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# THE STATE CORPORATE TAX AS A MEANS OF REGULATION

GEORGE VAUGHAN

This topic must be approached with a clear understanding of the import of the phrase "means of regulation." Obviously the key word of the theme is "regulation," and the range of inquiry is further bounded by three stakes, "tax," "corporate," and "state."

There is a popular supposition that an impost can be levied as a "tax," without disclosing a clandestine but main purpose of control. It may, in reality, more nearly resemble regulation or restriction than the exaction of a stipend to replenish the public fisc. The legislative and constitutional history of both the nation and the states is replete with the record of efforts to combine the functions of a couple of Siamese twins, the dual faculties of "police power" and "taxing power" converging in the state as the motivating control.

For example, a legislature on Monday will pass an act imposing a millage tax on property. The next day it will enact a law regulating the liquor traffic by the device of an annual license fee. On Wednesday, it will enact a franchise license tax, requiring corporations to pay a stipulated sum for the privilege of doing business for the ensuing year.

How shall we classify these several legislative acts? Is it not plain that the first is a revenue measure, pure and simple, based on a basic "public purpose"? It was born of the need of acquiring taxes, funds for the governmental budget. The measures passed on Tuesday and Wednesday likewise look toward a governmental goal, but here the "public purpose" is more than fiscal; it goes beyond a sordid quest for money for operating expenses.

Both of the latter exactions, the liquor license and the franchise fee, though called "taxes," are bottomed upon another major functional resource, the police power. This vaguely defined and in a sense residual power enables a state to pass such laws as shall promote the common good, the general welfare of society-at-large. Such measures are either repressive or progressive in effect, but they have characteristics not symbolized by the dollar mark—albeit they may incidentally yield some extra pocket change. They may provide for hospitals, with a tax ear-marked to meet the cost. They may, in some states, create an exemption in favor of certain taxpayers, or they may in other states where no constitutional bar forbids, grant subsidies from the public treasury to promote a desirable and beneficial cause. On the other hand, they may impose a "tax" so heavy as to be prohibitive and to prevent *in toto* the continued existence of the thing purported to be "taxed."

A government functioning through its legislative branch may exercise *ad libitum* numerous choices. It may (1) "pass the hat" for operative funds; (2) lay out a road for public travel; (3) levy a tax on motor fuel consumed on public roads; (4) require motorists to "keep to the right," or (5) prohibit the sale of opium or the carrying of concealed weapons. If the legislature chooses any one of these available options, or all, who shall say nay?

Social control, conceived of the people collectively, may be crystallized into law in a multitude of forms. After all, law is still "a rule of civil conduct prescribed by the supreme power of the state, commanding what is right and prohibiting what is wrong." But not always is it possible to trace with certainty the considerations or motives that prompted the legislative will to spend itself in enacting a given law, just as it is hard to say what physiological or muscular motor is brought into play in the performance of a casual commonplace act. Various factors, however, demand consideration.

#### *Social Control as a Legislative Objective*

The designation of "The corporate tax as a means of regulation" brings out in relief a pattern of impost sometimes levied upon corporate taxpayers not for the revenue alone, but to effect some degree of social control. The levy is not primarily a fiscal measure, but, designedly, has a different objective, non-fiscal in character, namely, the regulation and control of specified units of the body politic. This type of taxation is classified as "regulatory" or non-fiscal, even though its economic consequence is more or less financial as well as idealistic. The sanction behind such a tax is said to be not the affirmative power to tax but the general restraining superintendency of the state's police power. Hence, the wisdom and even the validity of the tax is in certain jurisdictions subject to challenge but the challenge is on the ground not of a lack of public purpose but because of a disturbing doubt as to whether that "purpose" stands upon the right foot of taxation or the left foot of police power. In the effort to solve this doubt, certain artificial canons are often cited which seem only to befuddle the issue.

In a broad and universal sense, the *end* in legislation justifies the means. And it matters little what specified brand of conceded power is exerted to attain a legitimate public purpose. Procedure is less important here than results. Whether altruistic in conception (regulatory) or materialistic (for pecuniary gain), the main thing is, a statute has been born—and born in lawful wedlock.

But restrictions are set upon the character of legislative creative activity. The Federal Government has not the free hand that inheres in the several sovereign states. The national police power is by the Federal Constitution restricted; whereas that of the states is plenary and virtually un-

shackled. Congress can "regulate" only affairs of strictly national import and having to do with interstate commerce or the legitimate flow of social intercourse among the states. Hence, efforts "to go regulatory" on a wholesale or country-wide scale, have been frustrated by the Supreme Court's deference to a famous scrap of paper with its potent "thus far and no further shalt thou go."

