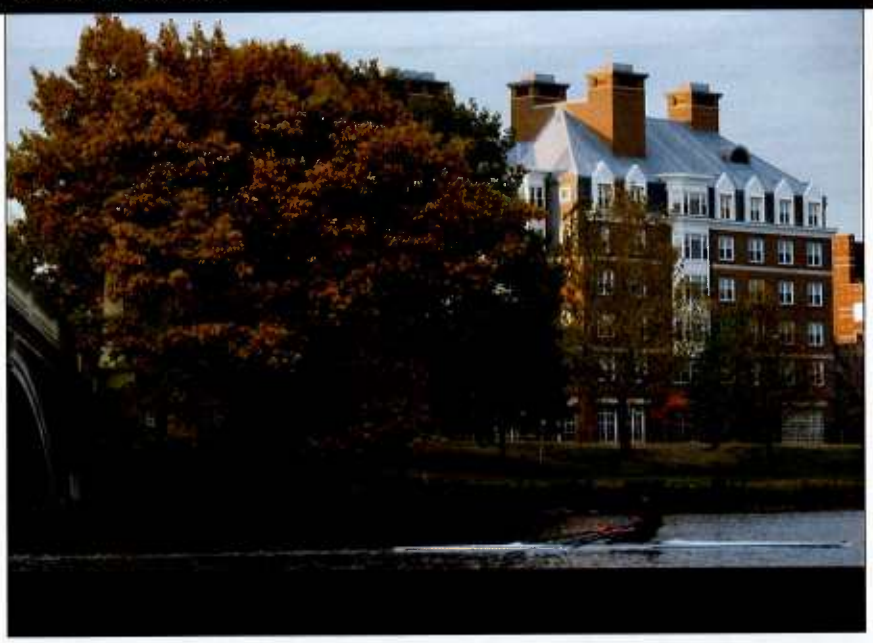

Mass. High Court Upholds Use Tax on Full Price of Vehicles Used in Interstate Commerce

State courts continue to grapple with the constitutionality of use tax imposed on tangible personal property used inside the taxing state for only a limited period. Generally, most state courts uphold the imposition of use tax in this situation, even if the actual use of the property in the state is minimal. For instance, courts have upheld use tax on airplanes entering a state just five times total and comprising less than 10% of the airplane's total use.

The Supreme Judicial Court of Massachusetts followed that trend in early 2016 in *Regency Transportation, Inc. v. Commissioner of Revenue*,[1] upholding the imposition of use tax on 100% of the purchase price of a fleet of trucks and trailers purchased outside Massachusetts. The vehicles were driven in Massachusetts for only 34-38% of the fleet's total miles driven, and they were also stored in Massachusetts at times. In addition, the taxpayer's corporate headquarters was also located in Massachusetts, and about 35% of the company's maintenance work was performed there as well.

The court held that imposing use tax on the entire purchase price did not violate the Commerce Clause of the U.S. Constitution under the four-part test from the U.S. Supreme Court in *Complete Auto Transit, Inc. v. Brady*.[2] The first prong (substantial nexus) was not in dispute. The second prong (fair apportionment) garnered the bulk of the court's opinion, as the court held that the use tax was fairly apportioned primarily because Massachusetts offered a credit for sales or use tax paid to other states. As a result, the court held, there was no risk of multiple taxation.

The court held that the third prong (non-discrimination against interstate commerce) was also satisfied because non-Massachusetts taxpayers and Massachusetts taxpayers would be taxed identically, based solely on *use* in Massachusetts. The court acknowledged that out-of-state companies would pay more per mile driven in Massachusetts, but the court repeatedly emphasized that use tax was imposed on the use of the *vehicles* in Massachusetts (including storage), not on the use of Massachusetts *roads*.

Finally, the court also held that the fourth prong (relation to state services) was satisfied because the police and fire protection, the use of public roads, and other similar benefits were provided to protect the taxpayer in employing the majority of its workforce in Massachusetts, and in storing and driving some of its vehicles there.

In the end, one of the primary factors driving the court's decision appeared to be the court's disapproval of the taxpayer escaping tax completely on its vehicle purchases. Because the Massachusetts use tax is an all-or-nothing, unapportioned tax (subject to credit for other sales or use tax paid), the court was forced to decide between upholding tax on 100% of the purchase price or allowing the taxpayer to avoid tax altogether on its purchases. Not surprisingly, the court seemed troubled by the fundamental unfairness of allowing the taxpayer to avoid taxation altogether, particularly because the taxpayer maintained its headquarters in Massachusetts, employed the majority of its workforce there, and used and maintained its vehicles there as well.

