Maryland Law Review

Volume 13 | Issue 2 Article 6

Effect of Import-Export and Commerce Clauses on Franchise Tax Measured by Gross Receipts - Canton R. Co. v. Rogan Western Md. R. Co. v. Rogan

EFFECT OF IMPORT-EXPORT AND COMMERCE CLAUSES ON FRANCHISE TAX MEASURED BY GROSS RECEIPTS

Canton R. Co. v. Rogan[1]
Western Md. R. Co. v. Rogan[2]

The State of Maryland imposed on steam railroad companies a non-discriminatory franchise tax measured by gross receipts apportioned to the length of their lines within the state in lieu of all other taxes.[3] Appellant, Canton Railroad, engaged in switching freight cars from its piers to lines of connecting railroads, wharfage, weighing of loaded freight cars, storage, and other services offered by a marine terminal. The appellant contested the validity of the tax under the import-export and commerce clauses of the United States Constitution.

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[1] 340 U. S. 511 (1951).
[2] 340 U. S. 520 (1951), argued and decided at the same time.
[3] Md. Code (1951), Art. 81, Secs. 127, 128.

The Maryland Court of Appeals sustained the tax, on the ground that since ad valorem taxes on property used in and derived from the process of importing and exporting are valid, franchise taxes in lieu of such ad valorem taxes are not barred by the import-export clause.[4] Two judges dissented. On appeal to the Supreme Court, the tax again was upheld, Justice Jackson reserving judgment in a separate opinion in which Justice Frankfurter joined. Justice Douglas, in the majority opinion, held the tax not to be repugnant to the import-export clause on the ground that the tax was not imposed on imports or exports, but merely on the handling thereof.

The Court took the view that the import-export clause does not afford protection against a tax on the activities connected with the process of importing or exporting (at least beyond the water's edge) because the scope of immunity should be more narrow when the tax is not upon the goods; otherwise, a zone of tax immunity never before imagined would be created.

Justice Jackson in his separate opinion stated that he did not feel in a position to express a final view on the question at issue since the effect of federal policy upon the validity of the Maryland tax was not argued by counsel. He discussed the point that the prohibition of a tax on exports and imports goes beyond exempting specific articles from ad valorem duties — that it prohibits taxing imports and exports as a process. He observed that this premise has been manifested in the preferred treatment of exports given by the Interstate Commerce Commission, the Supreme Court, and rail and motor carriers through lower rate structures. He saw in the detailed treatment which the federal constitution gives to imports and exports a recognition of the dangerous results which could ensue were the strategically located states enjoying advantageous ports to exploit their location.

In the companion case, *Western Maryland R. Co. v. Rogan,* decided the same day the Court, dividing the same way, upheld the same tax as applied to the Western Maryland Railway Co., which operates several piers in the port of Baltimore, as well as a grain elevator, with a substantial portion of its freight traffic to and from these facilities consisting of the transportation of goods into or to be exported from the United States. Mr. Justice Douglas, speaking for the majority said in part:

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[4] Western Md. R. Co. v. State Tax Com'n., 73 A. 2d 12 (1950).

"The present facts illustrate how wide a zone of tax immunity would be created if the contrary holding were made in the *Canton R. Co.* case. There we were dealing with the handling of exports and imports within a port. Here we have transportation of exports and imports to and from the port. If Maryland were required to grant tax immunity to the services involved in getting the exports to the port and the imports to their destination, so would any other State. The ultimate impact of such a holding is difficult to measure, since manifold services are involved in the movement of exports and imports within the country. Problems of this nature, like many problems in the law, involve the drawing of lines. So far as taxes on activities connected with bringing exports to or imports from the ship are concerned, we think the line must be drawn at the water's edge. Whether loading and unloading would be exempt is a question we reserve."

