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By virtue of this analysis the state is able to determine the suitability of its employees, yet the individual is protected in his fundamental rights inasmuch as they may not be unreasonably impaired.

David S. Bell

CONSTITUTIONAL LAW — STATE AND LOCAL TAXATION —
ASSESSMENT OF COMPENSATING USE TAX ON PROPERTY
MANUFACTURED BY USER

Plaintiff manufactured certain oil well service units in Oklahoma and shipped the finished units to Louisiana for use in his business. He then paid the Louisiana use tax¹ on them based on the cost of the materials used in their manufacture.² The Louisiana Collector of Revenue assessed a deficiency for failure to pay the use tax on the value of the goods attributable to labor and shop overhead. Plaintiff paid the alleged deficiency under protest, and instituted suit for refund. The trial court rendered judgment for the plaintiff. On appeal to the Supreme Court of Louisiana, *held*, reversed. The use tax is measured by the value of the property at the time it becomes taxable by the state. *Halliburton Oil Well Cementing Co. v. Reily*, 241 La. 67, 127 So.2d 502 (1961).

The United States Supreme Court has held that the commerce clause of the Federal Constitution³ forbids a state from using its economic powers to affect transactions occurring beyond its borders.⁴ Thus it has been held that a state sales tax is limited by the Constitution to transactions occurring within the taxing state.⁵ Because of this limitation, states which assessed sales taxes were faced with the problem that residents made their purchases in neighboring states which imposed no such taxes. This resulted in a loss of revenue and put local mer-

1. LA. R.S. 47:301-318 (1950).

2. The plaintiff was exempted from paying the Oklahoma sales tax because he manufactured for export. See OKLA. STAT. ANN. tit. 68, § 1251d (1951).

3. U.S. CONST. art. 1, § 8, cl. 3.

4. See *Baldwin v. Seelig*, 294 U.S. 511 (1935). Cf. *Welton v. Missouri*, 91 U.S. 275 (1875).

5. *McLeod v. Dilworth Co.*, 322 U.S. 327, 330 (1944): "[A] tax on an interstate sale . . . involves an assumption of power by a State which the Commerce Clause was meant to end." See *Miller Bros. v. Maryland*, 347 U.S. 340 (1954); *McGoldrick v. Berwind-White Co.*, 309 U.S. 33 (1940).

chants at a competitive disadvantage. To meet this problem⁶ many states enacted the compensating use tax.⁷

The compensating use tax is employed in conjunction with the sales tax to reach, indirectly, transactions occurring outside the state by taxing property brought into the state for use.⁸ In theory, it is a tax on the exercise of any right or power over tangible personal property incident to its ownership within the taxing state.⁹ Property subject to a state sales tax is exempted from use tax.¹⁰ Thus the use tax affects only property brought into the state from interstate commerce. The rate of the compensating use tax is the same as that of the sales tax and a credit against the use tax is allowed for a sales tax paid in another state.¹¹

The constitutionality of the compensating use tax was upheld by the United States Supreme Court in *Henneford v. Silas Mason Co.*¹² In rejecting the contention that the use tax was levied directly on interstate commerce, the court reasoned that "use" is an aspect of property and that states can separate the various aspects of property and tax them individually. The compensating use tax does not offend the commerce clause when

6. See *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937); *Chrysler Corp. v. New Orleans*, 238 La. 123, 114 So.2d 579 (1959); *Rodi & Miller, Revenue and Taxation in Louisiana*, 25 WEST'S LSA xxix, xliii (1950): "The use tax is complementary to a sales tax. . . . The purpose of the levy is to equalize the tax burden when tangible personal property is purchased outside the state and imported in the state for use. It places local merchants in a competitive position."

7. *Kust & Sale, State Taxation of Interstate Sales*, 46 VA. L. REV. 1290, n. 2 (1960) lists 34 states which have the compensating use tax in connection with its sales tax: Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Florida, Georgia, Hawaii, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Mississippi, Missouri, Nevada, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Washington, West Virginia, and Wyoming.

8. For a full discussion of the use tax and all of its ramifications, see HARTMAN, *STATE TAXATION OF INTERSTATE COMMERCE* 131 (1953); Greener, *The Use Tax: Its Relation to the Sales Tax*, 9 VAND. L. REV. 349 (1956).

9. LA. R.S. 47:301(18) (1950). See Comment, 25 MO. L. REV. 188 (1960).

10. While there is language in LA. R.S. 47:301-318 (1950) which might be interpreted to mean that the use tax applies to *all* users, no instance has arisen where it has been applied to one who manufactures goods within this state and uses them, and it seems to have been implied in the instant case that such a person would not pay the use tax.

11. *Id.* 47:305. The use tax has generally been characterized as an excise tax. *Mouledoux v. Maestri*, 197 La. 525, 2 So.2d 11 (1941). See *Brandtgen and Kluge v. Fincher*, 44 Cal. App.2d 939, 111 P.2d 979 (1941).

12. 300 U.S. 577 (1937); Notes, 1 MD. L. REV. 263 (1937), 35 MICH. L. REV. 1385 (1937). The State of Washington, in conjunction with its sales tax, levied a compensating use tax of 2% on the purchase price of goods for the privilege of using within the state any article purchased out-of-state by the user. The plaintiff, a contractor, bought goods outside of Washington, brought them to that state, and was assessed the use tax.

levied on the use and enjoyment of property which has left interstate commerce and come to rest in the taxing state, provided that the tax is non-discriminatory.¹³ Justice Cardozo suggested that the compensating use tax is not discriminatory where "the stranger from afar is subject to no greater burdens as a consequence of ownership than the dweller within the gates."¹⁴ None of the cases following *Henneford*¹⁵ has attempted to state the test of discrimination more precisely.¹⁶

In the present case¹⁷ the Louisiana Supreme Court reasoned that the incidence of the sales tax is on the purchase, while the incidence of the use tax necessarily is on the first use of the property in the state.¹⁸ At the incidence of taxation, then, the purchaser or the user is required to pay two percent of the item's value. Since the sales tax and the use tax both rest on the person who will eventually "use" the item all users, whether they pay sales tax or use tax, are subject to the same rate of tax on the value of the property.