Background. Taxpayer Regency Transportation (Regency) is an interstate common carrier operating a freight business with terminals in Massachusetts and New Jersey. Regency uses trucks and trailers to deliver goods throughout the eastern United States.

Regency's corporate headquarters is in Massachusetts. In addition, between 2002 and 2008, Regency's Massachusetts activities included: (1) storing some of its vehicles at four warehouses in Massachusetts, (2) performing 35% of its maintenance and repair work in Massachusetts, and (3) employing between 63% and 83% of its workforce in Massachusetts. Regency also operated five warehouses and two maintenance facilities in New Jersey.

Regency purchased its vehicles in New Hampshire, New Jersey, Indiana, and Pennsylvania, and Regency accepted delivery and possession outside Massachusetts. Regency registered the vehicles in New Jersey with New Jersey license plates. Regency paid no sales tax on the purchase of its vehicles because New Hampshire does not impose sales tax, and all of the other states allow a "rolling stock exemption" for purchases for use in interstate commerce. Massachusetts repealed its rolling stock exemption in 1996.

The Massachusetts Commissioner of Revenue assessed Regency for use tax on the full purchase price of each of Regency's vehicles from October 2002 through January 2008, with the assessment totaling $1,472,258.22, including $298,286.61 in interest and $391,323.95 in penalties. Regency appealed to the Massachusetts Appellate Tax Board in January 2011.

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The Board abated the penalties assessed against Regency because Regency relied on a letter ruling from 1980 that the Commissioner continued to publish in the Massachusetts Official MassTax Guide, even though the rule upon which the letter ruling relied was amended in 1996. However, the Board denied Regency's appeal of the tax, holding that imposing use tax on the full value of Regency's vehicle purchases did not violate the Commerce Clause. Regency appealed the Board's constitutional ruling and sought direct review by the Massachusetts Supreme Judicial Court. The court granted direct review.

Massachusetts use tax applies a rebuttable presumption in favor of taxation. The court began by examining Massachusetts law, noting that the Commonwealth imposes use tax on the "storage, use or other consumption in the commonwealth of tangible personal property."[3] The statute and applicable regulations create a rebuttable presumption that every vehicle brought into Massachusetts within the first six months after purchase is "presumed to have been sold or transferred for storage, use, or other consumption in Massachusetts."[4] However, Massachusetts law also provides an exemption from use tax if the purchaser has paid sales or use tax in another jurisdiction.[5]

Regency did not dispute that it used and stored its vehicles in Massachusetts during the applicable tax periods. Likewise, Regency did not dispute that it did not pay sales or use tax on the vehicles. As a result, the sole issue in the case was whether the imposition of use tax by Massachusetts under the circumstances violated the Commerce Clause of the U.S. Constitution.

***Complete Auto* test.** The court framed the issue as whether the imposition of use tax on Regency violated the Commerce Clause of the U.S. Constitution, based on an examination of "the practical effect of a challenged tax."

The court held that the U.S. Supreme Court's four-part test from *Complete Auto* would apply to determine the constitutional validity of imposing use tax on Regency. Specifically, the court noted, imposition of use tax would pass constitutional muster under the Commerce Clause if: (1) the tax applies 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 taxing state.[6]

The parties agreed that Regency's activities had a substantial nexus with Massachusetts. Consequently, the court focused its analysis on the other three factors, with most of its analysis focused on whether the tax is fairly apportioned.

Fair apportionment. The court described the "fair apportionment" requirement as ensuring that "each State taxes only its fair share of an interstate transaction."[7] Fair apportionment focuses primarily on whether a tax is both "internally consistent" and "externally consistent."

A tax is internally consistent if it is structured so that if every state were to impose an identical tax, no multiple taxation would result. Regency actually conceded this point in its argument before the Board, but Regency attempted to renew its internal consistency argument before the Massachusetts high court. The court noted in a footnote that Regency may have waived its argument by failing to raise it with the Board, but that due to the "public interest in promptly resolving the issue," the court would address the issue anyway.

The court's internal consistency analysis was brief and straight-forward: Massachusetts allows a credit for sales tax or use tax paid to another state. As a result, if every state applied the Massachusetts use tax statute, it would not result in multiple taxation because the maximum tax that Regency could incur would be on 100% of the purchase price of the vehicle. After that, no additional tax would be due. Presumably, this common sense result is the reason that Regency did not dispute the internal consistency of the use tax before the Board.

