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IMPORT-EXPORT CLAUSE: Kosydar v. National Cash Register Co., 417 U.S. 62 (1974).

INTRODUCTION

A question of continuing interest to those in the export industry, and to the states in which those industries are located, is the Supreme Court's determination of when the constitutional immunity from taxation, guaranteed by the Import-Export Clause,[1] attaches to export items. This issue has recently been re-addressed by the United States Supreme Court in *Kosydar v. National Cash Register Co.*[2]

National Cash Register (NCR) is a large manufacturer of data processing systems, accounting machines and cash registers, which has its main production facilities and warehouses in Dayton, Ohio.[3] For marketing purposes NCR is divided into two divisions, domestic and international, each wholly separate from the other.[4] The instant case concerns the latter division.

NCR maintains no inventory of machines to meet foreign demand.[5] When the international division receives an order, the machines are built specifically to meet the particular needs of that customer. After manufacture and inspection, the order is crated and taken to a warehouse in Dayton to await shipment, which often entails considerable delay.[6] The machines involved in *Kosydar* were awaiting shipment on December 31, 1967 when Ohio's tax commissioner assessed a personal property tax on them.

NCR appealed the assessment to the Ohio Board of Tax Appeals, claiming the machines were exports and thus immune from taxation under the Import-Export Clause of the Constitution. NCR sought to prove that, due to their unique design, the machines could not be diverted to the domestic market, that no machine had ever been

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1. U.S. CONST. art. I, § 10, cl. 2. "No State shall without the Consent of Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its Inspection laws . . . ."

2. 417 U.S. 62 (1974).

3. Total revenue for 1973 was $1,816,282,000. Revenue from international operations was $895,430,000. 1973 NCR ANNUAL REPORT 26 n.2.

4. 417 U.S. at 63.

5. *Id.*

6. Several reasons account for the delays. At times the importing nations require shipment of full orders only, which means storage until the full production run is complete. Difficulties in obtaining import licenses and uncertainties in the international monetary system also cause delays. 417 U.S. at 62 n.1.

diverted to the domestic market, and that no foreign purchaser had ever returned a machine to NCR.[7] The Board upheld the Commissioner's ruling that the immunity from taxation did not attach to exports until they actually commenced their journey to the foreign market. As these goods were not yet in the stream of export, they reasoned, the immunity had not yet attached.

The Supreme Court of Ohio reversed,[8] holding that the evidence showed a certainty of export[9] which rendered irrelevant the fact that the machines were still in storage on the date of assessment. However, the United States Supreme Court disagreed, holding that without some movement into the stream of export, the immunity did not attach.

The decision in *Kosydar* is based upon a rule propounded nearly 80 years ago.[10] Since that early ruling the realities of trade have changed dramatically, as has the involvement of the Federal government in the regulation of trade. These changes necessitate a modification of the somewhat mechanistic test applied by the Court through the adoption and use of more flexible criteria, so as to accommodate present day needs. This note will attempt to show that the test applied in *Kosydar* may lead to ambiguity and inconsistency, rather than the clarity sought by the Court. Policy arguments will be presented in favor of a more flexible, rational rule.

THE EXPORT TEST

The seminal case on the export tax question is *Coe v. Errol,*[11] wherein Coe and others cut logs to be floated from New Hampshire to Maine for processing. While the logs were stored awaiting spring high water, the city of Errol assessed a tax on them. Coe protested, arguing the tax was one on interstate commerce and a violation of the Export Clause of the Constitution. The tax was upheld by the New Hampshire Supreme Court and the Supreme Court of the United States.

Mr. Justice Bradley, speaking for the United States Supreme Court, viewed the question as whether

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7. 417 U.S. at 64 n.6. The custom built nature of the machines limits their diversion potential. Different nations have different characters and decimal placements which require unique keyboards, printing mechanisms and so forth. The machines are also often wired for use with electrical systems not available in the United States. More advanced American merchandising techniques also tend to render machines manufactured to meet foreign needs inappropriate for American use.

8. National Cash Register Co. v. Kosydar, 35 Ohio St. 2d 166, 298 N.E.2d 559 (1973).

9. 298 N.E.2d at 562.

10. Coe v. Errol, 116 U.S. 517 (1886).

11. *Id.*

> the owner's state of mind in relation to the goods, that is his intent to export them, and his partial preparation to do so, exempt the goods from taxation.[12]

Answering the question in the negative, Justice Bradley defined the point at which goods ceased to be part of the mass of goods in the state, that is when goods become exports.

