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Gas and Electricity in Interstate Commerce - Part III - State Taxation

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PART III

STATE TAXATION

During the past decade gas and electricity have become common subjects of taxation by the states, and a not inconsiderable volume of revenue is now being raised from levies upon their production, sale, transportation and consumption.[97] The subjection to a general property tax of the facilities for producing and dealing in these commodities creates no problem of special interest for the present discussion. The same considerations are involved as in the similar application of such a tax to other types of property, and it has long been recognized that the mere fact of use in the conduct of interstate business gives no valid claim to immunity from state taxation.[98] The more

97. Since 1925 more than half of the states have enacted statutes imposing some type of special taxes on gas or electricity, or upon both. The most common tax imposed has been the production tax. Ala. Gen. Acts 1931, No. 277, p. 325 (tax on gross receipts from electric companies); Ark. Acts 1929, Act 283, p. 1187 (production tax on natural gas); Conn. Pub. Acts 1927, c. 210, pp. 4283, 4284 (tax on production and sale of both artificial and natural gas and electricity); Fla. Gen. Laws 1931, c. 15658, s. 1 (tax on sale of natural and artificial gas and electricity); Idaho Laws, Ex. Session 1931, c. 3 (tax on generation of electricity); Ill. Laws 1933, p. 924, ss. 2 and 3 (Retailers' Occupation Tax measured by gross receipts from sales and construed as applicable to sales of gas and electricity); Ind. Acts 1933, c. 50, s. 3 (tax on gross income of those producing, transmitting or selling gas or electricity); La. Acts 1928, No. 5, s. 2 (8) (severance tax on natural gas); La. Acts 1932, No. 6 (tax on generation, sale and use of electricity); Me. Laws 1929, c. 280, s. 5 (tax on gross receipts from sale of surplus of hydroelectric power); Mich. Pub. Acts 1929, No. 48, pp. 85-88 (severance tax on natural gas); Public Acts 1933, No. 167, s. 1 (b2) (general sales tax applicable to sales of gas and electricity); Mo. Laws 1933, p. 422 (tax on electric transmission lines and gas pipe lines); 1933 Ex. Sess., p. 157, s. 2a (sales tax applicable to gas and electricity); Miss. Laws 1930, c. 88, s. 163 (tax on transportation of natural or artificial gas in pipe lines); c. 90, a. 1, s. 2-a (tax on production of natural gas); s. 2-d (tax on gross income of gas and electric light and power companies); Mont. Laws 1933, c. 180 (tax on distribution or transportation of natural gas through pipe lines); N. C. Pub. Laws 1925, c. 101, s. 83a (tax on gross receipts from sale of gas and electricity); N. H. Laws 1931, c. 124, s.1 (tax on all persons or corporations engaged in manufacture, generation, distribution, transmission or sale of gas or electric energy); N. M. Laws 1925, c. 83 (production tax on natural gas); OHIO GEN. CODE (Page, 1931) ss. 5416, 5470, 5475, 5483 (tax on gross receipts from sale of natural gas); Okla. Session Laws 1931, c. 66, art. 5 (production tax on natural gas), Session Laws 1933, c. 196, s. 4 (tax on gross proceeds of all sales of gas and electricity); Pa. Laws 1929, No. 285, p. 662-665 (tax on gross receipts from sale of electricity); R. I. Acts and Resolves 1932, c. 1919, ss. 7, 8 (statute authorizing cities and towns to levy a tax on consumption of gas and electricity); S. C. Acts 1931, No. 258, s. 1 (tax on generation and sale of electric power); Tex. Laws, 5th C. S. 1930, c. 134, s. 2 (tax on gross receipts of gas and electric companies); 1931, c. 73 (tax on production and on sale of natural gas and electricity); Utah Laws 1933, c. 63, 2 (b); Vt. Pub. Laws 1931, No. 18, Part II, s. 2 (tax on generation of electricity); W. Va. Acts, Ex. Sess. 1925, c. 1, s. 2 (a) (tax on production of natural gas). This list is probably incomplete because of lack of access to recent enactments in many states.

To this list may be added the Federal Power Tax of 3% of the amount paid for all electrical energy furnished for domestic or commercial consumption, Revenue Act of 1932, s. 616.

98. Postal Telegraph Cable Co. v. Adams, 155 U. S. 688 (1895); Adams Express Co. v. Ohio, 165 U. S. 194 (1897); Cudahy Packing Co. v. State of Minnesota, 246 U. S. 450 (1918).

specialized types of taxes, however, have given rise to some interesting problems in relation to interstate commerce. The most common of these have been the production taxes and the sales taxes.

A. Taxes on Production and Generation

State taxes on the production of natural gas and the generation of electrical energy have been more widely adopted than any other type of tax affecting these commodities, and at the same time have brought forth the most important questions from the point of view of the student of interstate commerce. Production or manufacture is not a part of interstate commerce, though the commodity produced may be intended for shipment to another state.[99] And while an article in actual transit on its way outside the state is beyond the control of the state,[100] until so started on its interstate journey, or entrusted to a carrier for that purpose, it may be subjected to taxation by the state of its origin.[101] For the ordinary type of interstate transactions the doctrines thus announced in *Kidd v. Pearson*[102] and *Coe v. Errol*[103] have never been seriously questioned. When the line of demarcation between those acts which produce an article of commerce and those which start it on its interstate journey becomes impossible to draw with clarity, the proper application of these doctrines becomes a matter of no little difficulty.