The court's application of the external consistency test was lengthier but conclusory and left much to be desired. As a general matter, the external consistency test examines whether the taxing state has taxed only the portion of revenues from interstate activity that "reasonably reflects the in-state component of the activity being taxed."

The court began its external consistency analysis by simply noting that the tax applies to the use of tangible personal

property, and Regency used and stored the vehicles in Massachusetts, "at least in part." Based on this, the court leapt to the conclusion that there were "ample facts to support the board's finding that Regency's tax liability reflects the in-State activity being taxed."

However, the court failed to explain why a tax on 100% of the purchase price of a vehicle could "reasonably reflect" the use or storage of property that occurs in Massachusetts only "in part." Instead, the court essentially treated the Massachusetts use tax as a sales tax for external consistency purposes. The court relied on the U.S. Supreme Court's opinion in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, where the Court explained that it has "consistently approved taxation *of sales* without any division of the tax base" under the external consistency analysis.[8]

However, looking more closely at the *Jefferson Lines* opinion on this point, the U.S. Supreme Court in that case explained that its analysis was predicated on the fundamental principle that a sale of goods is a "discrete event" and "could not be repeated by other States," reasoning that the same product "could not be delivered to two States at once."[9] In other words, apportioning 100% of a sale to one location made sense because a sale was a transaction that occurred in only one discrete location.

The Supreme Judicial Court of Massachusetts' reliance on *Jefferson Lines* appears misplaced. Although the "sale" of a product may be a discrete event, the "use" of a product is not a discrete event. Products can certainly be used in more than one state.

In fact, Regency's trucks were used in multiple states at various times. However, the court never addressed this issue, applying the sales tax-based holding in *Jefferson Lines* by treating the Massachusetts use tax as if it were a sales tax, reasoning that the use tax is "intended to prevent the loss of sales tax revenue from out-of-State purchases" and thus is measured "by the sale value of the vehicle."

The Massachusetts high court is not alone in glossing over the external consistency test when applying the fair apportionment prong to use tax. Other state courts have taken similar approaches in upholding the constitutionality of use tax on 100% of the purchase price, even where the product was only used in the taxing state on a limited basis.

For instance, the Missouri Supreme Court held in *Director of Revenue v. Superior Aircraft Leasing Company* that a use tax on 100% of the purchase price of an airplane was fairly apportioned to Missouri, even though the airplane only flew into Missouri on five limited trips for approximately 7% of the aircraft's total use.[10] Similarly, the Ohio Supreme Court in *PPG Indus., Inc. v. Tracy* upheld use tax on 100% of the purchase price of pace cars used in auto racing, where only 10% of the cars' actual track time occurred in Ohio (although the cars were also stored in Ohio "for significant times").[11]

In both cases, the courts failed to provide much (if any) analysis of the application of the external consistency test. Instead, the courts in both cases focused primarily on the internal consistency test, simply concluding that the use tax was fairly apportioned because the statute allowed for a credit for sales or use tax paid to other states.

At least one court, though, has reached the opposite conclusion. In *Boyd Brothers Transportation v. State Department of Revenue*, the Alabama Court of Appeals held that use tax on the entire purchase price of trucks purchased outside Alabama was not fairly apportioned to Alabama because it was "not apportioned based upon actual miles traveled in the performance of a contract in Alabama." The court noted that the tax "burdens taxpayers like Boyd Brothers that drive only eight percent of their mileage in Alabama."[12]

The situation with Regency in Massachusetts was less extreme than *Boyd Brothers*, with approximately one-third of Regency's driving mileage and one-third of Regency's fleet maintenance occurring in Massachusetts, as well as an unspecified amount of vehicle storage time in Massachusetts. However, the nature of the Massachusetts use tax statute does not allow for proportional allocation, which essentially forced the court to choose between two extremes—upholding use tax on 100% of the purchase price of the Regency vehicles, at one extreme, or striking down the tax in its entirety at the other extreme. Of course, striking down the tax in its entirety would mean that Regency would avoid sales or use tax altogether on its truck purchases, a result that most state courts are loath to reach.

