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Minnesota Supreme Court Upholds Varying Tax Base of the Tobacco Tax Under “Dormant” Commerce Clause

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The Minnesota Supreme Court recently issued a ruling upholding the constitutionality of the state’s tobacco tax. Affirming the decision of the state tax court, the court held that the tobacco tax is properly calculated using the price that a taxable tobacco distributor pays its suppliers for tobacco, rather than the price that those suppliers pay their manufacturers. The court went on to hold that this method of calculating the state’s tobacco tax does not violate the Constitution’s “dormant” Commerce Clause.

Minnesota’s Tobacco Tax¹

A tax is imposed upon all tobacco products in this state and upon any person engaged in business as a distributor, at the rate of 35 percent of the *wholesale sales price* of the tobacco products. The tax is imposed at the time the distributor:

- (1) brings, or causes to be brought, into this state from outside the state tobacco products for sale;
- (2) makes, manufactures, or fabricates tobacco products in this state for sale in this state; or
- (3) ships or transports tobacco products to retailers in this state, to be sold by those retailers.

¹ Minn. Stat. § 297F.05 (italics added).

The Minnesota Supreme Court's Decision

Factual and Procedural Background

Contending that it overpaid its tobacco tax between 2002 and 2005, McLane Minnesota, Inc.—a distributor of several products in Minnesota, including tobacco—sought a refund from the Minnesota Commissioner of Revenue. McLane argued that it erroneously calculated its tax on the basis of the price it paid its suppliers for tobacco products, rather than the manufacturer's list price. The Commissioner denied McLane's request for a refund, and on cross-motions for summary judgment, the state tax court upheld the validity of that decision. McLane petitioned the Minnesota Supreme Court for a writ of certiorari on the issue of whether it properly calculated its tobacco tax and, alternatively, whether that method of calculating the tobacco tax violated the Commerce Clause.

Minnesota imposes a tax on “all tobacco products in [Minnesota] and upon any persons engaged in business as a distributor.”² The tax rate is “35 percent of the wholesale sales price of the tobacco products.”³ During the relevant tax years, McLane bought over 90 percent of its tobacco from two companies, UST and Conwood. Each of those companies was divided into a manufacturing entity and a sales entity. The sales entity would purchase manufactured tobacco from the manufacturing entity and then sell it to distributors, such as McLane, at a marked-up price.

McLane calculated its tobacco tax on the basis of the marked-up amount it paid the sales entities, rather than the lesser amount that the sales entities paid the manufacturing entities for the tobacco products. In seeking a refund, McLane contended that the statute's use of the phrase “wholesale sales price” must always mean the manufacturer's price, regardless of the entity from whom the taxable distributor purchased the tobacco products. The Supreme Court rejected this argument.

A Taxable Distributor's Purchase Price Is the Proper Basis for Calculating the Tobacco Tax

McLane's refund action broke down along two tax periods based on revisions to certain definitions in the tobacco tax statute. From 2002 to 2003, the statute defined “wholesale price” as “the established price for which a manufacturer or person sells a tobacco product to a distributor, exclusive of any discount or other reduction.”⁴ McLane argued that the definition's use of the phrase “or person” merely clarified that a person could also be a “manufacturer”; thus, McLane contended that the manufacturer's sales price was always the proper measure of the tobacco tax, regardless of the person or entity from whom the taxable distributor purchased the tobacco products. The Supreme Court rejected this argument, finding it contrary to the plain language of the statute. The court concluded that the sales entities from whom McLane purchased tobacco

² *Id.*

³ *Id.*

⁴ Minn. Stat. § 297F.01.

products were “persons” for the purposes of determining “wholesale price.” Thus, the price that McLane paid those entities, rather than the price those entities paid the manufacturing entities, was the proper basis for assessing the tobacco tax.

In 2003, the Minnesota Legislature amended the tobacco tax statute substituting the definition of “wholesale sales price” as follows:

“Wholesale sales price” means the price stated on the price list in effect at the time of sale for which a manufacturer or person sells a tobacco product to a distributor, exclusive of any discount, promotional offer, or other reduction. For purposes of this subdivision, “price list” means the manufacturer’s price at which tobacco products are made available for sale to all distributors on an ongoing basis.

McLane focused on the second sentence of this amended definition, arguing that the sentence’s focus on “manufacturer’s price” clearly demonstrated the Legislature’s intent to define “wholesale sales price” as the manufacturer’s list price in all instances. The court rejected this argument. According to the court, the second sentence merely clarified that the “ ‘wholesale sales price’ may be determined by a ‘manufacturer’s price list,’ [] if the prices on that price list are prices at which tobacco products are made available for sale to all distributors on an ongoing basis.” Because McLane had purchased the tobacco at issue from a “person” rather than a manufacturer, the second sentence was not implicated, and the court again held that McLane properly calculated its tax.

Minnesota Tobacco Tax Held Not to Violate Dormant Commerce Clause

McLane alternatively argued that calculating the tobacco tax on the basis of the price a taxable distributor pays to its supplier unconstitutionally discriminates against interstate commerce. McLane contended that this method of calculating the tax causes the tax to “fall more heavily on tobacco products involved in out-of-state distribution than those involved in in-state distribution.” To support its argument, McLane relied on *Halliburton Oil Well Cementing Co. v. Reily*, where the United States Supreme Court struck down a tax that explicitly favored local merchants by imposing a higher tax on machines manufactured out of state and used in state than on those both manufactured and used in state.⁵

The Minnesota Supreme Court rejected this argument in summary fashion. It found *Halliburton* inapposite because, unlike the tax in that case, Minnesota’s tobacco tax did not include an additional tax on tobacco products manufactured out of state. Rather, the statute imposed a uniform tax on all tobacco products at the time of the first wholesale transaction in Minnesota, regardless of where the products were manufactured. The oddity in this case arose from the structure of the entities from whom McLane purchased tobacco, rather than any attempt by Minnesota to favor in-state tobacco manufacturers. Accordingly, the court held that

⁵ 373 U.S. 64, 71–73 (1963).

calculating the tobacco tax on the basis of McLane's purchase price did not violate the Constitution's "dormant" Commerce Clause. ■



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