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The Taxation of Corporate Income—Uniformity Under Equal Protection Clause

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partly on the ground that it feared the sections in the old act to be invalid and partly on the ground that the depressed condition of the real estate market made the rental value of the company's space, as defined in the statutes, a figure not representative of the true state of affairs,²⁹ since the rental value of the company's space varied inversely with the rents received from other tenants.³⁰ The company is no longer required to include in its gross income the rental value of space occupied by it but its deduction for taxes, expenses, and depreciation is limited to a sum which bears the same ratio to the total of taxes, expenses, and depreciation as the rental value of the space not occupied by the company bears to the rental value of the entire property.³¹ This provision appears to be more reasonable and equitable than the former one which was purely arbitrary and bore no real relation to the facts of each case.

JOHN F. MITCHELL.

THE TAXATION OF CORPORATE INCOME—UNIFORMITY UNDER EQUAL PROTECTION CLAUSE.—In a recent decision of the United States Supreme Court¹ determining the validity of a tax measure, the Court was confronted with the problem of whether it should be guided by the nature of the tax imposed, or the name assigned to the tax by the taxing statute. It appears that the state of Illinois levied a tax on the net receipts of foreign corporations engaged in fire, marine and inland navigation insurance business. The net re-

²⁹ "The Board of Tax Appeals has held that this limitation or condition upon the deduction is unconstitutional, and that the company may still deduct the entire amount of depreciation, taxes and other expenses upon its whole property notwithstanding there is included in its gross income rent from only a part of the property. Without regard to the legality of the present provisions, your committee believes that these provisions would operate somewhat severely in present depressed condition of real estate, and that is more equitable merely to allow so much of these deductions as pertain to the part of the property which is occupied by the company than to allow such deductions in full upon condition of including in gross income a more or less arbitrary determination of rental value." REPORT No. 665, Finance Comm., U. S. Senate, 72d Cong., 1st Sess., p. 36 (1932).

³⁰ See *Helvering v. Independent Life Insurance Co.*, *supra* note 25, in which case the operation of the old statute resulted in the rental value of the taxpayer's space being \$14,784 in 1923 and \$34,400 in 1924, although there had been only small changes in the taxes, expenses, and depreciation and in the book value of the building while rents from tenants showed a slight decline.

³¹ REGULATIONS 77, Art. 976 (1933) in explaining the operation of the new section states: "For example, if the rental value of the space not occupied by the company is equal to one-half of the rental value of the entire property, the deduction for taxes, expenses and depreciation is one-half of the taxes, expenses and depreciation on account of the entire property."

¹ *Concordia Fire Ins. Co. v. Illinois*, 292 U. S. 535, 54 Sup. Ct. 830 (1934).

ceipts of the corporation according to the statute was "subject to the same rate of taxation for all purposes, State, County, Town and Municipal that other personal property is subject at the place where located."² Foreign casualty insurance corporations doing a casualty business only, were exempt from the tax.³ Plaintiff in error, the corporation, in addition to its fire, marine and inland navigation insurance business insured against casualties. From 1923-1926 the corporation made returns of its net receipts from fire, marine and inland navigation insurance, but the receipts were not scaled down as was done in the assessment of other personal property. In 1927 the corporation made a return of its net receipts from fire, marine and inland navigation insurance but failed to include in its returns receipts from casualty insurance. The corporation was cited to appear before the Board of Review on a proposed re-assessment of its 1923-1926 returns and also on a review of the assessment made by the Board of Assessors as to the 1927 return. On appeal from the decision of the Board of Review taken to the Supreme Court of the State, the assessments for the years 1923-1926 were held invalid, for the reason that the net receipts were not scaled down as in the case of other personal property. But the Court in its opinion upheld the assessment as to the 1927 return, wherein the taxing authorities did not scale down the net receipts as in the case of other personal property and also increased the amount of the net receipts to cover the receipts from casualty insurance.⁴ The corporation thereupon brought this appeal and the United States Supreme Court held that a tax on the net receipts of the business of a foreign fire insurance corporation based on an assessment of their full value, when other personal property in the state is assessed at less than its full value violates the equal protection clause of the Fourteenth Amendment,⁵ and that it is essentially of the same character of arbitrary discrimination that was held invalid in *Hanover Fire Insurance Co. v. Harding* (*Hanover*

² ILL. LAWS (1869) §30, 209, 228; ILL. LAWS (1874) §30, 179; CAHILL'S ILL. REV. STAT., c. 73, §159.

³ *Fidelity & C. Co. v. Board of Review*, 264 Ill. 11, 105 N. E. 704 (1914).

