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WHITHER OR WITHER TAX IMMUNITIES?

D. J. Farage*

Three recent Supreme Court decisions, bearing upon the constitutional validity of various state taxing measures, bid fair to extend the permissible scope of the state taxing power and demonstrate a judicial attitude intent upon a repudiation of many artificial immunities evolved by the Court in previous decisions to curb the exercise of the states' power of taxation.

Foremost, perhaps, in interest and significance among the tax decisions handed down at the present term of Court is Atlantic Refining Company v. Commonwealth of Virginia.¹ There a Virginia statute imposed upon every foreign corporation seeking authority to do local business within the state, a license fee measured by the corporation's authorized capital stock. The Atlantic Refining company, seeking to enter the state for the first time to carry on local business, paid the fee under protest and sought to recover back the amount paid as having been unconstitutionally exacted. Chief Justice Hughes did not participate in the decision. The other members of the Court unanimously upheld the fee as valid.

That the privilege of admission into the state to do local business was a proper subject for the exaction was conceded by the taxpayer. What was controverted was the legality of measuring the amount of the fee by the authorized capital stock of the company, most of whose property was situated elsewhere than in Virginia. Invoking the doctrine of unconstitutional conditions, the company argued, inter alia, that such a measure was unreasonable and violated due process in that it sought to reach property outside the state. This the court denied, stating that authorized capital stock does not necessarily have any relation to the amount of property owned by the corporation.

No doubt, the relation between authorized capital stock and a corporation's property is more remote than the relation between issued capital stock and the corporation's property. The amount of a company's authorized capital stock represents the permissible limits of the company's growth, which may or may not have been fully attained. Nevertheless, taxes measured by authorized capital stock have often been declared invalid by the Supreme Court on the theory that such a measure constitutes an unconstitutional condition when imposed upon the foreign corporation.² The invalidity of such a measure might be explained on the

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¹ 158 S. Ct. 75 (1937).
² Cudahy Packing Company v. Hinkle, 278 U. S. 460 (1929); and see Court's note 5 in the principal case at page 80 for other cases.
theory that since authorized capital stock represents the permissible limits of the corporation's expansion, and since the privilege to grow is conferred by the state of incorporation, and not by the states wherein business may be carried on, the latter have no logical reason justifying their use of authorized capital stock as a tax measure.

Justice Brandeis speaking for the Court, when faced with this line of cases, distinguished them on the ground that in "each of those cases, the corporation had, before the exaction held unconstitutional, entered the State with its permission to do local business and pursuant to that permission had acquired property and made other expenditures."8 Earlier in the decision the Justice also said, "Unlike the cases in which the doctrine of unconstitutional conditions has been applied, the condition here questioned does not govern the corporation's conduct after admission."

It is submitted that this case is the first definitely to restrict the doctrine of unconstitutional conditions to regulations imposed subsequent to the admission of a foreign corporation. It is true that the cases cited by the court in which the tax was thus measured, appear to have involved conditions subsequent. However, no stress appears to have been placed by the court in any of these cases upon the fact that the condition was then imposed. Indeed, in many cases, the opinions do not indicate at all whether the condition was imposed before or after admission. The only definite suggestion of the possible distinction between antecedent and subsequent conditions which appears ever to have been made previously, is in a dictum in Hanover Fire Insurance Company v. Harding,5 a case which did not involve any attempt to use authorized capital stock as a tax measure.

Moreover, there is at least one decision which appears definitely to apply the theory of unconstitutional conditions to invalidate a requirement imposed prior to the corporation's admission. In Insurance Company v. Morse,6 a foreign corporation seeking admission into a state to do local business was compelled before entry to file an "agreement" foregoing its rights to sue in or remove suits to the federal courts. Later the corporation in violation of the "agreement", removed a case to the federal courts. The Supreme Court held that the state statute requiring a filing

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858 S. Ct. 75, 80 (1937).

4Id. at 77. The Court appears at first not to hold flatly that the doctrine of unconstitutional conditions applies only to conditions imposed after admission of the corporation, for Justice Brandeis adds, "But it may be assumed that the rule (i.e. the doctrine of unconstitutional conditions) . . . is applicable also to conditions to be performed wholly before admission; . . . . For we are of the opinion that in refusing to grant the authority to carry on local business except upon payment of the $5000, no constitutional right of the company was violated."

4Id. At this point, the Court seems to put the decision on the ground that the condition is reasonable no matter when imposed. However, when faced with Cudahy Packing Company v. Hinkle and the other cases referred to in note 2, the court was obliged to rely squarely on the distinction between conditions imposed before and conditions imposed after admission.

