ARTICLE I, SECTION 9, CLAUSE 5 — EXPORT CLAUSE — FEDERAL TAX ON INSURANCE PREMIUMS PAID TO FOREIGN INSURERS TO INSURE SHIPMENTS OF MERCHANDISE TO A DOMESTIC CORPORATION'S FOREIGN SUBSIDIARIES VIOLATES THE CONSTITUTION'S EXPORT CLAUSE — *United States v. International Bus. Mach. Corp.*, 64 U.S.L.W. 4419 (U.S. June 11, 1996).

The Supreme Court of the United States recently held that the Export Clause of the Constitution prohibits the imposition of general federal taxes on merchandise in export transit. *United States v. International Bus. Mach. Corp.*, 64 U.S.L.W. 4419 (U.S. June 11, 1996). In so holding, the Court reasoned that taxes on insurance premiums covering goods in export transit are equivalent to taxes on the export goods themselves. *Id.* at 4420. The Export Clause, which prohibits taxes on goods exported from any state, applies to export goods as well as those activities integrally related to the export process. *Id.*

Section 4371 of the Internal Revenue Code applies a tax on insurance fees paid to foreign insurers if the foreign insurers in question are not subject to federal income tax. *Id.* From 1975 to 1984, International Business Machines Corporation (IBM) exported its products to various foreign subsidiaries. *Id.* Many of these shipments were insured through foreign insurance companies. *Id.* An Internal Revenue Service (IRS) audit revealed that IBM had not reported Section 4371 taxes on premiums paid to foreign insurers for the years from 1975 to 1984. *Id.* The IRS assessed the tax against IBM, which filed a lawsuit contending that the Section 4371 tax violated the Export Clause. *Id.*

IBM commenced its suit to recover the Section 4371 taxes paid in the Court of Federal Claims. *Id.* The Court of Federal Claims concluded that the Section 4371 tax on policies that insure goods in export transit violated the Export Clause of the Constitution. *Id.* The government appealed the case to the Court of Appeals for the Federal Circuit. *Id.* The appeals court affirmed the decision of the lower court. *Id.*

The IRS appealed this decision to the United States Supreme Court. *Id.* The Supreme Court granted *certiorari* to consider whether the Section 4371 tax violated the Export Clause of Article I of the United States Constitution. *Id.*

Writing for the majority, Justice Thomas noted the simple and direct mandate of the Export Clause in Article I, Section 9, clause 5 of the Constitution: "No Tax or Duty shall be laid on Articles exported from any state." *Id.* The Court reiterated its policy of exempting export goods and the services or activities intimately related to the export process from federal taxation. *Id.* Even so, the majority expressed a limitation on the term "Articles exported" so to permit the federal taxation of pre-export services

and goods. *Id.*

Justice Thomas chronicled earlier cases upholding federal taxes on the manufacture of certain goods, such as tobacco, which are ultimately exported. *Id.* (citing *Pace v. Burgess*, 92 U.S. 372 (1876); *Turpin v. Burgess*, 117 U.S. 504 (1886); *Cornell v. Coyne*, 192 U.S. 418 (1904)). In those cases, the Court upheld the right of the federal government to impose nondiscriminatory pre-exportation taxes, even if the products are eventually shipped to foreign lands. *Id.*

While recognizing the government's right to tax, the majority explained that "the Export Clause strictly prohibits any tax or duty, discriminatory or not, that falls on exports during the course of exportation." *Id.* (citing *Fairbank v. United States*, 181 U.S. 283 (1901); *United States v. Hvoslef*, 237 U.S. 1 (1915); *Thames & Mersey Marine Ins. Co. v. United States*, 237 U.S. 19 (1915)). Justice Thomas acknowledged that the protection afforded by the Export Clause extends to activities and services closely related to export processes. *Id.* at 4421. The majority emphasized that a tangential relationship to export was not sufficient to exempt a service or activity from a tax such as Section 4371. *Id.*

