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CONSTITUTIONAL LAW - FRANCHISE TAX - BURDEN UPON INTERSTATE AND FOREIGN COMMERCE - DUE PROCESS - EQUAL PROTECTION OF THE LAWS

CONSTITUTIONAL LAW — FRANCHISE TAX — BURDEN UPON INTERSTATE AND FOREIGN COMMERCE — DUE PROCESS — EQUAL PROTECTION OF THE LAWS — The state of California adopted a franchise tax which was based upon the corporations' net income apportioned according to "that portion which is derived from business done within the State." When this was construed to include not merely the income from intrastate business alone, but rather the income from both this and from all interstate and foreign business attributable to California, its enforcement was resisted upon the grounds that (1) so construed it was repugnant to the commerce clause upon the theory that it burdened interstate and foreign commerce, (2) it violated the due process clause upon the theory that the income here taxed in excess of that derived solely from intrastate business had no relation to the state franchise, and (3)

it denied the equal protection of the laws since corporations engaged exclusively in interstate and foreign commerce were not taxed at all upon this disputed portion of their income. *Held*, that the state tax was not repugnant to any of these constitutional provisions. *Matson Navigation Co. v. State Board of Equalization of the State of California*, (U. S. 1936) 56 S. Ct. 553.

In possible modification of the absolute terms of the early cases,[1] it is now generally said that a state statute is invalid because of the commerce clause only when it directly and materially interferes with the freedom of interstate and foreign commerce in contrast to situations where such interference is merely incidental, indirect and immaterial.[2] Whether franchise taxes of various kinds so burden some federal function has frequently been before the courts and the taxes have been treated as valid where they are not directed specifically toward the federal specialty[3] and where the burden is not material.[4] However, in order that it shall not be a material burden, it is required that taxes based upon income or property shall reach only that proportion of the corporation's income or property as may fairly be allocated to the taxing state.[5] Where this is done, the decisions support the tax.[6] From the due process view-

[1] Gibbons v. Ogden, 9 Wheat. 22 U. S. 1, 6 L. Ed. 23 (1824).

[2] "The turning point of these decisions is, whether in its incidence the tax affects interstate commerce so directly and immediately as to amount to a genuine and substantial regulation of, or restraint upon, it, or whether it affects it only incidentally or remotely so that the tax is not in reality a burden, although in form it may touch and in fact distantly affect it." Hump Hairpin Mfg. Co. v. Emmerson, 258 U. S. 290 at 294, 42 S. Ct. 305 (1921); Western Cartridge Co. v. Emmerson, 281 U. S. 511, 50 S. Ct. 383 (1930). See generally, Powell, "Indirect Encroachment upon Federal Authority by the Taxing Power of the States," 32 HARV. L. REV. 902 (1919).

[3] " . . . it is settled that a state excise tax which affects such commerce, not directly, but only incidentally and remotely, may be entirely valid when it is clear that it is not imposed with the covert purpose or with the effect of defeating federal constitutional rights. . . ." Hump Hairpin Mfg. Co. v. Emmerson, 258 U. S. 290 at 294, 42 S. Ct. 305 (1921). To same effect, see Home Insurance Co. v. New York, 134 U. S. 594, 10 S. Ct. 593 (1889); Pacific Co. v. Johnson, 285 U. S. 480, 52 S. Ct. 424 (1932). But where specifically directed toward federal specialties, the tax is held invalid without further inquiry. Macallen Co. v. Massachusetts, 279 U. S. 620, 49 S. Ct. 432 (1928) (income from copyrights); Miller v. Milwaukee, 272 U. S. 713, 47 S. Ct. 280 (1927) (income from federal bonds); Welton v. Missouri, 91 U. S. 275, 23 L. Ed. 347 (1875) (license tax upon peddlers of goods manufactured in other states).

[4] Educational Films Corporation of America v. Ward, 282 U. S. 379, 51 S. Ct. 170 (1931).

[5] Western Union Tel. Co. v. Kansas, 216 U. S. 1, 30 S. Ct. 190 (1910); New Jersey Bell Tel. Co. v. New Jersey, 280 U. S. 338, 50 S. Ct. 111 (1904).

[6] St. Louis Southwestern Ry. Co. v. Arkansas, 235 U. S. 350, 35 S. Ct. 99 (1914). This case considered in relation to a franchise tax based upon the proportion of capital stock represented in the state the same three clauses considered in the principal case, namely, interstate and foreign commerce, due process, and equal protection of the laws, and held the tax repugnant to none of them. See also Union Refrigerator Transit Co. v. Kentucky, 199 U. S. 194, 26 S. Ct. 36 (1905); Adams Express Co. v. Ohio State Auditor, 166 U. S. 185, 17 S. Ct. 604 (1897); Western

point, the question is one of the reasonable relation of the proportion of the net income taxed to the jurisdiction of California to impose a tax.[7] Though part of this proportion may not have proceeded wholly from California, still the California franchise may be considered as in part contributing to it and its value is measurable by it.[8] This income must, therefore, have a sufficiently close relation to the California franchise to be a fair base for a tax upon it, and, as such fair base, it is consistent with due process. On the score of equal protection of laws, it must be conceded that a corporation engaged in both domestic and interstate and foreign business was subject to pay tax upon a part of its income which a wholly interstate and foreign company would not pay; however, mere different treatment of different classes is not of itself discriminatory so long as all members of that class are treated alike and the difference in treatment is reasonably founded.[9] Here the first condition, similarity within the class, was conceded to be satisfied; the second condition, reasonable basis for *this* classification, is satisfied in that in the one case the corporation is using no California franchise while in the other case a part of its operations are based upon the authority of a California franchise.[10] On all three grounds, therefore, it is submitted that the tax fell within the field previously marked out by the Court as available to the state for purposes of taxation.

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Cartridge Co. v. Emmerson, 281 U. S. 511, 50 S. Ct. 383 (1930); Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113, 41 S. Ct. 45 (1920).

[7] Union Tank Line Co. v. Wright, 249 U. S. 275, 39 S. Ct. 276 (1918); Fargo v. Hart, 193 U. S. 490, 24 S. Ct. 498 (1904).

[8] Cudahy Packing Co. v. State of Minnesota, 246 U. S. 450, 38 S. Ct. 373 (1918); Flint v. Stone Tracy Co., 220 U. S. 107, 31 S. Ct. 342 (1911); Pullman Co. v. Richardson, 261 U. S. 330, 43 S. Ct. 366 (1923).

[9] Radice v. New York, 264 U. S. 292, 44 S. Ct. 325 (1924); Buchanan v. Warley, 245 U. S. 60, 38 S. Ct. 16 (1917).

[10] The same sort of contention applied in St. Louis Southwestern Ry. Co. v. Arkansas, 235 U. S. 350, 35 S. Ct. 99 (1914), and was there argued but denied recognition, the Court holding, by implication, that a corporation's character as domestic or foreign is sufficient ground for different treatment in this sort of case.