5272 U. S. 494 (1926).

620 Wall. 445 (1874).
of said "agreement" was unconstitutional as an unreasonable condition.\(^7\)

It is perhaps highly significant that in *Cudahy Packing Company v. Hinkle*,\(^8\) which held the use of authorized capital stock improper as a tax measure, Justice Brandeis dissented, although the tax there involved was imposed subsequent to the corporation's admission. In a word, it appears that Justice Brandeis finds no valid objection to the use of authorized capital stock as a tax measure, whether the fee be exacted prior or subsequent to admission. *Atlantic Refining Company v. Virginia* is simply an initial step inaugurating a swing to the position taken by Justice Brandeis as a dissenter in the *Hinkle* case. I say "inaugurating" because as will be indicated presently there are definite possibilities for extending *Atlantic Refining Company v. Virginia*.

It is needless to point out that there is nothing in the Constitution itself which suggests that an entrance fee may be measured by authorized capital stock, whereas a tax subsequently imposed may not be thus measured. It is submitted that the only practical reason justifying a distinction between conditions prior and conditions subsequent to admission, is that it may be unfair, after a corporation has been admitted, and after it has changed its position by making substantial investments and expenditures, to impose upon it conditions which the court deems unreasonable. Where burdensome regulations are imposed as a condition precedent to entry, the corporation has the option, at least, of staying out of the state and avoiding the burdens sought to be imposed. To date, however, the Court, when it has declared any regulation invalid under the doctrine of unconstitutional conditions, does not appear to have examined the particular corporation in any given case to see whether the regulations, though subsequent, were unreasonable in the light of the amount of the particular company's investments and expenditures in the state. There has been no attempt to determine the extent of the company's change of position and the hardship that might ensue in view of that change. The doctrine of unconstitutional conditions appears to have been applied to invalidate regulations as being unreasonable per se, regardless of the extent of the particular corporation's change of position.

If, as the writer suggests, the only justification for a distinction between conditions imposed prior to admission and conditions imposed subsequently lies in the possibility of hardship where the regulations are subsequent, why may not the court, disposed to unshackle the state's taxing power, uphold a regulation

\(^7\)However, it should be noted that while the court in the Morse case treated the theory of unconstitutional conditions as applicable to regulations imposed prior to entry, the result might have been reached on other grounds without the necessity of resorting to the doctrine of unconstitutional conditions. It has been suggested that such an agreement even as between private individuals might be deemed void as against public policy for, attempting to oust competent jurisdiction of the federal courts. While thus distinguishable, the fact remains that the Court in the Morse case did invoke the doctrine of unconstitutional conditions, whether necessary to the decision or not.

\(^8\)278 U. S. 460 (1929).
such as that involved in *Atlantic Refining Company v. Virginia*, even if imposed *after* the entry of the corporation, if the particular corporation cannot show such a change of position as to make the imposition of the given subsequent regulations inequitably and unreasonably burdensome? Even though entry of the corporation was unconditional, if the subsequent regulations are imposed sufficiently promptly, before the corporation has commenced extensive operations, why should such regulation be declared unlawful merely because imposed subsequent to the corporation's admission?

In short, a court reluctant to sustain barriers to the states' taxing power, following *Atlantic Refining Company v. Virginia*, may declare that a state may impose upon a foreign corporation any tax however measured, not only as a condition precedent to entry, but even after entry, if the corporation's change of position in reliance upon its former admission, weighed against the burdensomeness of the tax is not sufficient to establish hardship upon the corporation. Such a development of the *Atlantic Refining Company* case, it is submitted, is logical, proper and likely.

Apart from the inroads being made upon cases like *Cudahy Packing Company v. Hinkle*, by this decision, and its effect in extending the states' power of taxation, the suggestion of Justice Brandeis that the doctrine of unconstitutional conditions is applicable only to regulations imposed *after* admission of a foreign corporation, does much to clarify what was formerly an obscure and seemingly inconsistent position of the Court.

Traditionally, the Supreme Court has adhered to the view that any state might exclude at will any foreign corporation seeking to enter the state to conduct local business. This doctrine has been consistently reiterated by the court even in decisions recognizing the newer doctrine of unconstitutional conditions. Thus in *United States v. Chicago M. & St. P. Railway Company* Justice Sutherland said:

"It has long been settled in this Court that the rejection of an unconstitutional condition imposed by a state upon the grant of a privilege, even though the state possess the unqualified power to withhold the grant altogether, does not annul the grant. The grantee may ignore or enjoin the enforcement of the condition without thereby losing the grant."

And Justice Holmes similarly remarked in another case:

"... we assume in favor of the defendants that the state has the power and constitutional right arbitrarily to exclude the plain-

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10282 U. S. 311, 328 (1931).
11 Italics ours.
12Fidelity & Deposit Company of Maryland v. Tafoya, 270 U. S. 426, 434 (1926).
tiff without other reason than such is its will. But it has been held a great many times that the most absolute seeming rights are qualified, and in some circumstances become wrongs. One of the most frequently recurring instances is where the so-called right is used as part of a scheme to accomplish a forbidden result."