Justice Thomas rejected the government's contention that the traditional plain meaning of the Export Clause should be reevaluated in light of historical changes in the interpretation of the Commerce Clause and the Import-Export Clause. *Id.* at 4421-22. The Justice underscored the literal text of the Export Clause which prohibits, on its face, Congress from establishing a tax on exports. *Id.* at 4422. While admitting that taxes on insurance policies covering exports are not precisely taxes on exports themselves, the majority cited precedent which found such taxes to be functionally equivalent to export taxes. *Id.* (citing *Thames & Mersey*, 219 U.S. 19 (1915)). Justice Thomas based the Court's reasoning on the policy of *stare decisis*. *Id.*

The Court noted that it did not find any ambiguity surrounding the term "Tax" found in the Export Clause. *Id.* at 4423. Justice Thomas observed that, in relation to the Export Clause, he could not ignore the meaning of the word "Tax" simply because a government tax does not discriminate against exports, *per se*. *Id.* The majority recognized that the Export Clause prohibits the federal government from regulating global commerce through export taxes and disallows any attempt to raise revenues from exports. *Id.* at 4424.

The majority then reviewed the historical reasons underlying the inclusion of the Export Clause in the Constitution. *Id.* Noting that the southern states originally feared that a northern controlled Congress would use taxes on southern exports as a cash cow, the Court realized that this originally narrow focus resulted in the expansive prohibition on taxing exports now found in the Constitution. *Id.*

Justice Thomas justified the expansive language of the Export Clause through historical reference to debates at the inception of the Republic. *Id.* Here, the Court made references to the Constitutional Convention whereby "Mr. Mason," "Mr. Butler," "Mr. Elseworth," and others were quoted as opposing any possible federal taxing power of exports. *Id.* While the Government argued for a narrow interpretation of the Export Clause based on the "North versus South" scenario, Justice Thomas proclaimed that such an explanation "cannot be squared with the broad language of the [Export] Clause." *Id.* Accordingly, the majority emphasized that the Framers of the Constitution purposely sought to alleviate state concerns by completely denying the federal government of the power to tax exports. *Id.*

Concluding, the majority affirmed the decision of the Court of Appeals for the Federal Circuit. *Id.* at 4425. The Court explicitly stated that the Export Clause forbids Congress from enacting nondiscriminatory taxes on goods in export transit. *Id.* The Court reasoned that the tax on insurance amounts paid to foreign insurers for insurance against the loss of merchandise in transit constituted an unconstitutional tax on exports. *Id.*

Justice Kennedy, joined by Justice Ginsburg, dissented. *Id.* (Kennedy, J., dissenting). Perplexed as to the issue decided and presumptions made by the majority, the dissent stated its disapproval of the assumption that a tax on insurance is a tax on exports. *Id.* Justice Kennedy opined that the majority's assumption had no precedent in Supreme Court jurisprudence. *Id.* In so finding, the Justice termed the decision "peremptory" and labeled the majority's deduction as "wrong." *Id.*

The dissent reasoned that a tax on a service which is distinct from the product, such as insurance taxes, is not a tax on the good itself. *Id.* Citing the "significant complexity" that the majority's decision might effect on Section 4371 administration, Justice Kennedy proclaimed that the Export Clause should not be applied in this case. *Id.*

The Justice characterized Section 4371 as a broad-based, yet rather simple federal tax, and maintained that the assessment is not discriminatory against exports. *Id.* The dissent further noted that the language of the statute not even mention the word "export." *Id.* Justice Kennedy opined that the statue is non-discriminatory and, hence, must be paid by domestic traders and individuals alike who are insured for domestic casualty risks. *Id.* Recalling the legislative intent in enacting Section 4371, the dissent emphasized that the purpose of the tariff was to eliminate unwarranted competitive advantages then favoring foreign insurers who were otherwise not subject to federal income tax. *Id.* (citing H.R. REP. No. 2333, 77th Cong., 2d Sess., 61 (1942)). Justice Kennedy highlighted that exemptions from the levy existed for any policy that was issued by a foreign insurer who was subject to federal income tax. *Id.*