A recent and one of the most informative documents extant in the field of public finance is a volume by the Twentieth Century Fund, Inc., entitled "Facing the Tax Problem," (New York 1937), in which Chapter 9 deals with taxation as an instrument of social control. No clearer statement of present-day sentiment has come to the attention of this writer; and the following paragraphs dealing with non-revenue aspects of taxation are apposite to the instant inquiry:

"All activities of government react on one another, and tax policies cannot be isolated from other governmental policies. Thus, even when a tax is being levied primarily for revenue, it will be judged partly by its effect on other governmental policies. Furthermore, the primary aim in imposing taxes is frequently not revenue but regulation. . . .

"To minimize the influence of taxation on economic activity is commonly recognized as a valid and important object of tax policy. The intentional use of taxation for purposes of control, however, has been vigorously opposed.

"Prior to the nineteenth century the association of persons in a corporation was a privilege granted by a government only under very special circumstances. During the past century, however, owing to the growth of business needs and the competition of states for revenue, incorporation with almost unlimited powers has been made practically a common right, although at law it is still a privilege granted by government.

"This development has resulted in two opposing attitudes toward the corporation. One is that since the corporation has been accepted as a common right the state should not encourage either incorporated business or unincorporated business at the expense of the other. They should not, for example, be subject to different tax burdens. The other attitude is that since corporate organization is a special privilege it should be taxed as such. The purpose of this chapter is not to decide what, if any, type of business organization should bear a heavier tax burden. Rather, it is to find out whether tax discrimination exists that tends to encourage or discourage the use of some particular form of business organization.

"Tax discrimination exists if the investor bears, either directly or through a tax on business, a higher tax on income derived through one form of organization than through another. Some types of taxation do not affect the form of business organization. Taxes on real estate, tangible personalty, and sales, for example, are imposed regardless of whether the business is incorporated. Taxes on income, profits, and capital stock, on the contrary, have generally been designed to rest more heavily on incorporated than on unincorporated businesses.

"Certain taxes are imposed on corporations but not on unincorporated

businesses. The chief examples at present are (1) state taxes imposed at the time of organization or entrance into business in the state; (2) annual state taxes on the capital stock or the value of corporate shares in excess of the assessment of corporate property; (3) the combination federal capital stock and excess profits; (4) federal and state income taxes; and (5) the federal tax on undistributed profits. The organization, capital stock, excess profits, and undistributed profits taxes are clearly special burdens resting on corporate investors. The income tax presents a more complex problem.

"The federal government and many of the states impose on corporations income taxes that are not imposed on unincorporated businesses. Only in New York State has a special net income tax been imposed on unincorporated business in addition to the personal income tax. The New York tax is an emergency tax, applying only to the years 1935 and 1936. A \$5,000 exemption is allowed, and the rate is 4 per cent, as compared with a corporation rate during the same years of 6 per cent. Federal and state individual income taxes require a partner or an individual proprietor to include in his personal return his entire share of the profits of the business. This requirement stands, regardless of whether any or all of the profits are kept in the business instead of being taken out for the taxpayer's personal use."

#### *Reasonable Classification*

It has been remarked by a resourceful commentator that the equal protection clause does not mean that a state may not reasonably classify objects for purposes of taxation. For example, unless the local constitution forbids, a state may tax horses without taxing other animals. There may be some reason, connected, for instance, with the policing or use of the streets, or the health of the people, why horses should be taxed and mules left untaxed. The reason may be so slight as that the number of mules to be taxed is small and that it would not pay the state to try to collect the tax. But to tax white horses and not horses of another color, would be unconstitutional under the equal protection clause because there is no reasonable basis for such a classification for the purpose of taxation.

Dr. A. S. Buehler, professor of economics in the University of Vermont, in his recent "Critique of the Present Methods of Business Taxation," deprecates the current practice of making too sharp a separation on the tax books between corporate and non-corporate enterprise. He reported that in 1934, for example, the states derived over half of their total taxes from business, excluding from the count all *property* taxes paid by business.<sup>1</sup> Quoting from a subheading, "Taxing Corporate and Non-corporate Enterprise".<sup>1a</sup>

"Both the Federal and the state governments have customarily col-

<sup>1</sup>How SHALL BUSINESS BE TAXED? A Symposium conducted by the Tax Policy League (N. Y. 1937), c. IV, pp. 45-62.

<sup>1a</sup>At page 55.

lected certain taxes from corporations which are not collected from unincorporated business, although in other cases, all types of enterprise may be taxed without distinction, as in the taxation of real estate or receipts. Franchise, capital stock, and various profits taxes are commonly imposed upon corporations but not upon noncorporate business. In some states, an unincorporated business tax has been introduced. The owners of unincorporated businesses are, of course, customarily taxed on their incomes where a personal income tax is collected.

