National Bank Taxation in California
(CONCLUDED)

V. THE MACALLEN CASE

The last installment of this article contained a detailed discussion of the measurement theory (i.e., the theory that a tax upon a taxable subject may be measured by a measure which includes non-taxable property or income if the measure bears a reasonable relation to the subject taxed) and also a discussion of its importance to the new methods of taxing national banks permitted by Section 5219 of the United States Revised Statutes. Since that installment was published the Supreme Court handed down its decision in Macallen Company v. Massachusetts—a case of the greatest importance to the measurement theory. It is proposed to discuss the Macallen case here only so far as is necessary to determine what was decided and the effect of the decision upon the recently enacted California Bank and Corporation Franchise Tax Act.

The Massachusetts statute with which the decision deals attempts among other things, as does the California statute, to levy an excise tax on domestic corporations measured by net income including income from federal and other tax exempt securities. The tax was held void in so far as it was derived from the income from exempt securities. The reasoning of the court was briefly as follows:

(1) The court declared its power and duty to "determine for itself by independent inquiry whether the tax is what, in form and by the decision of the state court, it is declared to be, namely, an excise tax on the privilege of doing business, or, under the guise of that designation, is in substance and reality a tax on the income derived from tax-exempt securities." In support of this proposition the court cited and discussed a number of its earlier decisions wherein it held void various taxes which it found to be "in substance and reality" taxes upon non-taxable property though otherwise entitled.

It is of course true that all the taxes in this field of inquiry whether held valid or void relate to situations in which taxable and non-taxable property are so intertwined that a tax on either class of property is in

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2 17 CALIFORNIA L. REV. 232.
5 49 Sup. Ct. 432, 434.
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6 Taxes upon taxable subjects thus intertwined with non-taxable subjects are valid or void depending upon whether they have or have not been based upon a measure which bears a reasonable relation to the taxable subject and not too intimate a relation to the non-taxable subject. When the court holds a statute in this field void, it generally does so by characterizing the statute as "in substance and effect" a tax upon the non-taxable element of the complex involved. If the court's proposition above quoted means anything, it means that the answer to the question which the court says it can and must determine might be that the tax involved in this case is void under the test applied in the cases cited by the court and set out above, i.e. on the ground that it is in "substance and effect" a tax on exempt securities. This, however, is not true; for the tax involved is identical so far as the present point is concerned, with that involved in Flint v. Stone Tracy Company,7 where it was held that a corporate excise was valid though measured by net income including income from exempt securities.

(2) The court examined the facts of the case and found as a fact that the motive of the legislature of Massachusetts in enacting this statute was to reach the non-taxable securities held by the corporations taxed. The court did not find that the legislature did not have other and legitimate motives as well.

(3) The court turned to the cases upon which the court below relied, "of which [says the court] Flint v. Stone Tracy Company . . . is the extreme example, holding that a tax lawfully imposed upon the exercise of corporate privileges within the taxing power may be measured by income from the property of the corporation although a part of such income is derived from non-taxable property."8 Speaking of these cases the court said, "It is implicit in all that the thing taxed in form was in fact and reality the subject aimed at, and that any burden put upon the non-taxable subject by its use as a measure of value was fortuitous and incidental."9 (Italics added.) The words italicized indicate the ground upon which the rest of the opinion distinguishes Flint v. Stone Tracy Company from the instant case.

It should be noted that the court did not find it necessary to overrule Flint v. Stone Tracy Company in order to hold the present statute void, although it is undeniable that the actual objective operation of

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6 See Metcalf & Eddy v. Mitchell (1926) 269 U. S. 514, 46 Sup. Ct. 172 quoted at length in this connection in the previous installment of this article. 17 CALIFORNIA L. REV. 232, 252, n. 41.
7 (1911) 220 U. S. 107, 31 Sup. Ct. 342.
8 49 Sup. Ct. 432, 434.
9 49 Sup. Ct. 432, 434.
the tax upheld in the *Flint* case and that condemned in the instant case is identical. This fact is plainly recognized by the court in its opinion and indeed was necessarily alive in the court's mind since *Flint v. Stone Tracy Company* was the principal authority upon which the state relied. Necessarily, therefore, one premise in the court's reasoning is the proposition that the tax in the instant case was unobjectionable so far as concerned its actual operation and was void because of the rule laid down that such a tax if imposed for the purpose of reaching exempt securities is for that reason and without more invalid. It is true that in some cases in this field the court has used language which seemed to make validity or invalidity of the particular statute depend upon the intent with which it was enacted. The extreme example is *Miller v. Milwaukee*10 (quoted at some length on this point in the last installment of this article11) which is quoted in the instant case by the court in part as follows:

"A tax very well may be upheld as against any casual effect it may have upon the bonds of the United States when passed with a different intent and not aimed at them, but it becomes a more serious attack upon their immunity when they are its obvious aim."12

In view of the foregoing discussion there is no question but that the court held the tax void even assuming that had that motive been

10 (1927) 272 U. S. 713, 47 Sup. Ct. 280.
11 17 CALIFORNIA L. REV. 232, 248, n. 36. It might perhaps be said on the basis of the court's language in the Miller case that such a tax would be void under the rule of that case solely because of its effect even though the purpose of its enactors was unimpeachable but this it seems would be a rather unreasonable conclusion from the language quoted for although the court first describes the test to be applied as, "the avowed purpose or self evident operation" of a statute it seems to end by making "self evident operation" not a direct ground for holding the statute void but rather as simply furnishing conclusive evidence of intent. Whether the court means this to be actual intent or only the kind of intent sometimes presumed by the law to supply a necessary premise in a legal syllogism does not appear. The facts in the Macallen case were treated as in effect identical with those in the Miller case. In form the Massachusetts legislature had enacted an amendment the only effect of which was to achieve the same result as would a tax on the net income of exempt securities. It had done this by adding net income from these securities to the net income of domestic corporations which was used to measure the franchise tax. But although the facts are treated as identical with those in the Miller case, the reasoning of the court is somewhat different in that the court examines evidence (a report of the Massachusetts Tax Commission) for the purpose of determining the actual motive of the legislature in enacting the amendment and finds that their actual motive was to reach exempt securities by indirection, i.e. by applying the form of tax upheld in *Flint v. Stone Tracy Company*.
12 272 U. S. 713, 715, 47 Sup. Ct. 280.
lacking the tax would have been valid, for the reason that it was enacted with the purpose of reaching non-taxable property.\textsuperscript{13}

Two questions are presented: (1) is the court's test of honest or dishonest motive a good test wherewith to judge these statutes; and (2) do the facts of this case justify the court's finding in regard to the purpose of the state of Massachusetts?

The second question will not be discussed here except to suggest that it would have been at least as consistent with the facts before the court and rather more consistent with the integrity ordinarily attributed to a state, to say that the earlier Massachusetts statute excluded income from exempt securities from the measure of the franchise tax because it was thought to be necessary, and that the statute was changed to include that income because this court had decided that a franchise tax is properly so measured.

The other question is more important. It seems rather unfortunate that the court should have chosen as a test of the validity of these statutes the motive impelling the legislature in each particular case. Admittedly the only justification for condemning any of these statutes is the duty of the Supreme Court to protect the federal government and its agencies from burdensome interference by the states. The application given to the court's test in the instant case, in the light of the \textit{Flint} case, which the court here recognizes as good law, compels the conclusion that the statute here involved would have been valid if the state of Massachusetts could have convinced the court that its motives were unimpeachable. But the statute would have been no less a burden upon the borrowing power of the federal government. In other words there is no reasonable relation between the test adopted by the court and the only justification for its application. The court has in effect adopted a rule of retributive justice. It seems obvious that a rule adopted in aid of the court's duty to prevent undue burdens on the activities of the federal government should turn upon the seriousness of the burdens rather than upon some factor varying independently of those burdens. The argument immediately suggests itself that such statutes may be void independently of the extent of the burden because

\textsuperscript{13}It is rather important to observe that the proposition just stated was the ground not only for distinguishing \textit{Flint} v. \textit{Stone Tracy Co.} but was the sole ground of the decision itself, for if legislative motive had been invoked only to distinguish the \textit{Flint} case and the decision itself had been put upon some other ground it would have been possible to suspect that the court had repented its decision in the \textit{Flint} case and that its ground for distinguishing the case was not to be taken very seriously. It cannot be thought, however, that the court has based the decision itself on a proposition of law in which it does not believe simply because the only alternative was the outright repudiation of its earlier decision.
of the motive of their enactment. It seems fairly safe to say, however, that there is nothing in the Constitution or elsewhere which compelled the court to hold that the motive of the legislature has any bearing whatever upon the validity of these taxes. If a statute does not impose an undue burden it seems rather difficult to say that it must nevertheless be held void if the legislature which enacted it consciously desired to go as far as it could.

The court's argument might be stated in another form as follows: (a) A valid tax of this kind is valid, in spite of the incidental burden on exempt securities, only because it is a justifiable attempt to tax a properly taxable subject in circumstances where this cannot be done without imposing an incidental burden on exempt securities; (b) if the motive of such a tax is the incidental effect itself that effect ceases to be incidental and the tax ceases to be a legitimate attempt to tax a taxable subject. It is apparent, however, that the essential vice of the rule is still present. The rule as last stated condemns taxes imposed with a bad motive, as first stated it upholds taxes imposed with a laudable motive. Clearly the criticism above set out applies equally to either.

It should be noted that the present case did not involve a tax on national banks. The question with respect to national banks is not identical with the question in the instant case for the reason that Congress has expressly consented to the imposition by the states of this kind of tax on national banks. The court expressly declined to decide whether such a tax on national banks would be valid:

"Whether under recent federal statutes, states are authorized to impose a tax upon the income from United States bonds held by national banks, we need not stop to inquire. Certainly there is no statute of the United States which undertakes to authorize a state to impose a tax upon such bonds held by other kinds of corporations. And what power Congress has under the Constitution in respect to such authorization we need not now determine."14

It seems that the question with respect to such a tax is whether Congressional consent is an impairment of the obligation of contract and as such is contrary to the due process of law clause. Prior to the instant case it was by no means clear that the contracts of exemption of the sorts ordinarily made with the exempt security holders are sufficiently explicit to lead the courts to hold that excise taxes were within the exemption contracted for. The present decision holds that taxes of this sort, when imposed with the intention and purpose of reaching the securities, are included within the meaning of the contract of exemp-

14 49 Sup. Ct. 432, 436.
That Congress' intention was to accomplish this purpose seems to have been confessed as clearly as was that of the state of Massachusetts. Although the court has never held that all statutes involving an impairment of the obligation of contracts are for that reason void under the due process clause it seems fairly clear that the taking of property effected by a tax is at least as serious and immediate a deprivation as was that involved in the Sinking Fund cases and United States v. Northern Pacific Railway Company, wherein the court strongly intimated that the government's impairments of contract there involved were as such void under the due process clause.