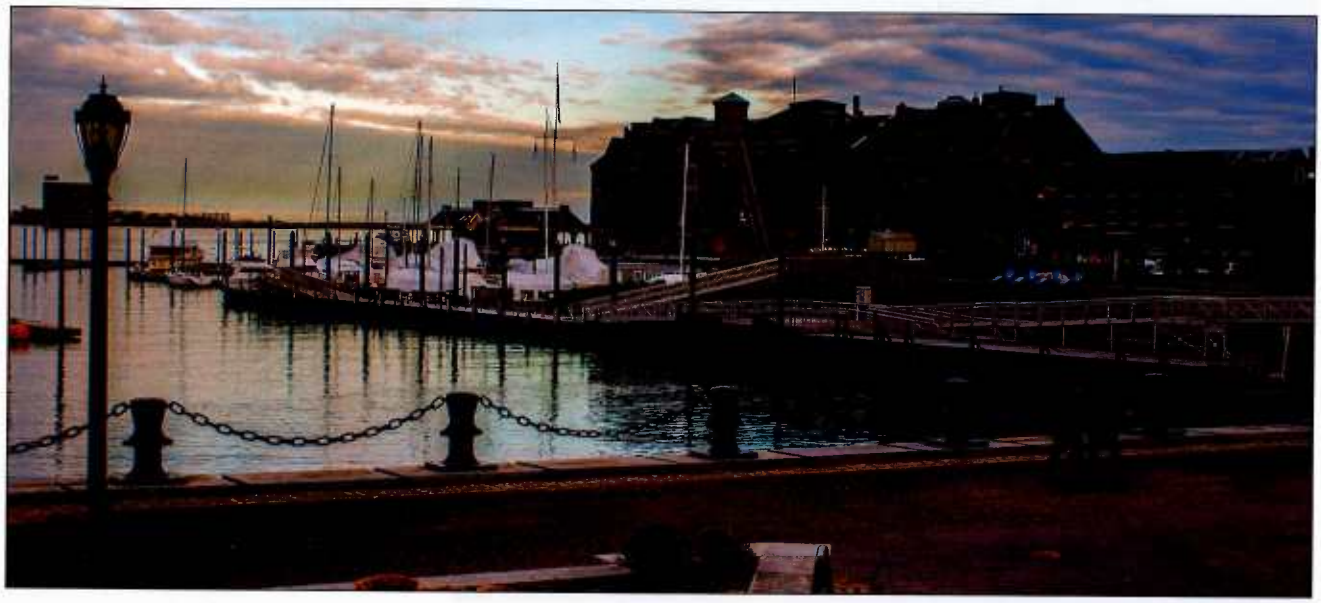
In light of this stark contrast and the possible consequences of Regency's vehicle purchases escaping tax altogether, the Supreme Judicial Court of Massachusetts concluded that use tax on 100% of the purchase of Regency vehicles was externally consistent. One significant difficulty with this aspect of the court's opinion, though, is that it provides no guidance to taxpayers as to when a tax will be fairly apportioned to a taxpayer's in-state activities.

Would one trip into Massachusetts suffice to impose use tax on 100% of a vehicle's purchase price? What about 1% of a vehicle's travel into Massachusetts? What about 5% of travel in Massachusetts but with regular storage there? These gray areas leave a great deal to be desired and provide room for future judicial opinions to set the parameters on these issues. For now, the simple answer is this: When in doubt, assume external consistency.

Discrimination against interstate commerce. In support of its argument that the use tax discriminated against interstate commerce, Regency argued that when the tax is divided by miles actually driven by Regency vehicles in Massachusetts, the tax is "significantly greater for Regency than for intrastate companies." The court rejected this argument by first noting that the use tax is based on "Regency's use and storage" of its vehicles, "not solely based on its use of roads within the Commonwealth."

The court also pointed out that discrimination against interstate commerce occurs when a tax applies differently to out-of-state taxpayers than in-state taxpayers, not