"The special taxes on corporations are defended as measures that are necessary to equalize the taxation of corporate and noncorporate business, and that they are a fair payment for the peculiar advantages enjoyed by corporations. These advantages are frequently exaggerated by legislatures, which overlook the fact that the particular advantages of corporations may be reflected in their earnings, property, or receipts, and disregard the fact that the proprietorship and the partnership forms also possess specific advantages which might call for special taxation. The corporation taxes are, to a considerable extent, a symptom of the antagonism to big and bad business. Since the larger concerns are usually incorporated, governments have found political support in playing off the corporations against the numerous small unincorporated enterprises in the formulation of tax policies."

#### *The State's Police Power*

It has been said that the "police power is the dark continent of our jurisprudence. It is the convenient repository of everything for which juristic classification can find no other place."<sup>2</sup> The police power is a fiction. Every judge whom we have seen attempt to analyze it falls back on Madison's "indefinite supremacy of the state." "Police power" is the ubiquitous John Doe in taxation nomenclature. If a given impost is not a property tax or a privilege license tax or an excise tax, then it may be just a manifestation of the *police power*, the *ultima thule* of governmental might.

Dr. E. R. A. Seligman in his classical "Essays in Taxation" (10th edition), makes an interesting appraisal under the sub-head of "The Police Power versus the Taxing Power":<sup>2a</sup>

"The commonly accepted distinction between these powers is that the former is for regulation and the later for revenue. One argument in support of this view is that advanced by authors like David A. Wells, who contend that a so-called tax which looks to anything besides the securing of revenue is not a tax, but an unconstitutional exercise of the taxing power. But even adherents to the distinction between the police power and the taxing power, like Judge Cooley, confess 'that, in the apportionment of taxes, other considerations than those which regard the production of a revenue are admissible, and that the right of any sovereignty

<sup>2</sup>J. W. Burgess, in POL. SCI. AND COMP. CONST. LAW, vol. 2, p. 136, quoted by W. W. Cook in (1907) 7 COL. L. REV. 322.

<sup>2a</sup>At page 402.

to look beyond the immediate purpose to the general effect cannot be disputed.<sup>2</sup>

"The position of Mr. Wells is the exact opposite of that of Prof. Wagner, who includes in the very definition of a tax the 'socio-political' element, or the duty of regulating and correcting the distribution and use of private property. The one writer would refuse the name 'tax' to an imposition looking to anything else than mere revenue; the other ought logically to withhold the name from an imposition *not* looking to anything else than mere revenue. These positions are mutually exclusive and equally extreme.

"On the other hand, the distinction of Judge Cooley is almost quite as untenable. Cases where the primary purpose is regulation, he thinks, are referable to the taxing power. Mr. Cooley himself confesses that import duties with incidental protection are taxes. But suppose, as has often occurred, that they are protective duties with incidental revenue. Are they any the less taxes on that account?"

#### *State Control over Corporations*

It is thoroughly settled that the state which is the creator of corporations has power to regulate, control, and even to dissolve them. And this visitatorial and absolute power can be achieved directly as well as indirectly by taxation. This applies to public or municipal corporations as well as to eleemosynary or business corporations. The state of Tennessee repealed the charter of the city of Memphis and abolished its municipal officers; and the population within its territorial limits were resolved back into the body of the state. And this action, on protest of bond-holders, was duly upheld by the Supreme Court.<sup>3</sup>

The historical development of business corporation taxation has been described in "State and Local Taxation of Business Corporations," a publication of the National Industrial Conference Board (1931), from which this excerpt is adapted:<sup>4</sup>

"The development and specialization of business corporation taxation had to wait on the growth in number and magnitude of the business corporations themselves. At the beginning of the nineteenth century there were only 225 private corporations in the United States, and of these only 6 were mercantile and 12 manufacturing concerns. Throughout the first half of the century, incorporation was generally a matter of special private legislative act. New York, far in advance of the rest of the states, permitted incorporation under a general public statute as early as 1811. Not until the Civil War period, however, did corporate organization under general laws become the rule.

"Moreover, the corporations organized during the first half of the nineteenth century were primarily banking, insurance, railroad, navigation, and water supply companies. Industrial corporations had already dominated manufacturing industry, and were making rapid progress in

<sup>2</sup>*Meriweather v. Garrett*, 102 U. S. 472 (1880).

<sup>3</sup>At page 11.

the mercantile field. The present commanding position of the corporation is in the sphere of business.

"The principle of the corporate excess tax is the application of the general property tax rate, or of a special tax rate, to the difference between the *capital* value of corporations and the actual or assessed value of their taxed realty and personalty. This difference, or "corporate excess," is viewed as measuring the intangible value of a corporation over and above the taxable properties that it owns. This form of taxation found favor during the period of from 1822 to 1911 as a method of preventing evasion of the general property tax by corporations with respect to their intangible personalty, and also because it was felt that corporations possessed a privilege or good-will value not reached by the taxation of their visible property holdings under the general property assessment.

