

PITFA & the Question:

Are There Limits on Congress' Ability to Preempt a State Tax?

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Agenda

- **Federal Preemption of State Taxes Overview**
- **Source of Federal and State Powers**
- **States' Power to Tax**
- **Congress' Power to Preempt**
- **Has Congress Acted within its Limits?**

Viewpoint and Disclaimer

- **Viewpoint**
 - Michael Fatale
 - Jeff Friedman

- **Disclaimer: The descriptions, views and opinions expressed in this presentation are not necessarily of either presenter or of the Massachusetts Department of Revenue or Sutherland Asbill & Brennan LLP.**

Federal Preemption of State Taxes Overview

Background

- **Dual sovereignty with shared authority between federal and state governments with each sovereign checking the other**
 - “Dual sovereignty is a defining feature of our nation’s constitutional blueprint.” *Fed. Mar. Comm. v. S.C. Ports Auth.*, 535 U.S. 743, 751 (2002).
- **“State sovereignty is not just an end in itself. Rather federalism secures to citizens the liberties that derive from the diffusion of sovereign power.” *Nat’l Fed’n of Indepen. Bus. v. Sebelius*, 132 S.Ct. 2566, 2578 (2012).**
- **Congress’ power is delegated by the Constitution**
- **Powers not delegated by the Constitution are reserved to the states and the people**

Notable Federal Preemptions of State Taxes

- **Public Law 86-272 (the Interstate Income Act of 1959)**
- **Airport Development Acceleration Act of 1973 (the “Anti-Head Tax Act”)**
- **Employee Retirement Income Security Act of 1974**
- **Railroad Revitalization & Regulatory Reform Act of 1976 (the “4R Act”)**
- **Motor Carrier Regulatory Reform and Modernization Act of 1980**
- **Airport and Airway Improvement Act of 1982**
- **Interstate Commerce Commission Termination Act of 1995**
- **State Taxation of Pension Income Act of 1995**
- **Permanent Moratorium of the Internet Tax Freedom Act (“PITFA”)**
 - Originally enacted in 1998 (Internet Tax Freedom Act of 1998);
 - Extended multiple times (e.g., Internet Tax Nondiscrimination Act of 2001, Internet Tax Freedom Act Amendments Act of 2007); and
 - Made permanent in 2016 (Trade Facilitation and Trade Enforcement Act of 2015).
- **Mobile Telecommunications Sourcing Act of 2000**

Source of Federal and State Powers

Congress' Authority from the Constitution

▪ Commerce Clause

- “The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.” U.S. Const. art. I, § 8, cl. 3.

▪ Necessary and Proper Clause

- “The Congress shall have Power . . . [t]o make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers[.]” U.S. Const. art. I, § 8, cl. 18.

▪ Supremacy Clause

- “This Constitution, and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land[.]” U.S. Const. art. VI, cl. 2.

Rights Reserved to States

- **Tenth Amendment**

- **“The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.” U.S. Const. amend X.**

Commerce Clause's Background

- **Intended to cure defects of the Articles of Confederation**
- **Articles of Confederation left individual States free to discriminate against or burden interstate commerce**
 - “[E]ach state would legislate according to its estimate of its own interests, the importance of its own products, and the local advantages or disadvantages of its position in a political or commercial view.” 1 Joseph Story, *Commentaries on the Constitution* § 259, at 240 (Hilliard, Gray, and Co. 1833).
 - Common for seaboard states “to derive revenue to defray the costs of state and local governments by imposing taxes on imported goods destined for customers in other States.” *Michelin Tire Corp v. Wages*, 423 U.S. 276, 283 (1976).

Commerce Clause's Background (cont'd)

- “[I]t is very certain that it [the Commerce Clause] grew out of the abuse of the power by the importing States in taxing the non-importing, and was intended as a negative and preventive provision against injustice among the States themselves[.]” 3 The Records of the Federal Convention of 1787 478 (Max Farrand ed. 1911).
- “[T]he Framers’ purpose [was] to prevent a State from retreating into [the] economic isolation . . . that had plagued relations[.]” *Dep’t of Revenue of Ky. v. Davis*, 553 U.S. 328, 338 (2008).
- “[T]he object of vesting in [C]ongress the power to regulate commerce with foreign nations and among the several states was to issue uniformity of regulation against conflicting and discriminating state legislation.” *Kidd v. Pearson*, 128 U.S. 1, 21 (1888).

Tenth Amendment's Background

- “There is nothing in the history of its adoption to suggest that it was more than declaratory of the relationship between the national and state governments as it had been established by the Constitution before the amendment[.]” *United States v. Darby Lumber*, 312 U.S. 100, 124 (1941).
- The Tenth Amendment “expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the States’ integrity or their ability to function effectively in a federal system.” *Fry v. United States*, 421 U.S. 542, 547 (1975).

States' Power to Tax

States' Power to Tax

- **“The power to tax is basic to the power of the States to exist.”** *Arkansas v. Farm Credit Servs. of Cent. Ark.*, 520 U.S. 821, 826 (1997).
- **“[T]he individual states would under the proposed Constitution, retain an independent and uncontrollable authority to raise revenue to any extent of which they may need, and by every kind of taxation, except duties on imports and exports.”** Hamilton, *The Federalist*, No. 33.

