Michigan Law Review

Volume 38 | Issue 7

1940

TAXATION - PRIVILEGE TAX ON FOREIGN CORPORATIONS - DUE PROCESS AND COMMERCE CLAUSES - VALIDITY OF FORMULA

James W. Deer
University of Michigan Law School

TAXATION — PRIVILEGE TAX ON FOREIGN CORPORATIONS — DUE PROCESS AND COMMERCE CLAUSES — VALIDITY OF FORMULA — The state of Texas levied an annual franchise tax on all corporations, both foreign and domestic, authorized to do business within the state.[1] The tax was assessed on the basis of the amount of the total capital stock which was allocable to Texas, the allocation being based on the proportion that Texas gross receipts bore to total gross receipts. This formula, as applied to the Ford Motor Company, gave the statutory base of $23,000,000 on which Ford paid the tax under protest.[2]

[1] Tex. Civ. Stat. Rev. Ann. (Vernon, 1939), art. 7084. The tax was sustained in Southern Realty Corp. v. McCallum, (C. C. A. 5th, 1933) 65 F. (2d) 934; Investment Securities Co. v. Meharg, 115 Tex. 441, 282 S. W. 802 (1926).

[2] $\frac{\text{(Texas gross receipts) } \$\ 34{,}000{,}000}{\text{(Total gross receipts) } \$888{,}000{,}000} = \frac{\text{(Taxable Base) } X}{\text{(Total Capital) } \$600{,}000{,}000.}$

$X = \$23{,}000{,}000.$

The evidence showed that the Ford Motor Company had only an assembly plant in Texas worth $3,000,000, that auto parts were shipped in, assembled, and sold in intrastate commerce. The circuit court of appeals affirmed the district court's judgment upholding the tax against the claim that it burdened interstate commerce and taxed property outside the state. On certiorari to the Supreme Court of the United States, *held*, the formula was constitutional because it fairly measured the value added to the privilege of doing intrastate business by use of property outside the state. Judgment affirmed. Justices Black and Douglas concurred in the result. Justice McReynolds dissented. *Ford Motor Co. v. Beauchamp*, 308 U. S. 331, 60 S. Ct. 273 (1939).

This case seems to be predicated on the broad premise that a tax may be imposed for the privilege of engaging in intrastate commerce if the privilege is equal to the tax. By placing the case on that ground the Court avoided some of the difficult inquiries that ordinarily arise under the unit rule. It may be that this case, along with *Great Atlantic & Pacific Tea Co. v. Grosjean*,[3] shows a disposition on the part of the Court to sustain a reasonable privilege tax without inquiring whether it meets the tests laid down by the courts in the cases following *Western Union Telegraph Co. v. Kansas*.[4] In the *Western Union* case the plaintiff was engaged in both interstate and intrastate commerce in the state of Kansas, which sought to impose an annual tax upon the whole capital stock of the company in return for the privilege of continuing to engage in the intrastate business. While the Court denied the validity of the tax clearly on the ground that it burdened interstate commerce, it was not entirely clear whether any tax of the size imposed would have been deemed a burden on the interstate business, or whether the tax burdened interstate commerce because it taxed property outside the jurisdiction of Kansas.[5] But it seems to have been assumed in the later cases that the fault was in measuring the tax on extra-state values. Certainly when the states measured their taxes on the capital stock attributable to local property only (calculated by a unit rule) the taxes were upheld as

[3] 301 U. S. 412, 57 S. Ct. 772 (1937). This case sustained an occupation tax levied by the state of Louisiana on retail grocery stores in the state, the amount of the tax on each establishment being measured by the total number of such establishments owned by the taxpayer, whether such establishments were located within or outside Louisiana.

[4] 216 U. S. 1, 30 S. Ct. 190 (1910); Pullman Co. v. Kansas, 216 U. S. 56, 30 S. Ct. 232 (1910); Ludwig v. Western Union Telegraph Co., 216 U. S. 146, 30 S. Ct. 280 (1910).

[5] Western Union Telegraph Co. v. Kansas, 216 U. S. 1, at 31-32, 30 S. Ct. 190 (1910): "So, in the case now before us, the exaction, as a condition of the privilege of continuing to do or doing local business in Kansas, that the Telegraph Company shall pay *a given per cent of its authorized capital stock*, is, for every practical purpose, a tax both on the company's local business in Kansas, and on its interstate business, or on the privilege of doing interstate business. . . ." (Italics used by the court.) Again, 216 U. S. at 30, the Court said: "That fee, plainly, is not based on such of the company's capital stock as represented in its local business and property in Kansas. The requirement is a given per cent of the company's authorized capital, that is, all its capital, wherever or however employed, whether in the United States or in foreign countries, and whatever may be the extent of its lines in Kansas as compared with its lines outside of that State."