Prior to the cases involving production taxes on natural gas and electrical energy, the Supreme Court applied these doctrines to a mining case under circumstances that created an important precedent for the cases to be discussed herein. In *Oliver Iron Mining Co. v. Lord*,[104] the Court sustained the application of an occupation tax to the business of a mining company, practically all of whose product was mined to fill existing contracts with consumers in other states and passed at once into the channels of interstate commerce. There was no market within the state for more than a very small percentage of the mining company's product, and most of the ore was loaded on the cars for its immediate interstate journey by the same action of the steam shovels which removed it from its natural bed. That there was a continuity of movement from the instant of severance and thus no perceptible break between the final act of mining and the beginning of the interstate transportation,

99. Kidd v. Pearson, 128 U. S. 1 (1888); United States v. E. C. Knight Co., 156 U. S. 1 (1895); Capital City Dairy Co. v. Ohio, 183 U. S. 238 (1902); *cf.* Cornell v. Coyne, 192 U. S. 418 (1904).

100. Champlain Realty Co. v. Town of Brattelboro, 260 U. S. 366 (1922); Hughes Brothers Timber Co. v. Minnesota, 272 U. S. 469 (1926). For an exhaustive treatment of this problem, see Powell, *Taxation of Things in Transit* (1920) 7 VA. L. REV. 167, 245, 429, 497.

101. Coe v. Errol, 116 U. S. 517 (1886); *cf.* Diamond Match Co. v. Ontonagon, 188 U. S. 82 (1903).

102. *Supra* note 99.

103. *Supra* note 101.

104. 262 U. S. 172 (1923).

and that the burden of the tax would be shifted wholly to consumers in other states,[105] did not deter the Court from finding that the mining was a local business within the taxing power of the state. Despite its inseparable connection with the interstate shipment on preexisting orders, the act of severing the ore from its natural bed was treated as a distinct act of production analogous to manufacture.

Because of its similarity to the leading gas production tax case, the decision of the Supreme Court in *Heisler v. Thomas Colliery Co.*[106] should not be overlooked in this preliminary discussion, although it involved the imposition of a property tax. The tax there sustained by the Court was imposed by a statute of Pennsylvania upon the value of all anthracite coal when prepared for market and ready for shipment or sale.[107] Aside from the peculiar circumstances of the particular case, such a tax, non-discriminatory in its terms, would have no special significance for the student of interstate commerce. Here, however, not less than eighty per cent. of all such anthracite was prepared for and went immediately into interstate commerce, and the extra-state consumers were almost completely dependent upon the Pennsylvania supply. Thus again, the burden of the tax was placed almost solely upon consumers outside the state,[108] and the nature of that burden was

105. For an excellent discussion of this aspect of the problem and the consequent effect on interstate commerce, see Powell, *State Production Taxes and the Commerce Clause* (1923) 12 CALIF. L. REV. 17.

106. 260 U. S. 245 (1922); *cf.* Missouri, Kansas & Texas Railway Co. v. Meyer, 204 Fed. 140 (W. D. Okla. 1913). But see State v. Cumberland & Pennsylvania Railroad Co., 40 Md. 22 (1874).

107. See Commonwealth v. Philadelphia & Reading Coal & Iron Co., 278 Pa. 338, 123 Atl. 315 (1924). *Cf.* American Manufacturing Co. v. City of St. Louis, 250 U. S. 459 (1919).

108. There was some indication that this fact was one of the reasons for the enactment of the statute. The contention that for that reason it was a burden on or an attempt to regulate interstate commerce and invalid was dismissed by Mr. Justice McKenna with the statement that "a tax upon articles in one state that are destined for use in another state cannot be called a regulation of interstate commerce, whether imposed in the certainty of a return from a monopoly existing, or in the doubt and chances because of competition." The contention, he thought, was substantially an assertion that "the products of a state that have, or are destined to have, a market in other states, are subjects of interstate commerce, though they have not moved from the place of their production or preparation. ... If the possibility, or, indeed, certainty of exportation of a product or article from a state determines it to be in interstate commerce before the commencement of its movement from the state, it would seem that it is such from the instant of its growth or production, and in the case of coals, as they lie in the ground. The result would be curious. It would nationalize all industries. . .and withdraw from state jurisdiction and deliver to federal commercial control. . .fruits unpicked, cotton and wheat ungathered, hides and flesh of cattle yet 'on the hoof', wool yet unshorn, and coal yet unmined, because they are in varying percentages destined for and surely to be exported to states other than those of their production." 260 U. S. at 259, 260.