⁴ *Illinois v. Concordia Ins. Co.*, 350 Ill. 365, 183 N. E. 241 (1932).

⁵ From the second decision of the Illinois court in *Hanover Fire Ins. Co. v. Harding*, 327 Ill. 590, 158 N. E. 849 (1927), the majority opinion in the instant case, *supra* note 1, at 542, 54 Sup. Ct. at 832, quoted as follows: "Section 30 provides: 'That net receipts shall be subject to the same rate of taxation * * * that other personal property where located.' The use of the word *other* indicates that the net receipts were to be considered as personal property and treated the same as other personal property. Clearly, this provision means not only the percentage of the rate but the basis of the valuation shall be the same. Taxing by uniform rules requires uniformity not only in the rate of taxation but also uniformity in the mode of the assessment upon the taxable valuation. Uniformity in taxing implies equality in the burden of taxation, and this equality of burden cannot exist without uniformity in the mode of assessment as well as in the rate percent of taxation." The earlier decision of the Illinois Court, 317 Ill. 366, 148 N. E. 23 (1925) was *rev'd* in *Hanover Fire Ins. Co. v. Harding* (*Hanover Fire Ins. Co. v. Carr*), *infra* note 6.

Fire Insurance Co. v. Carr).⁶ The United States Supreme Court further held that there was a denial of the equal protection of the laws to foreign fire, marine and inland navigation insurance corporations by the Supreme Court of the State in construing a statute imposing a property tax on their net receipts as applicable to receipts from casualty insurance business while foreign casualty insurance corporations doing a casualty business only, in direct competition with them were not subject to such tax or equivalent tax. In the majority opinion it was said:⁷

“This statement shows that Section 30 as the State construes and applies it works a very real and prejudicial discrimination. * * * There is no basis or reason for making a distinction between them that has any pertinence to the imposition of a property tax such as in question. The net receipts which are taxed are not different from those which are not taxed, and both come from the same source. Such a discrimination in respect of the taxation of real or tangible personal property obviously would be essentially arbitrary. In principle, it is not different from the net receipts. They are property and the tax which Section 30 imposes is, as the state court holds, a property tax.”

Justice Cardozo voiced his dissent as to the holding that the tax upon the net receipts of premiums for casualty insurance is a denial of the equal protection of the laws.⁸ The learned Justice declared that the validity of a tax depends upon its nature and not upon the name assigned.⁹

For many years in the state of Illinois property subject to an *ad valorem* tax was to be assessed at 30% or later 60% of its value and no more. For a considerable length of time the Supreme Court of that state held that the tax upon the net receipts was a tax upon personal property or at least was to be assessed in the same manner, that is by scaling down the values. This was the practice until 1921. In that year and for a time afterwards, the state court held that the tax did not come within this rule of debasement as an *ad valorem* tax but was rather a tax upon a privilege.¹⁰ In 1926 the United States Supreme Court held that the denial of the 30% debasement

⁶ 272 U. S. 494, 47 Sup. Ct. 179 (1926).

⁷ *Supra* note 1, at 549, 54 Sup. Ct. at 835.

⁸ Mr. Justice Brandeis and Mr. Justice Stone joined in this opinion.

⁹ *Concordia Fire Ins. Co. v. Illinois*, *supra* note 1, at 836; *St. Louis Compress Co. v. Arkansas*, 260 U. S. 346, 43 Sup. Ct. 125 (1922); *Federal Land Bank v. Crosland*, 261 U. S. 374, 43 Sup. Ct. 385 (1923); *Louisville Gas & E. Co. v. Coleman*, 277 U. S. 32, 48 Sup. Ct. 423 (1928); *Educational Films Corp. v. Ward*, 282 U. S. 379, 51 Sup. Ct. 170 (1931).

¹⁰ *Hanover Fire Ins. Co. v. Carr*, *supra* note 5. This is the earlier decision of the Illinois Court in the case.

to foreign corporations brought about an inequality so gross in comparison with the burdens of domestic corporations as to vitiate the tax and the statute that imposed it.¹¹ The Supreme Court of Illinois following that decision changed the position it had taken in 1921 and held there must be debasement of value similar to taxes upon personal property.¹² Justice Cardozo said:¹³

"No descriptive epithet applied to the tax by the Illinois Court or any other can transform the essential nature of the tax into something other than it is. * * * No descriptive epithet can make a tax upon the net receipts of the business of the whole year the same as one upon the property located on a particular day of the year within the area of the taxing district or the same as one upon the capital or income of investments. If the foreign corporations subjected to this tax on net receipts had taken the gross receipts out of the State at once after collection, or had placed them in an insolvent bank with the result that nothing remained when the assessment day arrived, the tax would have still been due without the abatement of a dollar."

