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ROBERT E. ROSENWALD, who writes on *Exemptions From Jury Service and Challenges for Cause in Missouri,* completes a series of two articles on this subject, the first having appeared in the third issue of the current volume. Mr. Rosenwald, who is an alumnus of the School of Law and a member of the Kansas City Bar, wrote on *The Right of Judicial Comment on the Evidence in Missouri* in Volume XIV.

SAMUEL BRECKENRIDGE NOTE PRIZE AWARD

Caspar R. Stauffacher's note on *Statutory Presumptions of Guilt* has been awarded the fifteen dollar prize as the best note in the second issue of the current volume.

Notes

FRANCHISE TAXES OF CORPORATIONS HAVING STOCK WITHOUT PAR VALUE

The traditional organization of a corporation formed to engage in business is based on par value stock, *i. e.,* shares in the business for which a certain amount stated in the shares is subscribed. But for various reasons, including the variation in market values of stocks so that par does not correspond to the market prices, but often misleads persons as to stock value, most of the states have passed laws allowing corporations to organize without stating par value on the stock certificates. The introduction of no par stock raises certain problems as to the manner in which it shall be treated. Among these is the question of taxation.

It has been traditional to distinguish between property taxes and franchise taxes upon corporations.[1] Franchises are special privileges which are conferred by the government upon indi-

[1] 2 Cooley, TAXATION (4th ed. 1924) secs. 799, 826-38; Hilliard, LAW OF TAXATION (1875) 20, 207, 209.

viduals and which do not belong to the citizens of common right.[2] Franchise taxes upon corporations are levied in consideration of, or as a prerequisite to, the extraordinary privilege of doing business in a corporate manner, which is a privilege conferred by the state and not a right such as the pursuing of ordinary lawful occupations by private persons.[3] Property taxes are those ordinary taxes levied for the support of the state upon all property owners, or upon certain classes, *e. g.* landowners. Corporations are clearly subject to taxation of their property to the same extent as individuals,[4] and shares of corporate stock may be taxed in the hands of individuals.

A convenient method of assessing franchise taxes uopn corporations was to evaluate the franchise by assuming it was worth the par value of the stock and calculating the tax accordingly. But when no par stock was introduced, the tax obviously could not be levied in this way. How then could the shares be fairly and quickly assessed and a tax levied which would not give rise to great litigation?

The different states through their legislatures have met this problem in different ways. Mr. Wickersham has distinguished four methods of imposing the tax:[5] (1) the imposition for purposes of taxation of a fictitious value or par value, usually $100.00 per share;[6] (2) the employment of a presumption that the stock is worth $100.00 per share in the absence of a showing that it is of different value;[7] (3) taxation according to the number of shares;[8] (4) taxation based upon the consideration for the shares received by the corporation from its stockholders.[9] The first method might be combined with the third since the amount of the tax in each instance is determined by the number of shares and not by their value. The fourth method is not greatly different, except that the amount of the tax may vary from corporation to corporation. But the second method is quite distinct, being based on the *actual* value of the stock, once it is determined.

In the application of the tax the question arises as to whether corporations of other states, commonly called foreign corporations, may be taxed equally with or to a greater extent than corporations originally incorporated in the state, referred to as domestic corporations. The original doctrine was that a state

[2] 2 Morawetz, PRIVATE CORPORATIONS (2d ed. 1886) sec. 922.

[3] Allgeyer v. Louisiana (1897) 165 U. S. 578, 589.

[4] Cooley, *op. cit.* sec. 818; Morawetz, *op. cit.* sec. 1085.

[5] Wickersham, STOCK WITHOUT PAR VALUE (1927) sec. 71.

[6] *Ibid.*, where the author cites Col., Conn., Ill., La., Md., Minn., Mo., N. H., N. C., Ore., Pa., R. I., Tenn., Utah, Vt., Va., W. Va.

[7] *Ibid.*, citing Ala., Kan., N. M.

[8] *Ibid.*, giving Me., Mass., Nev., N. Y., Ohio, Wis. [9] *Ibid.*, citing Texas.

might exclude foreign corporations from its territory altogether and, as a condition of permitting them to do business within the state, might impose any tax or obligation it chose.[10] However, a doctrine has grown up that a state may not impose an unconstitutional condition upon a foreign corporation as the price of its license to do business within its borders.[11]

