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Justice Souter’s Tax Opinions Show Steady Erosion of Respect for Commerce Clause

By Travis Greaves

Retiring U.S. Supreme Court Justice David Souter will be remembered for many things: being President George H.W. Bush's "stealth nominee," a propensity to dissent, and his controversial deciding vote to approve the use of eminent domain for private purposes in *Kelo v. City of New London*. In cases involving taxation Justice Souter will be remembered for his antipathy. When asked why he sang along with the late Chief Justice William Rehnquist at the Court's annual Christmas party, he responded, "I have to. Otherwise I get all the tax cases."[1] It is not surprising, then, that Justice Souter's contribution to tax jurisprudence is not as significant as those of his colleagues. However, as he leaves the bench it is worth reflecting on his votes and opinions in key tax cases.

He was a frequent dissenter in other areas of the law, but in tax cases Justice Souter often sided with the majority. In *West Lynn Creamery, Inc. v. Healy* (1994),[2] Justice Souter joined a 7-2 majority holding that the dormant Commerce Clause limits the power of a state to adopt regulations that discriminate against interstate commerce. The case concerned a Massachusetts law that imposed an assessment on all milk sold by dealers to Massachusetts retailers; the proceeds were distributed to Massachusetts dairy farmers. The majority found that such "premium payments" are effectively a tax that made milk produced out of state more expensive. Although the tax also applied to milk produced in Massachusetts, its effect on Massachusetts producers was entirely offset by the subsidy provided exclusively to Massachusetts dairy farmers. In joining the majority, Justice Souter showed respect for the dormant Commerce Clause, reining in states' abilities to tax activity which had an effect beyond their borders.

Another Commerce Clause/tax case on which Souter found himself in the majority was *Camps Newfound/Owatonna, Inc. v. Town of Harrison* (1997).[3] In that case, Justice Souter was the

deciding vote in the Court's 5-4 decision, which held that a state impermissibly discriminates against interstate commerce when it "distinguishes between entities that serve a principally interstate clientele and those that primarily serve an intrastate market."[4] Thus, Maine could not have a property tax exemption for charitable organizations but deny that exemption to charities that principally serve nonresidents (in this case, out-of-state campers staying at a Maine camp site). The Court reasoned that this type of tax exemption is discriminatory and a violation of the Commerce Clause, notwithstanding the states' general authority to legislate on subjects relating to the health, life, and safety of their citizens.

After these early-career opinions in which he joined the majority in limiting a state's ability to tax, Souter seemed to shift in his approach to dormant Commerce Clause and state tax issues. The first case worth noting was *Oklahoma Tax Comm'n v. Jefferson Lines*,[5] a 1995 case in which Souter wrote for the majority. The case concerned an Oklahoma sales tax on bus tickets between Oklahoma and other states. In his opinion, Souter concluded that while income taxes can be discriminatory and burden interstate commerce, a more lenient standard should apply for sales taxes. Rejecting reliance on earlier cases striking down state laws that taxed income without apportioning it by state, Souter wrote, "A sale of goods is most readily viewed as a discrete event facilitated by the laws and amenities of the place of sale, and the transaction itself does not readily reveal the extent to which completed or anticipated interstate activity affects the value on which a buyer is taxed."[6] In other words, because sales occur in one state and are unconnected to interstate commerce, there can be no such thing as a sales tax that burdens interstate commerce.

He went on: "We have therefore consistently approved taxation of sales without any division of the tax base among different States, and have instead held such taxes properly measurable by the gross charge for the purchase, regardless of any activity outside the taxing jurisdiction that might have preceded the sale or might occur in the future."[7]

In concluding that a sales tax cannot burden interstate commerce, Souter seemingly ignored the sales that occur across state lines, from mail orders to cross-country deals to Internet purchases. Congress subsequently overruled the Court's decision with the enactment of section 14505 of the Interstate Commerce Commission Termination Act (ICCTA), which prevents states from collecting or levying taxes on bus fares for interstate travel.

Two years later, Souter again sided with state taxing power in *General Motors Corp. v. Tracy*.[8] Writing for the majority, he found that Ohio's differential tax treatment of regulated and unregulated sellers of natural gas did not violate either the Commerce Clause or the Equal Protection Clause. He wrote, "We conclude that Ohio's regulatory response to the needs of the local natural gas market has resulted in a noncompetitive bundled gas product that distinguishes its regulated sellers from independent marketers to the point that the enterprises should not be considered 'similarly situated' for purposes of a claim of facial discrimination under the Commerce Clause."[9] In other words, the two types of sellers are so different as to be incomparable for discrimination purposes. It is as if a judge ruled that an employer showing favoritism to one group of employees is not guilty of favoritism because the employees were so different that they could not be compared. Had a traditional Commerce Clause analysis been employed, the tax would have been invalidated for taxing out-of-state sellers while not taxing in-state sellers. However, Souter (as well as seven other members of the Court) saw two different markets: an unregulated market in which GMC made its purchases, and a regulated market where the individual consumer is buying.

Souter's most recent, and perhaps last, state tax case came in *Department of Revenue of Kentucky v. Davis*.[10] The Tax Foundation had filed an amicus brief supporting the Davises, but the Court supported Kentucky in a 7-2 decision written by Souter. Kentucky, like most other states, exempts from its income tax the interest earned on Kentucky state and local municipal bonds, but interest earned on other states' bonds is taxable. The practice was challenged in Kentucky state court, and the Kentucky Court of Appeals ruled that the practice discriminated against interstate commerce.

The Supreme Court reversed, with Justice Souter's opinion straying once more from a line of Commerce Clause cases that permitted states to encourage in-state investment but prohibited them from creating laws that punished out-of-state investment. Souter confused the state's role in setting interest rates on its bonds with its role of granting the tax exclusion, strangely writing that the state was acting as a "market participant" like any other bond issuer. "[T]here is no forbidden discrimination because Kentucky, as a public entity, does not have to treat itself as being 'substantially similar' to the other bond issuers in the market," the majority opinion read.[11] On the contrary, as we wrote at the time, Kentucky's simultaneous taxation of out-of-state activity and exemption of identical in-state activity protected its economic policies from interstate competition, creating an unconstitutional "exit toll," not a permissible welcome mat.

Over the course of his 19 years on the Supreme Court, Justice Souter has been accused of transforming from a moderate "conservative" to a reliable "liberal" vote. Insofar as his views on discriminatory taxes go, there has been a shift. A justice who was once eager to question states' protectionist use of their taxing authority (to the detriment of the national market) has become over time a justice willing to twist the precedents to uphold such laws. Having begun on one side of the issue, Justice Souter will retire on the opposite side.

Notes

1. Paul L. Caron, "Tax Myopia, or Mamas Don't Let Your Babies Grow Up to Be Tax Lawyers," 13 *Va. Tax. Rev.* 517, 525 (1994).

2. 512 U.S. 186 (1994).

3. 520 U.S. 564 (1997).

4. Id. at 576.

5. 514 U.S. 175 (1995).

6. Id. at 176.

7. Id. at 186.

8. 519 U.S. 278 (1997).

9. Id. at 310.

10. 128 S.Ct. 1801.

11. Id. at 1803.

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