"In its earliest use, the corporate excess principle was applied, not to the taxation of the corporation itself, but to the shares held by individual owners. The purpose of the tax was not to reach a special intangible value inherent in the corporation as a form of business organization and its shareholders. The initiative for this departure from the broad outlines of the general property tax came from the courts, which in several cases held that taxation both of corporation property and shares in the hands of holders was unconstitutional double taxation."

#### *Legitimate Discrimination—Its Consequences*

Although the books make a sharp distinction between property and excise taxes, and restrictions are imposed by statutes and state constitutions upon the former from which the latter are exempt, yet it does not follow that excise, occupation, or privilege taxes are the only species that may be used as "regulatory devices." The general property tax, also, through uneven administration is not infrequently so employed.

In the highly developed modern schemes for ascertaining the value of corporate property for taxation, legislative ardor may outdo itself. If the technical formulae are faithfully followed, the "valuation" disclosed may be greater than the corresponding resultant of an offhand or unskillful appraisal of like properties belonging to firms or individuals. For example, the element of *good will*, often a substantial ingredient of a going prosperous concern, is by the special appraisal procedure prescribed for corporate assessments singled out, identified, and taxed as "intangible property" or as "corporate excess," while in the eyes of the appraiser of an unorganized competitor, this elusive element has been regarded as a mere phantom.<sup>4</sup>

This warning was sounded in the report of the Special Committee on Forest Taxation made to the fifteenth annual conference of the National Tax Association at Minneapolis in 1922. Dr. Fred R. Fairchild, of Yale University, headed the Committee; and in stressing the ways and means of se-

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<sup>4</sup>People ex rel. A. J. Johnston Co. v. Roberts, 159 N. Y. 70, 53 N. E., 685, 45 L. R. A. 120 (1899); Hart v. Smith, 159 Ind. 182, 64 N. E. 661, 53 L. R. A. 949 (1902).



curing a scientific valuation of forest property for taxation, he applied this check-rein:

“There is always the danger, however, that such efficient assessment, by arriving at the true value of forest property, will unjustly burden such property as compared with other property not so efficiently assessed. Equality in taxation must be real, not merely formal.”

Paradoxical as it may sound, the very effort to secure adequate scientific appraisal, for tax purposes, of technical assets, such as those of mining, manufacturing, transportation or financial enterprises, usually owned by corporations may, from an ethical viewpoint, if carried too far, defeat itself—and yet be upheld by the courts. Let me cite an interesting example quite in line with the general theme of the present symposium.

Scientific valuations of mineral properties have been made by several of the more progressive mining states, and in every instance with enormous public gain. In Michigan, the assessed valuation of the iron properties was increased pursuant to the appraisal of J. R. Finlay in 1911 from \$27,000,000 to \$85,000,000. And the 1921 assessment, in spite of the ten years depletion, reached, due to new discoveries, the goodly total of \$117,000,000.

The validity and effectiveness of a scientific appraisal is well illustrated by the experience of that state. In 1911, the board of tax commissioners, acting under authority of Act No. 114 of 1911, employed Mr. Finlay, an expert mining engineer, to assist it in making an appraisal of mining properties. He was aided by Dr. C. K. Leith, Professor of Geology in the University of Wisconsin, and a corps of junior assistants. The total cost was less than \$26,000. The concrete result—the fruit of enlightened legislation, coupled with fearless administration by an efficient tax commission—is shown in the following table:

Counties	Local Assessment	Finlay's Appraisal	As reviewed by tax commission
Gogebic	\$4,943,158	\$41,560,000	\$28,343,000
Dickinson	3,735,800	11,508,000	7,447,500
Iron	1,993,500	23,339,000	15,051,800
Marquette	8,951,050	42,734,000	34,800,000

The procedure, of course, was subjected to the acid test of judicial attack; but in the two test cases the assessments were fully sustained.<sup>5</sup>

In the *Sunday Lake* case, the plaintiff's property had been assessed by an inexperienced local assessor who, “proceeding in entire good faith,” adopted a value which his predecessor had placed upon the property—\$65,000. The state board, in the light of the Finlay appraisal, raised the assessment to \$1,071,000. The taxes were paid under protest, and the company promptly

<sup>5</sup>*Sunday Lake Iron Co. v. Wakefield*, 186 Mich. 626, 153 N. W. 14 (1915); *Newport Mining Co. v. Ironwood*, 185 Mich. 668, 152 N. W. 1088 (1915).

sued to recover what it termed the excess taxes for the current year, amounting to \$31,910.45. The supreme court of the state, in a unanimous decision, sustained the final assessment and affirmed the decision of the lower court which had approved and confirmed it.