There having been no definite suggestion prior to Atlantic Refining Company v. Virginia that the doctrine of unconstitutional conditions was restricted in its operation to regulations imposed subsequent to a corporation's entry, to many, if not all writers on the subject, such language as that here quoted appeared as an attempt to compromise two entirely inconsistent theories. With reasonable perplexity, it was asked in effect, how can a state be under a disability to impose unconstitutional conditions upon a foreign corporation, and yet be able to exclude that foreign corporation at will?

Some writers concluded that in fact the state did not have power to exclude at will under all circumstances. Most writers took the position that the "literal implication of the cases is that although a state may not exclude for a bad reason, it may fantastically enough, do so for no reason at all." Such conclusions are reasonable enough, if the premise be accepted that the doctrine of unconstitutional conditions applies to any unreasonable regulation, before or after the corporation's entry.

But Justice Brandeis, in restricting the operation of the doctrine to conditions imposed after entry only, dispels the notion that the Court had attempted a hybrid wedding of two inconsistent theories, and crystallizes the Court's position. It is perfectly consistent to say on one hand, as he does, that a state may absolutely withhold its permission that a foreign corporation enter, or attach any condition whatsoever to a grant of consent, and still say on the other hand, that after a corporation has been permitted to enter, such regulations must meet the test of the doctrine of unconstitutional conditions.

The decision in Atlantic Refining Company v. Virginia serves moreover to simplify the legal process by which the legality of entrance fees imposed upon corporations is determined. Heretofore, a dual problem was involved. First a proper subject for taxation must be found; then the measure of the tax must be scrutinized. The effect of this recent decision is to limit the legal question to the first consideration only, namely as to whether there is a taxable subject matter. So long as the fee is exacted for the privilege of entry, it would seem that the measure of the tax is no longer significant here no matter how unreasonable, and

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13Hale in his article "Unconstitutional Conditions and Constitutional Rights," 35 Col. L.R. 321, 357 (1935) asks: "Would it not be more accurate to say ... that in the circumstances it had no power to exclude ... the foreign corporation from the state?" Suggesting that the doctrine of unconstitutional conditions results in the abandonment of the traditional doctrine that a foreign corporation may be excluded at will, see Henderson, THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW (1918) at page 147.

14The Doctrine of Unconstitutional Conditions, 79 U. of P. L. R. 1118, 1128 (1931); and see Merrill, Unconstitutional Conditions, 77 U. of P. L. R. 879, 883, 884 (1929).
no matter how directly it may seem to affect property of the company situated outside of the state. This seems a permissible consequence of the rule that the state may attach any condition to the privilege to enter. The Court's effort to show that authorized capital stock has no relation to the company's property, therefore seems redundant. Indeed the Court itself said, "If Virginia had the power to charge $5000 for the privilege, the particular measure applied by the legislature in arriving at that sum would seem to be legally immaterial."16

One thing is certain. The decision represents a vigorous effort to minimize the extent of tax immunities. The same determination is evidenced by the majority opinion in another highly significant decision of the Supreme Court handed down at the present term of court. In James v. Dravo Contracting Company,16 it was held that contractors may be required by a state to pay an income tax measured by gross receipts, including money received from the federal government for contracting work done for it.

The contractor sought to deduct the money received from the federal government from the total taxable income, on the principle that a state tax thereon would constitute interference with a governmental activity of the United States. The Supreme Court, by a five to four vote, held that the contractor was not entitled to any such exemption.17

In upholding the state's power to tax the majority was faced with considerable prior authority which seemingly had denied such power. Foremost, among the cases relied upon by the minority, were Panhandle Oil Company v. Mississippi18 and Indian Motorcycle Company v. United States.19 In the former it was held that a state may not impose a sales tax against a vendor of gasoline sold to the United States. In the latter a sales tax imposed by the federal government against a vendor of motorcycles sold to a local police force was held invalid. James v. Dravo Contracting Company differed from these earlier cases only in that these involved a sales tax as to goods sold to the government whereas the James case involved a gross receipts tax as to income for goods and services furnished the government.

Chief Justice Hughes, speaking for the majority in upholding the tax contended himself with the assertion that decisions like the Panhandle Oil Company case are distinguishable and "must be deemed limited to their particular facts."20 His attempts to distinguish the case at bar, however, are not very persuasive.

Oddly enough, the Solicitor General of the United States, who filed a brief as amicus curiae and who sought to have the state tax upheld, disclaiming any burden upon the federal government from this state tax, conceded that cases like Panhandle Oil Company v. Mississippi are indistinguishable in principle from the

1658 S. Ct. 75, 77 (1937).
1659 S. Ct. 208 (1937).
17Roberts, Butler, Sutherland and McReynolds dissented, 58 S. Ct. 208, 221 (1937).
18277 U. S. 218 (1928).
19283 U. S. 570 (1931).
2058 S. Ct. 208, 217 (1937).
James case and conceded that to uphold the tax in the latter case the former decisions would necessarily require overruling.

