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A Study in Chaining the Chain Stores

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TAX COMMENT

Editor—THEODORE S. WECKER

A STUDY IN CHAINING THE CHAIN STORES.—Fraught with the danger of ignominious economic extinction, individual entrepreneurs assisted by small jobbers and wholesalers are now fighting for their very existence against powerful chain store organizations. So acute has the problem struck in the various states, that over 123 anti-chain bills were introduced in divers legislative halls during 1931.¹

The chain store has been considered as a throwback, or, a continuation of a monopolistic society. Starting in 1880 and continuing until after the World War, our credit and banking structure was subject to a mushroom growth and attained gigantic proportions. There was a rapid concentration of economic wealth² and as a result the independent entrepreneur was confronted by a practically invincible aggregation of chain stores³ seeking his expropriation.⁴ It is not the purpose of the writer to trace the growth of chain stores nor to comment on the causes thereof. This has already been ably accomplished.⁵ To examine the course of the judicial history of the various legislative attempts to bridle this growing Frankenstein is deemed more teleological.

State legislative regulation of the chain stores has generally taken the form of an occupation tax on retail selling, measured by gross volume of sales of all stores, and may limit the number of store units operated under unified control in a named territory.⁶ Another form is a license tax on the basis of the number of stores

¹ In 1930, bills containing a tax on chain stores were presented in 29 states. ANNUAL REPORT OF NATIONAL CHAIN STORE ASSOCIATION (1930) 16. The character and nature of the 1931 bills are presented in an issue of BARRON'S of August 3, 1931, in an article by William Nichols, *Chain Stores Fighting Unfair Taxes*.

² BERLE AND MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932); 2 HAYES, *OUR ECONOMIC SYSTEM* (1929) c. 56; PATTERSON AND SCHOLTZ, *ECONOMIC PROBLEMS OF MODERN LIFE* (1927) c. 22; cf. KING, *THE NATIONAL INCOME AND ITS PURCHASING POWER* (1930).

³ ZIMMERMAN, *THE CHALLENGE OF CHAIN STORE DISTRIBUTION* (1931) reports an 800% increase in store units during the last 15 years doing \$15,000,000,000 worth of business annually.

⁴ VEBLEN, *ABSENTEE OWNERSHIP AND BUSINESS ENTERPRISE: CASE OF AMERICA* (1923).

⁵ FLOWERS, *AMERICA CHAINED* (1931); FRYBERGER, *THE ABOLITION OF POVERTY* (1931); CAMERON, *OUR JUGGERNAUT* (1932); Becker and Hess, *The Chain Store License Tax* (1930) 7 N. C. L. REV. 115; Notes (1930) 44 HARV. L. REV. 1295; (1932) 80 U. OF PA. L. REV. 289; (1930) 40 YALE L. J. 431; (1931) 31 COL. L. REV. 145; (1930) 15 MINN. L. REV. 341; (1931) 17 IOWA L. REV. 72; (1932) 18 VA. L. REV. 72, 769.

⁶ Kansas and Maryland have such statutes.

over a given number operated by a single owner.⁷ Some states contain hybrid statutes combining both forms.

The first litigation on chain stores concerned a tax on groceries utilizing the services of delivery wagons. With the latter as a basis for classification, a Kentucky court in 1926 held the tax invalid.⁸ A distinction was attempted in that case between cash and carry stores and credit grocery stores but to no avail. In 1927 a license tax on a chain store was held invalid where the grounds for the discrimination was the prevention of monopolies and competition.⁹

In the following year close attention was riveted on the decision of the North Carolina Supreme Court, holding an anti-chain store tax unconstitutional in *Great Atlantic and Pacific Tea Co. v. Doughton*.¹⁰ A difference only in respect to ownership and method of operation was there said to be insufficient as a basis for classification. A federal district court subsequently reiterated this position in a case later to become noteworthy.¹¹ It is therefore apparent that at the outset the first round of legal battles favored the chain stores. This was rather surprising in view of previous decisions bearing on matters of a similar pattern.¹² To further blast the hopes of the private owners, the Supreme Court held unconstitutional a Pennsylvania tax on the gross receipts of corporations engaged in a general taxicab business but not upon the receipts of individuals or partnerships also in the taxicab business.¹³