On appeal to the United States Supreme Court, the cause was affirmed, that Court holding against the iron company on the two points urged, viz.: (1) that the failure of the board, because of alleged lack of time and inadequate information, to cause a general survey of all property, did not invalidate its action with respect to the Sunday Lake mine; and (2) that a mere error of judgment, if existing, did not support the claim of discrimination, since the good faith of the taxing officials is presumed.<sup>6</sup>

In the companion case of *Newport Mining Co. v. Ironwood*, the total actual real estate value of Gogebic County was \$56,467,012, and the assessment by the local assessors of both real and personal property was only \$12,829,605. Among the properties was that of the Newport mine, whose assessment was at \$2,188,640, and was appraised by Mr. Finlay at \$13,400,000. The value finally fixed by the commission was \$8,535,000. Taxes based on this revision, in the sum of \$98,996, were paid under protest, and the suit for recovery followed.

In an exhaustive opinion the court of last resort sustained the scientific valuation, notwithstanding the contention that the expert appraisal related only to the mining property, leaving untouched all other real estate and personal property of the county, urged as underassessed to an equal extent. It was further held in this case that the state is not limited to the capitalized royalty received by the owner of mining property, since the royalties themselves may be undervalued and the property may be worth more than the owner received. The court said:<sup>7</sup>

"It will be admitted that the availability and value of minerals, unmined, are not matters of common knowledge, nor to be correctly ascertained or estimated except by men possessed both of certain particular information and of expert knowledge."

And again, apropos of the principle we are emphasizing in this paper, the court continued:<sup>8</sup>

"There is no reasonable ground for contending that the state may not use the methods of business to ascertain such values. In such a case, it is not compelled to ignore, or discount, the facts of demonstrated availability, quantity, and quality of mineral. If a rule or method exists by which engineers and business men ascertain the values of ore bodies for the purpose of buying and selling them, if no better rule is or can be suggested, how can it be said that the rule is wrong in principle

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<sup>6</sup>Sunday Lake Iron Co. v. Township of Wakefield, 247 U. S. 350 (1918).

<sup>7</sup>Newport Mining Co. v. Ironwood, 185 Mich. 668, 152 N. W. 1088 (1915).

<sup>8</sup>*Ibid* p. 1094.

when adopted by the state? The state must, of necessity, treat the peculiar subject of taxation as the subject requires, not to change or modify a cardinal rule of taxation, but to apply it. Upon this record no other rule is suggested, and the rule employed is conceded to be the rule of engineers in like cases."

But in judicial policy the states are far from uniform in drawing this distinction. For example, the Oklahoma gross production tax was declared a property tax—probably because it was used in lieu of the general property levy on the mines affected.<sup>9</sup> Across the state line in Arkansas, a similar exaction, the severance tax, was declared a privilege charge or license on the occupation of extracting natural products from the soil.<sup>10</sup>

Again, in Mississippi a "privilege tax or occupation fee" of 20 cents an acre on holders of more than 1000 acres of timber land was, notwithstanding its title, held to be a property tax.<sup>11</sup> Likewise, the tax imposed in that state on those who would as a business extract turpentine from standing trees was pronounced a property tax and not a privilege fee.<sup>12</sup> But in Pennsylvania the tax on anthracite coal and not on bituminous, long a source of substantial revenue, was finally tested in the Supreme Court of the United States and upheld as a justifiable privilege tax.<sup>13</sup>

<sup>9</sup>Re Skelton Lead and Zinc Gross Prod'n Tax, 81 Okla. 134, 197 Pac. 495 (1921).

<sup>10</sup>Floyd v. Miller Lbr. Co., 169 Ark. 17, 254 S. W. 450 (1923).

<sup>11</sup>Thompson v. Kreutzer, 112 Miss. 165, 72 So. 891 (1916).

<sup>12</sup>Thompson v. McLeod, 112 Miss. 383, 73 So. 193, L. R. A. 1918C, 893 (1916).

<sup>13</sup>Heisler v. Thomas Colliery Co., 260 U. S. 245 (1922).

The following table, based on data reported in "FACING THE TAX PROBLEM" (1937), p. 530 *et seq.*, and "TAX SYSTEMS OF THE WORLD" (6th edition 1936) p. 120 *et seq.* will give some idea of the importance of the several types of taxes levied by the states. Asterisks indicate distribution of the corporate tax burden: One \* borne in part (roughly one half) by corporation; two \*\* born *in toto* by corporations.