Since the authority to issue stock not yet issued is one of the privileges granted by the incorporating state alone, a tax by a foreign state on authorized stock may be subject to greater criticism than a tax regulated by the amount or value of outstanding stock. In *Air Way Electric Corporation v. Day*[12] a Delaware corporation had issued one-eighth of its authorized no par shares. It was located in Ohio where it did 28 per cent of its business. Ohio levied an annual fee on foreign corporations of "five cents per share on the proportion of the number of shares of authorized common stock represented by property . . . and business . . . in this state." This was a tax of an arbitrary amount on each share authorized. The court held that the tax violated the commerce clause of the Federal Constitution, Art. 1, sec. 8, § 3, since all the foreign corporation's business and property were represented by the issued shares, and a tax on all the shares *authorized,* or on a greater number than those outstanding, amounted to a tax and burden on all the property and business, including interstate commerce. "The number of shares not subscribed or issued has no relation to the privilege held by plaintiff in Ohio, and is not a reasonable measure of such a fee."[13] The fee had no relation to what was paid in for the stock or to its value or capital, its property or business. The classification was held to be unequal in its results, not requiring like fees for equal privileges, and to have no relation to the purpose for which it was made. Hence the act violated the equal protection clause of the Fourteenth Amendment.

The above reasoning admits that a tax on issued shares is valid, whether by the parent or a foreign state. And it denounces a tax by a foreign state on shares authorized but not issued. As to whether the parent state itself may tax the corporation by the measure of authorized stock without regard to actual issuance we turn to the later case of *Roberts and Schafer v. Emmerson.*[14] Here the domestic corporation issued the full amount of authorized no par shares at $5.00 per share. The annual tax was figured so that "for the purpose of fixing the fee,

[10] Horn Silver Mining Co. v. N. Y. (1891) 143 U. S. 305; (1927) 25 MICH. L. REV. 278.

[11] Henderson, THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW (1918) ch. 7; Western Union Tel. Co. v. Kan. (1895) 216 U. S. 1.

[12] (1924) 266 U. S. 71.

[13] *Ibid.* 83.

[14] (1926) 271 U. S. 50, 45 A. L. R. 1495.

no par shares shall be considered to be of the par value of $100.00 per share," and the tax was to be on the authorized shares. The tax was attacked on the ground that corporations of equal worth but of different authority to issue shares would be taxed unequally, the corporation claiming such difference to be a violation of the equal protection clause. The court distinguishes the *Air Way* case as holding that "the authority to issue its capital stock was a privilege conferred by another State and bore no relation to any franchise granted to it by the State of Ohio or to its business and property within that state"[15] and that a tax on authorized capital stock may not be levied on a foreign corporation, as this results in unconstitutional discrimination. But a tax on authorized capital stock is legal as a franchise tax on a domestic corporation.[16]

As shown above in the *Air Way* case, the question of such taxes interfering with interstate commerce frequently arises. It has been decided that a tax is unconstitutional if it is measured by the whole issued capital stock of a foreign corporation without regard to the assets in the state, or their proportion to the whole assets.[17] But when the tax is on a proportion of outstanding capital stock determined by the value of the property in the jurisdiction, the tax is valid whether on the property or

[15] *Ibid.* 54.

[16] *Ibid.* 54; Kansas City Ry. v. Kansas (1915) 240 U. S. 227, 232-3; Kansas City v. Stiles (1916) 242 U. S. 111.

[17] Cudahy Packing Co. v. Hinkle (1929) 278 U. S. 460, commented on in (1929) 42 HARV. L. REV. 952. It was thought that an exception had been developed by the Baltic case where the tax on the *whole* authorized par stock of a foreign corporation but limited to a specified sum ($2000), was held valid as not taxing property in other states nor constituting a burden upon interstate commerce. Baltic Mining Co. v. Mass. (1913) 231 U. S. 68, at 87, disapproved by Alpha Portland Cement Co. v. Mass. (1924) 268 U. S. 203, 44 A. L. R. 1219. The court was of the opinion that the measure of this privilege tax was allowable, the taxation of such a privilege being in itself lawful. When the maximum was removed, the tax became unconstitutional. International Paper Co. v. Mass. (1917) 246 U. S. 135. This point was revived in Cudahy Packing Co. v. Hinkle (D. C. Wash. 1928) 24 F. (2d) 124, where the District Court held valid a tax on both foreign and domestic corporations measured by the entire authorized capital stock but limited to $3000. A foreign corporation doing some intrastate business but a much greater amount of interstate business was subjected to the tax, which was found to be reasonable and to bear a reasonable relation to the amount of intrastate business done. This case was reversed on appeal, the Supreme Court disallowing any exception to the general rule of non-discrimination against foreign corporations. Even a relatively small tax may not be sustained if it really burdens interstate commerce and reaches property beyond the state. The amount is unimportant when there is no legitimate basis for the tax.