The dissent opined that the plain text of the Export Clause makes no

mention of and has no bearing on services provided to exporters because the "service" is not exported. *Id.* Justice Kennedy criticized the majority's failure to distinguish between a direct tax on goods and a federal tax on insurance premiums. *Id.*

Realizing that the government had avoided the claim that Section 4371 was a tax on insurance and not a tax on exports, the dissent excoriated the majority for not addressing this precise issue when the Court had plainly done so in the past. *Id.* at 4426 (Kennedy, J., dissenting) (citations omitted). Justice Kennedy maintained that the majority's failure to entertain this integral question was a dubious decision because the query was "essential to the analysis" of the issue presented. *Id.* (quoting *Procunier v. Navarette*, 434 U.S. 555, 559-60 n.6 (1978)). Arguing on this basis, the Justice proclaimed that the question was before the Court and should have been decided. *Id.*

Continuing with this line of reasoning, the dissent again criticized the majority's refusal to rule on the question of whether a tax on insurance constitutes a tax on export goods. *Id.* at 4427 (Kennedy, J., dissenting). Justice Kennedy proffered that, due to the complexity involved in the insurance business, the IRS will face an array of new and unexpected problems. *Id.* The Justice proffered the example that the IRS may now be forced to determine when exportation has begun and prorate the Section 4371 tax so to suit the Court's mandate. *Id.* In addition, the Justice noted that the IRS must now determine if new types of insurance would constitute taxes on exports. *Id.* The dissent warned of a slippery-slope which could develop due to the majority's decision. *Id.* Justice Kennedy maintained that severe administrative burdens would result in determining the application of the Export Clause on such expensive topics as the warehousing of goods in transit and domestic transportation insurance on goods for export. *Id.*

The dissent harkened to the Framers' understanding of the Export Clause. *Id.* at 4428 (Kennedy, J., dissenting). Justice Kennedy interpreted the text of the Clause in a literalist manner — there are to be no federal taxes on goods exported. *Id.* (citing U.S. CONST. art. I, § 9, cl. 5). The Justice maintained that the Export Clause does not apply to services which have an indirect affect on articles exported. *Id.*

Accordingly, the dissent concluded that Congress should not be deprived of important revenue-raising and regulatory weapons such as Section 4371. *Id.* While open to forbidding taxes which representing proxies for assessments on goods, Justice Kennedy opined that the tax on insurance premiums found in Section 4371 was not a tax on export goods. *Id.* at 4429-30 (Kennedy, J., dissenting). The Justice noted that Section 4371 taxed services, and maintained that the majority had made a "serious mistake" in its application of the Export Clause in this case. *Id.* at 4430 (Kennedy, J., dissenting).

Analysis

The Supreme Court, in *International Business Machines*, recognized that a tax which can be raised directly can also be increased indirectly. The taxing of exports, which is forbidden by the Export Clause of Article I of the United States Constitution, may appear in various forms. A tax, even a nondiscriminatory one, may be a hidden disincentive by which the federal government may gain revenue on the exportation of American products.

"A [r]ose [b]y any other word would smell as sweet." WILLIAM SHAKESPEARE, ROMEO AND JULIET act 2, sc. 2. Where a federal tax directly relates to a common exporting practice, such as insuring shipments, the price of the export and cost of the shipment increase. At the same time, the government gains revenue it would not have obtained absent the existence of the export. Therefore, the government is taxing exports without directly levying a tax on the export itself. Such assessments would seem to be unconstitutional pursuant to the Export Clause.

Politicians and economists constantly link the nation's economic future to increases in exports of goods. While the government does have a legitimate interest in regulating business matters, exports are vital to America's continued economic health. The prohibition on taxing exports is not only in line with wise economic policies, but is also in the spirit of the Export Clause of the United States Constitution.

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