The situation took on a more hopeful complexion for the individual entrepreneur when North Carolina practically reversed its

⁷ Alabama, Arkansas, Georgia, Illinois, Iowa, Michigan, Mississippi, North Carolina, Pennsylvania, Rhode Island and Kentucky are some of the states representing the latter form.

⁸ *City of Danville v. Quaker Maid Co.*, 211 Ky. 677, 278 S. W. 98 (1926).

⁹ *Keystone Grocery and Tea Co. v. Huster* (Md. Equity 1927) (unreported). Compare the present mind of the U. S. Supreme Court on this point now, *infra* note 25.

¹⁰ 196 N. C. 145, 144 S. E. 701 (1928). See extended discussion of the legal and economic implications in Becker and Hess, *Chain Store License Tax* (1930) 7 N. C. L. Rev. 115; see also STRAUN, *BATTING THE CHAIN STORE* (1930) 27; Note (1930) 40 *YALE L. J.* 431, 433.

¹¹ *Jackson v. State Board of Tax Commissioners*, 38 F. (2d) 652 (Ind. 1930), overruled in *Tax Commissioners v. Jackson*, *infra* note 16.

¹² The basis of the amount of business transacted is a reasonable or fundamental difference in the character of a business as wholesaler and retailer. *Southwestern Oil Co. v. Texas*, 217 U. S. 114, 30 Sup. Ct. 496 (1910). Co-operative markets are considered of a separate class. *Liberty Warehouse Co. v. Burley Tobacco Growers Co-op.*, 276 U. S. 71, 48 Sup. Ct. 291 (1928).

Judicial pronouncements are numerous, allowing the legislatures to classify objects of legislation in different categories regarding taxation, as long as the tax bears equally and rests on a substantial basis. *Heisler v. Thomas Colliery Co.*, 260 U. S. 245, 43 Sup. Ct. 83 (1922); *Radice v. New York*, 264 U. S. 292, 44 Sup. Ct. 325 (1914); *Louisville Gas & Electric Co. v. Coleman*, 277 U. S. 32, 48 Sup. Ct. 423 (1928). A more complete list can be found in Note (1931) 31 *COL. L. REV.* 145 and (1930) 15 *MINN. L. REV.* 341.

¹³ *Quaker City Cab Co. v. Pennsylvania*, 277 U. S. 389, 48 Sup. Ct. 533 (1928). It is interesting to note that the present Mr. Justice Roberts of the Supreme Court argued the appeal for the taxicab corporations.

former ruling¹⁴ and upheld a tax against chain stores in *Great Atlantic and Pacific Tea Co. v. Maxwell*.¹⁵ A substantial difference between a business of one store and the operation of a business of many stores was suddenly discerned. In 1931, the Supreme Court dispelled all doubts as to the constitutionality of a license tax on chain stores. The Court emphasized in *Tax Commissioners of Indiana v. Jackson*¹⁶ that it was not its function to consider the propriety or unjustness of a tax, or to seek for the motives, or to criticize the public policy that prompted its enactment. It was rather to sustain the classification adopted if there were substantial differences between the occupations separately classified.¹⁷

Here, the tax was graduated or based on the number of stores operated by a single owner. The dissenting judges based their argument on the *Quaker City Cab Co.*¹⁸ case, Mr. Justice Sutherland saying that classification cannot be based on the number of roofs under which a business is carried on. Nor can it be based on the amount of income or the character of the sources but rather it must be determined on the number of sources from which the income is obtained.