#### STATISTICS OF STATE TAXES

State Revenue Yields (1936)—Comparisons: (in millions of dollars)	Including	Excluding	Number of states
	local shares	local shares	
*Property	\$160	\$158	4
*Severance	27	23	17
**Corporation, Income	103	88	32
**Corporation, Other	238	206	10
Personal, Income	144	107	5
*General Sales	357	275	34
*Liquor	193	155	31
*Tobacco	46	40	18
*Motor Vehicle	325	254	48
*Motor fuel	652	519	49
Death taxes	117	114	46
Poll	3	2.8	47
*Other (including Pari-Mutuel in 23 states)	114	104	
Total	2500	2048	

*The Adjective Phase*

May a state so administer its fiscal scheme as to employ its spare time in pursuing delinquent corporate taxpayers while omitting to prod individual slackers? Is there anything in law or manual to invalidate or discount the partially performed program or *agenda* of the legislature? There are such things as a policy in governmental economy, a style in writing, a variety in standards of idealism or conduct and latitude and range in the field of *discretion*, judicial or otherwise.

In 1887, the General Assembly of the State of Arkansas passed a measure imposing upon the Attorney-General the duty of bringing suits in the Chancery Court for the collection of overdue taxes from corporations. Definite procedure was laid out for the judicial examination of the grounds upon which such demands were to be based, including the declaration of a lien upon the property untaxed or inadequately taxed for the period involved. The act also authorized a decree awarding the state and her political subdivisions judgment for the amount of back taxes found due, and if not paid seasonably, enforcement of the tax lien by a sale of the property so omitted or undervalued. Such actions are given "precedence of all other suits" on the docket.

The law was amended in 1911 and in 1913; and the efficient terms of the statute include the following provision:

"Where the Attorney-General is satisfied . . . or it is made to appear to him . . . that in consequence of the failure from any cause to assess and levy taxes, or because of any pretended assessment and levy of taxes upon any basis of valuation other than the true value in money of any property hereinafter mentioned, or because of any inadequate or insufficient valuation or assessment of such property or undervaluation thereof, or from any other cause, there are overdue and unpaid taxes owing to the State or any county or municipal corporation . . . by any corporation upon any property now in this State which belonged to any corporation at the time such taxes should have been properly assessed and paid, it shall become his duty to institute at once a suit in chancery in the name of the State of Arkansas, for the collection of same, in any county in which the corporation owing such taxes may be found or in any county in which any part of such property as may have escaped the payment in whole or in part of the taxes as foresaid may be situated; . . . provided this act shall be construed as retrospective as well as prospective in operation.<sup>14</sup>

In *State v. Kansas City and Memphis Ry. & Bridge Co.*,<sup>15</sup> this back-tax statute was construed and its constitutionality upheld against a challenge for alleged repugnance to the state constitution's requirement of equality and uniformity, and the equal protection clause of the Fourteenth Amendment to the Federal Constitution.

<sup>14</sup>Act March 1, 1887, p. 33, § 1, as amended by act March 12, 1913, p. 724; *POPE'S STAT.* § 13, 987.

<sup>15</sup>117 Ark. 606, 174 S. W. 248 (1914).

In summarizing the conclusions which resulted from the careful and exhaustive consideration of the problem (the case was held "under advisement" nearly a year) the court said (per McCullough, Chief Justice):

"We conclude that the statute in controversy is not a statute for the classification of property for taxation. It was a legislative determination that property then within the jurisdiction of the State had in past years escaped the payment in whole or in part of its just proportion of the burden of taxation, by reason of not having been assessed or having been valued upon a wrong basis, or by reason of having been undervalued, and that it was for the best interest of the state that a remedy should be provided whereby the amount which should have been assessed against certain property may be ascertained and the property forced to contribute the full amount of its proportionate share of taxation.

"We cannot say that the failure to include within its terms individual as well as corporate property was an arbitrary discrimination against corporations. It cannot be presumed that its enforcement will result in unequal taxation. It should rather tend to make it equal and uniform.

"The payment of a part of the amount justly due did not release the tax debtor from his obligation to pay the balance. That one is compelled to pay what he justly owes, while the others are not sued, is not an infringement of any constitutional right nor even a just cause of complaint. To compel all to be sued might result in such a burden of litigation as to make it not worth while to sue any. This is a matter for the exercise of the legislative judgment and discretion."

And, as rebutting the contention that the law arbitrarily discriminated against corporations as such in contravention of the requirement of the constitution that property taxation shall be "equal and uniform" throughout the state, the court's answer was:<sup>16</sup>

"Section 5, article 16 of the state Constitution, is satisfied by assessments and fixed methods of collection of taxes according to the same rate and proportionate valuation and applies to prospective statutes only. It has no application to statutes *which only provide a remedy for the collection* of taxes already past due. It was not intended to afford constitutional protection to the owner of property which has escaped taxation against the enforcement of his obligation, unless all others similarly situated are compelled to pay."