The tax being void as to other corporations it may seem subject to a further objection as applied to national banks because, since applied to them only, it operates to discriminate against them. This objection was discussed at considerable length in the previous installment of this article.

The report which was before the California legislature when it enacted the tax law corresponding to the Massachusetts tax statute, contained in substance the same observations on the possibility of reaching exempt securities as did that before the Massachusetts legislature which is quoted by the court as showing intention to tax them by indirection. Furthermore, both the form and the effect of the taxes in the two states are substantially identical so far as concerns the qualities that led the court to hold the Massachusetts tax void. The only difference of any consequence between the two taxes is that the Massachusetts tax acquired these qualities and effects by virtue of an amendment which had no effect save to bring the income from exempt securities within the measure of the tax. If the court means to adopt the rule that the actual intention in the minds of the legislators is controlling, this difference is irrelevant. But it is still possible perhaps, though not probable, that the court invoked legislative intention because it thought that intention to reach exempt securities was a necessary premise, as a matter of law, to the conclusion that the state had exceeded its powers. If the court desired to do so, therefore, it could dis-
tinguish the California tax from that held void in the instant case, for
the burdening of exempt securities is only one of the elements of the
operation of the California statute.\textsuperscript{21}

VI. SUMMARY

Before taking up a detailed consideration of the bank tax situation
in California, it will perhaps be profitable to sum up rather dogmatically
the federal statutory and decisional law upon the subject of state taxa-
tion of national banks set forth in the preceding sections of this article.\textsuperscript{22}
A summary of that law will be convenient in determining whether a
change in the California law was necessary in order to meet the federal
requirements, and in determining to what extent those requirements
have been met by the Bank and Corporation Franchise Tax Act recent-
ly enacted by the California legislature.\textsuperscript{23}

I. The Constitutional Basis of State Taxation of National Banks.\textsuperscript{24}

A. The states' power to tax national banks depends entirely\textsuperscript{25} upon

\textsuperscript{21} The court could logically distinguish at least five possible situations: (1) taxes operating solely or primarily to burden exempt securities and enacted with that intent. This is the instant case; (2) taxes operating solely or primarily to burden exempt securities the actual motive for which does not appear, the intention to accomplish the only purpose effected being presumed. This is Miller v. Milwaukee, \textit{supra} n. 10; (3) taxes the operation of which is solely or primarily to burden exempt securities enacted in good faith. Such a tax would presumably be brought under the rule of the Miller case; good faith would probably be held to be legally impossible; (4) taxes the operation of which is only incidentally to burden exempt securities enacted in good faith. This is Flint v. Stone Tracy Com-
pany; (5) taxes of the operation of which the burdening of exempt securities is only an incident, enacted with the intent of reaching (among other things) exempt securities. This is the California Bank and Corporation Franchise Tax Act.

\textsuperscript{22} 17 \textit{California L. Rev.} 83, 232.

\textsuperscript{23} Cal. Stat. 1929, c. 13.

\textsuperscript{24} See 17 \textit{California L. Rev.} 83-94.


Section 5219 now reads as follows: "The legislature of each State may deter-
mine and direct, subject to the provisions of this section, the manner and place of
taxing all the shares of national banking associations located within its limits. The
several States may (1) tax said shares, or (2) include dividends derived therefrom
in the taxable income of an owner or holder thereof, or (3) tax such associations
on their net income, or (4) according to or measured by their net income, provided
the following conditions are complied with:

"1. (a) The imposition by any State of any one of the above four forms of
taxation shall be in lieu of the others, except as hereinafter provided in subdivision
(c) of this clause.

"(b) In the case of a tax on said shares the tax imposed shall not be at a
greater rate than is assessed upon other monev capital in the hands of individual
citizens of such State coming into competition with the business of national banks:
\textit{Provided}, That bonds, notes, or other evidences of indebtedness in the hands of in-
dividual citizens not employed or engaged in the banking or investment business
Section 5219 of the United States Revised Statutes in which the various methods for the state\textsuperscript{26} taxation of national banks, consented to by Congress, and the prescribed conditions to which each is subject, are set forth.

1. Section 5219 should be considered an express declaration by Congress that certain forms of state taxation of national banks will not be deemed an interference with the purposes of Congress in creating such banks, and an implied declaration that all other kinds and degrees of state taxation will be deemed an interference with those purposes.

a. State taxation of national banks if invalid is so because it conflicts with the purposes of Congress in creating such instrumentalities.

and representing merely personal investments not made in competition with such business, shall not be deemed moneyed capital within the meaning of this section.

"(c) In case of a tax on or according to or measured by the net income of an association, the taxing State may, except in case of a tax on net income, include the entire net income received from all sources, but the rate shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing State upon mercantile, manufacturing, and business corporations doing business within its limits: \textit{Provided, however}, That a State which imposes a tax on or according to or measured by the net income of, or a franchise or excise tax on, financial, mercantile, manufacturing, and business corporations organized under its own laws or laws of other States and also imposes a tax upon the income of individuals, may include in such individual income dividends from national banking associations located within the State on condition that it also includes dividends from domestic corporations and may likewise include dividends from national banking associations located without the State on condition that it also includes dividends from foreign corporations, but at no higher rate than is imposed on dividends from such other corporations.

"(d) In case the dividends derived from the said shares are taxed, the tax shall not be at a greater rate than is assessed upon the net income from other moneyed capital.

2. The shares of any national banking association owned by nonresidents of any State, shall be taxed by the taxing district or by the State where the association is located and not elsewhere; and such association shall make return of such shares and pay the tax thereon as agent of such nonresident shareholders.

3. Nothing herein shall be construed to exempt the real property of associations from taxation in any State or in any subdivision thereof, to the same extent, according to its value, as other real property is taxed.

"4. The provisions of section 5219 of the Revised Statutes of the United States as in force prior to March 25, 1926, shall not prevent the legalizing, ratifying, or confirming by the States of any tax heretofore paid, levied, or assessed upon the shares of national banks, or the collecting thereof, to the extent that such tax would be valid under said section." \textit{44 Stat. 223} (1926), 12 U. S. C. \S\ 548 (1928), U. S. \textit{Rev. Stat.} \S\ 5219.

\textsuperscript{26}The word state is construed to mean territory as well. \textit{Talbott v. Board of County Comrs. of Silver Bow County} (1891) 139 U. S. 438, 11 Sup. Ct. 594.
b. The only limitation upon the power of Congress to create instrumentalities is that they promote in some degree the fulfillment of the congressional purpose to which they are directed. If a tax-free instrument is, in the opinion of Congress, necessary to carry out its powers, Congress may so declare; if it believes its powers may be carried out by an instrument subject to state taxation, it may likewise so declare. If Congress has created an instrument and expressly withheld from it an immunity from state taxation, there is no conflict with an exercise of federal power, and the state's taxing power becomes operative.

B. State taxes on national banks permitted by Section 5219 are as follows:

1. Real property of national banks in the state or any subdivision thereof may be taxed to the same extent and according to its value as other real property is taxed even though the state in addition may employ any one of the forms of taxation mentioned below.

2. Personal property of national banks cannot be taxed as no permission is granted to tax it and thus is impliedly prohibited.27

3. Four different methods of taxing national banks by the states are provided for:
   a. Taxation of the shares of the banks to their owners;
   b. Inclusion of the dividends from national bank shares in the taxable income of the owners or holders thereof under personal income taxes;
   c. Taxation of the banks on their net income;
   d. Taxation of the banks according to or measured by their net income.

4. These methods may be utilized by the states only upon compliance with certain conditions:
   a. As a general condition Section 5219 provides that the imposition by the state of any one of the four forms of taxation must be in lieu of the others,28 except that,

28 See First Nat. Bank in St. Louis v. Buder (E. D. Mo. 1925) 8 F. (2d) 883. Missouri for some years imposed a tax on the shares of national banks. In 1917 the state levied a personal income tax upon incomes derived from all sources. In 1923 Section 5219 was amended by Congress to permit among other things the taxation of the dividends from national bank shares under personal income taxes and provided that the use of one of the four methods of taxing national banks then
i. If the state employs method (c) or (d) *supra*, it may at the same time employ method (b) on condition that it also includes dividends from domestic corporations (and may likewise include dividends from national banks located without the state on condition that it also includes dividends from foreign corporations) but at no higher rate than is imposed on dividends from such other corporations.

b. Certain prescribed conditions summarized in the following sections are related to the particular methods set forth in Section 5219.

II. The share method of national bank taxation:

A. In General:

1. A state cannot tax national bank shares at a "greater rate" than is assessed upon "other moneyed capital" in the hands of individual citizens.\(^\text{29}\)

allowed should be in lieu of the others. The District Court held that by reason of the 1923 amendment to Section 5219 the Missouri income tax was operative against dividends from national bank shares and therefore the national banks were being taxed under two methods at once. Since this result was in violation of Section 5219 both taxes were invalid as against the national banks. However, in Buder v. First Nat. Bank in St. Louis (C. C. A. 8th, 1927) 16 F. (2d) 990 the Circuit Court of Appeals reversed the District Court, holding the share tax method to be the only one in effect in that the share tax was already in force and the provision that one method should be in lieu of all others prevented any other from taking effect. A petition for a writ of certiorari to the Circuit Court of Appeals was denied by the Supreme Court, First Nat. Bank in St. Louis v. Buder (1927) 274 U. S. 743, 47 Sup. Ct. 588.