There was no attempt at a rational discussion of the actual effect of such a tax, in the circumstances of this case, upon the interstate commerce in the coal. It was treated as an ordinary property tax on an article later to become the subject of interstate commerce and upheld on the authority of such cases as Coe v. Errol, *supra* note 101.

substantially no different from that of a tax imposed directly upon the privilege or the act of interstate transportation.[109] The Court saw no serious obstacle to validity in these considerations, nor in the further fact that this was not a general property tax with its safeguards against burdening interstate business more heavily than local business, but a special levy upon a product the principal markets for which were in other states, and thus more or less discriminatory against interstate commerce in its ultimate economic effect.

With these cases as a background, and in the light of their determination, the Court approached the consideration of its first gas production tax case, *Hope Natural Gas Co. v. Hall*,[110] involving a statute of West Virginia imposing an occupation tax upon the business of mining or producing natural gas and other named natural resources, the tax to be measured by the gross proceeds from their sale "regardless of the place of sale or the fact that deliveries are made to points outside the state."[111] Practically all of the product of the Hope Natural Gas Company passed into interstate commerce by a continuous movement directly from the producing wells, and was sold, delivered and consumed in Ohio and Pennsylvania. Where permanent physical connections exist by means of which the gas is released from the producing wells in one state and conducted directly to the burner-tips in another by the single operation of opening a valve or turning a gas jet in the latter state, it is not possible to mark the dividing line between production and interstate transportation in any satisfactory fashion. Even where the natural pressure is insufficient and the gas is pumped at higher pressure, the situation is not essentially different. The continuity of production and transportation is even more direct than in the *Oliver Iron Mining Co.* case. If, by the doctrine asserted in *Coe v. Errol* and applied in the *Champlain Realty Co.* and *Hughes Brothers Timber Co.* cases,[112] the gas is beyond the state's taxing power the moment it is started on a continuous movement outside the state, and if the single act of pumping or of turning the gas jet under natural pressure which starts the continuous movement is also the only act of production, it is somewhat difficult to find either a distinct and separate act of production subject to an occupation tax or an instant of time at which there is in existence gas separated from its natural reservoir and not yet a part of interstate commerce so as to be subject to the state's property tax. This feature was not pressed in the case, however, the sole controversy having to do with the method of valuation for tax purposes. It was apparently admitted by the parties and assumed by the courts, on the basis of the mining cases[113] previously

109. For a careful consideration of this matter, see Powell, *op. cit. supra* note 105.
110. 274 U. S. 284 (1927).
111. W. Va. Acts, Ex. Sess. 1925, c. 1, s. 2 (a).
112. *Supra* note 100.
113. Oliver Iron Mining Co. v. Lord, *supra* note 104; and Heisler v. Thomas Colliery Co., *supra* note 106.

discussed, that such a production tax, measured by the value of the gas at the well, would be valid. But the trial court considered the statute as imposing a tax upon the gross receipts from the sale of the gas, whether within or without the state, and, as to the latter, invalid as an interference with and burden upon interstate commerce. The Supreme Court of Appeals[114] interpreted the statute as being applicable to the value of the gas within the state and before it entered interstate commerce, and said the gross proceeds from sales in other states were only to be taken into consideration for purposes of finding that value, and modified the decree enjoining collection of the tax. Although this was probably a highly strained interpretation of the statute, it was accepted by the United States Supreme Court and the tax was sustained. The tax in this case was not restricted in its application to gas but was applicable alike to the production of numerous other natural resources, whether used within or without the state, and although the gas here involved was practically all consumed outside the state, no point was made of the fact that the tax would ultimately have to be paid, as in the *Thomas Colliery Co.* case, by consumers in other states.

The electrical generation tax cases have brought before the courts as the principal issue the matter of continuity of production and transportation as a single indivisible act which was passed over in the *Hope Natural Gas Co.* case. The most important of these cases is *Utah Power & Light Co. v. Pfost.*[115] A statute of Idaho imposed a license tax of one-half mill per kilowatt hour upon the "manufacture, generation, or production, within the state, for barter, sale, or exchange, of electricity and electrical energy" to be "measured at the place of production."[116] The Utah Power and Light Company maintained hydroelectric plants in Idaho at which it generated a large volume of electrical energy and supplied it to consumers in Idaho, Utah and Wyoming. More than eighty-six per cent of its total product was being sent outside the state of generation, and the tax was attacked as a direct burden on interstate commerce. The issue as stated by the Court was whether the generation of electrical energy was to be considered as a process essentially local in character and complete in itself, like manufacture or production generally; or as so linked with the transmission as to make it an inseparable part of a transaction in interstate commerce. Opposing theories were presented by the Power and Light Company and by the Commissioner of Law Enforcement against whom a restraining order was sought, as to the nature of the processes involved in the generation and transmission of electricity. By the former it was asserted that its entire electric system was solely a transferring device for transmitting the force of the falling water to its place of utilization, a single con-

114. 102 W. Va. 272 (1926).
115. 286 U. S. 165 (1932).
116. Idaho Laws, Ex. Sess. 1931, c. 3.