There were dissents by Justices Wood and Smith. The former in a belated dissenting opinion appended to the later case of *State v. Bodcaw Lumber Co.*,<sup>17</sup> had vigorously protested against approval of the back-tax statute, on ground of arbitrary discrimination. And his language is here inserted that both sides of the issue may have parallel consideration:

"The conclusion reached by the majority of the court (in the *Bodcaw* case), it seems to me, is the only logical result to follow, conceding, as

<sup>16</sup>Italics supplied.

<sup>17</sup>128 Ark. 505, 194 S. W. 662 (1917).

I do, that the act is now a valid law. However, in view of the far-reaching consequences that it may have, I have determined, while my mind is on the statute, to record here my views as to the constitutionality of the act which would have been more appropriate to record in the case of *State ex rel v. K. C. & M Ry. & B. Co.*, *supra*, but which at that time I was unable to reduce to writing by pressure of other urgent duties.

"I am firmly of the opinion that the act under which this suit was brought is unconstitutional, because the Legislature, by striking out the words 'or persons' from the original back tax act of 1887, and leaving the act to apply only to corporations, showed its deliberate purpose to discriminate against corporations and to favor natural persons.

"While it is well settled that the sovereign power may classify for taxation, it is equally settled that such classification must have some basis in reason to justify a distinction between taxpayers. The cases which recognize the right of the sovereign to classify, in stating the rule also recognize the principle that if the classification be clearly unreasonable and arbitrary, and without any just distinction to rest upon, such classification comes within the inhibition of the equal protection clause of the Fourteenth Amendment to the Constitution of the United States. (Here are cited several cases.)

"I contend that any law which, shows on its face no other reason for classification than that one taxpayer is a corporation and the other an individual is based on considerations that have no possible connection with the duties of citizens as taxpayers. Such a statute is purely arbitrary, capricious, and oppressive, and is in plain violation of article 16, 5, of our Constitution, requiring all taxes to be equal and uniform throughout the state, and by violating this provision it also violates the Fourteenth Amendment, which prohibits the states from denying to any person the equal protection of the laws."

Further approval of the validity of the procedure was added by the Arkansas Supreme Court in *State v. Bodcaw Lumber Co.*,<sup>18</sup> *State v. Fort Smith Lumber Co.*,<sup>19</sup> *White River Lumber Co. v. State*,<sup>20</sup> and other cases.

The *Fort Smith* and *White River Lumber* cases were both appealed to the Supreme Court of the United States, the defense of alleged violation of the Federal Constitution having been seasonably interposed. But the decisions of the state court were affirmed—in the first appeal (1920) by a five to four vote, and nine years later (1929) by a vote of six to three.<sup>21</sup>

These Arkansas cases are truly landmark decisions, and fully deserve, it would seem, the space allotted in this paper on the remedial or adjective branch of this discussion. Two vital points were involved in the *Fort Smith* case: (1) arbitrary discrimination in the system of taxing corporations, and (2) attacking only corporations in suits for back taxes even if due. The

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<sup>18</sup>128 Ark. 505, 194 S. W. 692 (1917).

<sup>19</sup>131 Ark. 40, 198 S. W. 702 (1917).

<sup>20</sup>175 Ark. 956, 2 S. W. (2d) 25 (1928).

<sup>21</sup>*Ft. Smith Lbr. Co. v. Arkansas*, 251 U. S. 532 (1920); *White River Lbr. Co. v. Arkansas*, 279 U. S. 692 (1929).

one angle raised the question of legality of the remedy, while the other assailed the validity of the tax in the first instance.

In the *Fort Smith Case* Justice Holmes, speaking for the majority, was explicit and very brief:<sup>22</sup>

"It is within the power of the State, he said, so far as the Constitution of the United States is concerned, to tax its own corporations in respect of the stock held by them in other domestic corporations, although unincorporated stockholders are exempt. *A State may have a policy in taxation.* . . . A discrimination between corporations and individuals with regard to a tax like this cannot be pronounced arbitrary although we may not know the precise ground of policy that led the State to insert the distinction in the law.

Thus was condensed in a short paragraph the Court's *ratio decidendi*, a doctrine which accords to the states untrammelled liberty in devising and formulating their own revenue laws. They are not restrained by any iron-clad rule of uniformity. It is always open season for the pastime of searching new revenue sources.

The point first dealt with above was the most serious question in the *Fort Smith Lumber Company* case, and the state's contention there was sweepingly sustained. But also on the other point, the remedial angle germane to the instant branch of this discussion, the Holmes opinion was equally decisive; for the final paragraph contained this *imprimatur*:

"The same is true with regard to confining the recovery of back taxes to those due from corporations. It is to be presumed, until the contrary appears, that there were reasons for more strenuous efforts to collect admitted dues from corporations than in other cases; we cannot pronounce it an unlawful policy on the part of the State."