> Such goods do not cease to be part of the general mass of property in the State, subject, as such, to its jurisdiction, and to taxation in the usual way, until they have been shipped or entered with a common carrier for the transportation in a continuous route or journey.[13]

Since Coe's logs had not yet commenced their final journey, it was determined the immunity did not attach. This is the rule the Court has followed since the *Coe* decision.[14]

The Court in *Kosydar* rejected the certainty of export test, accepted by the Ohio court, for a test which requires certainty as well as entrance into the stream of export.[15] While conceding that the goods in question would be used for export,[16] the Court reasoned that to grant the immunity despite a lack of movement into the stream of export required too sharp a departure from the settled line of cases beginning with *Coe*.[17] To answer criticism that the decision represented a wooden or mechanistic application of *Coe*, the Court said:

> [T]his is an instance, however, where we believe simplicity has its virtues. The Court recognized long ago that even if it is not an easy matter to set down a rule determining the moment when articles obtain the protection of the Import-Export Clause, "it is highly important both to the shipper and to the state that it should be clearly defined so as to avoid all ambiguity or question." [citation omitted][18]

The rule of *Coe* has led the Court to limit its inquiry to the factual matters involved to determine whether

> sufficient commencement of the process of export has occurred so as to immunize the article at issue from state taxation.[19]

THE RULE OF REASON

By limiting itself to a factual determination, it can be argued that the Court failed to consider several realities of trade. Further, while striving to prevent ambiguity, the Court has effectively created

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12. *Id.* at 525.
13. *Id.* at 527.
14. *See, e.g.*, Joy Oil Co. v. State Tax Commission, 337 U.S. 286 (1949); Empresa Siderurgica, S.A. v. Merced County, 337 U.S. 154 (1949); Richfield Oil Corp. v. State Board of Equalization, 329 U.S. 69 (1946); A.G. Spalding & Bros. v. Edwards, 262 U.S. 66 (1923); Cornell v. Coyne, 192 U.S. 418 (1904).
15. 417 U.S. at 69.
16. *Id.* at 70.
17. *Id.* at 69.
18. *Id.* at 71.
19. *Id* at 69.

it. As the following pages will argue, this situation could be alleviated by applying a rule, sanctioned by the courts in recent cases, which would place more emphasis on the certainty that goods will enter the stream of commerce than on the mere fact that they were located within the state on the day the tax was assessed.

An alternative to the mechanistic rule applied in *Kosydar* would be to accept a bifurcated test such as that articulated by the Ohio Supreme Court. Under such a rule, the immunity would attach if there was delivery of the goods to a common carrier, or if there was substantial certainty that the goods would be exported. If not, the goods could be taxed with the mass of other goods in the state. Some support for this proposition may be found in the case law.

In *Empresa Siderurgica, S.A. v. Merced County*[20] Justice Frankfurter considered issues similar to those in *Kosydar*. In *Empresa* he dissented from the Court's application of the *Coe* test because, as he stated:

> [A] mechanistic formula, whether derived from phrases in *Coe v. Errol*, or elsewhere culled advances us little toward the solution of such a concrete problem.[21]

In *Empresa*, a South American company purchased a cement plant located in Merced County, which was to be dismantled and shipped to Colombia. On the tax date, 12 percent of the plant had been shipped, 10 percent crated but not shipped, 34 percent dismantled but not crated and 44 percent remained intact. Merced County levied taxes on the 88 percent remaining in the county. The company paid the tax under protest and subsequently brought suit for recovery of its payment. The Supreme Court affirmed a denial of recovery, holding that the parts of the plant were not entitled to the immunity from taxation under the Import-Export Clause because there was no movement of them into the stream of export.

Justice Frankfurter was troubled by the rigid approach approved by the Court. The plant, he wrote, might be considered to be an organic whole, or merely the sum of its parts, with differing results. If it were an organic unit, the immunity might attach.[22] If not an organic whole, but only the sum of separate parts, the immunity would not apply.[23] He cited with approval language found in *Richfield Oil Corp. v. State Board*:[24]

> the certainty that goods are headed to sea and that the process of exportation has started may normally be best evidenced by the fact that they

20. 337 U.S. 154, 157 (1949) (Frankfurter, J., dissenting).
21. *Id.* at 158.
22. *Id.* at 161.
23. *Id.*
24. 329 U.S. 69, 82 (1946).

> have been delivered to a common carrier for that purpose. But the same degree of certainty may exist though no common carrier is involved.