tinuous process, all of which was a part of interstate commerce and not subject to the taxing power of the state. On the part of the commissioner it was asserted that the tax was laid upon the generation of electrical energy as a distinct act of production without regard to its subsequent transmission; that the process of generation was one of converting the mechanical energy of the falling water into electrical energy; that the resulting change was substantial and was completed before the pulses of the energy passed from the generator in their flow to the transformer; and that the transmission was subsequent to, and separable from generation, in effect, as the transportation of tangible goods is subsequent to, and separable from their manufacture. The Court inclined to the latter view. Speaking through Mr. Justice Sutherland, it was asserted that a distinct product was brought into being by the process of generation and transmitted to the places of use. "The result is not merely transmission; nor is it transmission of the mechanical energy of falling water to the places of consumption; but it is, first, conversion of that form of energy into something else, and, second, the transmission of that something else to the consumers. While conversion and transmission are substantially instantaneous, they are . . . essentially separable and distinct operations."[117] In response to the contention that the process is merely one by which the consumer in Utah turns a switch and draws directly from the water fall in Idaho electrical energy which appears instantaneously ready for use, it was asserted by Mr. Justice Sutherland that,

> "the turning of the switch in Utah is not to draw electrical energy directly from the water fall, where it does not exist except as a potentiality, but to set in operation the generating appliances in Idaho, which thereupon receive power from the falling water and transform it into electrical energy. In response to what in effect is an order, there is production as well as transmission of a definite supply of an article of trade. . . . The generator and the transmission lines perform different functions, with a result comparable, so far as the question here under consideration is concerned, to the manufacture of physical articles of trade and their subsequent shipment and transportation in commerce."[118]

It was thought by the Court that the principles adhered to in the *Oliver Iron Mining Co.* and *Hope Natural Gas Co.* cases were completely controlling and necessitated a similar result.

As is not infrequently the case, the scientific and engineering experts differed in their opinions as to just what was the real nature of the process.[119] But even if it be scientifically correct that there are not two separate and

117. 286 U. S. at 179.
118. *Ibid.* 179, 180.
119. Utah Power & Light Co. v. Pfost, 54 F. (2d) 803, 804 (1931).

distinct processes, perhaps that should not necessarily control the legal conclusions with respect to the constitutional power of the states.

On the theory that nothing takes place but the transmission of the energy of falling water from the waterfall where nature placed it to the point of consumption in another state, and that the whole process is therefore included in interstate commerce, a distinction would apparently have to be made between the steam and the hydro generated products. In the case of the former, clearly something more takes place than the transmission of the latent energy in coal and water, and probably it would not be seriously contended that the process is not assimilable to that of manufacture for purposes of state taxation. And yet, the process is as continuous and instantaneous in the one case as in the other. The same turning of a switch has a like effect in both cases. By either process, according to the courts, a distinct product[120] is brought into being which is transmitted to points of utilization in other states. If the generation and transmission are more instantaneous than in the case of natural gas or the ore in the *Oliver Iron Mining Co.* case, there is nevertheless the creation of a distinct product which is not true in the latter cases. There, instead of production in the sense of manufacture, it is rather the severance or extraction from its place in nature of a commodity already existing. For purposes of applying constitutional principles, however, the processes are distinctly analogous.

There would seem to be no greater difficulty in conveiving of the generation of electrical energy as distinct from its transmission, or as bringing into existence a new article or force, the creation of which is a local process and therefore taxable as such, than in conceiving of electrical energy or force as a commodity of interstate trade in the same sense that coal or shoes or grain are said to be. The latter proposition is, of course, no longer open to question. There is, perhaps, no greater reason for exempting electrical generation from state taxation because the product is to go across state lines, than for exempting mining or manufacture for the same reason, although the immediacy of the interstate movement is much greater in the one case than in the others. The real source of difficulty appears to be that our terms, production and transportation, were invented and applied at a time when electric light and power current as an article of trade, or the hydroelectric generating plant as a means of its production, had never yet been dreamed of. It is a question of whether our categories are rigid and restricted to the exact transactions originally placed within them, or are sufficiently flexible to be made to embrace new situations as they arise. Our whole constitutional development points

120. To the contention that there is nothing in the process equivalent to manufacture or production, that no new energy is created but merely that existing energy is changed in form, it may be said that the same is largely true of many other processes about which there is no question in this connection. In the same sense, little but change of form takes place when lumber is made into boxes, leather into shoes, or wheat into flour.

