

A state statute requires corporations located in the state to pay a use tax on equipment they purchased out-of-state for in-state use. The statute specifies that the use-tax rate is the same as the state's sales-tax rate for in-state equipment purchases. The statute also provides tax credits to corporations in the amount of the sales or use tax they paid on the same equipment in other states.

A construction company that builds homes in the state has refused to pay the state's use tax on equipment it purchased outside the state. The company has sued to challenge the state tax, arguing it is unconstitutional.

Is the state tax likely constitutional?

- A. No, because it discriminates against interstate commerce.
- B. No, because the commerce clause gives Congress the power to regulate interstate commerce.
- C. Yes, because it does not unduly burden interstate commerce.
- D. Yes, because the Tenth Amendment reserves to the states the power to construct their own tax system.

Explanation:

The Tenth Amendment reserves to the states any power that the Constitution does not expressly grant to the federal government, including the power to construct a state tax system. But when exercising this power, states must comply with other constitutional provisions **(Choice D)**. This includes the negative implication of the commerce clause (ie, **dormant commerce clause**), which **prohibits** states from **unduly burdening interstate commerce**.

A state tax on goods used in the state but purchased in another state (ie, use tax) affects interstate commerce. Therefore, to comply with the dormant commerce clause, the **state tax must be**:

- applied to a person or activity that has a **substantial nexus** with the taxing state
- **fairly apportioned** so that goods are not subject to multiple taxation in other states
- **not discriminatory** against interstate commerce, which is established when the use-tax rate on goods purchased out-of-state is not higher than the sales-tax rate on goods purchased in-state *and*
- **fairly related** to the benefits or services provided by the taxing state.

Here, there is a substantial nexus between the company and the state since the company builds homes there. The use tax is fairly apportioned because tax credits are provided for the sales or use tax that corporations paid on equipment in other states. The use tax is not discriminatory since it equals the state's sales tax for in-state equipment purchases **(Choice A)**. It is also fairly related to the benefits provided by the state (eg, use of public roads). Therefore, the state tax does *not* unduly burden interstate commerce and is constitutional.

(Choice B) The **commerce clause** gives Congress the power to regulate interstate commerce. However, states may still tax goods within their borders if the tax satisfies the negative implication of this clause (as seen here).

Educational objective:

A state tax on goods purchased out-of-state for in-state use is valid if (1) the state has a substantial nexus with the taxed person or activity, (2) the tax is fairly apportioned, (3) the tax is nondiscriminatory, and (4) the tax is fairly related to benefits or services provided by the state.

References

- Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (setting forth the four-factor test used to determine if a state tax violates the commerce clause).

- *Henneford v. Silas Mason Co.*, 300 U.S. 577, 584–85 (1937) (holding that a state's use tax on goods purchased out-of-state for in-state use is valid as long as the use-tax rate is not higher than the state's sales-tax rate).
- 67B Am. Jur. 2d Sales and Use Taxes §§ 155–59 (explaining the four-factor test for determining whether a use tax violates the commerce clause).

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State taxation of interstate commerce

State taxes

- Ad valorem property – tax on value of property in state
- Sales – tax on sale of goods within state
- Use – tax on goods purchased out-of-state but used within it
- Doing business – tax on privilege to do business in state



Tax affects **interstate commerce**



Complete Auto test

- **Substantial nexus** between state & taxed person/activity
- **Fairly apportioned** pursuant to rational formula
- **Not discriminatory** against interstate commerce
- **Fairly related** to state services/benefits



Tax complies with dormant
commerce clause