The tax in question, that is, one on net receipts of a business, is generally called an excise tax.¹⁴ But regardless of what it is called, it is a tax on net receipts.

Justice Cardozo states that the United States Supreme Court did not hold in *Hanover Fire Insurance Co. v. Harding* (*Hanover Fire Insurance Co. v. Carr*),¹⁵ that if the tax was an excise it would be void even though the assessment were to be debased. All that was held in the case was that calling it an excise tax would not save it if the benefit of debasement was withheld in a discriminatory manner. Therefore, calling it a property tax does not make it invalid if debasement is allowed. The Illinois Court did not decide, in retracting the description of a tax upon a privilege, that a tax on property is identical with a tax upon the net receipts of a business. "Things so essentially different would not become the same even if a Court were to confuse them and speak of them as one."¹⁶ All that the Illinois Court held was that the tax would be viewed as a property tax and so subject to debasement.

The question in the instant case¹⁷ still remains as to what kind of classification is permissible when net receipts of business are the subject matter of a tax.

¹¹ *Supra* note 6.

¹² *Hanover Fire Ins. Co. v. Harding*, *supra* note 5. This is the second decision of the Illinois Court in the case.

¹³ *Supra* note 1, at 551, 54 Sup. Ct. at 836.

¹⁴ *Flint v. Stone, Tracy Co.*, 220 U. S. 108, 31 Sup. Ct. 342 (1911).

¹⁵ *Supra* note 6.

¹⁶ *Supra* note 1, at 552, 54 Sup. Ct. at 837.

¹⁷ *Supra* note 1.

The dissenting opinion declared the rule, which is well supported by decisions of the court, that a tax upon the net receipts of one form of business is not invalid merely because a like tax or an equal one is not laid on the net receipts of every other kind of business.¹⁸ If this were the case, the whole statute must fall and not only that part which affects the casualty premiums:

“To say that a tax on net receipts of one kind of business was void because a like tax is not laid on different forms of business would mean that the net receipts of insurance companies may not be taxed without laying a like tax on manufacturers and merchants.”¹⁹

It was further stated in the dissent that the assailant of the tax must satisfy the courts that the classification had its creation in nothing better than “whim and fantasy, a tyrannical exercise of arbitrary power,” before it would be declared invalid.²⁰

With these rulings before us, we are in a position to determine logically whether in the instant case²¹ the taxing statute was “whimsical and fantastic” in levying a tax upon all the net receipts of foreign fire insurance corporations, including those receipts derived from casualty business, when no such tax is imposed upon insurance corporations that do a casualty business only.

If this statute is “whimsical and fantastic,” Justice Cardozo states, it must be because the activities in one class overlap to some degree the activities of the other class. There is no rule, he declares, and correctly so, that overlapping classes can never be established except at the expense of the violation of the Federal Constitution.²² If this were the case, it would mean that a department store’s receipts may not be taxed unless all the many activities thus brought under the single roof are taxed in the same manner when separately conducted. If this were so, it would be necessary to tax the receipts of the business of the shoemaker, draper, carpet dealer and jeweler, and by the same reasoning the owner of a retail market dealing in meats, groceries and fruit would then escape, at least proportionately, a tax upon its receipts, if the statute did not include the receipts of

¹⁸ *Bells Gap R. Co. v. Pennsylvania*, 134 U. S. 232, 10 Sup. Ct. 533 (1890); *Pacific Express Co. v. Siebert*, 142 U. S. 339, 12 Sup. Ct. 251 (1892); *Adams Express Co. v. Ohio*, 165 U. S. 223, 17 Sup. Ct. 305 (1897); *Southwestern Oil Co. v. Texas*, 217 U. S. 114, 30 Sup. Ct. 496 (1910); *Oliver Iron Min. Co. v. Lord*, 262 U. S. 172, 43 Sup. Ct. 526 (1923); *Stebbins v. Riley*, 268 U. S. 142, 45 Sup. Ct. 424 (1925); *Ohio Oil Co. v. Conway*, 281 U. S. 146, 50 Sup. Ct. 310 (1930); *Union Bank & T. Co. v. Phelps*, 288 U. S. 181, 53 Sup. Ct. 321 (1933).

¹⁹ *Supra* note 1, at 553, 54 Sup. Ct. at 837.

²⁰ *Id.* at 554, 54 Sup. Ct. at 837.