\(^\text{29}\)It is generally recognized that when property is taxed at a greater rate than is authorized by law, the tax is not entirely void, but is invalid only as to the excess beyond that legally authorized. State Railroad Tax Cases (1875) 92 U. S. 575. In recognition of this principle it is held that as a condition precedent to the granting of an injunction to restrain the collection of excessive taxes, that the part which is not excessive must be paid or tendered. State Railroad Tax Cases, *supra*; German Nat. Bank v. Kimball (1880) 103 U. S. 732; Albuquerque Bank v. Perea (1893) 147 U. S. 87, 13 Sup. Ct. 194; Northern Pac. R. R. Co. v. Clark (1894) 153 U. S. 252, 14 Sup. Ct. 809; Peoples Nat. Bank v. Marye (1903) 191 U. S. 272, 24 Sup. Ct. 65; Mobile & O. R. Co. v. Schnipper (E. D. Ill. 1929) 31 F. (2d) 587. However, for certain exceptions to this rule regarding injunctions in this situation see Ritterbusch v. Atchison, T. & S. F. Ry. Co. (C. C. A. 8th, 1912) 198 Fed. 46 and Village of Norwood v. Baker (1898) 172 U. S. 269, 291, 19 Sup. Ct. 187, 195. The general rule has been repeatedly applied in cases where shares of national banks are taxed "at a greater rate than other moneyed capital." Pelton v. Commercial Nat. Bank of Cleveland (1879) 101 U. S. 143; Cummings v. Merchants Nat. Bank of Toledo (1879) 101 U. S. 153; German Nat. Bank v. Kimball, *supra*; Hills v. Nat. Albany Exchange Bank (1881) 105 U. S. 319; First Nat. Bank of Albuquerque v. Albright (1908) 208 U. S. 548, 28 Sup. Ct. 349.
a. The Supreme Court, adopting a purposive rather than a purely literal connotation for the words "other moneyed capital" has held that they only include capital that competes with the business of national banks.30

"Moneyed capital is brought into such competition where it is invested in shares of state banks or in private banking; and also where it is employed substantially as in the loan and investment features of banking in making investments by way of loan, discount or otherwise in notes, bonds, or other securities with a view to sale or repayment and reinvestment."31

b. The words "greater rate" refer to the entire process of assessment as well as to the rate of percentage and thus apply to any substantial discriminatory taxation (except II-B-2 infra) of national bank shares.32

2. Section 5219 does not require absolute equality of treatment of national bank shares and other moneyed capital in the hands of individual citizens. Nor does it prescribe any uniform rule as to the manner of taxing national bank shares. If the actual burden on such shares is not in excess of the burden upon "other moneyed capital" the state may exercise its own independent judgment regarding its tax methods without fear of violating Section 5219. The states are thus given what seems a quite proper and harmless freedom in the choice of methods of taxing "other moneyed capital."33

a. The burden of proving discrimination is upon the taxpayer.34

B. Specific things the states may do under the share method of national bank taxation:

1. Include in the value of national and state bank shares the value contributed thereto by (a) tax exempt securities held by the banks; 35 (b) real estate located in the state and taxed there, 36 and (c) real estate in other states and taxed there. 37
   a. The court has repeatedly held that as the tax is on the shares alone, it makes no difference how the bank's capital is invested. 38
2. Tax national bank shares without deducting the value of federal securities held by the bank from the taxable value of the shares, although private bankers, taxed upon their banking capital, are allowed to deduct therefrom the value of federal securities held by them. 39
3. Exempt the following from taxation even though national bank shares are taxed:
   a. Savings banks deposits, 40 shares of mining companies, 41 gas companies, 42 telephone companies, 43 building and loan associations, 44 and insurance companies. 45
4. Tax shares held by national banks in other national banks. 46

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41 Talbott v. Bd. of County Commrs. of Silver Bow County (1891) 139 U. S. 438, 11 Sup. Ct. 594.
44 Mercantile Nat. Bank of Cleveland v. Hubbard (C. C. N. D. Ohio 1899) 98 Fed. 465. See also other cases cited, supra n. 40.
5. Tax national bank shares at the place within the state where the bank is located without regard to the residence of the shareholders.47

6. Require national banks to pay the taxes levied on the shareholders as agent for the shareholders and subject the banks to penalties for failing to do so even though state banks are not required to make such payments for their shareholders.48

   a. But a tax on the bank measured by the value of its shares is not one on the shares and is therefore invalid.49

C. Specific things the state may not do under the share method of national bank taxation:

1. Allow deductions from the value of state bank shares, e.g., capital invested in exempt securities or intangible elements of value, or allow the deduction of debts by state shareholders from the value of their shares without allowing the same deductions to be made in the assessment of national bank shares.50

2. Tax state banks directly, deducting from their assets the value of federal securities held by them when national bank shares are taxed at full value.51

3. Impose a heavier tax burden upon national bank shares than upon bonds, notes, or other evidences of indebtedness in the hands of individual citizens.52


51 Montana National Bank of Billings v. Yellowstone County (1928) 276 U. S. 499, 48 Sup. Ct. 331. For a discussion of this case see 17 CALIFORNIA L. REV. 83, 116 et seq. If national and state banks hold federal securities and the state wants to tax national bank shares at full value, it must tax state bank shares at full value and not the state banks directly, for in levying a direct tax on state banks the value of federal securities must be exempted and this exemption brings about the forbidden discrimination.

4. Tax national bank shares without deducting from their value the value of shares held by the bank in another national bank when the shares in the other national bank are taxed by the state.\textsuperscript{53}

5. Tax national banks on shares they hold in state banks.\textsuperscript{54}

6. Tax national bank shares, regardless of whether they are held by residents or non-residents elsewhere than at the place within the state where the bank is located.\textsuperscript{55}

banking or investment business and representing merely personal investments not made in competition with such business, shall not be deemed moneyed capital within the meaning of this section." 42 Stat. 1499 (1923), 12 U. S. C. § 548 (1926). Apparently Congress, in this provision, made an attempt so to define "other moneyed capital" as to allow the states to tax "bonds, notes and other evidences of indebtedness" in the hands of individuals at a lower rate than national bank shares without rendering the bank share tax invalid under Section 5219. This attempt was ineffective, for the court, in considering this amendment, held it declaratory of the rule already followed in respect to other moneyed capital. Therefore, after this amendment, the states could no more give preferential treatment to individual holders of bonds, notes and other evidences of indebtedness without violating Section 5219 than they could before its passage.

The decision of the court in the Anderson case would seem, also, to render innocuous the following provision added to Section 5219 as part of the above amendment, which provided, "The provisions of Section 5219 of the Revised Statutes of the United States, as heretofore in force, shall not prevent the legalizing, ratifying, or confirming by the States of any tax heretofore paid, levied, or assessed upon the shares of national banks, or the collecting thereof, to the extent that such tax would be valid under said section." 42 Stat. 1499 (1923), 12 U. S. C. § 548 (1926). The meaning of this provision is not clear, for it is not certain whether "under said section" means Section 5219 before the amendment of 1923, or Section 5219 as amended in 1923. As long as it was believed that the amendment changed "other moneyed capital" so that a measure, formerly invalid, would be valid under the new provision, the question whether or not "said section" referred to the amended or unamended Section 5219 was highly important. In Minnehaha National Bank v. Anderson (D. S. D. 1924) 2 F. (2d) 897, "said section" was held to mean the unamended section. In McFarland v. Georgetown National Bank (1925) 208 Ky. 7, 13, 270 S. W. 995, 997, the opposite and seemingly better view was taken: "The words 'said section' must mean the section as amended by this act, or else the words 'would be valid' are meaningless. The provision plainly refers to taxes which would be valid under the act but might not be valid under the original act. The states needed no authority to collect taxes properly levied under the old act. The section was intended to give the power to collect taxes levied under the old act, if such levy was valid under the amended act. This is conclusively shown by the words 'legalizing, ratifying or confirming' for there was no need to legalize, ratify, or confirm previous levies if they were valid under the old statute." Furthermore, the ineffectiveness of this provision is specially to be noted in that it applies only to the share method of national bank taxation.


\textsuperscript{54} Bank of California, National Association v. Richardson, supra n. 53. See also First Nat. Bank of Albuquerque v. Albright (1908) 208 U. S. 548, 28 Sup. Ct. 349.

\textsuperscript{55} National Bank of Redemption v. Boston (1888) 125 U. S. 60, 3 Sup. Ct. 772.
7. Systematically and intentionally undervalue other moneyed capital through tax officials, although the state's statutes do not sanction such action.68
8. Tax the capital of a national bank in solido against the bank.57
9. Tax the shares of national banks and also include dividends derived therefrom in the taxable income of an owner or holder thereof.68
10. Prior to the 1926 amendment to Section 5219, exact a license, franchise or analogous tax.69

III. Taxation of dividends derived from national bank shares as a part of the taxable income of a holder thereof under personal income tax:

A. Is valid although there is also levied a tax on national bank shares on, or according to, or measured by their net income subject to limitations set forth in I-B-4-a-i supra.60
B. Cannot be at a greater rate than is imposed upon the net income from “other moneyed capital.”
   1. “Other moneyed capital” will probably have the same meaning in this connection as under the share method of bank taxation.

IV. Taxation of national banks on their net income and “or according to, or measured by their net income”:

A. A tax according to, or measured by net income is a tax upon the bank in the nature of an occupation or excise tax upon the occupation of banking.
B. The rate of such tax shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the state upon mercantile, manufacturing and business corporations doing business within its limits.
   1. By using the limiting words, “higher than the highest” rather than the word “higher” in regard to mercantile, manufacturing and business corporations, the statute allows the state a reasonable freedom in classifying the types of corporations mentioned for purposes of taxation and means in substance

68 Section 5219, supra n. 25.
60 Section 5219, supra n. 25.
that national banks in the matter of state taxation cannot be the least favored class of corporations doing business within the state.

C. If national banks are taxed “on” their net income, income from tax exempt securities cannot be included in the tax base.\textsuperscript{61}

1. The same is probably true of a tax measured by the net income of national banks although the question is not absolutely free from doubt.\textsuperscript{62}

D. If the net income method, or the according to, or measured by, net income method is employed, bonds, notes, mortgages and other evidences of indebtedness or other moneyed capital may be given preferential treatment or be entirely exempt from taxation.\textsuperscript{63}

E. It would seem, on the authority of the cases under the share method of national bank taxation, that if national banks are taxed on their net income, or according to, or measured by, their net income, the tax on the other corporations mentioned need not be in form an income tax so long as the ultimate burden, when translated into an income tax, does not violate the conditions set forth under IV-B-1 \textit{supra}.\textsuperscript{64}

VII. THE SITUATION IN CALIFORNIA.

A. WAS THE CALIFORNIA SHARE TAX ON NATIONAL BANKS INVALID?

The share method of national bank taxation was employed continuously in this state from 1910 until 1929.\textsuperscript{65} This method, which, except for the taxation of the real property of national banks, was the only one permitted at the time of its adoption, is set forth in Article XIII, Section 14(c) of the State Constitution and in Section 3664c of the California Political Code. In pursuance of these constitutional and statutory provisions national and state bank shares were taxed by the state at a flat rate on their book value, \textit{i.e.}, capital, surplus and undivided profits, less a deduction of the assessed value, as fixed by the county assessors, of any real estate, “other than mortgage interests therein,”\textsuperscript{66}


\textsuperscript{62}Macallen Co. v. Massachusetts (1929) — U. S. —, 49 Sup. Ct. 432. See \textit{supra} p. 456 for discussion of this case.

\textsuperscript{63}See 17 \textit{CALIFORNIA L. REV.} 232 et seq.

\textsuperscript{64}See 17 \textit{CALIFORNIA L. REV.} 232, 236, n. 11.

\textsuperscript{65}For an excellent discussion of the situation prior to 1910 see the Report of the Commission on Revenue and Taxation of the State of California for 1906 and 1910.

\textsuperscript{66}See \textit{infra} n. 68. See argument (2), heading (1) of the text for the significance of the failure to allow the deduction of mortgage interests in real estate held by banks.
owned by the banks and taxed locally. Because of the interpretation given by the United States Supreme Court to the words "other moneyed capital" as used in Section 5219, the California statutes imposing taxes on bonds, notes, mortgages and solvent credits generally must be considered in relation to statutes taxing bank shares. Such consideration reveals that the methods employed by this state in taxing bank shares and "other moneyed capital" might be regarded as having violated the restrictive conditions of Section 5219 because of the constitutional and statutory provisions for (1) the exemption of mortgages; (2) the preferential treatment of other intangibles. This possible violation will be briefly analyzed in the following discussion.

