Commerce Clause treatment.[146] The very question at hand was the subject of a compact among the states, a compact that was entered into to deal with a problem that Congress, although it had had opportunities to act, had failed to address adequately.

Professors Tribe and Michelman in their criticisms of the *National League of Cities* decision both interpreted the Court's opinion within the framework of an individual rights paradigm.[147] In the words of Professor Tribe:

> In broad outline, the argument is that policy-based legislation by Congress that endangers the provision of certain vital services, unlike similar legislation directed only at private parties or at government services usually provided only privately, is constitutionally problematic not because it strikes an unacceptable balance between national and state interests as such, but because it hinders and may even foreclose attempts by states or localities to meet their citizens' legitimate expectations of basic governmental services.[148]

This approach, although perhaps not without some merit, tends to overlook the purposes of structure in the constitutional scheme. It also reflects the tendency to place the individual rights paradigm at the center of constitutional adjudication. That is precisely what the Court did in the two 1982 tax apportionment cases. Federalism

---

[146] Professor Eule has criticized the Court's failure to address adequately dormant Commerce Clause issues and has argued that the Court should not be in the business of trying to institutionalize through constitutional decision making an interstate free market except when states engage in zealous protectionism. His arguments are certainly not without merit. However, he goes on to suggest the substitution of a Privileges and Immunities Clause analysis for the use of dormant Commerce Clause analysis. He recognizes that there would be little utility to this approach unless the Court were to reverse its decision in Paul v. Virginia, 75 U.S. (8 Wall.) 168 (1869), excluding corporations from the protection of the Privileges and Immunities Clause. Eule, *supra* note 11, at 446-54. His argument is novel and well-put, but it also suffers from the common failure to recognize the value of structure. The use of the Privileges and Immunities Clause would substitute a line of analysis balancing governmental action against individual or corporate interests for a line of analysis that focuses, in form if not in fact, on the relative statuses of sovereigns.

[147] L. TRIBE, *supra* note 4, § 5-7, at 240-41 n.2; §§ 5-21 to 5-22, at 307-318; Michelman, *States' Rights and States' Roles: The Permutations of Sovereignty in* National League of Cities v. Usery, 86 YALE L.J. 1165 (1977); Tribe, *Unravelling* National League of Cities: *The New Federalism and Affirmative Rights to Essential Government Services*, 90 HARV. L. REV. 1065 (1977).

[148] L. TRIBE, *supra* note 4, § 5-22, at 313.

as a central paradigm is not dead, but its resurrection or revitalization is proceeding with all deliberate speed.