The majority holding in these two cases seems difficult to reconcile with prior decisions involving the import-export clause. While the commerce clause[5] vests in Congress plenary power to deal with interstate commerce, it does not in terms prohibit state taxation. Consequently, such prohibition is implied only when the state tax constitutes an undue burden on or regulation of interstate commerce.[6] On the other hand, the import-export clause[7] expressly prohibits *all* state taxation without the consent of Congress, with only one named exception. It follows that a state tax could be valid as respects interstate commerce, but invalid as to foreign commerce.[8]

Taxes on or measured by gross receipts from interstate commerce have generally been held invalid.[9] Where, how-

[5] United States Constitution, Art. 1, Sec. 3, cl. 3.

[6] Fargo v. Michigan, 121 U. S. 230 (1887); Leloup v. Mobile, 127 U. S. 640 (1888); McCall v. California, 136 U. S. 104 (1890); Adams Express Co. v. New York, 232 U. S. 14 (1914); McGoldrick v. Berwind-White Co., 309 U. S. 33 (1940).

[7] United States Constitution, Art. 1, Sec. 10, cl. 2.

[8] Mr. Justice Douglas, in Joseph v. Carter and Weekes Co., 330 U. S. 422, 434 (1947), pointed out in his dissent (p. 445) that the Court has been free to balance local and national interests in regard to state taxation of interstate commerce since the commerce clause does not expressly forbid any such tax, but that the import-export clause admits of only one exception; that consequently a state tax might survive the commerce clause, but fall under the import-export clause.

[9] Philadelphia Steamship Co. v. Pennsylvania, 122 U. S. 326 (1887); Ratterman v. Western Union Tel. Co., 127 U. S. 411 (1888); Western Union Tel. Co. v. Alabama, 132 U. S. 472 (1889); Galveston, Harrisburg and San Antonio Railway Co. v. State of Texas, 210 U. S. 217 (1908).

ever, such taxes have been non-discriminatory and either fairly apportioned[10] or in lieu of other legitimate property taxes,[11] they have been sustained, since they have then no unduly restrictive effect upon interstate commerce; and, that being so, interstate commerce should "pay its way", i.e., should assume its fair share of the state tax burden. In such cases, the court's task is to reconcile the competing demands of interstate commerce to be free from restrictive state taxation on the one hand, and the power of the state to make interstate commerce pay its way on the other.[12] But a state tax on imports or exports, being expressly prohibited by the federal constitution, is void, whether or not its effect upon the import-export process would be restrictive and irrespective of the extent of the restriction. In construing taxes involving the import-export clause the court is not free, as in cases under the commerce clause, to look at the effect of the tax, and to determine its validity with reference thereto.

It has been held in *Crew Levick Co. v. Pennsylvania*,[13] that a state tax on gross receipts from the sale of goods in foreign commerce is a tax on exports and void for that reason. In *Brown v. Maryland*,[14] the Supreme Court held invalid a state license tax on the privilege of selling imports, declaring such a tax to be tantamount to a direct tax on the imported articles, thereby forbidding a state to accomplish indirectly that which is constitutionally proscribed when attempted directly.

As regards the instant case, assuming the tax may be justified as a tax on interstate commerce, because of its being non-discriminatory, apportioned, and in lieu of all other taxes, nevertheless, such characteristics would seem irrelevant if the tax is viewed as being a direct tax on imports. Consequently, in order to sustain the validity of the tax, the court is necessarily driven to a holding that it is not a tax on imports or exports, but that the tax is merely on the handling of the articles.

If the selling of imports is an activity intimately and indispensably connected with imported articles, as *Brown v. Maryland* and *Crew Levick Co. v. Pennsylvania* seem to

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

[11] Maine v. Grand Trunk Ry. Co., 142 U. S. 217 (1891); United States Express Co. v. Minnesota, 223 U. S. 335 (1912); Cudahy Packing Co. v. Minnesota, 246 U. S. 450 (1918).

[12] Postal Telegraph Cable Co. v. Richmond, 249 U. S. 252, 259 (1919); Western Livestock v. Bureau, 303 U. S. 250 (1938); McGoldrick v. Berwind-White Coal Mining Co., 309 U. S. 33 (1940).

[13] 245 U. S. 292 (1917).