(I) The Taxation of Mortgages in California.

The arguments upon which the California share tax on national banks might be deemed to have violated the conditions of Section 5219 because of the preferential treatment of mortgages may be summarized briefly as follows:

(1) Mortgages on real property situated in California are exempt from taxation in the hands of owners subject to ad valorem taxation in California. Investments made by individuals in this type of security are "other moneyed capital" within the meaning of Section 5219 for national banks are authorized, subject to certain restrictions, to loan...

68 Mortgages: "... a mortgage, deed of trust, contract, or other obligation by which a debt is secured when land is pledged as security for the payment thereof, together with the money represented by such debt, shall not be considered property subject to taxation." CAL. CONST. Art. XIII, § 1. See also CAL. POL. CODE § 3617, tit. 2, subd. 3; tit. 6; § 3628 and § 3629 (7). The extent to which national banks may deal in real mortgages is governed by Section 24 of the Federal Reserve Act, 38 STAT. 273 (1913), 12 U. S. C. § 371 (1926), as amended in 1927, 44 STAT. 1232 (1927), 12 U. S. C. § 371 (1928). Formerly national banks had no power to make loans on real estate. Union Nat. Bank of St. Louis v. Matthews (1878) 98 U. S. 621; National Bank of Genesee v. Whitney (1880) 103 U. S. 99. This prohibition was partially withdrawn by the passage of the act mentioned. The power of national banks to deal in real mortgages is now governed by the terms of that act. First Nat. Bank of Guthrie Center v. Anderson (1926) 269 U. S. 341, 46 Sup. Ct. 135. A summary of a bank's powers in this regard follows: (1) The mortgage lien must be a first lien; (2) the real estate must be situated within the Federal Reserve District or within 100 miles radius of the bank's location; (3) the amount of the loan must not exceed 50 per centum of the actual value of the real estate offered for security; (4) the loan must not be made for a period exceeding five years; (5) the bank may make such loan in the aggregate sum equal to 25 per centum of the capital stock actually paid in and unimpaired and 25 per centum of its unimpaired surplus fund, or, at the election of the association, to an aggregate amount of one-half of its savings deposits.
money on real estate mortgages. National bank shares are thereby taxed at a higher rate than this particular form of "other moneyed capital" which is not taxed at all. Therefore the tax on such shares is repugnant to the provisions of Section 5219.

However, as has been pointed out by Professor Plehn in his penetrating article in the last issue of The California Law Review, there is no real exemption as to this form of moneyed capital, since the land represented by the mortgages is already taxed. It is, no doubt, an economic fact that the sum of a piece of land, plus a mortgage thereon, does not amount to or represent any more wealth than would the unencumbered land. It follows that "exemption" of mortgages from taxation is not, economically, the exemption of any of the wealth of the state from taxation. But this, in the present context at least, does not remove the objection to the exemption of mortgages, as shown in the paragraph next following.

(2) Mortgages on California real property, then, are not taxed, because to tax them, as well as the land hypothecated for them, would involve double taxation. But the value of national bank shares is due in part to the value of the mortgages held by such bank. It follows that in the case of bank share taxation there is present the double taxation avoided in the case of individual holders of mortgages. Since mortgaged land is, as Mr. Justice Stone in First Nat. Bank v. Hartford: "Here plaintiff is shown to have investments in real estate mortgages and to be engaged in selling them. The sale of mortgages and 'other evidences of debt' acquired by way of loan or discount with a view to reinvestment is, we think, within the recognized limits of the incidental powers of national banks. . . . To that extent the business of acquiring and selling such mortgages and evidences of debt, carried on by numerous individuals, firms, and corporations in Wisconsin, comes into competition with this incidental business of national banks. That the exercise of this incidental power has become of great importance in the business of national banks appears from the Report of the Comptroller of the Currency for 1924, 44 et seq. showing that approximately one-third of the investment of national banks consists of Government, railroad, public service corporation and other bonds, and 'collateral trust and other corporation notes.'" 273 U. S. at 560, 47 Sup. Ct. at 466, 59 A. L. R. at 9. See also the opinion of the court in First National Bank of Guthrie Center v. Anderson, supra: "We find [in the allegations in the petition] no specific mention of farm mortgages, nor anything indicating that they refer only to such mortgages. No doubt they are broad enough to include farm mortgages; but this does not weaken the allegation of competition, for while national banks were formerly prohibited from making loans on real estate, Rev. Stats. §§ 5136, 5137; Union National Bank v. Matthews, 98 U. S. 621, 625; National Bank of Genesee [sic] v. Whitney, 103 U. S. 99, the prohibition was partly withdrawn and much of that field was opened to such banks by the Acts of December 22, 1913, c. 6, § 24, 38 Stat. 273, and September 7, 1916, c. 461, 39 Stat. 754." 269 U. S. at 353, 46 Sup. Ct. at 140.

gage investments are "other moneyed capital," there is, in violation of Section 5219, a clear discrimination against national bank shares in favor of "other moneyed capital." There seems to be no escape from this conclusion.

It is clear, then, that the exemption of mortgages rendered the tax on national bank shares contrary to the provisions of Section 5219. Would it have been possible to remedy this defect by providing that the value of mortgages held by national banks should be deducted from the taxable value of the shares thereof? The argument stated in the last paragraph leaves this question open, since that argument goes no further than to say that regardless of whether or not the allowance of this exemption to the banks would remedy the defect, failure to make such allowance to the banks was fatal. It is by no means clear, however, that the objection to the exemption of mortgages could have been thus remedied, for even if banks were allowed this exemption it would still be true: (a) that bank shares were taxed; (b) that mortgages are "other moneyed capital in the hands of individual citizens." Section 5219 requires that bank shares shall be taxed no higher than other moneyed capital, and at least the letter of this prohibition would be violated. It might be argued, however, that the spirit of the statute was not infringed, for it is well established that the purpose of the statute was to prevent discrimination against national banks in favor of competing capital and it may be that no such discrimination would exist if mortgages were exempted both to banks and individuals. It may be, therefore, that the difficulty of exempting from taxation credits secured by mortgages could have been remedied by deducting the value of such obligations held by the banks from the taxable value of their shares.72

(2) The Taxation of Intangibles in California.72

Acting in reliance upon the supposed authorization granted the states by the congressional amendment of 1923 to Section 5219, to

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71 This is not unquestionable, however, for it might still be held that individually held mortgages competed with other varieties of investments by banks which were not exempted. But the language of the court in the Anderson case, quoted supra n. 69, which seems to imply that mortgages became "other moneyed capital" only when national banks were given power to deal in them seems to call for the conclusion that the court believes that mortgage investments do not compete with other types of bank business.

72 The following is a summary of: (1) the types of intangibles which were exempt from taxation; (2) the types of intangibles taxable under the laws in effect in this state prior to the 1929 enactments of the legislature. Inasmuch as the purpose of this part of the present article is to determine whether or not the share tax on national banks was invalid because of the methods of taxing intangibles the
accord preferential treatment to bonds, notes, and other evidences of indebtedness in the hands of individual citizens without invalidating their taxes on national bank shares, California, in 1924, added Section

new intangible tax law (Cal. Stat. 1929, c. 14) will not be considered here, but the discussion will be confined to the law as it existed at the time the share tax on national banks was in effect.

I. Intangibles exempt from taxation:

1. Shares of Stock in Corporations: “Shares of stock in corporations possess no intrinsic value over and above the actual value of the property of the corporation which they stand for and represent. The assessment and taxation of such shares, and also of all the corporate property, would be double taxation. All property belonging to corporations shall be assessed and taxed, in the manner provided by law; but no assessment shall be made of shares of stock in any corporation except as prescribed in the constitution of this state and the laws enacted pursuant to such provisions of the constitution.” Cal. Pol. Code § 3608.

Section 3627 of the Political Code, as amended in 1927, provided: “All taxable property must be assessed at its full cash value. In determining the full cash value of shares of capital stock there shall be deducted the value of the property in California of the corporation by which such shares of capital stock are issued. . . .”

Dealing in stocks of other corporations, while not expressly prohibited national banks, is impliedly prohibited by a failure to grant the power, and a purchase thereof by such banks is ultra vires. The prohibition, however, does not prevent a bank from taking stock in payment of a preexisting indebtedness when it is necessary to do so to save itself from loss. California Savings Bank v. Kennedy (1897) 167 U. S. 362, 17 Sup. Ct. 831. It is therefore apparent that the exemption accorded by the above quoted statute has no effect upon the validity of the bank tax. It was pointed out in the first installment of this article, in commenting upon the case of First National Bank of Guthrie Center v. Anderson (1925) 269 U. S. 341, 46 Sup. Ct. 135, that the extension of the power of national banks apparently effects a corresponding extension of the field of business activities that compete with the business of national banks. It is important to point out in this connection that the National Bank Act, as amended in 1927, allowing national banks to deal in “investment securities” gives the Comptroller of the Currency the power to define this term so that the banks may deal in these types of securities. 44 Stat. 1227 (1927), 12 U. S. C. § 57 (1928). The limitations upon the exercise of this power by the comptroller are not defined. A broad discretion to extend the application of the term “investment securities” would apparently widen the scope of the words “other moneyed capital,” and this in turn would involve a corresponding increase in the number of possibilities of holding invalid state taxes on national bank shares.

2. Mortgages on California real property. See supra n. 68.

3. Bonds:

a. Bonds “issued by the State of California, or by any county, city and county, municipal corporation, or district (including school, reclamation, and irrigation districts) within this state.” Cal. Const. Art. XIII, § 134.

For a discussion of the taxation of shares of stock, although part of the book value thereof is contributed by tax exempt bonds held by the corporation, see 17 California L. Rev. 83, 114-118; and for a consideration of the problem of corporate franchise taxation measured by total net income without deducting therefrom income from tax exempt securities, see 17 California L. Rev. 232 et seq.


12½ to Article XIII of its Constitution authorizing the legislature to tax non-exempt intangibles at a rate, or rates, and at a valuation different from other taxable property. In carrying out this constitutional grant of power, the legislature in 1925 modified Section 3627 of the Political Code and added thereto Section 3627a, providing that "notes, debentures, shares of capital stock, bonds, solvent credits, and mortgages or deeds of trust which are taxable to the owner thereof under provisions of the laws of this State other than this Section and Section 3627" should be assessed at seven per cent of their full cash value. Under the decision of the United States Supreme Court in First National Bank of Guthrie Center v. Anderson (which held the 1923 Amendment to Section 5219 merely declaratory of the existing law) the 1925 modification in the California law even if it had been valid under the

II. Taxable intangibles:
1. Credits, i.e. debts owing taxpayers: See Cal. Pol. Code §§ 3617(6), 3627a, 3628, 3628b, 3629, 3650, 3693.
   a. Accounts receivable;
   b. Notes not secured by real estate;
   c. Commercial bank accounts;
   d. Bonds unsecured by real estate in California;
   e. Chattel mortgages;
   f. Real mortgages not secured in California;
   g. Deeds of trust not secured in California;
   h. Conditional sales contracts, see Whiting Finance Co. v. Hopkins (1926) 199 Cal. 428, 249 Pac. 853.
   i. Debentures.
2. Franchises:
   Cal. Const. Art. XIII, § 14(d): "All franchises, other than those expressly provided for in this section, shall be assessed at their actual cash value, in the manner to be provided by law, and shall be taxed at the rate of one per centum (changed pursuant to Subdivision F of this section) each year, and the taxes collected thereon shall be exclusively for the benefit of the state." See also Cal. Pol. Code §§ 3664, 3667a, 3667b, 3667c, 3667(12).
   Supra n. 52.

