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Taxation--Federal Securities Owned by a Corporation Not Deductible from Franchise Tax Base

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The dissenting opinion prefers the third party beneficiary theory and would agree with the lower court that there is federal jurisdiction in this case. They find the individual hiring subsidiary to the collective agreement in which the terms of the employee-employer relationship is detailed. It is proper, then, to say that the right asserted is predicated upon a violation of the contract between employer and union and that the controversy comes within federal jurisdiction as conferred by Section 301(a). After finding jurisdiction of the subject matter, the dissent relies on Rule 17(a) of the Federal Rules of Civil Procedure[15] and Section 301(b) of the Labor Management Relations Act[16] for authority to sue in federal court for the benefit of those whom it represents.

It seems that the better solution to the difficult problem presented in the instant case is found in the well-reasoned majority opinion. The theory advanced by the majority seems fairest to all parties concerned under the present labor law.

FRED SIEGEL

TAXATION — FEDERAL SECURITIES OWNED BY A CORPORATION NOT DEDUCTIBLE FROM FRANCHISE TAX BASE

The State of Ohio levies a franchise tax against the "value of the issued and outstanding shares of stock" of a corporation.[1] In determining the value of the shares of stock, a corporation may not deduct therefrom the value of the federal securities it owns,[2] even though the federal law states that such securities shall be exempt from taxation by state authorities.[3] This view was enunciated in the recent Ohio Supreme Court decision of *Fifth Third Union Trust Co. v. Peck*[4] which expressly overruled the opposing view as stated in *Wrenn Paper Co. v. Glander.*[5] In the latter case it was held that federal securities may properly be deducted from the assets of a corporation in determining the value of the issued and outstanding shares of stock of that corporation.

The *Wrenn* case came before the supreme court from a decision of the Board of Tax Appeals affirming an order of the Tax Commissioner denying claims of the plaintiff corporation for certificates of abatement[6] relating to alleged overpayment of franchise taxes for the years 1945 through 1950. In determining the value of the issued and outstanding shares of stock, on

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[15] "Every action shall be prosecuted in the name of the real party in interest; but . . . a party with whom or in whose name a contract has been made for the benefit of another . . . may sue in his own name without joining with him the party for whose benefit the action is brought."

[16] "Any such labor organization may sue or be sued as an entity and in behalf of the employees whom it represents in the courts of the United States." 61 Stat. 156 (1947), 29 U.S.C. § 185(b).

which figure the tax is based, the Commissioner had included in the assets of the corporation certain federal securities.

There were two reasons given by the court in the *Wrenn* case for holding the assessment invalid. First, federal securities are exempt from taxation by state authority.[7] Inclusion of them in the tax-base formula would impose an illegal tax on such securities. Secondly, Ohio Revised Code Sections 5701.06, 5709.02, 5709.03 and 5733.05 must be read *in pari materia*[8] and, when so read, exclude federal securities from the tax base for the purpose of determining the franchise tax.[9]

In the principal case the court was confronted with precisely the same issues as in the *Wrenn* case. The plaintiff banking corporations filed certificates of abatement, contending that their franchise taxes for the years 1947 through 1951 had been computed erroneously because the tax base contained the value of certain federal securities. The Board of Tax Appeals reversed the Tax Commissioner's findings,[10] and ordered that the abatement be granted. The Ohio Supreme Court reversed the Board of Tax Appeals.

The inclusion of federal securities in the tax base was held to be consistent with the federal code[11] for the reason that the tax levied under the Ohio code is a franchise tax based on the value of the capital stock, and is not a tax on the securities alone. Courts for years have recognized the distinction between property taxes and franchise taxes, holding that a tax imposed upon

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[1] OHIO REV. CODE § 5733.05.

[2] Fifth Third Union Trust Co. v. Peck, 161 Ohio St. 169, 118 N.E.2d 398 (1954).

[3] 31 U.S.C. § 742 (1952).

[4] 161 Ohio St. 169, 118 N.E.2d 398 (1954).

