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ATTORNEY GENERAL OPINION NO. 86- 29

The Honorable Joseph F. Norvell
State Senator, Thirty-Seventh District
Room 452-E, State Capitol
Topeka, Kansas 66612

Re: Taxation--Kansas Retailers' Sales Tax--Tax Imposed; Interstate Commerce

Synopsis: The issue of whether a state or local sales tax imposed on interstate long-distance telephone calls violates the commerce clause of the United States Constitution has not yet been addressed by the United States Supreme Court. However, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977) and subsequent cases indicate that such a tax may be upheld if: 1) the tax is applied to an activity with a substantial nexus with the taxing state; 2) the tax is fairly apportioned; 3) the tax does not discriminate against interstate commerce; and 4) the tax is fairly related to the services provided by the state. Cited herein: U. S. Const., Art. §8, cl. 3.

* * *

Dear Senator Norvell:

You have requested our opinion regarding the constitutionality of a state imposed sales tax on interstate long-distance telephone services. Specifically, you question whether such a tax would violate the Commerce Clause

of the United States Constitution, Article I, Section 8, Clause 3.

This particular issue has not yet been addressed by the United States Supreme Court. Early decisions of the Court indicated that a tax on a business engaged in interstate commerce would not be upheld. Western Union Telegraph Co. v. Pennsylvania, 128 U.S. 39, 9 S.Ct. 6, 32 L.Ed. 345 (1888), held that "[t]he interstate business of a telegraph company is not subject to state taxation in any way," because "[a] state cannot regulate or tax the operations or objects of interstate or foreign comerce." See also, Western Union Telegraph Co. v. Seay, 132 U.S. 472, 473, 10 S.Ct. 161, 33 L.Ed. 409 (1889) and Cooney v. Mountain States Telephone and Telegraph Co., 294 U.S. 384, 392, 393, 55 S.Ct. 477, 79 L.Ed. 934 (1935). This holding has gradually been eroded, however, by cases such as Freeman v. Hewitt, 329 U.S. 249, 67 S.Ct. 274, 91 L.Ed. 265 (1946), which hold that a state could tax interstate commerce "to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." Id. at 253.

More recently, the Court has determined that a state tax on interstate commerce will be sustained "when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977). See also, Washington Rev. Dept. v. Stevedoring Assn., 435 U.S. 734, 98 S.Ct. 1388, 55 L.Ed.2d 682 (1978). In examining this four-part test, several cases and law review articles provide insight as to what circumstances will be sufficient to meet each of the four parts. For example,

> "[T]he nexus requirement demands a more specific relationship than the generation of income within the state to the interstate business; nexus instead demands that the state somehow provide a service to the business, a service which so far has been found to be present when there is at least one employee in the state." 42 La.L.Rev. 951, 969 (1982).

In Stevedoring Assn., supra, the Supreme Court held that the tax challenged therein was fairly apportioned

because it was levied solely on the value of the in-state stevedoring activities of loading and unloading ships' cargo. The Court then defined as nondiscriminatory those taxes which apply the same rates to interstate business as to intrastate business. It has since been pointed out, however, that "[t]axes may discriminate against interstate commerce either because they are computed on discriminatory bases or because their 'economic incidence falls disproportionately on interstate activities.'" 1982 B.Y.U.L. Rev. 765, 772 (1982), citing The Supreme Court, 1976 Term, 91 Harv. L.Rev. 70, 78-81 (1977).

Finally, in Commonwealth Edison Co. v. Montana, 453 U.S. 609, 101 S.Ct. 2946, 69 L.Ed.2d 884 (1981), the Court answered the fair relation requirement by asking whether the state has given anything for which it might ask return, and adopting "a per se rule that any tax the amount of which is determined as a percentage of the value of the taxpayer's activities in the state is 'fairly related to the services provided by the state.'" 1982 B.Y.U.L. Rev. 765, 774 (1982), quoting Commonwealth Edison, supra.