It is arguable, however, that in applying the test of discrimination at the incidence of taxation, the court has deviated from the spirit of the *Henneford* case and its successors. In those

13. Subsequent decisions of the Court regarding the incidence of taxation have broadened the jurisdiction of the state to apply the use tax, holding that when the goods have ceased to move in interstate commerce, and are used, stored, or consumed in the state for a time, they become subject to the state's taxing power. *Pacific Tel. Co. v. Gallagher*, 306 U.S. 182 (1939) (applied to storage of telephone equipment for use on telephone lines); *Southern Pacific Co. v. Gallagher*, 306 U.S. 167 (1939) (use tax applied to storage of parts to be used on an interstate railroad).

14. *Henneford v. Silas Mason Co.*, 300 U.S. 577, 584 (1937).

15. *United States v. Detroit*, 355 U.S. 466 (1958); *General Trading Co. v. State Tax Commission*, 322 U.S. 335 (1944); *Nelson v. Montgomery Ward*, 312 U.S. 373 (1941); *Nelson v. Sears Roebuck & Co.*, 312 U.S. 359 (1941); *Pacific Tel. Co. v. Gallagher*, 306 U.S. 182 (1939); *Southern Pacific Co. v. Gallagher*, 306 U.S. 167 (1939); *Felt and Tarrant Mfg. Co. v. Gallagher*, 306 U.S. 62 (1939).

16. Many problems have arisen concerning equality between intrastate and interstate collectors of the use tax which are beyond the scope of this Note. See *Scripto v. Carson*, 362 U.S. 207 (1960); *Miller Bros. v. Maryland*, 347 U.S. 340 (1940); *Nelson v. Sears Roebuck Co.*, 312 U.S. 359 (1941); *Felt and Tarrant Mfg. Co. v. Gallagher*, 306 U.S. 62 (1939).

17. The ruling in the instant case was somewhat foreshadowed in the earlier case of *Fontenot v. S.E.W. Oil Corp.*, 232 La. 1011, 95 So.2d 638 (1957), which held that the person importing an article into this state must pay the use tax the same as if it had been sold at retail. For a criticism of the *Fontenot* case see *The Work of the Louisiana Supreme Court for the 1956-1957 Term—State and Local Taxation*, 18 LOUISIANA LAW REVIEW 95 (1957).

18. The court also found that the use tax is not levied directly on interstate commerce but on use after that commerce is at an end. It would appear that due to the ruling in the *Henneford* case and its successors this aspect of the opinion is sound. See *Pacific Tel. Co. v. Gallagher*, 306 U.S. 182 (1939); *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937); *Kust & Sale, State Taxation of Interstate Sales*, 46 VA. L. REV. 1290 (1960).

cases¹⁹ the user needed to purchase goods to perform a task within the taxing state. He could have chosen to obtain the goods in the taxing state or in interstate commerce. His choice was not hampered by the effect of the use tax, since he would have paid the same tax on the goods whether he purchased in the taxing state or in commerce. It would appear that this is the real basis for upholding the compensating use tax, *i.e.*, that the prospective user was not put at a disadvantage because he went into interstate commerce to obtain the goods.²⁰

In the instant case the plaintiff chose to *manufacture* the goods he needed for a particular task. As a result of the instant decision, since he chose to manufacture them outside of the state he was required to pay the use tax on the value of the finished product. Had he chosen to manufacture in Louisiana, he would have been required to pay the use tax only on the cost of the component parts brought into Louisiana for use in the manufacture and not on the costs of the labor and shop overhead. It therefore seems clear that the plaintiff was subjected to a form of discrimination because he chose to manufacture the goods out of the state.²¹ It is submitted that this constitutes a burden on interstate commerce²² contrary to the rationale of the *Henneford* case and its successors and thus that this application of the Louisiana use tax is offensive to the commerce clause.

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19. See note 15 *supra*.

20. See *Best and Co. v. Maxwell*, 311 U.S. 454, 457 (1940): "The freedom of commerce which allows the merchants of each state a regional or national market for their goods is not to be fettered by legislation, the actual effect of which is to discriminate in favor of intrastate businesses, whatever may be the ostensible reach of its language."

21. The total use tax for a four-year period paid by Halliburton on the labor and shop overhead amounted to \$30,942.20. *Halliburton Oil Well Cementing Co. v. Reilly*, 241 La. 67, 71, 127 So.2d 502, 504 (1961). The case is now on appeal to the United States Supreme Court. Briefs amicus curiae were filed in that appeal by the following companies: Humble Oil and Refining Co., Chicago Bridge and Iron Co., Sperry Rand Corp., Thomas Jordan Inc., American Can Co., Rossen-Richards Processing Co., and Wate-Kote Co., Ltd. The use tax these companies allegedly would pay on labor and shop overhead of goods manufactured out-of-state should the case be affirmed amounted to nearly \$200,000.

For a discussion of the use tax and its effect on the maritime operator, see Marshall, *Louisiana Sales and Use Tax Problems of the Maritime Operator*, 35 TUL. L. REV. 183 (1960).

22. It will be noted that if the author's standard for determination is applied an out-of-state purchaser will pay more use tax than an out-of-state manufacturer of the same item, resulting in a seeming discrimination between the two. However, it is suggested that a manufacturer and a purchaser are in different classes of taxpayers for the purposes of use tax.