This amendment was necessary to authorize special treatment of intangibles because of Section 1 of Article XIII of the California Constitution, which reads in part as follows: "All property in the state except as otherwise in this constitution provided, not exempt under the laws of the United States, shall be taxed in proportion to its value to be ascertained as provided by law or as hereinafter provided." See Revenue Laws of California, annotated (1928) p. 19 et seq. for the citations and holdings of the court decisions interpreting this section. For the latest constitutional and statutory provisions relating to the taxation of intangibles see Cal. Const. Art. XIII, § 16(4), adopted November, 1928, and Cal. Stat. 1929, c. 14, passed in pursuance thereof.

Section 3617(5) of the Political Code reads as follows: "The terms 'value' and 'full cash value' mean the amount at which the property would be taken in payment of a just debt from a solvent debtor."

Supra n. 52.
State Constitution would undoubtedly have had the effect of making the share tax on national banks a tax at a higher rate than that levied against other moneyed capital contrary to the conditions of Section 5219. In an effort to remove the discrimination, the legislature in 1927 completely changed the provisions of Sections 3627 and 3627a and imposed a rate of 1.45% (the bank share rate) upon the full cash value of all taxable intangibles. However, in the case of *Arnold v. Hopkins*, both the 1925 and 1927 laws were declared unconstitutional by the State Supreme Court for non-compliance with the terms of the State Constitutional Amendment of 1924.

With these laws rendered inoperative, the forms of intangible property covered by them would be governed by the tax provisions which the 1925 and 1927 statutes aimed to supersede. Consequently, these particular intangibles were still taxable at full cash value as determined by the county assessors and at rates fixed by the local taxing authorities.

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80 (1928) — Cal. ——, 265 Pac. 223. The case involved an application of a taxpayer for a writ of mandate to prohibit the assessor of Los Angeles County, who considered the 1927 law invalid, from proceeding under the 1925 law. The court read the provisions of the amendment (Section 12 1/2 of Article XIII) together as follows: "First, 'the Legislature . . . shall have the power to provide for the assessment, levy, and collection of taxes upon all notes,' etc.; second, 'taxes imposed by any act of the Legislature adopted pursuant to the powers hereby conferred shall be in lieu of all other property taxes, state, county' . . . ; third, 'the Legislature shall provide for an equitable distribution of such taxes to the county, municipality or district in which such property is taxed'; fourth, 'the rate or rates of taxation of such securities and penalties shall not exceed those assessed or imposed upon other property in the state not exempt from taxation'; fifth, 'when the same shall have been fixed by the Legislature they shall not be altered except by vote of two-thirds of all the members elected to each of the two houses voting in favor thereof.'" The court then went on to say, "When these provisions of this amendment are thus read together, they would seem to compel the conclusion that the duty imposed upon the Legislature thereby was that of providing a law covering the entire field of taxation of the forms of property designated therein, and embracing in its express provisions [1] the valuation, [2] the rate or rates of taxation, and [3] the equitable distribution of the taxes to be derived from the burden thus to be laid upon such properties." 265 Pac. at 226. The court then held the 1925 law invalid because of the failure of the legislature to fulfill its duty under (2), and held the 1927 law invalid for failure to comply with requirement (3). See Note (1928) 16 CALIFORNIA L. REV. 301 for a discussion of the reasoning of the court in this case.

81 Inasmuch as Section 12 1/2 of Article XIII, under authority of which the 1925 and 1927 laws were passed, is not self-executing, the provisions of § 1 of Article XIII of the Constitution that all taxable property shall be taxed in proportion to its value unless otherwise provided in the Constitution, and the provisions of Section 3627 of the Political Code that all taxable property must be assessed at its full cash value would, therefore, seem applicable.

82 CAL. POL. CODE §§ 3617, 3627, 3628, 3629, 3650.
ties. Thus it would seem that, unless the local authorities imposed discriminatory rates, the owners of national bank shares would have no complaint insofar as the effects of the invalidity of the 1925 and 1927 statutes are concerned. However, as to the claimed discrimination resulting from allowance of the deduction of debts from credits as to other moneyed capital and not to national banks, a different problem is raised.

(3) Deduction of Debts from Credits.

The legislature is given power to provide for the deduction of debts from credits by the provision in Section 1 of Article XIII of the State Constitution, which reads: "The legislature may provide, except in the case of credits secured by mortgage or trust deeds, for a deduction from credits of debts due to bona fide residents of the state." In pursuance of this constitutional section, the deduction of debts from solvent credits is provided for in Section 3628 of the Political Code wherein the prescribed method for tax assessments is set forth. However, such deductions are not allowed as to bank shares. This is explained by the fact that bank shares are dealt with in other sections of the code, and to these sections the provisions as to deductions are not considered as applying.


Because of the omission to mention Section 3627a in the provisions of the Political Code for the reassessment of property (Cal. Pol. Code § 3681a), an interesting question arises whether those provisions should have applied in this situation. Section 3681a provides in part as follows: "Every assessment of property made under the provisions of section three thousand six hundred twenty seven and three thousand six hundred twenty eight of the Political Code which is or may hereafter be adjudged to be invalid by reason of indefinite description, any illegality, invalidity, or irregularity declared or existing in the assessment of such property, or in any of the acts thereafter performed . . . shall be remade and the property reassessed and equalized for each year for which such assessment is invalid as aforesaid and for the year for which the assessment of such property was invalid as aforesaid and such reassessment and equalization shall be made by the same officers and boards at the same time or times as are prescribed by law for the assessment and equalization of property of the same classes or kinds as the property which is hereby required to be reassessed." It might be argued that the enumeration of these two code sections would require an exclusion of Section 3627a so that the reassessment provisions would be inapplicable thereto. However, inasmuch as Section 3627a is unconstitutional and, therefore, as inoperative as if it had never been passed (Wheeler v. Herbert (1907) 152 Cal. 224, 92 Pac. 353), the assessments should have been made under Sections 3627 and 3628 in the first place and for that reason it seems reasonable to say that the previous assessment under the void statute was in legal effect no assessment at all, so that a new assessment would be simply a delayed original assessment. See the following cases for a discussion of the validity of reassessment statutes: Weyerhaeuser v. Minnesota (1900) 176 U. S. 550, 20 Sup. Ct. 485; Hunt v. Perry (1896) 165 Mass. 287, 43 N. E. 103; Auditor General v. Rutter (1910) 161 Mich. 470, 126 N. W. 650; Douglas v. Board of Supervisors (1902) 68 App. Div. 296, 74 N. Y. Supp. 144.
The fact that owners of credits receive this right of deduction and
owners of national bank shares do not, amounts, it is claimed, to dis-
crimination against the bank shares in violation of Section 5219. This
form of alleged discrimination was early considered by the courts. In
People v. Weaver, the United States Supreme Court held that a
New York statute allowing debts to be set off against all forms of per-
sonal property, except national and state bank shares, was in violation
of Section 5219. However, it should be remembered, as pointed out in
the first installment of this article, that a shareholder cannot attack
the statute unless he has debts to deduct, and furthermore an actual
discrimination must be proved. Such proof is exceedingly difficult where
two different systems of taxing are involved, as in the case where na-
tional banks are taxed in a manner different from that employed in
the taxing of "other moneied capital."

In Amoskeag Savings Bank v. Purdy, the Supreme Court upheld
a New York statute which taxed national bank shares without allowing
deductions while other moneied capital was allowed debt deduction.
In this case, however, national bank shares were assessed on their book
value, which did not include good will and other elements affecting
market value, while other moneied capital was taxed upon full value
which, apparently, included the elements not included as to national
bank shares. The Court pointed out the difference in method of taxing
bank shares as a basis for distinguishing the statute in question from
that involved in the Weaver case. In view of the different basis of taxa-
tion, it was held that allowing deduction of debts from the value of
other property was unlikely to discriminate against national bank shares
but "as against the owner of bank shares, who, by alleging discrimina-
tion, assumes the burden of proving it, and, who fails to show that
the method of valuation is unfavorable to him, it may be assumed to
be advantageous." Section 5219 "clearly prohibits discrimination
against shareholders in national banks and in favor of the shareholders
of competing institutions, but it does not require that the scheme of
taxation shall be so arranged that the burden shall fall upon each and
every shareholder alike, without distinction arising from circumstances
personal to the individual."

It may be concluded, therefore, that, as far as the allowance of de-
ductions of debts from credits in California is concerned, it is doubtful,
in view of the striking parallel between the California situation and
that before the court in the Amoskeag case, if national bank share-

84 (1879) 100 U. S. 539.
85 17 CALIFORNIA L. REV. 83, 112.
86 (1913) 231 U. S. 373, 393, 34 Sup. Ct. 114, 122.
holders could prove the discrimination necessary to render the California bank share tax invalid. In both situations the tax upon national bank shares is fixed upon a basis different from that employed in the taxing of "other moneyed capital." In California this follows from the fact that national bank shares are taxed upon the basis of "book value" which does not take into account such elements of value as "good will" while the tax upon "other moneyed capital" is based upon "actual value." A further difference is found in the fact that under the share tax national banks enjoyed an exemption from the payment of personal property taxes and all other taxes and licenses, state, county and municipal while "other moneyed capital" was not granted such exemption.

Aside from the Amoskeag case, the burden of establishing the claimed discrimination is upon the taxpayer, and with such different systems of taxation, it is virtually impossible to reduce two different types of taxes to a unit standard so that comparative values may be presented and the discrimination shown.

B. DOES THE INVALIDITY OF THE SHARE TAX ON NATIONAL BANKS INVALIDATE THE SHARE TAX ON STATE BANKS?

The claim may be made that if the tax on national bank shares under Political Code Section 3664c is invalid, the tax on state bank shares is also invalid for the following reasons:

1. The tax on national bank shares and the tax on state bank shares were enacted by the legislature as inseparable provisions, so that the failure of one must necessarily mean the failure of the other;
2. To tax the state bank shares while no tax or a lower tax is laid upon national bank shares is to grant more favorable terms to a foreign than to a domestic corporation contrary to the provisions of Article XII, Section 15 of the State Constitution.
3. To tax state bank shares while no tax or a lower tax is levied against national bank shares is to deny the state bank shareholders equal protection of the law contrary to the Fourteenth Amendment to the Constitution of the United States.