irresistibly to the latter view. The new processes fit neither into the one category nor the other without some readjustment of conventional notions. Manufacture as commonly understood, or even production, hardly describes the process by which a waterfall is harnessed and its energy turned into electricity. Neither is the whole enterprise one of transportation in the sense that a product of manufacture, or a natural object previously prepared therefor, is transported from state to state. The terms manufacture and transportation as thus used are not straight-jackets for the conceptions involved, which can never be varied to include new processes, but, like other language, are merely the vehicles by which the conceptions are given expression,[121] and when applied to those conceptions upon which the force of governmental powers may be brought to bear, must maintain that flexibility of which the Constitution itself as a living instrument is the best exemplification. Our hitherto formulated notions of manufacture or production and transportation as separate transactions, the former of which is essentially local while the latter may be completely interstate, should not be rigidly restricted to those conventional transactions from which they derived their origin. Rather, they should be considered sufficiently broad to include within their scope new and different methods of dealing. The principles as originally enunciated in *Coe v. Errol* and *Kidd v. Pearson*, and since adhered to, are not to be considered iron clad dogmas requiring straight-jacketed adherence for all time, but, like the provisions of the Constitution itself, flexible enough to be applied to changing conditions. The question for determination is not solely whether a commodity has been manufactured or produced in the orthodox sense. It is rather, again, a matter of judgment. And when there is conducted within a state, under the protection of local laws, a profitable enterprise which results in a commodity of interstate commerce, there seems ample reason for saying that those principles, originally enunciated as applicable to the production within a state by an ordinary process of manufacture of commodities of interstate commerce, may be made to apply, directly or by analogy, to the new enterprise and bring it within the taxing power of the state.[122] A liberal attitude in recognition of the

121. "A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used." Mr. Justice Holmes in Towne v. Eisner, 245 U. S. 418, 425 (1918).

122. For a full consideration of the problems herein discussed by a federal district court, see South Carolina Power Co. v. South Carolina Tax Commission, 52 F. (2d) 515 (1931). The expert testimony of Dr. Robert A. Millikan, physicist, to the effect that the whole electric system is merely a device for transferring the force of falling water to and applying it at the point of utilization, was set forth at some length and the contention was considered in detail. The court came to the conslusion that the principles of Oliver Iron Mining Co. v. Lord and Hope Natural Gas Co. v. Hall were controlling and sustained the tax. (*Aff'd* by the Supreme Court in Broad River Power Co. v. Query, *supra* note 48). A variant note is injected by the assertion of the court that the "current generated in South Carolina, upon which the tax is imposed, is not the current transmitted in interstate commerce. The current upon which the tax is imposed is the generated low-voltage current;

states' necessity to provide themselves with revenue has been maintained in the past with respect to this type of situation. Even if the processes of generation and transmission of electrical energy were, for such purposes as regulation, considered inseparable parts of a single interstate enterprise, that enterprise receives the same benefits of state protection as does a similar business carried on completely within the state, and there appears to be no very good reason why it should not in like manner contribute to the support of the government whose protection it enjoys. Such a conclusion would not be inconsistent with the results reached invalidating attempts on the part of the states to prohibit exportation of natural gas or hydroelectric power in interstate commerce. The one stops commerce at state lines and seriously interferes with a national policy of commercial development, control of which the Constitution confides to Congress; the other merely requires the interstate enterprise to bear its fair share of a common burden by the payment of a non-discriminatory tax which in no way discourages the conduct of interstate commerce.

In the *Utah Power & Light Co.* case no point was made of the fact that the tax in question was not a general one but a special excise on the generation of electricity, or that all but a small percentage of the current upon which the tax was levied went to consumers outside the state[123] and thus the ultimate burden of supplying that part of the state's revenue fell upon residents of other states. Apparently the *Hope Natural Gas Co.* case is regarded as having fully settled these matters. Despite the fact that such a tax may place upon interstate commerce substantially the same degree of burden as would a forbidden tax on transportation, the decision in that case is probably sound. That interstate commerce may be taxed if only it is done in the right way[124] is amply borne out by the cases. In the situation here in question there is no positive discrimination against extra-state consumers in the sense that they are made to bear a burden of which domestic consumers are relieved.[125] It merely chances that most consumers of the product reside in other states, and, as the nature of the tax is such that it may be readily shifted by the producer, the ultimate economic burden is borne primarily by such non-residents.

the current transmitted in interstate commerce is the high-voltage current induced in the transformers of the company. The statute does not attempt to impose a tax upon this." (525)

For a criticism of the cases herein discussed and a point of view contrary to that of the present writer, see Note, *State Taxation of Electric Power* (1932) 42 YALE L. J. 94. The position is there taken that if the decisions are to be justified the doctrine of Coe v. Errol must be modified. The Court should assert, it is said, that in all cases interstate commerce will be held not to commence until after production is completed, even though the extra-state movement has already begun, and that wherever the doctrines of Coe v. Errol and Kidd v. Pearson conflict, the latter shall prevail.

123. Of all the electrical energy produced in the State of Idaho in 1931, approximately 40% was exported. N. E. L. A. STATISTICAL BULL. No. 8 (July 1932). According to the study made by the Bureau of Business Research of Harvard University in 1926, Idaho at that time exported 63% of the power generated within her borders. MOSHER, ELECTRICAL UTILITIES (1929) 133.

124. Powell, *op. cit. supra* note 105, at 18.

125. *Ibid.* 21 et seq.