The more liberal attitude of the *Jackson* case was not unexpected. With *O'Gorman & Young v. Hartford Fire Insurance Co.*¹⁹ in mind, a tolerant attitude toward state legislative action was expected.²⁰ Although the case involved an exercise of police power there is sufficient similarity between both to indiscriminately use decisions of one as indicia for the other.²¹ That a state could infringe on the equal protection clause of the Constitution by its revenue laws encouraging one industry at the expense of another is clear. It seems by a great weight of authority that the wisdom of the legislature is beyond the power of the courts.²² The 1932

¹⁴ *Supra* note 10.

¹⁵ 199 N. C. 433, 154 S. E. 838 (1930), *aff'd* in 284 U. S. 575, 52 Sup. Ct. 26 (1931) decided solely on the basis of the *Jackson* case, although the dissenters in that case still announce their divergent opinions.

¹⁶ 283 U. S. 527, 51 Sup. Ct. 540 (1931); Note (1932) 6 ST. JOHN'S L. REV. 163. This case was followed in all fours in *Mitchel v. Penny Stores*, 284 U. S. 576, 52 Sup. Ct. 27 (1931).

¹⁷ Opinion of Mr. Justice Roberts, who was elevated by this time to the Supreme Court Bench. His position is *contra* to his part played in *Quaker City Cab Co. v. Pennsylvania*, *supra* note 13.

¹⁸ *Supra* note 13.

¹⁹ 282 U. S. 251, 51 Sup. Ct. 130 (1931), a restriction on fire insurance companies was upheld. The conservatives here used the subterfuge of liberty of contract but Mr. Justice Brandeis saw enough public interest involved to invoke police powers.

²⁰ Hamilton, *The Jurists Art* (1931) 31 COL. L. REV. 1073.

²¹ Pendleton Howard, *The Supreme Court and State Action Under the 14th Amendment* (1933) 81 U. OF PA. L. REV. 505.

²² *Tyson v. Banton*, 273 U. S. 418, 47 Sup. Ct. 426 (1927); Finkelstein, *From Mumm v. Ill. to Tyson v. Banton* (1927) 27 COL. L. REV. 769. In that decision Mr. Justice Stone says at p. 446, 47 Sup. Ct. 433, "It would be better to recognize that the legislature can do whatever it sees fit to do unless it is restrained by some express prohibition of Court of the U. S. or of the State

term of the Supreme Court carried on in this vein in *Lawrence v. Tax Commissioners of Mississippi*,²³ but weakened in the *Liebman* case.²⁴ State taxation of chain stores as an exercise of police powers might be upheld on the basis of these decisions.

Recently, however, the security of the states maintaining the right to discriminate against chain stores was rudely shaken by *Louis K. Liggett Co. v. Lee*.²⁵ Nevertheless, a close examination of the majority opinion should dispel any fears as to a reversal of the principles of the *Jackson* case for, in reality, the principles of the latter are given added strength. Doubtless this case is a landmark in sociological jurisprudence as is evidenced by the exhaustive and scholarly dissenting opinion of Mr. Justice Brandeis.

In the main case, Florida imposed a license tax, for operating stores, on any person, firm, corporation, association or co-partnership under the same general management or ownership, graduated according to the number of stores and increased if the stores are located in different counties.²⁶ Mr. Justice Roberts, writing for the majority, held the tax invalid, stating:

1. The state legislature may utilize the distinction between a chain store merchandising method and that adopted by a department store or one individually operated, as well as the difference between the integrated and voluntary chain as a basis for classification. The differences need not be great to uphold the legislative classifica-

Courts, and that the courts should be careful not to extend such prohibition beyond their obvious meaning by reading into them conceptions of public policy that the particular court may happen to entertain."

²³ 286 U. S. 276, 52 Sup. Ct. 556 (1932). A state law exempting domestic corporations from a tax on activities outside the state was held constitutional, since the protection furnished by state laws merited a tax on foreign corporations.

²⁴ 285 U. S. 262, 52 Sup. Ct. 371 (1932).

²⁵ 52 Sup. Ct. 481 (U. S. 1933).