In view of this claim it is necessary to inquire into the arguments for and against each of these three contentions.

(i) Partial Unconstitutionality and Inseparability.

It is clearly established that a legislative enactment may be declared invalid in part, while effect is given to the remaining valid provisions. However, to be effective these remaining provisions must be in fact separable, and must have been intended by the legislature to be
effective even though the other provisions were held invalid.¹⁷⁷ Thus, in these cases the problem is one of construction — first of determining whether there is separability in fact, by construing the parts, and secondly, of determining the intention of the legislature as to whether the remaining several provisions should be given effect standing alone.

In the bank tax situation it would seem that the provisions in question are in fact separable. As between the tax on the national bank shares and the tax on state bank shares there seems to be no fundamental interdependence. In so far as giving effect to the provision is concerned, the state bank shares can be taxed without taxing the shares of national banks. Hence, if the provisions are to be held inseparable it must be upon the basis of legislative or constitutional intent.

It may be that in the absence of other legislative declaration the presumption is that the legislature intends an act to be effective as an entirety.¹⁸ But this presumption is rebuttable. Since the taxation of national bank shares is only by the authorization of, and is subject to, the technical and far-reaching provision of Section 5219, a state's tax upon the shares of national banks runs the constant danger of being held invalid whenever other features of the state's tax system conflict with the restrictions of the federal statute. Therefore, in view of the fact that the tax on national bank shares is more or less always in a precarious position, for reasons which do not affect other taxes, it is not unreasonable to hold that the legislature intended that the tax on state bank shares should be given effect even if the tax on national bank shares were invalid. For the same reason it may be held that separability was intended by the constitutional provision, i.e. Article XIII, Section 14c, in pursuance of which Section 3664c of the Political Code was enacted.

Although the legislative intent of separability is reasonably justified from the circumstances alone, it finds more definite expression in the so-called saving clause found in Section 6 of the Act of March 5, 1921, amending Section 3664c and other sections of the Political Code.¹⁸⁸


¹⁸⁸ Cal. Stat. 1921, p. 23. It should be noted that the saving clause as applied to Section 3664c was by way of amendment. Therefore, an inquiry into the circumstances of the amendment is necessary in view of the holding that the intent of the legislature must be determined from the terms of the statute at the time of its enactment and not by any amendments subsequently adopted. Town of Martínez
Courts have differed in their opinions as to the effect of such clauses. While it is evident that such a clause cannot save a provision that cannot be given effect standing alone, there may be a difference of opinion as to how conclusive a saving clause is as to legislative intent. It may be considered as a mere aid to the court's determination of the legislative intent, or it may be considered as imposing upon the court a duty to hold separable as far as possible. The California courts in considering saving clauses seem to hold them to be conclusive evidence of intention of separability.

In view of the above it would seem that in so far as Section 3664c is concerned the tax on state bank shares is separable, and that this section is not in conflict with Article XIII, Section 14c, which it is reasonable to hold also intended separability.

(2) Article XII. Section 15 of the California Constitution.

Would the tax on state bank shares under Section 3664c of the Political Code violate Article XII, Section 15 of the California Constitution if the tax on national bank shares were invalid? This section provides:

"No corporation organized outside the limits of this state shall be allowed to transact business within this state on more favorable conditions than are prescribed by law to similar corporations organized under the laws of this state."

If the tax on national bank shares under Section 3664c is invalid and state bank shares are taxed under that section, national bank shares would be receiving more favorable treatment than that accorded state bank shares. Therefore, upon the assumption that national banks are "corporations organized outside the limits of this state" it may be argued that under Section 3664c they are "allowed to transact business within this state on more favorable conditions than similar domestic

v. Johnson (1927) 201 Cal. 397, 404, 257 Pac. 853, 856. However, in the case cited the provisions of the original act were not reenacted, the amending material being enacted as additional matter. Since, in the case of Section 3664, the amendment incorporating the saving clause was a reenactment of the entire section, the intention of the legislature so expressed controls, regardless of the legislative intent at the time of the original enactment.

90Bacon Service Corporation v. Huss (1926) 199 Cal. 21, 34, 248 Pac. 235, 240: "But we cannot view the language of the statute as an inexorable command, for it is a judicial question in each case whether the good may stand notwithstanding the bad." See also Dorchy v. Kansas (1924) 264 U. S. 286, 44 Sup. Ct. 323; Williams v. Standard Oil Co. of Louisiana (1929) 278 U. S. 235, 49 Sup. Ct. 115.

corporations, i.e. state banks, for while the tax is not upon the bank as such the imposition of a tax upon its shareholders is obviously one of the "conditions" upon which it transacts business within the state. The merit of this claim depends upon the meaning given to the constitutional provision in respect to the particular conditions that were intended to be included under the language, "more favorable conditions" of the constitutional provision.

It is evident that if the phrase "more favorable conditions" is construed in an absolute sense, any inequality whatever operating in favor of foreign corporations is prohibited. Under this construction, the effect would be that all the limitations which by reason of the federal system are imposed upon the state by an outside force in its dealings with foreign corporations would be operative against the state in dealing with its own corporations. It is unreasonable to believe that the enactors of the constitutional provision intended an interpretation that would result in such an extensive limitation upon the state in the control of its internal affairs. It is more reasonable to hold that Article XII, Section 15, is not applicable when "in the nature of things, it is impossible to provide exactly the same system of laws for foreign as for domestic corporations." That this provision was not intended to prohibit all inequality of whatsoever nature is apparently the view taken by the California courts.

To apply this reasoning to the problem before us, it seems if Congress, as it unquestionably could, should enact that national banks should be totally exempt from state taxation, Article XII, Section 15 of the Constitution, literally interpreted, would compel the conclusion that the state could not levy any taxes whatsoever on state banks, for then national banks would be doing business in the state "on more favorable conditions than are prescribed by law to similar corporations organized under the laws of this state." However, for the reasons given above, it seems highly improbable that Article XII, Section 15 would be so construed. The court would be faced with two alternatives: it would either have to hold that the constitutional prohibition against favoring foreign corporations was not intended to operate in such a situation, or hold that all the property and business of all the banks in the state were exempt from taxation permanently or temporarily at the will of Congress. It would be unreasonable to ascribe intent to effect such a result. The present case differs from the one supposed only because the alternative to holding the statute valid is not quite so obviously undesirable. It

93 Miles v. Woodward (1896) 115 Cal. 308, 311, 46 Pac. 1076.
is nevertheless very seriously so. Here the state, by submitting to the conditions imposed by Congress, may tax national bank shares. It can not tax those shares except in compliance with the prescribed conditions. As those conditions stand, this tax can only be levied by adjusting the state's entire system of taxation of intangibles to meet the conditions prescribed. It seems reasonably clear that if the state can, but does not, tax the shares of foreign corporations under its customary tax system while the shares of domestic corporations are so taxed, such treatment should amount to allowing the "more favorable conditions" prohibited by the Constitution. However, it is not clear that if the state can only tax foreign corporations at the cost of changing its customary tax system, and at the risk of having its whole tax system upset for non-compliance with technical conditions of uncertain meaning imposed by federal authority, e.g. Section 5219, and does not do so, but taxes the shares of its domestic corporations in a manner prohibited as against the foreign corporations, such treatment should be within the intended constitutional prohibition. In fact, it is unreasonable that such an interpretation was intended, for upon the basis of the arguments advanced above such interpretation would compel the state to accept outside conditions imposed, not merely upon its treatment of its domestic corporations, but upon the lines of its entire system of taxation. Therefore the more reasonable view seems to be that the taxation of state bank shares under Section 3664c, while national bank shares are untaxed or more favorably taxed, is not in violation of the prohibited "more favorable conditions" clause of Article XII, Section 15 of the Constitution.

A further argument may be based upon the language of Article XII, Section 15 itself. This section provides that:

"No corporation organized outside the limits of this state shall be allowed to transact business within this state on more favorable conditions than are prescribed by law to similar corporations organized under the laws of this state." (Italics added.)

This section may be interpreted in two ways: (1) It may be construed to mean simply what it says. Now it will be observed that the thing prohibited is a certain variety of affirmative treatment of foreign corporations. The section does not say that domestic corporations shall or shall not be allowed to do business thus and so, but deals only with the treatment of foreign corporations. So far as anything this provision says, domestic corporations may be treated in whatever way the legislature pleases. The section simply provides that however they are
treated foreign corporations shall be treated no better. This interpretation seems to be followed in California and in almost all jurisdictions with like constitutional provisions. Thus, the constitutional provision is considered as self-executing. That is, it is interpreted as automatically extending to domestic corporations all statutes conferring more favorable terms on foreign corporations and extending to foreign corporations all burdens imposed on domestic corporations. London and S. F. Bank v. Block (C. C. N. D. Cal. 1902) 117 Fed. 900; Bank of British North America v. Madison (1893) 99 Cal. 125, 33 Pac. 762; Anglo-Californian Bank Ltd. v. Field (1905) 146 Cal. 644, 80 Pac. 1080; General Conference of Free Baptists v. Berkey (1909) 156 Cal. 466, 105 Pac. 411; Thomas v. Wentworth Hotel Co. (1910) 158 Cal. 275, 110 Pac. 942; Franscioni v. Soledad Land and Water Co. (1915) 170 Cal. 221, 149 Pac. 161; Provident Gold Mining Co. v. Haynes (1916) 173 Cal. 44, 159 Pac. 155; Commonwealth Acceptance Corporation v. Jordan (1926) 198 Cal. 618, 246 Pac. 796. If the section is considered as self-executing it may only amount to a constitutional provision as to the scope of corporation legislation, so that by virtue of the section any legislation addressed to "domestic corporations" or "foreign corporations" which would result in "more favorable conditions" will be construed as reading, "all corporations." If this view, as to the purpose of the section, be accepted, there can be no cases, so far as state law is concerned, of unequal legislative treatment in favor of foreign corporations; for every such statute having such an effect will apply to all corporations, both domestic and foreign. Consequently, it may be claimed that there is no violation of the section if, in the equal application of a statute, a superior power makes equal effectiveness impossible.

Thus, under this view, if the state bank shares had been taxed with no mention made of national bank shares, the effect of the provision would not have been to declare the tax invalid, but instead to make it applicable to national banks as well as to state banks. The provisions of the section would have been satisfied by such application; and while by reason of Section 5219, if the tax could not have been given effect against the national bank shares, this fact would not have invalidated the tax as to the state bank shares. In carrying out this view, it would seem that no different result should obtain as to Section 3664c, and that where the state has taxed both state and national bank shares, Article XII, Section 15, is satisfied, although effect cannot be given to the tax on national bank shares by reason of Section 5219. While there does not seem to be any case involving the constitutional section so as to bring out the arguments advanced above, it must be noted that in California no statute has ever been declared invalid under Article XII, Section 15.