It is perhaps unfortunate that courts are loath to admit inconsistency. The deliberate overruling of prior cases, but with an arbitrary insistence that nonexistent distinctions operate to preserve the earlier authorities, may have face-saving value. It does, however, make for uncertainty, obscurity, and folklore because it seeks to conceal the vital fact that there has been a basic change of judicial attitude. A frank admission by the courts of inconsistency with former decisions is, in the long run, less likely to evoke criticism and less likely to prejudice the courts' prestige than a thin policy of artificially seeking to preserve a thin coat of consistency.

The actual result of the James case is not unsound. It might better have been reached, however, on the reasoning of the Solicitor General. The latter's argument after admitting the necessity of overruling prior cases, took the broad ground that no state tax should be invalidated unless it discriminates against the federal government in favor of other taxpayers.20a

To this argument, the minority speaking through Justice Roberts replied that the non-discriminatory nature of a tax, as applied to a federal instrumentality will not save it because:

"... the doctrine of federal immunity from state taxation is based upon the right of the federal government to carry on its lawful operations free from burden or impediment ... there is implied from the federal power ... an immunity from interference or burden by the states."21

The difficulty with the minority view seems to be in regarding a non-discriminatory tax as necessarily a burden. What is overlooked is the fact that the term burden suggests a relative concept. One is burdened if required to carry more than his fellows, but one does not deem himself "burdened" merely because he is wearing shoes or socks. Assuming what is not necessarily true, that the contractor passed the amount of the taxes exacted over to the federal government by increasing the gross receipts of the construction work, the ultimate result of granting the taxpayer an immunity against the imposition of the state tax is not to prevent the infliction of a burden upon the federal government. On the contrary, it would merely place the government in a preferred position over private individuals who require the services of the contractor, for as to money received from these for...

20aAs this issue goes to press, Solicitor General Reed has been nominated for the post in the Supreme Court left vacant by the retirement of Justice Sutherland. With the appointment of Mr. Reed to the Supreme Court, the remarks and views expressed in his brief as amicus curial take on added significance. Who knows but that under his influence the court may eventually adopt his test of discrimination vel non as determinative of the validity of taxes affecting governmental instrumentalities. As for the Dravo Contracting Company case, Mr. Reed's elevation to the Supreme Court operates virtually to make a 6-3 decision of it.

21Id. at page 231, 232. Italics ours.
services, the validity of the income tax is unassailable. It may be quite proper to find in the Constitution, implied prohibitions against the states' power to burden the federal government. It is an altogether different matter to construe a prohibition against burdens as a command to give preferences.

Of course, the Panhandle Oil case and like decisions, have thus broadly construed the word burden, all because of the unnecessarily broad dictum of Marshall that the power to tax is the power to destroy. As stated, such decisions are necessarily in the way of the holding of the *James* case and must be overruled whether expressly or impliedly in order to permit a continuance of the judicial policy evident in the *James* case.

One other recent tax decision invites attention. In *Puget Sound Stevedoring Company v. Tax Commission of Washington*, the Court upheld a state tax imposed for the privilege of conducting a stevedoring business, measured by a certain percentage of gross receipts. The particular company involved in the case, derived its income from a mixed interstate and local business. Upon a finding that the tax was solely for the privilege of doing local business, the tax was upheld. Not one word was said as to the validity of the measure of the tax, namely, gross receipts. If such gross receipts included receipts from interstate as well as local commerce it would seem that the measure of the tax would render its execution unlawful, under a long line of cases. Curiously enough, in *James v. Dravo Contracting Company*, previously discussed, both the majority and minority opinions, by dicta recognized this line of cases as subsisting law. Yet, not one dissent or objection was heard in the *Puget Sound Stevedoring Company* case as to the propriety of the measure of the tax. Query, whether this case should be viewed as overruling their earlier decisions?

Taken together, these cases, *Atlantic Refining Company v. Virginia, James v. Dravo Contracting Company*, and *Puget Sound Stevedoring Company v. Tax Commission of Washington* show a definite attitude at least on the part of the majority of the Supreme Court as now constituted, against the policy of encumbering the taxing power through immunities or exemptions. That new barriers to the taxing power will not be recognized, and that doubtful cases will be resolved in favor of the taxing power seems probable. How far past authority will be overthrown in the attempt to rehabilitate the taxing power admits of no positive answer. That there has been some retracing of its steps by the court in these recent cases is difficult to deny. Only the future and the Court itself holds the answer as to how far existing tax immunities will survive.

Carlisle, Pa. D. J. FARAGE.

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2238 S. Ct. 72 (1937).
25Id. at page 232.