imposed as a franchise tax.[18] The state has authority to tax the paid-up issued stock of domestic corporations for the privilege of incorporation, and the fact that some capital stock represents capital in other states or in interstate commerce, not subject to the taxing power of the state, does not render the tax invalid.[19]

Having dealt with the relation of franchise taxation to interference with interstate commerce, we may go directly to the question of valuation of no par stock for purposes of taxation. The most common method of levying the tax is to disregard actual worth and either to set a fictitious value on each share or to measure the tax by the number of shares, with similar results. The fictitious value usually is higher than the actual value. Consequently taxes based upon such values are opposed upon the ground that they deny the equal protection of the laws, because par stock corporations are taxed on par value which frequently is less than the market value, while no par stock corporations are assessed on the higher fictitious value. Where state constitutions provide that taxation must be equal, an additional ground of invalidity can be asserted.

State courts have not always held the tax allowable. In *People ex rel. Terminal* and *Town Taxi Corporation v. Walsh*[20] the provision that shares be deemed to have a face value of $100.00 each for the purpose of assessing the tax was held unconstitutional because it was entirely arbitrary and necessarily resulted in unequal taxation. The court followed a former New York case, *People ex rel. Forrington v. Mensching*,[21] holding in effect that the corporation tax must be measured by face or actual value, which it seemed to regard as the same, and that all other methods resulting unequally would be unconstitutional and void. The effect of the case was partially overcome by the same court in *People ex rel. Griffith v. Loughman*.[22] A license fee on foreign corporations of six cents on each issued no par share employed in the state was held valid as a premium for entering the state, but its application to corporations already in the state was denied. But it has been held that a foreign corporation may attack a discriminatory statute existing at the time of its admission.[23] It is conjectured that the New York court was merely taking a half-way position before giving the tax full application. The law was later fully upheld by the Supreme Court of the United States.[24]

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[18] Hump Hairpin Co. v. Emmerson (1922) 258 U. S. 290.
[19] Kansas City Ry. v. Kansas (1916) 240 U. S. 227.
[20] (1922) 202 App. Div. 651, 195 N. Y. S. 184.
[21] (1907) 187 N. Y. 8, 79 N. E. 884.
[22] (1928) 249 N. Y. 369, 164 N. E. 253.
[23] Power Mfg. Co. v. Saunder (1927) 274 U. S. 490, and case comment in (1927) 41 HARV. L. REV. 95.
[24] Note 35, below.

The Arkansas court did not restrict the operation of a similar tax on foreign corporations to subsequent incorporators. In *State v. Margay Oil Corporation*[25] it held that the effect of the statute was simply to provide a definite method for fixing the franchise tax; that separating par and no par corporations was a reasonable classification; and that the corporation, having chosen the no par method by its voluntary act, could not complain that other corporations with the same amount of assets were taxed differently.

Massachusetts in 1921 held that a statute taxing no par stock as having a par value of $100.00 was valid.[26] It seemed as fair for these corporations to pay a tax on such amounts as for a corporation with depreciated par stock to pay tax on par. The state might put an arbitrary value on the privilege of doing business in the state.

Of course the highest authority on constitutionality is the Supreme Court of the United States. In the *Air Way* case,[27] the corporation had contended that the basis of taxation must reflect the value of the privilege.[28] The court agreed that some relation to such value is a reasonable requirement and stated obiter that "the number of non par value shares of the corporation is not an indication of, and does not purport to be a representation of the amount of its capital. Each outstanding share represents merely an aliquot part of its assets." On the basis of this dictum Mr. Wickersham concluded that any tax not on actual value is unconstitutional.[29]

In the *Schaefer*[30] case, however, the court took up the question of whether there are such differences between par and no par stock as to constitute a proper basis for classification for taxation of corporate franchises, so that the amount of tax on par stock may be based on par and in the case of no par upon the arbitrary value fixed in the statute. The court held that the difference is substantial, and, therefore, the classification is not discriminatory or unreasonable. The nature of these differences is indicated: no par stock may be issued from time to time at different prices or values, although holders of all shares are en-

[25] (1925) 167 Ark. 614, 269 S. W. 63, *aff'd* (1926) 273 U. S. 666, note 34, below.

[26] American Uniform Co. v. Commonwealth (1921) 237 Mass. 42, 129 N. E. 622. The Michigan Court in Detroit Manufacturing Corp. v. Sec. of State (1920) 211 Mich. 320, 178 N. W. 697, 182 N. W. 528, applied such a clause in the Delaware law to a Delaware corporation in Michigan for the purpose of assessing the stock in Michigan without questioning its constitutionality.