When the *White River Lumber Company* case came on for hearing nine years later, the personnel of the Court had undergone substantial change; and counsel for the corporation no doubt entertained the hope that the *Fort Smith* decision, with its narrow one-man margin, would be overruled. Accordingly, the attack was renewed upon the issue of constitutionality. But the opinion of affirmance, now pronounced by Justice Sanford, one of the new judges, notwithstanding the force of an intervening deliverance urged as *contra*,<sup>23</sup> adhered to the former Arkansas precedent.

In an eight-page opinion in which a number of prior decisions were cited and explained,<sup>24</sup> the Court shortly stated its conclusion of the whole matter:

<sup>22</sup>Italics supplied.

<sup>23</sup>*Quaker City Cab. Co. v. Pennsylvania*, 277 U. S. 389 (1928).

<sup>24</sup>*Whitney v. California*, 274 U. S. 357, 370 (1927); *Quaker City Cab Co. v. Pennsylvania*, 277 U. S. 389 (1928); *Winona & St. Peter Land Co. v. Minnesota*, 159 U. S. 526, 539 (1895); *New York State v. Barker*, 179 U. S. 279, 285 (1900); *Florida Central & R. Co. v. Reynolds*, 183 U. S. 471, 480 (1902); and *Ft. Smith Lumber Co. v. Arkansas*, 251 U. S. 532, 534 (1920).

"We see no ground for distinguishing the *Fort Smith Lumber Co.* case from that now under consideration; and on that authority and for the reasons stated therein and in the earlier cases which we have cited, we hold that the back tax statute of Arkansas, although confined to the property of corporations, does not deny to them the equal protection of the laws in violation of the Fourteenth Amendment."

But Mr. Justice Butler, another new judge, announced at length the grounds of his dissent (in which concurred Chief Justice Taft and Mr. Justice Van Devanter). The reasoning of the dissenting group spent itself on the *facts* of the *White River* case which differed from those of the *Fort Smith* decision in that here was an attempt to collect tax arrearages on lands lying side by side with other lands of individuals equally underassessed and undisturbed.

In concurring opinion of Judge Wood in the *Bodcaw* case,<sup>25</sup> wherein he had dissented from the *Memphis Bridge*<sup>26</sup> case, was cited as support in this last-ditch resistance to the enforcement of a measure which Justice Butler felt was unequal and unfair from its very inception in 1887. "The discrimination," he declared, "is deliberate." And he further explained:

"The law directs the Attorney General to collect back taxes not in all cases where the taxes originally levied and paid were based on undervaluation, but only where property belongs to corporations at the time of the assessment and also at time of suit. He is not permitted to bring suit to make such collections against lands owned by individuals even if they were owned by corporations when undertaxed. As here applied the Act singles out the lands of corporations, leaving those of natural persons free from such claims. Transfer to an individual, whenever made, prevents the operation of the Act."

In the minority view, the case could not be distinguished from the *Quaker City Cab Co.* case. And the *Fort Smith Lumber Co.* decision was differentiated in that the suit there was to enforce an obligation of the corporation itself and not merely a claim for taxes against its land. That decision it was insisted, rested upon the ground that the tax was peculiarly applicable to corporations, while a tax on land is not; and "the classification, at least when applied to land is fanciful and capricious."

### Conclusion

Finally, if it be conceded—(1) That the world of commerce recognizes and seeks business advantage in the corporate form of activity; and (2) That rapidity of turnover (and hence profit) is enhanced by volume of operations; and (3) That the impact of the property tax falls upon a static and immovable base, having no uniform connection with ability to pay; and (4)

<sup>25</sup>128 Ark. 505, 523, 194 S. W. 692 (1917).

<sup>26</sup>117 Ark. 606, 174 S. W. 248 (1914).



That an income or sales tax can seize its quarry "on the fly" and when most expedient; *then these conclusions must follow—*

(1) That state lawmakers are at liberty to adopt the income, the profits, or the sales tax as revenue measures; and

(2) That though the selection may be undesirable for the larger business units; and

(3) Corporations, especially, may be saddled with an extra load; yet

(4) the added burden thus falling on the corporation will incidentally tend to "regulate" or control its management in the interest of the general welfare.

As a result of that "policy" on the part of the people the owners of the corporation may reconsider their private policy and determine whether or not they will continue to plod along in the "hampering" harness. Whether they carry on or disorganize may or may not be to the advantage of the community at large; but at least all interested parties shall have had their options in the fiscal program. So after all has been said, the question here discussed is one of public policy rather than of legality. *Capacity to pay* is still a valid and persistent principle; and only by its observance may society "arrive in the end to a more genuine equality."