²⁶ LAWS FLA. 1931 (EX. SESS.) cc. 156, 24, §§5, 11. The relevant sections read as follows: "The license fees herein prescribed shall be

"(1) Upon one store, the annual license fee shall be Five Dollars for each such store.

"(2) Upon two stores or more, but not exceeding fifteen stores, where the same are located in any one county, the annual license fee shall be Ten Dollars for each such additional store.

"(3) Upon two stores or more, but not to exceed fifteen stores, where the same are located in different counties, the annual license fee shall be Fifteen Dollars for each such additional store.

"(4) Upon each store in excess of fifteen, but not to exceed thirty, when all are located in any one county, the annual license fee shall be Fifteen Dollars for each such additional store. * * *

"(5) Upon each store in excess of fifteen, but not to exceed thirty, where the same are located in different counties, the annual license fee shall be Twenty Dollars for each such additional store. * * *

"In addition to the above amounts, Three Dollars for each and every One Thousand Dollars of value of stock carried in each store or for sale in such store."

tion as long as it is reasonable between the subjects taxed. The position of the Court in the *Jackson* case was completely reiterated.

2. Both a graduated county license tax and a municipal license tax, each consisting of 25% of the state tax imposed on store owners based on the number of licensee's stores within the county or municipality, respectively, without regard to other stores beyond the county limit, is constitutional.

3. A chain store license tax of \$3 on each \$1,000 value of stock carried in each store does not deprive chain store operators of equal protection even though wholesalers are subject to but half the same tax. In the absence of record proof or legislative declaration, the court will not construe the statute as antagonizing large corporate chains.

4. Mere gradation of a tax according to the number of stores operated is constitutional. However, where the tax is increased solely because they are operated in *different counties*, the Fourteenth Amendment is violated, and that part of the statute is *unconstitutional*.

Mr. Justice Cardozo, dissenting in part, insists that the test of territorial expansion is valid in this case since movement from one field of activity to another implies inner changes and a desire to play for larger stakes. He stresses the importance of knowing why a discrimination is desired, to what end directed, and the relation between the end and means.²⁷ Mr. Justice Cardozo is content merely to show the majority the deficiency of the ground of their decision points to the brilliant opinion of his colleague for further elucidation.

Mr. Justice Brandeis, in what no doubt shall be considered as one of his outstanding declarations of social and economic policy, submits several grounds for upholding the Florida anti-chain tax overlooked by the majority decision and counsel alike. First, since all the appellants are corporations, the state may discriminate against them as a price for the privilege of carrying on intrastate business in any way it sees fit. This is a continuance of the limitations always placed on corporate bodies.²⁸ The necessity for a prolonged

²⁷ Mr. Justice Cardozo, *supra* note 25, at 504, "If the motive is vindictiveness, ensuing in mere oppression, the result may be one thing. If the motive and the end attained are the advancement of the public good, the result may be quite another. * * * The legislature has found them in those variations of degree that separate a chain within the territorial unit of the locality from chains that are reaching out for wider fields of power. There is no need to approve or disapprove the concept of utility or inutility reflected in such laws."

²⁸ Mr. Justice Brandeis, at p. 500, "Whenever the discrimination is for a permitted purpose—as when a state, having concluded that activity by corporations should be curbed, seeks to favor businesses conducted by individuals—the corporate character of the owner presents a difference in ownership which may be made the sole basis of classification in taxation, as in regulation. The discrimination cannot, in such a case, be held arbitrary, since it is made in

and constant control is the basis of a brilliant sociological, political and economic study. Second, the plaintiffs being among the giant corporations which have too closely concentrated economic power merits chastisement lest they dominate the state and thwart American ideals.²⁹