Later in his opinion he agreed with Justice Bradley in *Coe* that "intent to export no matter how firm, is not by itself enough to confer immunity,"[25] but he did find, at least in certain factual situations, that the mechanistic application of the rule in *Coe* would be inadequate. Such a situation exists when the certainty of export is clear and the danger of diversion to domestic use non-existent.[26]

At least one California court has accepted this line of reasoning.[27] Montrose Chemical made a compound used in the preparation of D.D.T. Concentrate, a chemical banned from use in the United States.[28] Under contract with the General Services Administration and the United Nations Children's Fund (UNICEF), Montrose shipped the compound to another company for fabrication into Concentrate and packaging for overseas shipment. While in a warehouse awaiting shipment, Los Angeles County levied a tax on the finished, packaged chemicals. The trial court upheld the tax, while the Court of Appeals reversed. The Court of Appeals noted that the D.D.T. concentrate was committed to export as it had been packaged for overseas shipment under contract with a particular purchaser and could not be legally diverted to domestic use. Using tests enunciated in other cases,[29] the court held "if the certainty of a foreign destination is plain, levying a tax is improper even though there is no delivery to a common carrier."[30]

The point being made by Justice Frankfurter in *Empresa* and the court in *Montrose Chemical* is that the Export test is one of reason, not mechanical application. Where there is no likelihood of the taxed item being diverted, it is already an export, notwithstanding lack of actual physical entry into the stream of export. Therefore, the Constitutional immunity should apply.

CRITICISM OF THE *Coe* AND *Kosydar* TEST

Justice Frankfurter and the *Montrose* court rejected applications of the *Coe* test as it was applied by the Court in *Kosydar*. However, a rule of such import and longevity ought not be discarded solely on the basis of dissenting opinions and state court holdings, no matter how persuasive. If, as is here the case, it can be shown that maintain-

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25. 337 U.S. at 161.

26. *Cf.*, Joy Oil Co. v. State Tax Commission, 337 U.S. 286 (1949) (Douglas, J., dissenting).

27. Montrose Chemical Corp. v. County of Los Angeles, 243 Cal. App. 2d 300, 52 Cal. Rptr. 209 (1966), *cert. denied*, 386 U.S. 1004 (1967).

28. 52 Cal. Rptr. at 210.

29. Hugo Neu Corp. v. County of Los Angeles, 241 Cal. App. 2d 703, 50 Cal. Rptr. 916 (1966).

30. 52 Cal. Rptr. at 212.

ing the rule fails to accomplish the intended result, then altering the rule necessarily follows. Further, if it can be shown that the national interest requires a different result from that obtained by the Court, then reconsideration of the rule is necessary.

The Court says it adheres to the rule as laid down in *Coe* because it serves to prevent ambiguity.[31] This is not, however, the result. When the expansiveness of the definition of stream of commerce (under the Commerce Clause of the Constitution, Art. I, § 8, cl. 3)[32] is compared with the narrow interpretation given the stream of export, inconsistencies are clearly evident.

A recent example of this problem is found by comparing the holding of *Kosydar* with that of *Allenberg Cotton Co. v. Pittman.*[33] Allenberg, a Tennessee corporation, contracted with Mississippi farmers, including Pittman, for the delivery of cotton to its Mississippi warehouse without first qualifying to do business in Mississippi by registering with the State. At the time for delivery, the market price for cotton was higher than that specified in the contract and Pittman refused to deliver. Allenberg brought suit in Mississippi for damages and injunctive relief. The Mississippi Supreme Court sustained Pittman's defense that failure to qualify to do business in the state meant that the state's courts were not open to Allenberg.[34]

The United States Supreme Court reversed, holding that though delivery of the cotton might seem like a wholly intrastate transaction, in fact the events were part of the vast interstate system of cotton delivery.[35] The necessity of keeping the cotton in the warehouse awaiting accumulation of the requisite amounts for shipment, rather than defeating the interstate nature of the transaction, was "an integral first step"[36] in the system. In making this decision, the Court stated:

> [D]elivery of the cotton to a warehouse, taken in isolation, is an intrastate transaction. But that delivery is also essential for the completion of the interstate transaction. The cotton in the Mississippi sale, though temporarily in a warehouse, was still in the stream of commerce.[37]

Although the Court specifically states that it did not deal with the "possible local tax incidents of these contracts,"[38] the analogy

31. 417 U.S. at 71.

32. "The Congress shall have the power: . . . (3) To regulate commerce with foreign nations, and among the several states, and with the Indian tribes." *See, e.g.*, Katzenbach v. McClung, 379 U.S. 294 (1964); Wickard v. Filburn, 317 U.S. 111 (1942).

33. 43 U.S.L.W. 4001 (1974).

34. Pittman v. Allenburg Cotton Co., 276 So. 2d 678 (1973).

35. 43 U.S.L.W. at 4003.

36. *Id.*

37. *Id.* at 4004.

38. *Id.* at 4005.

between the cotton in *Allenberg* and the business machines in *Kosydar* is striking. Delivery of NCR's machines to its warehouse was an integral first step in its distributive system. It was dictated by circumstances beyond NCR's control, much like the cotton in *Allenberg*. Storage of the machines was "essential to the completion of the [international] transaction."

The inconsistency of these two rulings is clear. Justice Rehnquist makes note of this in his *Allenberg* dissent.[39] While the Court in *Kosydar* hopes to prevent ambiguities, its holding there and in *Allenberg* fail to establish clear, unequivocal guidelines.