While, in view of the above, it would seem that without other argument, it is more reasonable to hold that the tax on state bank shares under Section 3664c does not violate Article XII, Section 15, there remains another somewhat technical argument against the opposite claim. Even if it be assumed that Article XII, Section 15, intends to prohibit any inequality whatever between domestic and foreign corporations this absolute prohibition must be subject to the exceptions of later constitutional provisions. Article XIII, Section 14c, provides for the tax against both national and state bank shares and Section 3664c of the Political Code is the statutory enactment of this tax. Therefore, if under 3664c the state bank shares are taxable while the national bank shares are untaxed, it is because the two tax provisions in that code section are held separable, and to be held separable it must be that the constitutional provision in Article XIII, Section 14c, also intended separability. Hence, if the tax against the state bank shares under 3664c stands, it is by virtue of the fact that Article XIII, Section 14c, intended that the state bank
foreign corporations (which are determined specifically by reference to those imposed or conferred upon domestic corporations) it obviously implies that the burdens and privileges of which it speaks are of a sort which the legislature has power to confer or impose on foreign corporations, since it would be idle to prohibit conduct beyond the power of the authority addressed. The objection to the state bank share tax is that a similar tax is not imposed upon national banks, with the result that the latter are doing business in the state on more favorable conditions than the former. But this is not because the statute has "allowed" this advantage to national banks, since it was an advantage which the statute could not deny. The statute has offended, if at all, not by allowing an advantage to a national bank which it denied to a state bank, but by imposing a burden on a state bank which it could not impose on a national bank. With this introduction, the second possible construction of the statute may be stated in two parts as follows:

(a) The legislature shall with respect to foreign corporations confer no privileges which it can withhold, nor withhold any burdens which it can impose which are conferred or imposed on domestic corporations.

(b) The legislature shall not impose upon domestic corporations burdens which it is without power to impose on similar foreign corporations. Part (b) is not expressly stated in the constitutional provision either in form or substance. It rests upon the supposition that the statute prohibits not only the allowing of favors to foreign corporations but prohibits any legislation which has the same result as the allowing of favors to foreign corporations. This is no doubt a perfectly sound interpretation of the general intent of the provision, but it is so not because the statute says so, but because it is fair to suppose that was its general purpose. Obviously, the court is not compelled in effectuating the assumed ultimate purpose of the provision to treat the provision as if that purpose were stated expressly in so many unequivocal and unqualified words which left no room for construction.

(3) Equal Protection of the Laws.

Assuming the tax on national bank shares under Political Code Section 3664c to be invalid in whole or in part, it may be contended that the levying of the full tax upon the share of state banks under shares should be taxed even though the national bank shares were untaxed, that is, Article XIII, Section 14c, provided an exception to the assumed absolute prohibition of Article XII, Section 15. It is evident in conclusion that Section 3664c, even if it taxed state bank shares without taxing national bank shares it would not be invalid under Article XII, Section 15, regardless of the view taken of the intended meaning of the section, unless the tax is already invalid under Article XIII, Section 14c, by reason of inseparability.
that section is invalid by reason of the Fourteenth Amendment to the Constitution of the United States as denying the holders of state bank shares the equal protection of the laws. In construing this constitutional provision the Supreme Court has held that mere inequality of treatment does not amount to a denial of equal protection of the laws in that the provision "does not prevent a state from adjusting its legislation to differences in situation or forbid classification in that connection, although it does require that the classification be not arbitrary."

Therefore, while under this provision there must be a discrimination to give rise to the claim of denial of equal protection of the laws the merit of the contention rests not upon the fact of discrimination alone but upon the reasonableness or unreasonableness of the classification upon which the discrimination is based. It is evident that if the state bank shares are taxed while those of national banks are untaxed, or taxed at a lower rate, there is an inequality of treatment. However, this will only be invalid as a denial of equal protection of the laws if the classification of national as against state banks for the purpose of this particular tax be judged unreasonable. In respect to classifications the Supreme Court has held that, "any classification is permissible which has a reasonable relation to some permitted end of governmental action."

In the instant situation the state legislature imposed the same tax on national and state bank shares. If, as is assumed, the tax on national bank shares is invalid in whole or in part, the tax on state bank shares takes full effect only upon the basis of holding that the legislature intended separability, that is, that state bank shares should be taxed even though national bank shares were taxed less or not at all. This is to hold that the legislature intended that in the event that the attempt

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86 Bells Gap Railroad Co. v. Pennsylvania (1890) 134 U. S. 232, 237, 10 Sup. Ct. 533, 535: "The provision in the fourteenth amendment that no state shall deny to any person within its jurisdiction the equal protection of the laws, was not intended to prevent a state from adjusting its system of taxation in all proper and reasonable ways. It may, if it chooses, exempt certain classes of property from any taxation at all. . . . We think we are safe in saying that the fourteenth amendment was not intended to compel the state to adopt an iron rule of equal taxation." See also Arkansas Natural Gas Co. v. Arkansas R. R. Comm. (1923) 261 U. S. 379, 384, 43 Sup. Ct. 387.


to tax national bank shares was invalid if bank shares were to be classified as national and state for different treatment. Under the equal protection of the laws clause this classification will be valid only if not unreasonable, that is, if it has a "reasonable relation to some permitted end of governmental action."

It may be that if the state in all respects had the same power to tax national bank shares as it had to tax state bank shares, a classification for different tax treatment would be related to nothing other than a purpose to discriminate and might be a denial of equal protection. However, in the situation at hand, the state has no such equal power over national and state bank shares. Therefore, the inability to treat alike furnishes the basis for classification which should be valid if reasonably related to an approved governmental end. As was brought out in the discussion under the preceding heading, the state can tax national bank shares only by complying with conditions affecting its entire tax system. It is submitted that in view of the widespread effect of complying with these conditions, it is a reasonable tax policy of the state to refuse to submit to conditions imposing such a burden upon its system of taxation. In other words, the state could refuse to

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90 It is suggested that under the reasoning of Quong Wing v. Kirkendall (1912) 223 U. S. 59, 32 Sup. Ct. 192, even if the state intended to discourage state banks a discriminatory tax to that end would be valid. This case involved a Montana statute imposing a fee upon all persons engaged in the laundry business other than the steam laundry business, providing that it should not apply to women so engaged when not more than two women were employed. In the course of the opinion, delivered per Mr. Justice Holmes, it is said: "A state does not deny the equal protection of the laws merely by adjusting its revenue laws and taxing system in such a way as to favor certain industries or forms of industry ... It may make discriminations, if founded on distinctions that we cannot pronounce unreasonable and purely arbitrary, as was illustrated in American Sugar Refining Co. v. Louisiana, 179 U. S. 89, 92, 95; Williams v. Fears, 179 U. S. 270, 276; W. W. Car- gill Co. v. Minnesota, 180 U. S. 452, 469. ... If the State sees fit to encourage steam laundries and discourage hand laundries that is its own affair." 223 U. S. at 62, 32 Sup. Ct. at 193.


tax national bank shares at all because of its unwillingness to accept the burdensome conditions of Section 5219, and could classify national and state bank shares to that end. Surely, if the state could refuse to tax national bank shares at all, in pursuance of its tax policy, without rendering invalid the state bank share tax, it could as well provide that if the concessions made by it were inadequate to meet the conditions of Section 5219, it would make no further concessions and state bank shares should be taxed regardless of the validity or invalidity of the tax on national bank shares. ¹⁰²

C. THE PRESENT SYSTEM

(1) The Constitutional Amendment of 1928.

An exaggerated fear that the state might lose $22,050,000 in revenue if the share tax on banks was not changed;¹⁰³ unwillingness to recommend a change in the law regarding mortgage exemption; and a desire to have preferential treatment provided for intangibles, induced the California Tax Commission to recommend to the Governor the calling of a special session of the legislature for the purpose of proposing an

¹⁰² These arguments were not considered in State Bank of Omaha v. Endres (1923) 109 Neb. 753, 757, 192 N. W. 322, where the Supreme Court of Nebraska held that the state constitutional provision that required that taxes be uniform as to class, prohibited tax discrimination as between national and state bank shares so that the invalidity of the national bank share tax invalidated the state bank tax.

¹⁰³ See the Final Report of the California Tax Commission submitted to the Governor, March 5, 1929, p. 252, 253. For a brief review of the facts regarding the litigation pertaining to the 1926 and 1927 bank share taxes, see the Report of the State Board of Equalization for 1927-1928, in which it is pointed out that the entire amount involved in the bank tax suits for the 1926 and 1927 levies is $2,253,245.51. Political Code Section 3669a would seem to bar any other actions than those already instituted for the recovery of taxes levied for the years mentioned. For these same years, the Tax Commission fixed the possible loss to the state at $7,685,000. Comparable over-estimation appears to have been made with reference to the 1928 revenues deemed in jeopardy. The remainder of the $22,050,000 is composed of taxes projected for 1929 and 1930 on the share tax method and estimated at $9,680,000. To avert this loss (involving the assumption that no taxes whatever could have been exacted from banks during 1929 and 1930, which is extremely unlikely) the substituted taxes based on net income must yield approximately $4,840,000 annually during the next two years. However, this yield cannot be anticipated because in all probability, interest from tax exempt sources must be excluded from the tax base as a result of the decision in Macallen Co. v. Massachusetts (1929) — U. S. —, 49 Sup. Ct. 432. In fact, the commission's advisor and director of research, Professor Robert Murray Haig of Columbia University, has observed, "the exclusion of tax exempt interest from the base was of importance only in the case of the banks, who were the only large holders of government bonds. For them, it meant practically complete exemption. Several of the largest and most prosperous banks in the state . . . would pay no franchise tax whatsoever. . . . Had the proposal (to exclude tax exempt interest) prevailed, the new tax would have been completely wrecked." (XIV, Bulletin of the National Tax Association, 231, 236.) See also infra n. 104.
amendment to the State Constitution permitting the taxation of banks according to the fourth alternative of Section 5219, i.e., according to or measured by their total net income. A special session of the legislature, convened September 4, 1928, voted unanimously to submit the commission's amendment to the people for approval in November, 1928. The amendment, which is quoted in the margin, was adopted by a large majority at the general election November 6, 1928.

104 In view of the dangers and pitfalls in the use of the "measured by theory" to reach income from exempt securities, discussed in the course of this article (17 California L. Rev. 232 et seq. and supra p. 456-462), and in view of the fact that it was by no means clear that the California bank share taxes were invalid (see supra p. 471-489), it would seem that a more uncertain and precarious system from the standpoint of the possible loss of revenue involved, was recommended for taxing banks than the one already existing.

105 "Sec. 16. Notwithstanding any other provision of the constitution:

1. (a) Banks, including national banking associations, located within the limits of this state, shall annually pay to the state a tax according to or measured by their net income, which shall be in lieu of all other taxes and licenses, state, county and municipal, upon such banks, or the shares thereof, except taxes upon their real property. The amount of the tax shall be equivalent to four per cent of their net income.