Briefly then, the *Liggett v. Lee* decision illustrates the utility of the Fourteenth Amendment as a control not on the legislative privilege of impolicy but rather on the legislative right to be rational according to the thought of five men on the Supreme Court. The majority reiterates the legislative right to serve a public service in checking chain stores but becomes picayune in its strict construction of "reasonable classification." As long as the Indiana type of statute is employed (passed on in the *Jackson* case), where the basis of taxation is the number of units operated by a single owner, the chains are subjected to the tender mercies of the legislature. Evidently, the majority of the Supreme Court insists upon a rigid adherence and a strict construction. They refuse to follow Mr. Justice Holmes' theories of constitutional presumptions as to penumbras of permitted legislative unreasonableness, or to consider the propriety, the necessity for factual foundations, or the public policy motivating the legislative enactment.³⁰

Of greater significance is the exalted position of the Supreme Court in the determination of social control. However serene it may pretend to be in itself, the Court is a focal point of a set of dynamic forces which plays havoc with the landmarks of the American state. Its decisions operate to shift or stabilize the balance of social control and in a statesmanlike fashion controls the modes of developing capitalism.³¹ The power to deal with fundamental economic and social questions arising in the states are wholly derived from its interpretation of the Fourteenth Amendment. The esoteric functions of applying these constitutional guarantees to taxation has enormously increased the prestige and authority of the Su-

order to effect the permitted hostile purpose and is appropriate to that end. Compare *Lawrence v. State Tax Commission*, 286 U. S. 276, 283-285, 52 Sup. Ct. 556; *People of State of New York ex rel. New York & Albany Lighterage Co. v. Lynch*, 288 U. S. —, 53 Sup. Ct. 400."

²⁹ And at p. 497, "The citizens of the state, considering themselves vitally interested in this seemingly unequal struggle, have undertaken to aid the individual retailers by subjecting the owners of multiple stores to the handicap of higher license fees. They may have done so merely in order to preserve competition. But their purpose may have been a broader and deeper one. They may have believed that the chain store, by furthering the concentration of wealth and of power and by promoting absentee ownership, is thwarting American ideals; that it is making impossible equality of opportunity; that it is converting independent tradesmen into clerks; and that it is sapping the resources, the vigor and the hope of the smaller cities and towns."

³⁰ Dissenting opinions of Mr. Justice Holmes (1930); FRANK, *LAW AND THE MODERN MIND* (1930) 253 *et seq.*; Frankfurter, *Mr. Justice Holmes and the Constitution* (1927) 41 HARV. L. REV. 121.

³¹ Max Lerner, *The Supreme Court and American Capitalism* (1933) 42 YALE L. J. 668.

preme Court and has thrown into striking relief the American doctrine of judicial review of legislation.³²

Early in the present century the small man found himself crowded out by Big Business. Consequently, State Granger legislation, the Sherman Anti-Trust Act, and the Interstate Commerce Act were effectuated. Trust-busting became a rampant activity. But the Supreme Court soon crippled these activities by emasculating the effects of the statutes.³³ Big Business saw to it that the court remain impervious and lassitudinous toward economic reality.³⁴ The majority of the Court working within technical and legal barricades could easily utilize such subterfuges as *stare decisis*, police power, due process, liberty of contract, and doctrine of consistency.

In direct contrast, Mr. Justice Brandeis has stood firmly for holding business enterprise rigorously to its social responsibilities. He has kept himself sensitive to current trends in economic organization. Believing in competition and in the present economic set-up, he has sought to socialize and ethicize business. He believes the state should control by judicious intervention, wherever necessary, our economic and social organization.³⁵ Although the present set-up of the Court is nominally liberal, it seems that their liberality applies only to personal liberty. It shall continue to be conservative in the protection of property rights. This is paradoxical in this period of weakening individualism and it seems that there should have been more toleration in departing from an absolute concept of property and liberty.³⁶

In its final analysis, it seems unfortunate that the interpretation of what is reasonable and arbitrary is made so flexible that it bends as the will of only five Supreme Court judges. The mental background of these judges, their sense of ethical and social values seem too intangible to determine vital problems. The immediate will of the people is left outside the scope of their consideration. Judicial fiat should not solve the issues of economics, business and sociology. The state should be given freedom of experimentation, especially in the field of chain store taxation, and, if it finds its

³² BOUDIN, *GOVERNMENT BY JUDICIARY* (1932). His thesis points out the super-legislative powers of the Supreme Court being particularly dangerous, since outside the scope of popular control. FRANKFURTER AND LANDIS, *THE BUSINESS OF THE SUPREME COURT* (1927) make manifest that under the guise of legal form the court exercises far-reaching economic and social control.