property taxes.[6] This left the following situation: (1) if the tax burdened interstate commerce, it might be sustained as a property tax if the measure did not include extraterritorial values; (2) if the tax did not burden interstate commerce, it was valid if (a) the subject of the tax was within the jurisdiction of the state and (b) the measure of the tax was proper.[7] In order to decide the principal case the Court might have gone no further than to place it in the first or second category, and then to decide whether the measure of the tax included extra-state values. Rather than open up the question whether the formula properly allocated property, tangible and intangible, to Texas,[8] the Court relied on three cases which went much further and sustained taxes measured by extra-state values.[9] The first two of these cases are not strictly in point. The *Botkin* case relied strongly on *Baltic Mining Co. v. Massachusetts*,[10] in which the Court said that a state tax on the whole capital stock of an inter-

[6] St. Louis Southwestern Ry. v. Arkansas, 235 U. S. 350, 35 S. Ct. 99 (1914).

[7] See 51 HARV. L. REV. 508 (1938).

[8] When the validity of the tax in the principal case was sustained by the circuit court of appeals, that court stated that the formula was a proper allocation of the property to Texas. Southern Realty Corp. v. McCallum, (C. C. A. 5th, 1933) 65 F. (2d) 934. The court said: "When the corporation is to do business in other states also, avoidance of a trespass on interstate commerce or on that done beyond the territorial jurisdiction of the taxing state is secured by apportioning the business potency of the corporation represented by its business capital according to the business actually done during the preceding calendar year in the taxing state as indicated by gross receipts, compared with all its business everywhere." 65 F. (2d) at 936. The court cited three cases in support of its statement: International Shoe Co. v. Shartel, 279 U. S. 429, 49 S. Ct. 380 (1928); National Leather Co. v. Massachusetts, 277 U. S. 413, 48 S. Ct. 534 (1928); and Western Cartridge Co. v. Emmerson, 281 U. S. 511, 50 S. Ct. 383 (1930). The first two of these cases involved taxes where the formula measured the tax by the proportion of local property, not gross receipts, to total property. The Emmerson case involved a tax on capital stock but measured by a combination of local business and property to total business and property. There are cases in which the proportion of local gross receipts to total gross receipts have been held to be a proper measure of the local business, but the incidence of the tax was on local net income, not local property. None of these cases is quite like the Ford case.

[9] Kansas City, Ft. S. & M. R. R. v. Botkin, 240 U. S. 227, 36 S. Ct. 261 (1916); Atlantic Refining Co. v. Virginia, 302 U. S. 22, 58 S. Ct. 75 (1937); Great Atlantic & Pacific Tea Co. v. Grosjean, 301 U. S. 412, 57 S. Ct. 772 (1937).

[10] 231 U. S. 68, 34 S. Ct. 15 (1913). A corporate excise tax which is measured by authorized capital of such corporations, but limited to a specified sum ($2000), was not deemed an unconstitutional burden on interstate commerce. The tax involved in the Botkin case, Kansas City, Ft. S. & M. R. R. v. Botkin, 240 U. S. 227, 36 S. Ct. 261 (1916), was also levied directly on the entire capital stock, and had a specified maximum of $2500. Much of the property represented by the capital was outside the taxing state. The Court referred to and relied on the Baltic case, saying, 240 U. S. at 235: "It was because the tax, although measured by authorized capital stock, could not in view of its limitations be regarded as imposing a direct burden upon interstate commerce that the tax was upheld." On the same page, referring to the identical type of tax in the case at bar the Court said: "We find no ground for saying that a tax of this character, *thus limited*, is in any sense a tax imposed on interstate commerce." (Italics inserted by the writer.)

state corporation was not burdensome because a maximum was set by the statute. However, the *Baltic Mining* case was overruled [11] after the *Botkin* case and it would seem that both cases are discredited in so far as they stand for the proposition that the existence of a maximum may prevent a tax measured partially by interstate commerce from being a burden on it. If the *Botkin* case still stands it must be on the ground that the tax was levied on a domestic corporation and not a foreign one. The *Atlantic Refining* case also involved a franchise tax measured by total capital stock, but was upheld on the ground that the corporation was being excluded, not evicted from the state. One can only speculate why the Court relied on cases which would have supported the tax even though it had been measured by extra-state property. The tax might have been sustained on narrower grounds. Apparently the Court has returned to the position expressed by Holmes' dissent in the *Western Union* case, with the qualification that the state's tax on the privilege must be reasonable in view of the privilege granted.

James W. Deer

[11] Cudahy Packing Co. v. Hinkle, 278 U. S. 460, 49 S. Ct. 204 (1929); Alpha Portland Cement Co. v. Massachusetts, 268 U. S. 203, 45 S. Ct. 477 (1925).