At least two state courts have upheld a sales tax on interstate telephone calls originating in and billed to telephones within the taxing area. In Douglas v. Glacier State Tel. Co., 615 P.2d 580 (Alaska 1980), the plaintiffs brought an action over the imposition of local sales taxes on long distance phone calls charged to phones within the taxing unit, which in this case was the Kenai Peninsula Borough. The challenged ordinances read as follows:

> "There is levied a consumers' sales tax of three percent on all retail sales, on all rents, and on all services made or rendered within the Borough, measured by the gross sales price of the seller." Kenai Peninsula Borough Book of Ordinances, Sec. 25.10.05;
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> "'Services' includes all services of every manner and description which are performed or furnished for compensation, except services rendered to an employer by an employee, including but not limited to:
>
> . . . .

> "(C) Utilities and utility services not constituting a sale of personal property, including sewer, water, electrical and telephone services and repair." Sec. 25.10.030(7);

and

> "The obligation of the tax is upon the buyer. The seller shall collect the tax at the time of sale. Collection is enforceable by the seller as a certified tax collector of the Borough: provided, however, that this shall not limit the liability of the buyer to the Borough." Sec. 25.10.010.

The Supreme Court of Alaska held that the tax did not violate the Commerce Clause, finding that the plaintiffs "failed to meet their burden of showing that a palpable risk of multiple taxation, constituting a burden on interstate phone communications beyond its fair share of supporting local services, [would] result from validating this tax." Douglas, supra, at 588. The court noted further that "taxes based on charges to phones located within a state could be enacted in all states without taxing the same phone call twice in any instance, and to the extent that the charges for long-distance calls reflect the value of services rendered outside the Borough, we consider that burden on interstate commerce to be too attenuated to invalidate a practical scheme of local taxation not otherwise shown to discriminate against interstate transactions." Id. at 588, n. 17.

The Court of Appeals of Wisconsin has also held that a sales tax imposed on interstate telephone calls originating in Wisconsin and billed to Wisconsin telephones did not impermissibly burden interstate commerce in violation of the commerce clause. Wisconsin Tel. Co. v. Wisconsin Dept. of Rev., 371 N.W.2d 825 (1985), involved a sales tax statute which read as follows:

> "For the privilege of selling, performing or furnishing the services described under par. (a) at retail in this state to consumers or users, a tax is imposed upon all persons selling, performing or furnishing the services at the rate of *

> * * 5% of the gross receipts from the sale, performance or furnishing of the services * * *.
>
> "(a) The tax imposed herein applies to the following types of services:
>
> . . . .
>
> "4. The sale of telephone services of whatever nature including, in addition to services connected with voice communication, any services connected with the transmission of sound, vision, information, data or material other than by voice communication, and connection move and change charges, except services paid for by insertion of coins in a coin-operated telephone and except interstate service, unless that interstate service originates from and is charged to a telephone located in the state." Wis. Stat. Ann. §77.52(2)(a)(4).

Applying the four-part Complete Auto Transit test, the court found as follows: Wisconsin had a sufficient nexus with the telephone service sales, in that the buyers and sellers of the services were all located in Wisconsin and the placing of the call and subsequent billing occurred in Wisconsin; the same factors showed the impracticality of another state imposing a tax on the services, thus reducing the possibility of multiple taxation and unfair apportionment; the tax did not discriminate against interstate commerce because interstate and intrastate activities were placed on equal footing; and the measure of the tax was reasonably related to services provided by the state in that the telephone companies were all "incorporated, organized, or doing a substantial share of their business in Wisconsin." 371 N.W.2d at 829-831.

Neither of these cases was appealed any further than the state supreme court. As yet, the United States Supreme Court has not addressed the issue of whether a state or local sales tax imposed on interstate long distance telephone calls is constitutional under the Commerce Clause. Complete Auto Transit and subsequent cases appear to indicate, however, that such a tax would be upheld if the four parts of the test

are met. Thus, it is our opinion that if the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state, it will not violate the Commerce Clause of the United States Constitution.

Very truly yours,

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