³³ *Vide* FEDERAL ANTI-TRUST LAWS, A SYMPOSIUM (1932); Watkins, *The Federal Trade Commission* (1932) 32 COL. L. REV. 272.

³⁴ BEARD, *ECONOMIC INTERPRETATION OF THE SUPREME COURT* (1913). The author indicates that the Supreme Court might effectively control capitalistic growth if only it remained static, but the former is too dignified and formalistic.

³⁵ Lerner, *Social Thought of Mr. Justice Brandeis* (1931) 41 YALE L. J. 1. In *American Column and Lumber Co. v. United States*, 257 U. S. 377, 42 Sup. Ct. 114 (1921), Mr. Justice Brandeis presents his clear-cut analysis with a passionate and engaging persuasiveness.

³⁶ Shulman, *The Supreme Court's Attitude Toward Liberty of Contract and Freedom of Speech* (1931) 41 YALE L. J. 262.

remedial tax measures unwise, the state legislature itself should undo the harm without the assumed paternalistic intervention of the Supreme Court.

WILLIAM H. SHAPIRO.*

THE GIFT TAX AS APPLIED TO REVOCABLE TRUSTS.—Congress, in 1924, included among the provisions of the revenue act of that year, a tax upon gifts.¹ "For the calendar year 1924 and each calendar year thereafter * * * a tax * * * is hereby imposed upon the transfer by a resident by gift during such calendar year of any property wherever situated, whether made directly or indirectly * * *."² This levy was included to supplement the estate and income taxes, which had been frequently avoided by the making of large gifts.³ The gift tax being a new venture in the field of taxation, Congress did not expressly state its intention in regard to all the situations that might arise. It was not known until the case of *Burnet v. Guggenheim*,⁴ whether Congress intended to include as a gift *inter vivos* the delivery of the revocable deed of trust or whether the intent was to tax such gift upon the extinguishment of the power of revocation.

In the *Guggenheim* case⁵ it appeared that in June, 1917, the defendant executed two deeds of trust for the benefit of each of his two children. The trusts were to continue for ten years. At the end of the ten-year period, the principal and accumulated income were to go to the beneficiaries if living. In the event of their death, other dispositions were made. The settlor also reserved to himself powers of control in respect to the trust property and its investment and administration. In particular, there was an unrestricted power to modify, alter or revoke the trusts except as to

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¹ REV. ACT OF 1924, 43 Stat. 253, 313, c. 234, §§319, 320, 26 U. S. C., §§1131, 1132; see (1930) 28 MICH. L. REV. 778. This section was repealed by the Revenue Act of 1926 and later incorporated into the Revenue Act of 1932. GLEASON AND OTIS, INHERITANCE TAXATION (4th ed.) 182, "The federal gift tax is a new departure in taxation—never before in the history of English-speaking people has such a tax been levied, and yet it is a natural outgrowth of the effort of Congress and the state legislatures to reach the corpus of all estates undiminished by any act of the decedent during his lifetime." *Bromley v. McCaughn*, 280 U. S. 124, 50 Sup. Ct. 46 (1929); (1930) 4 ST. JOHN'S L. REV. 314.

² *Ibid.*

³ Hunter, *Gifts in Contemplation of Death*, 7 NAT. TAX ASS'N BULLETIN 146; Note (1930) 5 ST. JOHN'S L. REV. 147.

⁴ 287 U. S. —, 53 Sup. Ct. 369 (1933).

⁵ *Ibid.*