²¹ *Supra* note 1.

²² *Cf. State Tax Commissioners v. Jackson*, 283 U. S. 527, 51 Sup. Ct. 540 (1931); *Louis K. Liggett v. Lee*, 288 U. S. 517, 53 Sup. Ct. 481 (1933).

the owner of a store who derived a modest income from the sale of peanuts and bananas. Consequently few taxes upon earnings would pass so fine a sieve.

Statistical records disclose that only a small amount of casualty insurance business was done by foreign fire insurance companies in the State of Illinois.²³ In that State, fire insurance companies although organized in other states, had never been allowed to do a general casualty business,²⁴ whereas, foreign casualty companies received premiums of a greater amount when compared to the premiums when received from casualty business of foreign fire insurance companies.²⁵ In the instant case²⁶ the corporation's principal business was to provide insurance against fire. It also did a casualty business to a limited extent and is in a class of its own with capacities essentially different from those companies that are unable to provide insurance against fire but who do insure against almost every other conceivable loss.

A division of one business may be similar to a division of another and yet the kindred divisions may be burdened with unequal taxes.²⁷ If any other principle were adopted Justice Cardozo asserts it would mean that if a tax were levied on the receipts of a drug store selling medicines and the drug store had a lunch counter, the receipts from the sale of edibles must be excluded from the reckoning unless there were a like tax on the receipts of a restaurant. The result of this would be:

"That the legislature in that view may no longer classify the forms of business with an eye to a composite group of uniformities and differences. There must be a segregation of forms of business into their constituent activities which to the extent that there is identity, must be taxed for any one group as they are taxed for any other. Immunity from the tax laws of unequal operation have never until now been pressed to that extreme."²⁸

In *Bells Gap R. Co. v. Pennsylvania*,²⁹ Justice Bradley delivering the opinion of the court said:³⁰

²³ 60th Annual Report, pt. I at 96-105.

²⁴ Act of March 11th, 1869; Act of May 31st, 1879; Act of June 30th, 1885; Act of May 6th, 1905; Act of June 11th, 1912; Act of June 30th, 1925.

²⁵ 60th Annual Ins. Report, pt. 3 at 77-92.

²⁶ *Supra* note 1.

²⁷ *Supra* note 1, at 557, 54 Sup. Ct. at 839, the dissenting opinion stated: "Coincidence of some of the parts is not enough unless the parts are so many as to determine the identity of the whole."

²⁸ *Supra* note 1, at 557, 54 Sup. Ct. at 839.

²⁹ *Supra* note 18.

³⁰ *Bells Gap R. Co. v. Pennsylvania*, *supra* note 18, at 237.

“The provision in the Fourteenth Amendment that no State shall deny to any person within its jurisdiction the equal protection of the laws, was not intended to prevent a State from adjusting its system of taxation in all proper and reasonable ways. * * * It may impose different specific taxes upon different trades and professions and may vary the rates of excise upon various products; it may tax real estate and personal property in a different manner. * * * All such regulations and those of like character, so long as they proceed within reasonable limits and general usage are within the discretion of the State Legislature. * * * We think we are safe in saying that the Fourteenth Amendment was not intended to compel the State to adopt an iron rule of equal taxation.”

It is therefore submitted that the dissenting opinion is logically correct and practical in operation for the following reasons:

1. The nature of the tax in question is one on the receipts of a business, and is not a tax on property, regardless of the name assigned to it. A tax statute is not to be condemned because of the name. If a tax of the net receipts of one form of business is invalid because a similar tax is not levied on other kinds of business it would mean that the business receipts of one form of business could not be taxed unless a tax was imposed on every kind of business. Certainly, this was not within the contemplation of the statute in question.

2. The tax levied against the casualty receipts of foreign fire insurance companies in Illinois was reasonable, since their casualty business formed only a small part of their operations. Foreign fire insurance companies in that state were in a class different from those companies that did a casualty business only. If this tax measure is held invalid the ultimate result would be that few businesses would escape taxation although justified in being exempted.

3. The Fourteenth Amendment does not compel a state to adopt an “iron rule of taxation.” There was no abuse of discretion in the tax on receipts of casualty business done by foreign fire insurance companies in Illinois, and the tax should have been declared valid.

IRVING WEINSTEIN.

INCOME TAX—CONSOLIDATED CORPORATION’S LIABILITY FOR TAX INCURRED BY CONSTITUENT CORPORATION.—The Oswego Falls Pulp & Paper Company was a constituent corporation to a consolidation of the taxpayer (Oswego Falls Corporation) with itself on