1 473 Mass. 459, 42 N.E.3d 1133 (2016).
2 430 U.S. 274, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977).
3 Mass. Gen. Laws ch. 641, § 2.
4 830 Mass. Code Regs. 64H.25.1(c)(2); Mass. Gen. Laws ch. 641, § 8.
5 Mass. Gen. Laws ch. 641, § 7.
6 430 U.S. at 281.
7 Quoting *Goldberg v. Sweet*, 488 U.S. 252, 260-61, 109 S. Ct. 582, 102 L. Ed. 2d 607 (1989).
8 514 U.S. 175, 186, 115 S. Ct. 1331, 131 L. Ed. 2d 261 (1995) (emphasis added).
9 *Id.* at 186-87.
10 734 S.W.2d 504, 509 (Mo. 1987).
11 74 Ohio St. 3d 449, 451-52, 659 N.E.2d 1250 (Ohio 1996).
12 976 So. 2d 471, 473-82 (Ala. Civ. App. 2007).
13 Quoting *American Trucking Associations, Inc. v. Scheiner*, 483 U.S. 266, 107 S. Ct. 2829, 97 L. Ed. 2d 226 (1987).
14 Quoting *M&T Charters, Inc.*, 404 Mass. 137, 140, 533 N.E.2d 1359 (Mass. 1989).
15 514 U.S. at 199-200.
16 Quoting *Goldberg*, 288 U.S. at 267.



when a state "subjects all taxpayers to tax on a transaction that another State may exempt." Along these lines, the court pointed out that the "adverse economic impact in dollars and cents upon a participant in interstate commerce for crossing a State boundary" is not a valid basis for interstate commerce discrimination.[13]

Here, the court reasoned, the use tax at issue did not treat in-state taxpayers differently from out-of-state taxpayers. Both types of taxpayers must pay use tax on the full value of a vehicle used in Massachusetts, subject to an exemption or credit for sales or use tax paid elsewhere.

In its discrimination analysis, the court also described Regency's arguments as attempting to escape tax entirely, something that courts generally frown upon: "Regency seeks to use the commerce clause of the United States Constitution not as protection against multiple or discriminatory taxation, but as an escape from any taxation at all. This the Constitution does not permit."[14] Although the court did not explain how critical this aspect of its holding was to the outcome of the case, it appeared to be fairly significant and seemed to color the court's entire analysis.

Relation to state services. Finally, the court addressed the fourth prong of the *Complete Auto* analysis—whether the tax is fairly related to the services provided by the taxing state. This prong presents a fairly low threshold. As the U.S. Supreme Court noted in *Jefferson Lines*, the "fairly related" prong "requires no detailed accounting of the services provided to the taxpayer on account of the activity being taxed." Rather, this element "asks only that the measure of the tax be reasonably related to the taxpayer's presence or activities in the State."[15]

As a result—not surprisingly—the court held that the Massachusetts use tax was fairly related to the "police and fire protection, the use of public roads and mass transit, and the other advantages of a civilized society" provided by Massachusetts to Regency in allowing Regency to store and operate its vehicles in the Commonwealth.[16]

Key take-aways. A few lessons to learn from *Regency Transportation, Inc. v. Commissioner of Revenue* are as follows:

Regularly and critically review published agency authorities. Regency ended up in the procedural posture it did primarily because it relied on an outdated letter ruling from the Massachusetts Commissioner of Revenue. The letter ruling failed to account for a rule amendment that occurred more than 20 years ago, and yet it still appears in the Commonwealth's state tax guide.

In short—and this may seem obvious—companies cannot always rely on published tax guidance from state agencies. Courts are often required to apply tax statutes de novo, without taking into account any prior department actions, and a taxpayer's ability to affirmatively rely on department guidance is generally very limited. Companies must "do their homework" and make sure they understand the underlying tax issues without relying on secondary department authorities.

The external consistency test from *Complete Auto* is ripe for further judicial construction, but courts generally defer to the taxing authority. Although courts (including the Supreme Judicial Court of Massachusetts here) have applied fair apportionment principles from sales tax cases in use tax cases, the incident of use tax is different than the incident of sales tax. If companies are tagged with use tax with only limited in-state presence in a state similar to Massachusetts, it may make sense to press further in arguing that the tax does not "reasonably reflect the in-state component of the activity being taxed."

On the other hand, because the standard of "reasonable reflection" is fairly amorphous and expansive, courts defer to the taxing state and are generally unwilling to critically examine this apportionment relationship. As a practical matter, if a tax is internally consistent, courts are more likely to conclude that it is also externally consistent.

A "no-tax" position usually leads to a "no-win" result for taxpayers. Courts are extremely reluctant to grant a taxpayer relief if it will result in significant tax-free transactions. This is due in part to the simple fact that judges are human, and in making decisions, they often (like many of us) rely on notions of fundamental fairness and equity.

If a taxpayer's position simply seems unfair to states and looks like taxpayers are trying to "game the system" by avoiding payment of tax, any close calls will be decided in favor of the state. This is especially true in an era of state funding shortfalls. ■