[14] 12 Wheat. 419 (U. S., 1827).

hold, then it would appear that their transportation or handling should be so characterized also. Prior cases have not confined the scope of the import-export clause to taxes on the goods themselves, but have struck down a stamp tax on bills of lading covering exported gold and silver,[15] a federal stamp tax on foreign bills of lading,[16] a federal tax on charter parties,[17] a federal tax upon baseball equipment when applied to foreign shipments,[18] and a stamp tax on ocean marine insurance.[19]

In *Joseph v. Carter & Weekes Co.*,[20] the Supreme Court declared invalid a New York City excise tax on the gross receipts of a stevedoring corporation engaged solely in New York City in loading and unloading vessels moving in interstate and foreign commerce on the ground that it was unduly burdensome to interstate and foreign commerce, and thus repugnant to the commerce clause. It is important to observe that this case dealt with a tax on the gross receipts derived from the handling of goods. Justice Douglas, dissenting in part, expressed the view that the tax was valid under the commerce clause, but invalid under the import-export clause,[21] stating that loading and unloading are a part of "the exporting process" which the import-export clause protects from state taxation, and cited with approval a case holding that activity which is a "step in exportation" has the same immunity.[22]

The words "imports" and "exports" as used in Art. 1, par. 10, cl. 2 of the federal constitution are words of art

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[15] Almy v. State of California, 24 How. 169 (U. S., 1860). Although this case was later held to have been erroneously decided on the facts, it was upheld under the interstate commerce clause. Woodruff v. Parham, 8 Wall. 123, 137-8 (U. S., 1868).

[16] Fairbank v. United States, 181 U. S. 283 (1901).

[17] United States v. Hvoslef, 237 U. S. 1 (1915).

[18] Spalding & Bros. v. Edwards, 262 U. S. 66 (1923).

[19] Thames & Mersey Ins. Co. v. United States, 237 U. S. 19 (1915).

[20] 330 U. S. 422 (1947).

[21] *Ibid*, 434 *(dis. op.)*.

[22] *Ibid*, 434, 445, citing Spalding & Bros. v. Edwards, *supra*, n. 18. A minor but interesting question arises out of the facts of the Canton case. Constituting a very small part of Canton's gross receipts was the rent received by Canton from a stevedoring company for the privilege of using Canton's cranes. Located upon Canton's dock, the cranes scooped quantities of ore and other raw materials from docked ships and deposited the material into hopper cars. This seems to be a part of the unloading process. If the gross receipts derived from the use of human labor engaged in loading and unloading are exempt from taxation, as the Joseph v. Carter and Weekes case held, then it would seem to follow that the rental proceeds from the use of machinery in loading and unloading would be entitled to a like immunity. However, the court said that since Canton did not do the loading and unloading, but merely rented a crane, it was not necessary to decide whether the loading and unloading were immune from the tax.

which include not only the articles of import and export but also the processes of importation and exportation.[23]

Although the court in the instant case takes cognizance of the above propositions, it escapes a direct conflict with the *Joseph v. Carter & Weekes* case by the adoption of a "water's edge" test so far as the handling of goods is concerned. Such a test has not been heretofore resorted to, either as to taxes on the goods themselves[24] or on dealing therewith.[25]

If the handling of goods in the harbor is part of the import-export process because such goods are import-export articles, as the *Joseph v. Carter & Weekes* case implies and the instant case seems to recognize, there is no apparent reason why it is not equally so beyond the water's edge if the goods are of like character. It is the character of the goods handled, rather than the place of handling, which is determinative.

The distinction seems to have been made by the Supreme Court frankly as a matter of policy on the ground that the zone of immunity from state taxation would be expanded to an undesirable extent were the limitation not imposed. The court expressed apprehension that, were the water's edge test not adopted, the immunity would extend back to the forests, mines, and factories. This, it is submitted, is hardly likely in the light of prior decisions.