B. Taxes on Sales and Gross Receipts

While sales tax statutes applicable to gas and electricity have become a common legislative phenomenon in recent years,[126] few questions involving the commerce clause have been before the courts. Just as a state may not impose a tax upon interstate transportation,[127] it finds a similar obstacle in the commerce clause to the taxation of interstate sales.[128] For that reason, no doubt, care has been taken in drafting the statutes in several states to exclude interstate sales.[129] As a result, the problem of the sales tax as an interference with interstate commerce has not been a serious one for the state of origin. Such litigation as has arisen has involved the taxing statutes of the states of destination. The one issue of importance has been the determination of when the commodity loses its interstate character and becomes mingled with the mass of property within the state. This question was discussed somewhat at length above in connection with state regulation of rates because of the fact that the Supreme Court in the leading taxation case under the present heading expressly repudiated the doctrine of *Pennsylvania Gas Co. v. Public Service Commission*,[130] theretofore the leading regulation case dealing with this matter. For that reason the present discussion may well be brief.

East Ohio Gas Co. v. Tax Commission of Ohio[131] involved a socalled excise or privilege tax upon all natural gas companies operating in the state, measured by a percentage of the gross receipts from sales in intrastate business. The sole difficulty involved was the determination of what business was thus included. The East Ohio Gas Company obtained three-fourths of its supply from West Virginia and Pennsylvania and one-fourth in Ohio. Some customers were supplied with gas solely from Ohio wells, others from a mixture of that originating within and without the state, and still others with gas of extra-state origin alone. The principal controversy had to do with the tax on the receipts from the last group. Ownership and control of the gas was assumed at the state line, but the whole passage from the producing wells in the other states through the high-pressure lines of both the producing company and the East Ohio Company to the connection with the latter's local systems was treated as interstate commerce of a national character throughout. But the reduction in pressure by passing through reducing stations and the division

126. *Supra* note 97.

127. Case of the State Freight Tax, 15 Wall. 232 (1873); Western Union Telegraph Co. v. Texas, 105 U. S. 460 (1882); Eureka Pipe Line Co. v. Hallanan, 257 U. S. 265 (1921); United Fuel Gas Co. v. Hallanan, 257 U. S. 277 (1921); State Tax Commission of Mississippi v. Interstate Natural Gas Co., 284 U. S. 41 (1931).

128. Heyman v. Hays, 236 U. S. 178 (1915); State v. Welsh, 61 S. D. 593, 251 N. W. 189 (1933); *cf.* Crew Levick Co. v. Pennsylvania, 245 U. S. 292 (1917).

129. See, e. g., the statutes of Florida, North Carolina, Pennsylvania and South Carolina, *supra* note 97.

130. 252 U. S. 23 (1920).

131. 283 U. S. 465 (1931).

into tiny streams for delivery to consumers was said to be analogous to the breaking of an original package for the disposition of its contents at retail. The subsequent sale and delivery was, therefore, held to be not a part of interstate commerce but a purely local business subject to the complete control of the state. With its interstate character thus ended, in the determination of which the *Pennsylvania Gas Co.* case was expressly disapproved, no objection remained to the validity of the state tax. Since the case here under discussion is a tax case and the *Pennsylvania Gas Co.* case was one of rate regulation, the possibility of distinguishing them should not be entirely overlooked, but the Court had before it exactly the same problem as to local or interstate business and expressly stated that the former case had been decided on the basis of a theory not entirely consistent with the earlier regulation cases,[132] that the considerations leading to its present decision had not been there presented to the Court, and that "the opinion in that case must be disapproved to the extent that it is in conflict with out decision here."[133] The Court may adhere to different theories as to the power to tax and the power to regulate where it considers interstate commerce of a local nature as being involved, but it is hardly likely that it will treat the same business as purely intrastate for one purpose and as interstate, local in nature, for another.[134] But however this matter ultimately may be determined, whether held to be the one or the other, it should be borne in mind that "it does not follow that, because a thing is subject to state taxation, it is also immune from federal regulation under the commerce power."[135] It may be so far local in its nature as to permit state taxation, and yet sufficiently a part of, or so far related to, interstate commerce as to justify regulation at the hands of Congress.[136]

Certain other theories, not employed by the courts in these cases, might be suggested as conceivable bases for reaching the same result as that arrived at in the *East Ohio Gas Co.* case, regardless of the conclusion as to when interstate commerce in the gas or electricity comes to an end. If the determination should ultimately prevail that delivery to local consumers by a transporting company is a part of interstate commerce, local in its nature, as was held in the *Pennsylvania Gas Co.* case, the states need not necessarily be deprived of this source of revenue so long as no discrimination is practiced. While there are no Supreme Court decisions on the matter, two possibilities seem worthy of consideration. By the well established doctrine of *Cooley v. Board of Wardens of the Port of Philadelphia*,[137] states may legislate in regulation of interstate

132. Public Utilities Commission v. Landon, 249 U. S. 236 (1919); Missouri v. Kansas Natural Gas Co., 265 U. S. 298 (1924).
133. 283 U. S. at 472.
134. But *cf.* Addyston Pipe & Steel Co. v. United States, 175 U. S. 211, 246 (1899).
135. Binderup v. Pathé Exchange, Inc., 263 U. S. 291, 311 (1923).
136. State of Minnesota v. Blasius, 290 U. S. 1 (1933).
137. 12 How. 299 (1851).