[27] Note 12, above.

[28] Looney v. Crane (1917) 245 U. S. 178; Internat'l Paper Co. v. Mass. (1917) 246 U. S. 135.

[29] Wickersham, *op. cit.* 167.

[30] See note 14, above.

titled to share equally in the distribution of profits; thus, greater ease and facility is permitted in issue and marketing of shares in no par stock. After laying this sound legal basis, the court says that a difference in tax is unavoidable in taxing authorized stock, for some value must be assigned although shares are issued from time to time at varying prices, and until issued can have no value. The court concludes the discussion: "The inequalities complained of result from a classification which, being founded upon real differences, is not unreasonable, and the discrimination which results from it is not arbitrary or prohibited by the Fourteenth Amendment. It is enough that the classification is reasonably founded upon or related to some permissible policy of taxation."[31]

This case puzzles Mr. Wickersham who had concluded from the *Air Way* case and the *Walsh* case that setting up such arbitrary values for taxation was unconstitutional.[32] He attempts to distinguish it on the ground that the tax was on authorized stock:

> Even if the *Schaefer* case is to become settled law, however, the distinction between a tax on authorized stock and a tax on outstanding stock must be borne in mind. The former is clearly one on the privilege of issuing stock only. It [the tax] must often be paid long before the stock is issued and irrespective of actual issuance. But a tax on outstanding stock is one on that part only of the privilege which has been exercised. The issued and outstanding stock represents the property of the corporation, and a tax on or measured by such stock is essentially one on or measured by the amount of the property. Hence, where a fictitious value is placed upon it for tax purposes, there is a resulting discrimination which is very direct and real, emphasizing the unfairness and resulting discrimination. These considerations might lead the same court to reach different conclusions where the tax is on the outstanding rather than the authorized stock.[33]

Mr. Wickersham says that the decision is disappointing in that it fails to give full effect to the obvious discrimination within the class, that it overlooks the fact that other states have solved the difficulty without discrimination. He disapproves of the case and says it can be supported only on the "slender thread" that there is "value in the mere authority to issue no par stock which varies with the amount authorized, whether the shares

[31] *Idem.* 57; Watson v. State Comptroller (1922) 254 U. S. 122.
[32] Wickersham, *op. cit.* 137, 155-6.
[33] *Idem.* 141.

are issued or not." He raises the query "whether it [the tax] is valid if it is based on the outstanding stock," with a clear intimation that it should not be.

Thus, the position of the courts was subjected to doubt. However, in 1926 the Supreme Court in two *per curiam* decisions[34] sustained the Arkansas franchise tax on foreign corporations. The tax was figured by determining the ratio of property and business in Arkansas to the whole property and taxing the same proportion of issued and outstanding shares at $25.00 per share valuation. One case affirmed the Arkansas decision in the *Margay Oil Corporation* case commented on above. The court based its decision on the authority of the *Schaefer* case, thus extending it to foreign corporations and issued stock. A discussion of the principles involved, however, was not forthcoming until May 13, 1929, when the Court decided two cases which seem to settle the matter. The viewpoint of the *Schaefer* case was taken and taxes based on an arbitrary figure applied to the issued capital stock were upheld for both domestic and foreign no par value corporations. It will be valuable to analyze these cases.

In *People of State of New York v. Latrobe*[35] the New York law imposing a license fee on foreign corporations doing business within the state, based on that proportion of its total capital stock which its gross assets employed within the state bear to its total assets, was upheld.[36] In case of stock having no par value the fee was fixed at six cents per share, whereas par value stock was taxed at one-eighth of one per cent of par value. The state's claim for unpaid taxes, filed in the bankruptcy of the Thermiodyne Radio Corporation, incorporated in Delaware, though expunged in District Court and the Circuit Court of Appeals, was allowed by the Supreme Court. The tax was called a license fee and paid but once, for the privilege of exercising corporate privileges in the state. 250,000 shares of the bankrupt corporation had been issued at $2.32 per share, but the assets were only about $1.12 per share, all located in New York. The tax of six cents per share amounted to $15,000, the same amount that would have been levied on a corporation with $12,000,000 of par-value stock. The stock here had been sold for but $580,000. The state's claim was attacked on the ground that the arbitrariness of the amount infringed the equal protection clause of the Fourteenth Amendment. The court rejected the conten-

[34] Margay Oil Corporation v. Applegate (1926) 273 U. S. 666, note 25, above; Gilliland Oil Corp. v. Arkansas (1926) 274 U. S. 717.

[35] (1929) 279 U. S. 421.