Limits on States' Power to Tax

- **States' power to tax is limited to what was surrendered to the federal government through the Constitution**
- **“[I]t may be exercised to an unlimited extent . . . except so far as it has been surrendered to the Federal government, either expressly or by necessary implication[.]” *Union Pac.R. Co. v. Peniston*, 85 U.S. 5, 29 (1873).**

Impact of the Supremacy Clause

- **Valid laws enacted by Congress under its Commerce Clause power preempt any state laws that may conflict under the Supremacy Clause**
- **“[T]he constitution and the laws made in pursuance thereof are supreme; that they control the constitution and laws of the respective states, and cannot be controlled by them. From this, which may be almost termed an axiom, other propositions are deduced as corollaries[.] . . . These are, 1st. That a power to create implies a power to preserve: 2d. That a power to destroy, if wielded by a different hand, is hostile to, and incompatible with these powers to create and to preserve: 3d. That where this repugnancy exists, that authority which is supreme must control, not yield to that over which it is supreme.”**
M'Culloch v. Maryland, 17 U.S. 316, 426 (1819).

Impact of the Supremacy Clause (cont'd)

- “The states have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control the operations of the constitutional laws enacted by congress to carry into effect the powers vested in the national government.” *M'Culloch v. Maryland*, 17 U.S. 316, 317 (1819).
- “[T]axation is said to be an absolute power, which acknowledges no other limits than those expressly prescribed in the constitution, and like sovereign power of every other description, is intrusted to the discretion of those who use it. But the very terms of this argument admit, that the sovereignty of the state, in the article of taxation itself, is subordinate to, and may be controlled by the constitution of the United States.” *M'Culloch v. Maryland*, 17 U.S. 316, 427 (1819).

Congress' Power to Preempt

Congress' Power to Regulate Commerce

- **“The power of Congress over commerce exercised entirely without reference to coordinated actions of the states is not restricted, except as the Constitution expressly provides, by any limitation which forbids it to discriminate against interstate commerce and in favor of local trade. Its plenary scope enables Congress not only to promote but also to prohibit interstate commerce, as it has done frequently and for a great variety of reasons.”**
***Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 434 (1946).**

Congress' Power to Regulate Commerce (cont'd)

- “That power does not run down a one-way street or one of narrowly fixed dimensions. Congress may keep the way open, confine it broadly or closely, or close it entirely[.]” *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 434 (1946).
- Includes the power to restrict and expand states' authority over interstate commerce
 - For example, McCarran-Ferguson Act removed any Commerce Clause restriction upon states' power to tax the insurance business. See *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946); *Western & S. Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648 (1981).

Power to Regulate Commerce versus Power to Tax

- **“The grant of the power to lay and collect taxes is, like the power to regulate commerce, made in general terms, and has never been understood to interfere with the exercise of the same power by the State[.] . . . But the two grants are not, it is conceived, similar in their terms or their nature. Although many of the powers formerly exercised by the States, are transferred to the government of the Union, yet the State governments remain, and constitute a most important part of our system. The power of taxation is indispensable to their existence, and is a power which, in its own nature, is capable of residing in, and being exercised by, different authorities at the same time.”**
Gibbons v. Ogden, 22 U.S. 1, 198-199 (1824).

Power to Regulate Commerce versus Power to Tax (cont'd)

- “[W]hen a State proceeds to regulate commerce with foreign nations, or among the several States, it is exercising the very power that is granted to Congress and is doing the very thing which Congress is authorized to do. There is no analogy, then, between the power of taxation and the power of regulating commerce.” *Gibbons v. Ogden*, 22 U.S. 1, 199-200 (1824); see also *Nw. States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959) (“The taxes are not regulations in any sense of that term”).
- *Direct Marketing Ass'n v. Brohl*, 135 S.Ct. 1124 (2015).
- *Nat'l Fed'n of Indepen. Bus. v. Sebelius*, 132 S.Ct. 2566, 2589 (2012).

Limits on Congress' Power to Regulate Commerce

- “While Congress's authority under the Commerce Clause has of course expanded with the growth of the national economy, our cases have ‘always recognized that the power to regulate commerce, though broad indeed, has limits.’” *Nat’l Fed’n of Indepen. Bus. v. Sebelius*, 132 S.Ct. 2566, 2589 (2012).
- If Congress has the ability to regulate in the manner suggested, “it is difficult to perceive of any limitation on federal power, even in areas . . . where the States have historically been sovereign.” *Morrison v. United States*, 529 U.S. 598, 613 (2000).
- “Simply because Congress may conclude that a particular activity substantially affects interstate commerce does not necessarily make it so.” *United States v. Lopez*, 514 U.S. 549, 617 (1995).