commerce, local in its nature, until Congress acts to occupy the field. Thus far that doctrine has apparently been restricted to police power cases.[138] That it might be extended to taxation so as to allow the states to raise revenue by means of a privilege tax upon the sale of gas and electricity to consumers as a transaction peculiarly local in its nature, although subject to the superior regulatory power of Congress, is a proposition not without considerable merit. Perhaps a more plausible means of arriving at the same desired result would be by the application of the doctrine of *Sonneborn Brothers v. Cureton*[139] to the facts here involved. Articles of commerce from a sister state, not yet removed from their original package so as to bring to an end their character as articles of interstate commerce, but whose interstate transportation has ended, are nevertheless subject to non-discriminatory state taxation, either in the form of a property tax[140] or a tax upon their sale, when they have become localized by being held by the "importer" for purposes of sale. That the principles responsible for this doctrine might fully justify a tax in the present situation where the gas or electricity is in effect being held by the "importer" in its system of distribution lines for delivery to local consumers, the levy to be imposed upon the sale, appears to be an entirely reasonable conclusion. No such suggestion seems to have been made in any of these cases, however. Possibly also such a business might be likened to that of a salesman from another state who carries his goods with him to serve the needs of an established group of customers,[141] and subject to taxation which makes no discrimination because of the extra-state origin of the articles he has for sale. Be that as it may, perhaps the theory employed by the Court is as satisfactory as any that may be devised, and it appears to reach an entirely desirable result.

The doctrine of the *East Ohio Gas Co.* case has been applied to a kilowatt tax on the sale of electricity in *South Carolina Power Co. v. South Carolina Tax Commission*.[142] In the first decision of this case, dealing with sales to

138. It is interesting to note in this connection that the federal district court in Utah Power & Light Co. v. Pfost, 52 F. (2d) 226 (1931), in sustaining a tax on the generation of electricity, used this as a partial basis for its holding. No mention was made of it, however, in the decision of the Supreme Court, 286 U. S. 165 (1932), discussed *supra* under taxes on generation and production.

139. 262 U. S. 506 (1923).

140. Brown v. Houston, 114 U. S. 622 (1885); Wiloil Corporation v. Pennsylvania, 55 S. Ct. 358 (1935).

141. Wagner v. City of Covington, 251 U. S. 95 (1919).

142. 52 F. (2d) 515 (1931). The statute of South Carolina, *supra* note 97, imposed a tax of five-tenths of one mill upon each kilowatt hour of electric power sold in the state. The South Carolina Power Company brought much of its current from its own hydro-electric plants in Georgia and sold and delivered it to consumers in South Carolina. In some cases it delivered to industrial consumers at high voltage and to two towns which had their own distribution systems. In one of the latter delivery was made at high voltage, in the other with voltage reduced. As to all other purchasers, it delivered at reduced voltage ready for consumption. No point was made of these differences in the first case, but an attempt was made to restrain enforcement of the statute as to all as a burden on interstate commerce. The denial of an interlocutory injunction was affirmed by the Supreme Court without

domestic consumers, it was said that the change in voltage by stepping up or stepping down was not a mere change in the current, but the production of a new and different current. It was therefore concluded that the tax on sales was not levied upon the high-voltage current which comes into the state in interstate commerce, but upon the low-voltage current which is sold. This was not the sole reliance of the court, however. It found an analogy to the original package idea in the breaking up of the high-voltage current and asserted that the *East Ohio Gas Co.* case was completely controlling to end the interstate character of the transaction and validate the tax. On final hearing, where the matter of deliveries at high voltage to mills and a town with its own local distribution system were dealt with, a different theory had to be invoked. This problem, which was discussed at some length above in connection with regulation, will not be dealt with fully here. Suffice it to say that the fact of distribution at reduced voltage from the same lines to numerous consumers before the deliveries here in question were made was considered sufficient to characterize such lines as the company's distribution system within the state by means of which it carried on a local business. On that basis the interstate character of the current was thought to be lost when it was placed upon those lines for its local sale and delivery. The fact of delivery at high voltage in some cases was considered immaterial. If this conclusion as to the ending of the interstate business, as previously discussed, is sound, there can be no doubt as to the validity of the tax. If it is not, this would present an admirable situation for an attempt to apply the doctrine of the *Sonneborn* case.[143]

C. *Taxes on Transportation*

That a state may not, consistently with the commerce clause of the Constitution, impose a tax upon interstate transportation, is well settled.[144] That the business of local transportation may be subjected to state taxation is quite obvious. The only problem in the application of such a tax is in the determination of whether the transportation is interstate or local. Few states have provided for taxing the transmission of gas and electric light and power cur-

opinion in Broad River Power Co. v. Query, 286 U. S. 525 (1932). When the case came on for final hearing, 60 F. (2d) 528 (1932), which, for purposes of the present discussion, might be treated as a separate case, the court dealt solely with the deliveries to the towns and industrial purchasers but reached the same result. On final appeal to the Supreme Court in Broad River Power Co. v. Query, 288 U. S. 178 (1933), where the interstate commerce contention was not pressed, the denial of the injunction was again affirmed. An additional feature of interest in these cases, involving both the validity of the sales tax here considered and that of the generation tax imposed by the same statute and discussed *supra* in note 122, was the contention of the power companies that as licensees of the Federal Power Commission they were agencies of the federal government and not subject to the taxing power of the state. That contention was dismissed, largely on the authority of Susquehanna Power Co. v. State Tax Commission of Maryland, 283 U. S. 291 (1931).