[36] Cahill's Consol. Laws N. Y. (1923) c. 61, sec. 181; Griffith v. Loughman (1928) 249 N. Y. 369, 164 N. E. 253, note 22, above.

tion, limiting the *Air Way* case to taxes on authorized share of a foreign corporation. It pointed out that in taxation of par value stock the objection that the tax is not on the actual value, but often is based on something far different, *i. e.*, par, has not been held to invalidate such taxes. Moreover "the kind and number of shares with which a foreign corporation is permitted to carry on its business within the state is a part of the privilege which the state extends to it, and is a proper element to be taken in fixing a tax on the privilege." Hence the tax is "reasonably related to the privilege granted by the state and to the protection of its similar policy of taxation with respect to domestic corporations, and so does not infringe any constitutional immunity." The court lastly brings out "the difference in the rights of creditors of the two classes of corporations" as a basis for differentiating them and taxing par and no par differently; in the case of no par stock difficulties arise in the enforcement by creditors of the liability of stockholders for unpaid subscriptions, or of the directors for improper diversion of capital.

Companion to this case is *International Shoe Co. v. Shartel.*[37] Plaintiff, a Delaware corporation doing business within the state of Missouri, prayed for an injunction to restrain the officials of the state of Missouri from collecting a franchise tax levied under two state statutes providing, (1) that a tax of one-twentieth of one per cent of the par value of capital stock and surplus employed in business in the state shall be collected, the proportion of capital stock and surplus so employed to be determined by the proportion that the corporation's assets in the state bear to the total assets wherever located, and (2) that for the purpose of computing such tax each share of stock without any nominal or par value, shall be considered the equivalent of a share having a par value of one hundred dollars. It was held (1) that such a tax is not an unlawful regulation of interstate commerce and is justified as a tax on the privilege of exercising the corporation's franchises within the state, and (2) that such tax is not a taking of property without due process of law nor a denial of equal protection of the laws. The assignment to shares of a value in excess of their present worth does not operate to tax property outside the state, according to the Court, because the tax "is a privilege tax and not a property tax." And the provisions of the tax in the principal case apply equally to domestic and foreign corporations. The issued stock is a measure of the privilege exercised. Thus, the court clearly considered all taxes paid by corporations because they are corporations, as franchise taxes, not property taxes. Despite Mr. Wickersham's logic,[38] no distinction is in fact made.

[37] (1929) 279 U. S. 429; (1929) 77 U. PA. L. REV. 817-19.

[38] Note 33, above.

The cases treat the corporation franchise tax as a privilege tax or as a condition for doing business as a corporation within the state, whether the corporation be domestic or foreign. The tax need have no relation to the property held nor to the business done nor to the value of the stock or the amount paid for it. Only some relation to the privilege granted or exercised must be shown to render the tax constitutional.[39] And the relation of the tax to the privilege, required for equal protection, need not be to the value of the privilege; for the franchise is not assessed or evaluated as by a business man. As regards classification of corporations, it is sufficient if legal distinctions[40] are made, based, for example, upon freedom in fixing the price of the stock with the attendant ease and facility in its issue and marketing.

The result of these cases seems clear. Taxes on the number of shares or based on an arbitrary valuation are constitutional under the equal protection clause, on either authorized or issued stock of domestic corporations, and on the issued stock of foreign corporations. Only the authorized stock not yet issued by foreign corporations is exempt, partly because of the operation of the commerce clause of the Federal Constitution. But the constitutionality of the taxes does not imply fairness or expediency which now become the main questions for the tax making bodies. The unequal results of a fixed method regardless of actual value have been pointed out, so arbitrary value or tax on the number of shares have been disapproved. And the *Latrobe* case observed that even taxation on par or the consideration received brought some serious discrepancies. This leaves us with the possibility of Mr. Wickersham's second method of those that have been tried, that of taxing according to a fixed value until the actual value is shown. The expense of collecting the tax is an element in determining expediency. Assessing is more expensive than an arbitrary method, and it is difficult to determine the value of the property or franchise of a large corporation. This hindrance is alleviated by causing the overtaxed corporation to present to the court a schedule of assets before the assessment may be changed. The practical difficulties have weight, but should not overweigh the consideration of what is fair and equitable.

ROBERT J. HARDING, '30.

DETERMINING PROFITS OF FIRE INSURANCE COMPANIES FOR RATE REGULATION

Administrative control over the rates and premiums of insurers is a recent development. The people, having brought the

[39] Southwestern Oil Co. v. Texas (1909) 217 U. S. 114 at 126.

[40] Quaker City Cab Co. v. Pennsylvania (1928) 277 U. S. 389; (1929) 27 MICH. L. REV. 800.