Activities Congress Can Regulate Under the Commerce Clause

- **Three categories identified by the Supreme Court:**
 - **The channels of interstate commerce;**
 - **The instrumentalities of interstate commerce, or persons or things in interstate commerce, even though the threat may come only from intrastate activities; and**
 - **Activities that substantially affect interstate commerce.**

***United States v. Lopez*, 514 U.S. 549 (1995); *United States v. Morrison*, 529 U.S. 598 (2000).**

Activities that Substantially Affect Interstate Commerce

- **Expansive category**
- **Includes intrastate activities (commercial and non-commercial) that are not themselves a part of interstate commerce**
 - ***Wickard v. Filburn*, 317 U.S. 111 (1942) (a farmer's decision to grow wheat for himself).**
 - ***Gonzalez v. Raich*, 545 U.S. 1 (2005) (the production and use of homegrown marijuana, even in states that approve its use for medicinal purposes).**

Activities that Substantially Affect Interstate Commerce: Regulating States as States

- Congress may sometimes regulate private conduct by regulating the “states as states.” See, e.g., *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528 (1985) (mandating states to comply with Fair Labor Standards Act).
- But Congress may not “commandeer” the states to enact and enforce a federal regulatory program. *New York v. United States*, 505 U.S. 144 (1992); see also *Printz v. United States*, 521 U.S. 898 (1997).

Activities that Substantially Affect Interstate Commerce: The Necessary & Proper Clause

- It is through the Necessary and Proper Clause that an intrastate activity affecting interstate commerce can be reached through the Commerce Clause powers. *Gonzalez v. Raich*, 545 U.S. 1, 35-36 (2005).
- The Supreme Court has been deferential to Congress' determination that a regulation is necessary and has upheld laws that are “‘convenient, or useful’ or ‘conducive’ to the authority’s ‘beneficial exercise.’” *Nat’l Fed’n of Indepen. Bus. v. Sebelius*, 132 S.Ct. 2566, 2592 (2012).

Activities that Substantially Affect Interstate Commerce: The Necessary & Proper Clause (cont'd)

- The Supreme Court has read the Necessary and Proper Clause to strike down laws that are not “consistent with the letter and spirit of the constitution.” *Nat’l Fed’n of Indepen. Bus. v. Sebelius*, 132 S. Ct. 2566, 2592 (2012).
- The Necessary and Proper Clause “does not license the exercise of any great substantive and independent powers beyond those specifically enumerated.” *Nat’l Fed’n of Indepen. Bus. v. Sebelius*, 132 S. Ct. 2566, 2591 (2012).
- “It is of fundamental importance to consider whether essential attributes of state sovereignty are compromised by the assertion of federal power under the Necessary and Proper Clause.” *Nat’l Fed’n of Indepen. Bus. v. Sebelius*, 132 S. Ct. 2566, 2592 (2012).

Impact of the Dormant Commerce Clause

- **Invoked by the Supreme Court in absence of relevant federal legislation to invalidate state taxes that discriminate against interstate commerce or subject it to undue burdens**
- **Holdings have addressed discrimination, nexus, and apportionment**
- **The Supreme Court affirmed Congress' authority under the Commerce Clause**

Impact of the Dormant Commerce Clause (cont'd)

- “[T]he appropriate level of state taxes must be resolved through the political process. . . . [T]he determination is to be made by state legislatures in the first instance and, if necessary, by Congress, when particular state taxes are thought to be contrary to federal interests.” *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 628 (1981).
- Addressing the risk of multiple taxation resulting from different apportionment regimes, the Supreme Court found that “it is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income.” *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 280 (1978).
- Regarding remote vendors’ use tax collection responsibilities on interstate states, the Supreme Court found that “Congress is now free to decide whether, when, and to what extent the States may burden interstate mail order concerns with a duty to collect use taxes.” *Quill v. North Dakota*, 504 U.S. 298, 318 (1992).

Has Congress Acted within
its Limits?

Notable Proposed Federal Preemptions

- **Mobile Workforce State Income Tax Simplification Act (H.R. 2315 / S. 386)**
- **Business Activity Tax Simplification Act (“BATSA”) (H.R. 2584)**
- **Digital Goods and Services Tax Fairness Act (H.R. 1643 / S. 851)**
- **Marketplace Fairness Act (S. 698)**
- **Remote Transactions Parity Act (H.R. 2775)**

Permanent Moratorium of the Internet Tax Freedom Act (H.R. 644)

- **Trade Facilitation and Trade Enforcement Act of 2015**
- **Became law on February 24, 2016**
- **Permanently extended the moratorium on state and local taxation of Internet access and “multiple” or “discriminatory” taxes on electronic commerce**
- **Phases out the Grandfather Clause by allowing the seven grandfathered states to continue to tax Internet access until June 30, 2020**

Considerations

▪ **Constitutional Considerations**

- What is the constitutional grounding of the preemption?
- Does the preemption unconstitutionally infringe on state sovereignty?

▪ **Other Considerations**

- Does the preemption serve an appropriate purpose?
- Is preemption the appropriate means to address the issue?
- Is the issue better addressed by Congress, the states, or the courts?
- What should happen when the preemption outlives its usefulness?
- What is the precedential impact of Congressional practice?
- What are the possible costs to private industry?

Questions?

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