Two methods are open to the Court to resolve this conflict. It can narrow the scope of its rulings under the Commerce Clause, an unlikely choice, or it can expand its interpretation of the meaning of export. There are sound policy reasons for choosing the latter course of action. At present the United States is suffering a persistent balance of trade deficit, caused in large part by the four-fold increase in oil prices since the middle of 1973.[40] To counter the massive outflow of dollars to foreign oil producers it is necessary to generate continuing exports, which requires goods and services produced in the United States with a competitive edge over those of other nations. Manufactured goods, which is the category under which business machines are counted, are the country's second largest category of exports.[41] Because NCR's profit margin on machines for export is only five percent,[42] it is prevented from absorbing the various taxes which must therefore be passed on to NCR's foreign consumers in the form of higher, less competitive prices.

Currently, Congress is grappling with the problems generated by the outflow of American dollars in foreign investment. It is felt that this phenomena costs American workers jobs and contributes to balance of payments difficulties. One method discussed for limiting the capital outflow would be to limit the tax benefits obtained when

39. *Id.* at 4007 n.6. "Cases such as Kosydar v. National Cash Register Co. . . . make it clear that the cotton stored in Mississippi is subject to state taxation. The Court today leaves the tax standing but illogically deprives Mississippi of its sole means of enforcement of the tax."

40. The Wall Street Journal, Dec. 30, 1974, at 4, col. 4. "Merchandise imports exceeded exports by a seasonally adjusted $113 million last month. The November deficit stemmed partly from . . . continued high prices for imported oil. Imports of crude oil and petroleum [were] 185.3 million barrels, which cost $2.12 billion, sharply higher than in November [1973] when the U.S. imported 215.8 million barrels of crude oil and petroleum products at a cost of only $885.7 million. The November trade deficit widened the total U.S. trade gap for the January-November period to a $2.43 billion deficit, in contrast to a $768 million surplus in the year-earlier 11 months."

41. UNITED STATES DEPARTMENT OF COMMERCE, SURVEY OF CURRENT BUSINESS 37 (1973).

42. 298 N.E.2d at 561.

investing abroad. By closing tax loopholes, the argument goes, the money will be used for domestic investment.[43] While this may or may not be true, other alternatives, based on creating a favorable investment climate internally, are available.

One of these can be the easing of tax burdens on exports. If this is done, producers may find it profitable to export from the United States, rather than investing in production facilities in foreign countries. While the states or Congress may act in this area, it remains the province of the Court, as the final arbiter of the Constitution, to define when an article comes within the protection offered by the Import-Export Clause. By applying the more flexible test presented herein, the Court can ease this burden of business somewhat.

It has been said that the rationale behind the mechanistic *Coe* rule is to balance the need for free exports with the need of the states to raise revenue.[44] While the need of the states for revenue is great, it must be said that even if taxes such as those in *Kosydar* were prohibited, exports would remain substantial contributors to local revenue. The states may tax the materials used in exports.[45] They may tax income earned on foreign sales. In the case of NCR this amounted to nearly half of total revenues, over $800,000,000.[46] The plant and equipment used to manufacture exports are subject to property taxes. The income of workers employed is taxable by the states. Clearly, the argument that revenue from the taxation of finished products such as the machines in *Kosydar* is needed by the states is without force.

CONCLUSION

As the court in *Kosydar* explains, exporters and the states must have guidance concerning when a commodity does in fact become an export.[47] Some of the decisions, following *Coe*, have set down this test for determining an export: there must be certainty of export evidenced by some movement into the stream of export, usually indicated by delivery of the goods to a common carrier.[48] Other cases have recognized the restrictive nature of this test, and have used a more rational rule which grants immunity to goods with substantial certainty of export or which have physically entered the stream of export. This rule, while requiring a factual determination, would be more compatible with present day needs. These criteria are clear enough to give the necessary guidance to exporters, the states and the

43. *See, e.g.*, Patrick, *supra* this issue.

44. Joy Oil Co. v. State Tax Commission, 337 U.S. 286, 288; Comment, *International Trade-Taxation of Exports*, 6 N.Y.U. J. INT'L L. AND POL. 140 (1973).

45. *Cf.*, Youngstown Sheet & Tube v. Bowers, 358 U.S. 354 (1959).

46. NCR ANNUAL REPORT, *supra* note 3.

47. 417 U.S. at 71.

48. *See, e.g.*, A.G. Spalding & Bros. v. Edwards, 262 U.S. 66 (1923).

courts, as well as liberal enough to provide a broad immunity, which is in the national interest.

In *Kosydar* there was substantial certainty that the taxed goods would be exported. Like the cotton in *Allenberg*, movement of NCR's machines to the warehouse was the first step in a vast scheme of international distribution. Providing them with the cloak of export immunity is required by logic and economic reality.

Ian B. Bird