In order to prevent just such undue expansion or distortion of the scope of the import-export clause, the court in the past has upheld state taxation on imported articles when their original packages have been broken;[26] when they have been commingled with other property in the taxing state;[27] when they have been sold;[28] or when they have been devoted to the purpose for which they were imported.[29] As to articles destined for exportation, they are subject to state taxation until the articles of commerce are on their

[23] Lectures on the Constitution of the United States, (1893) Miller, 591.

[24] Hooven and Allison Co. v. Evatt, 324 U. S. 652 (1945); Joy Oil Co. v. State Tax Commission, 337 U. S. 286 (1949).

[25] *Cf.* Richfield Oil Corp. v. State Board, 329 U. S. 69 (1946). One hundred and twenty-five years ago counsel for Maryland in the famous case of Brown v. Maryland argued that the entrance into the country of the imports (which is a test similar to the "water's edge" test) should be the point at which the article's immunity from state taxation should cease, but the court specifically repudiated the contention (*supra*, n. 14, 441, 442). Moreover, the same counsel, Roger B. Taney, when he became chief justice of the very court before which he previously argued, rejected his earlier argument. Thurlow v. Massachusetts, 5 How. 504, 575-576 (U. S., 1847).

[26] May v. New Orleans, 178 U. S. 496 (1900).

[27] *Ibid*, 508; Brown v. Maryland, 12 Wheat. 419, 441-2 (U. S., 1827).

[28] Waring v. The Mayor, 8 Wall. 110 (U. S., 1868).

[29] Hooven & Allison Co. v. Evatt, 324 U. S. 652, 666 (1945).

final journey;[30] or when the goods are earmarked and committed to the stream of exportation by actual delivery to the carrier.[31] It is the entrance of the articles into the export stream that marks the start of the process of exportation.[32] Until shipped or started on its final journey out of the state its exportation is a matter altogether *in fieri* and not at all a fixed and certain thing.[33]

As pointed out in Justice Jackson's opinion, both the result and the reasoning of the instant case may hold unsettling and unpredictable consequences. It is submitted that the court in the instant case, as in cases under the commerce clause is in effect testing the validity of state taxation in terms of its restrictive effect, and attempting to balance local and national interests according to its view as to what a proper adjustment thereof requires. As Justice Jackson warns, if the express constitutional prohibition against state taxation can be avoided by shifting the tax from the articles of import and export to some incident of the necessary processes involved in importation and exportation taking place beyond the water's edge,[34] the policy and purpose of the import-export clause can be nullified as a practical matter.

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[30] *Cf.* Coe v. Errol, 116 U. S. 517 (1886); Empresa Siderurgica v. Merced County, 337 U. S. 154 (1949); Joy Oil Co. v. State Tax Comm'n., 337 U. S. 286 (1949).

[31] Joy Oil Co. v. State Tax Comm'n., *ibid.*

[32] Empresa Siderurgica v. Merced County, *supra*, n. 30, 157.

[33] *Cf.* Coe v. Errol, supra, n. 30; and see Joy Oil Co. v. State Tax Comm'n., *supra*, n. 30.

[34] Also consider Joy Oil Co. v. State Tax Comm'n., *supra*, n. 30, where the court sustained a Michigan ad valorem tax upon gasoline purchased in Michigan, for export to Canada, shipped by rail to Detroit under bills of lading marked "For Export to Canada", which gasoline was stored in tanks in Dearborn due to an inability to transport the gasoline because of wartime restrictions. The majority held that the tax did not contravene the import-export clause, since the first step in exportation, though taken, had been sufficiently interrupted to break the continuity of the exportation process. Despite the result of the case, it is important to note that the court held that the exportation process started when the goods were earmarked by the bill of lading and put on board the carrier in Grand Rapids, Michigan. Here the goods were held to be in the exporting process though they were more than one hundred miles from the water's edge. It is true that the tax here was directly upon the goods, but the court, in order to ascertain if the goods were in fact exports, looked to see whether or not the goods were in the stream of the export process. Consequently, no mere dictum is involved in the Joy case's statement as to when the exportation process begins. The ratio decidendi of the Joy case is that goods in the export process, which are stored for 15 months are no longer exports, but are subject to a state ad valorem tax.