[5] 156 Ohio St. 583, 103 N.E.2d 756 (1952), *aff'd*, 158 Ohio St. 15 (1952).

[6] OHIO REV. CODE § 5703.05, permits corporations to apply to the Tax Commissioner for certificates of abatement for overpayments of taxes within five years of the application.

[7] 31 U.S.C. § 742 (1952) provides that ". . . all stocks, bonds, treasury notes and other obligations of the United States, shall be exempt from taxation by or under state or municipal or local authority."

[8] Black's Law Dictionary, 4th Edition (1951) states: "Statutes *in pari materia* are to be construed together."

[9] OHIO REV. CODE § 5733.05 defines the tax base and then states: "In determining the value of intangible property . . . the commissioner shall be guided by sections 5709.02 and 5709.03 of the Revised Code." OHIO REV. CODE § 5709.02 provides: "All . . . intangible property of persons residing in this state shall be subject to taxation, except as provided in this section or as otherwise provided or exempted . . . in this title." OHIO REV. CODE § 5701.06 which is included in the same title with the last mentioned statute, qualifies the definition of "investments" as follows: ". . . excepting those issued: (1) By the United States. . . ."

[10] The Tax Commissioner had ordered deduction of a portion of the banks' federal securities from their capital accounts, in the proportion that such federal securities bore to their total assets.

[11] 31 U.S.C. § 742 (1952).

the corporate franchise is not void merely because the corporation may have seen fit to invest its money in securities of the United States.[12] The reason for this distinction is that a franchise tax is a tax on the privilege of exercising the corporate franchise within the state, and not a tax on the property of the corporation, as such.[13]

Rules to determine franchise taxes must be reasonably fair and just in their operation and must not result in absurd situations.[14] The court in the instant case held it would not be fair and just to exclude a major portion of the assets of one corporation because of the character of some of its investments, and, at the same time, include all the assets of another corporation because it has no such investments.

As to the statutory construction problem, the court reasoned as follows: Ohio Revised Code Section 5733.05 provides for certain specific exclusions from the tax base, such as reserves for depreciation, taxes due and goodwill. There is no specific provision in the section directing that federal securities shall be excluded. It must follow therefore that the legislative intent was not to exclude federal securities from the tax base. The court further pointed out instances where an *in pari materia* construction of the statutes involved would lead to absurd consequences. The court held that the legislature did not intend this result, and that the language should be construed accordingly.[15]

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[12] Pacific Co. v. Johnson, 285 U.S. 480, 52 Sup. Ct. 424 (1931); Educational Films Corp. of America v. Ward, 282 U.S. 379, 51 Sup. Ct. 170 (1931); Home Insurance Co. v. New York, 134 U.S. 594, 10 Sup. Ct. 593 (1890); Provident Institution v. Massachusetts, 6 Wall. 611 (U.S. 1867); Coite v. Society for Savings, 6 Wall. 594 (U.S. 1864); People *ex rel.* U.S. Aluminum Printing Co. v. Knight, 174 N.Y. 475, 67 N.E. 65 (1903); People *ex rel,* Bank of Commerce v. Commissioners, 40 Barb. 334 (N.Y. 1863).

[13] Hamilton Mfg. Co. v. Massachusetts, 6 Wall. 632 (U.S. 1867); Holly Springs Savings and Insurance Co. v. Marshall County, 52 Miss. 281 (1876); Manufacturers' Insurance Co. v. Loud, 99 Mass. 146 (1868); Monroe County Savings Bank v. Rochester, 37 N.Y. 365 (1867).

[14] Western Union Telegraph Co. v. Omaha, 73 Neb. 527, 103 N.W. 84 (1905).

[15] State v. Nickles, 159 Ohio St. 353, 112 N.E.2d 531 (1953); Railway v. Jump, 50 Ohio St. 651, 35 N.E. 1054 (1893); Moore v. Given, 39 Ohio St. 661 (1884); State v. Blake, 2 Ohio St. 147 (1853); Kent v. Bierce, 6 Ohio 336 (1834).