143. *Supra* note 139.

144. *Supra* note 127.

rent, and such cases as have come before the Supreme Court have resulted in a determination that the state had overstepped the proper bounds. West Virginia imposed a tax some years ago on the transmission of natural gas in pipe lines within the state which came before the Supreme Court of the United States in *United Fuel Gas Co. v. Hallanan*.[145] The gas carried by the United Company, for the most part, was gathered or purchased within the state, and the great bulk of it was destined to points outside, either by its own lines or those of connecting companies to whom much of the gas was sold. The whole of the transportation with respect to that part which ultimately moved out of the state was held to be interstate commerce, and beyond reach of the state's taxing power, although the necessities of the business required that a much smaller part destined to points within the state be carried undistinguished in the same pipes.[146] The further fact that as to most of the gas sold to connecting companies, the United Company before sale, and the purchasers thereafter, were free to change their minds before the gas left the state and make other disposition of it was considered immaterial.[147]

A similar result was reached in the application of a like tax by the state of destination in *State Tax Commission of Mississippi v. Interstate Natural Gas Co.*[148] Interstate transportation of gas was being carried on through trunk lines of pipe extending from gas fields in Louisiana into Mississippi and back into the former state. From this trunk line passing through Mississippi, deliveries were made to certain distributing companies with pressure reduced. This reduction in pressure by the pipe line company before the gas passed into the lines of the purchasers was held not to affect the interstate character of the transaction or bring it within the the taxing power of the state. It was characterized by Mr. Justice Holmes as being work done upon the flowing gas to help the delivery and plainly incident to the interstate transmission. "The plaintiff simply transports gas and delivers it wholesale, not otherwise worked over than to make it ready for delivery to independent parties that dispose of it by retail."[149] As involving wholesale deliveries direct from interstate transportation lines, the case is entirely consistent with the regulation cases heretofore considered, such as *Missouri v. Kansas Natural Gas Co.*[150] and *Public*

145. 257 U. S. 277 (1921).

146. *Cf.* Eureka Pipe Line Co. v. Hallanan, 257 U. S. 265 (1921), arriving at a similar result with respect to oil under the same statute. W. Va. Acts, Ex. Sess. 1919, c. 5.

147. The state court had taken the position that at the time the gas sold to three of the connecting companies was put in course of transportation it had no fixed destination other than the point of delivery to the purchasing company, that it was not then known what percentage would ultimately leave the state, and that, although past experience justified the assumption that much of it would do so, none of it was, as yet, in interstate commerce. The tax was consequently upheld. Pipe Line Co. v. Hallanan, 87 W. Va. 396 (1920).

148. 284 U. S. 41 (1931).

149. *Ibid.* 44.

150. *Supra* note 132.

151. *Ibid.*

Utilities Commission v. Landon,[151] both of which were here relied on. It has been noted that reduction in pressure or voltage has been emphasized in some cases[152] as the equivalent of breaking an original package and as marking the transition from interstate to intrastate business. In those cases, the contention, based on expert testimony, that all stepping up or stepping down in pressure or voltage was merely incident to the proper transportation and delivery of the commodities in interstate commerce was rejected by the courts. This was especially urged in the *South Carolina Power Co.* case with respect to electricity, but it is equally applicable to gas. In this last mentioned case the reduction in voltage was for the purpose of delivery to consumers and the current was then put on the wires of the local distribution system. Quite properly, it would appear, this reduction in voltage and entrance upon the system of wires maintained for service to local consumers was held to bring the interstate transaction to an end. What came thereafter was intrastate business. In the *Interstate Natural Gas Co.* case the reduction in pressure was not for delivery to consumers as a local business, but was merely incident to the convenient reception by the wholesale customer from the interstate transportation company. The cases are, therefore, entirely reconcilable. As previously emphasized, no single test, such as reduction in pressure or voltage, or delivery at the state line, is a never failing guide. "Interstate commerce is a practical coneption and what falls within it must be determined upon a consideration of established facts and known commercial methods."[153] So it is in these cases with respect to that which brings such commerce to an end and marks the beginning of a local business fully subject to the taxing power of the states.

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152. East Ohio Gas Co. v. Tax Commission of Ohio, *supra* note 130; South Carolina Power Co. v. South Carolina Tax Commission, *supra* note 141.

153. Public Utilities Commission v. Landon, 249 U. S. 236, 245 (1919).