(b) The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, in lieu of such tax, may provide by law for any other form of taxation now or hereafter permitted by the congress of the United States respecting national banking associations; provided, that such form of taxation shall apply to all banks located within the limits of this state.

(c) If it be finally determined that any tax levied upon or respecting any bank, national banking association, or the shares thereof, is invalid, said bank or association, or the shares thereof, shall be reassessed in conformity with any method provided by law. No claim against the state for refund or rebate of taxes paid shall be allowed without first deducting therefrom the amount of any such unpaid reassessment.

2. (a) All financial, mercantile, manufacturing and business corporations doing business within the limits of this state, subject to be taxed pursuant to subdivision (d) of section 14 of this article, in lieu of the tax thereby provided for, shall annually pay to the state for the privilege of exercising their corporate franchises within this state a tax according to or measured by their net income. The amount of such state tax shall be equivalent to four per cent of their net income. Such tax shall be subject to offset, in a manner to be prescribed by law, in the amount of personal property taxes paid by such corporations to the state or political subdivisions thereof, but the offset shall not exceed ninety per cent of such state tax. In any event, each such corporation shall pay an annual minimum tax to the state, not subject to offset, of twenty-five dollars.

(b) The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, may provide by law for the taxation by any other method authorized in this constitution of the corporations, or the franchises, subject to be taxed pursuant to subdivision (a) of paragraph 2 of this section or subdivision (d) of section 14 of this article.

3. The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, may change by law the rates of tax, or the percentage, amount or nature of offset provided for in paragraphs 1 and 2 hereof.

4. Notes, debentures, shares of capital stock, bonds, solvent credits, deeds of trust, mortgages, and any legal or equitable interest therein, of the classes now
On March 1, 1929, the legislative enactment passed in pursuance of this amendment known as "The Bank and Corporation Franchise Tax Act," was signed by the Governor.

An examination of the amendment discloses that it is amenable to certain objections, namely, (1) it is not clear what corporations are taxable under its provisions; (2) it contains provisions the validity of which may be questioned; (3) because of its wording, it may have undesirable effects not intended by its framers. Each of these defects will be briefly analyzed in the following discussion.

(a) What Corporations Are Taxable Under the Amendment?

The amendment as worded leaves open interesting and puzzling questions as to the corporations taxable under its provisions, questions which will undoubtedly require determination by the courts. The amendment provides that the corporations taxable are all banks and "all financial, mercantile, manufacturing, and business corporations doing business within the limits of this state, subject to be taxed pursuant to subdivision (d) of section 14 of this article in lieu of the tax thereby provided for [shall pay the tax herein provided]." In other words, to be taxable under this amendment the corporation must (1) be a bank, or a financial, mercantile, manufacturing or business corporation doing business within the limits of the state; and (2) if it is a corporation other than a bank it must have been subject to taxation under Section 14(d) of Article XIII. This second condition precludes the taxation under the amendment of the franchises of insurance companies, public utilities and highway transportation companies, for they taxable to the owner thereof and not otherwise taxed under subdivisions (a) or (b) of section 14 or under section 15 of this article, shall be declared in a manner to be prescribed by law and shall be taxed upon their actual value at the rate of three-tenths of one per cent. The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, may by law change the rate or rates upon any one or more of the classes of property herein enumerated, provided that no rate shall exceed four-tenths of one per cent. Said tax shall be in lieu of all other property taxes thereon, and the proceeds of said tax shall not go to the state but to such political subdivisions thereof, and in such manner, as may be provided by law.

5. The Legislature shall define 'corporations' and 'doing business'; shall define 'net income,' and may define it to be the entire net income received from all sources; shall provide for the allocation of income, for the assessment, levy and collection of the aforesaid taxes, and for reassessment in the event of the invalidity of any tax under 2 (a) or 2 (b) hereof. Said taxes shall become a lien on the first Monday in March of 1929 and of each year thereafter. The Legislature shall pass laws necessary to carry out this section. The acts of the forty-eighth session of the Legislature passed pursuant to this section shall be effective immediately upon their passage." Cal. Const. Art. XIII, § 16.

were not subject to taxation under Section 14(d) of Article XIII of the constitution.

Although under the amendment, and the statute passed in pursuance thereof, the corporations taxable are "all financial, mercantile, manufacturing and business corporations doing business within the limits of the state," the terms "business corporation" and "doing business" are likely to cause difficulty by reason of their generality and vagueness. Since the terms "corporations" and "doing business" have been defined by the statute, these parallel provisions of the amendment and statute as to corporations taxable will be discussed together at this point.

In the Bank and Corporation Franchise Tax Act (Section 5) the legislature sets forth the following definitions:

(1) "The term 'corporation,' as herein used, shall include every financial corporation, other than a bank or banking association, and every mercantile, manufacturing and business corporation of the classes referred to in subdivision one (c) of Section 5219 of the Revised Statutes of the United States."

(2) "The term 'doing business' as herein used, means any transaction or transactions in the course of its business by a corporation created under the laws of this state, or by a foreign corporation qualified to do or doing intrastate business in this state."

It is evident that as applied to "business corporations" in the first provision above, and as used in the phrases "doing business" and "doing intrastate business" in the second provision, the term "business" refers to three different situations. In the first use it characterizes a kind of corporate activity; in the second it relates corporate activity to corporate purpose, and in the third it characterizes the kind and degree of corporate activity of foreign corporations over which the state may have taxing jurisdiction. It is apparent that these three different uses of the term can not be related for the purpose of mutual definition.

In the first use "business" refers to a difference in kind between corporations. Only corporations of the kind specified are taxable under the act. The provision classifies the taxable types as "financial," "mercantile," "manufacturing," and "business." It is true that the section does not define the quality that characterizes a corporation as a "business corporation," however, neither does it do so as to "financial," "mercantile" or "manufacturing" corporations. The exact definition in each case must be found in judicial decision with the difference perhaps that the nature of a "business corporation" is less clearly recognized than that of the other types listed.

In view of the fact that the wording of the statute incorporates the wording of Section 5219, judicial determination of the term "business corporation" as used in that section would determine the definition of
that term as used in the California statute. However, since there has been no decision upon this point under Section 5219, we must turn to other decisions for assistance in determining the nature of a business corporation,\(^\text{107}\) and we find numerous cases supporting the view that any corporation whose purpose is that of personal material gain of a pecuniary nature to its members is a business corporation.\(^\text{108}\)

In view of the statutory definitions above quoted it may be asked if a non-profit corporation is or is not a business corporation within the meaning of the amendment and statute. Since it would seem to follow from the second definition above quoted that profit in the sense of money dividends is not the necessary quality of a business activity, it would appear that an examination of the nature of each particular non-profit corporation would be necessary. If non-profit activities are means of furthering a non-business purpose (as in the case of charitable or fraternal organizations), corporations engaging in such activities should not come under the act. However, where the non-profit activity is in furtherance of a business or mercantile end (as in the case of a co-operative marketing association), corporations engaged in such activities will probably be subject to taxation under the act as other corporations organized for financial, "mercantile, manufacturing or business ends."

The act itself supports this view by implication, for subdivision (k) of Section 5 thereof provides, with respect to "associations organized


\(^{108}\) McLeod v. Lincoln Medical College of Cotner University (1903) 69 Neb. 550, 553, 96 N. W. 265, 266: "The character of a corporation is determined from its articles of incorporation and the statute authorizing its formation. In this case it is apparent from both the articles of incorporation and the provisions of section 15, chapter 16, Compiled Statutes, that this organization is an educational and not a 'business' or 'trading corporation' for the pecuniary profit of its members." Greenough v. Board of Police Commissioners of Town of Tiverton (1909) 30 R. I. 212, 219, 74 Atl. 785, 789: "Is it embraced within the provisions of 'Class I.—Business Corporations'? The definition of the noun 'business', according to Webster's Internat. Dict. is: (3) 'Financial dealings; buying and selling; traffic in general; mercantile transactions.' A corporation organized for such purposes is therefore a business corporation." Flint v. Stone Tracy Co. (1911) 220 U. S. 107, 171, 31 Sup. Ct. 342, 357: A business is that "which occupies the time, attention, and labor of men for the purpose of a livelihood or profit." People v. Board of Trade of Chicago (1875) 80 Ill. 134, 136, in which the court, speaking of the Chicago Board of Trade, said: "This organization is not maintained for the transaction of business or for pecuniary gain, but simply to promulgate and enforce among its members correct and high moral principles in the transaction of business. It is not engaged in business, but only prescribes rules for the transaction of business." George R. Barse Live Stock Company v. Range Valley Cattle Co. (1897) 16 Utah 59, 65, 50 Pac. 630, 632: "To do business' as defined by Webster is 'to carry on any particular occupation or employment for a livelihood or gain, as agriculture, trade, mechanic arts, or profession'."
and operated in whole or in part on a coöperative or a mutual basis," for exempting from the tax base, income derived from non-profit activities. In light of this provision it is evident that the act itself intended that non-profit organizations engaged in financial, mercantile, manufacturing and business ends should come under the provisions of the act. The most important practical effect of this conclusion, as it affects these corporations, is that, if there is no net income after the statutory deductions are allowed, the provision for a minimum tax of $25.00 on every corporation taxable applies.

The specified kinds of corporations are taxable if they "do business" within the state. The act, in the second provision quoted above, merely provides that a corporation is "doing business" if it engages in any transaction or transactions in the course of its corporate purpose, that is in the course of its business. Thus, under this definition, regardless of the nature of a corporation, any act done to further its purpose is "doing business," although such "doing business" makes the corporation liable to taxation under the act only if it furthers a corporate purpose classified as "financial," "mercantile," "manufacturing," or "business" in the sense of the first provision. Furthermore, it would seem as a consequence that the character of an act in furtherance of a corporate purpose is determined not by the nature of the act itself, but by the nature of the corporate purpose it serves.\(^1\)\(^0\) Apparently this was the view taken by the California Supreme Court in the case of General Conference of Free Baptists v. Berkey.\(^1\)\(^1\) The court held that, since this act was in furtherance of its religious and charitable activity, the act took its quality from the end it served and did not amount to doing business in the sense of engaging in activity for personal profit.

The question of the taxability of a holding company is also raised in connection with the words "doing business." Under the constitutional and statutory provisions, it would seem that the status of this type of corporation is no different from that of any other. If its corporate purpose is that of holding the stocks of other corporations, then

\(^{10}\) Silveira v. Associated Milk Producers (1923) 63 Cal. App. 572, 219 Pac. 461.

\(^{11}\) (1909) 156 Cal. 466, 470, 105 Pac. 411: "This corporation was certainly not engaged in the business of buying and selling land. As we have said, in another connection, its charter plainly indicates that the power conferred upon it to make such purchase and sale was not granted for the purpose of enabling it to do such acts as a means of making a profit thereon. The buying and selling permitted to it were merely incidental to the carrying on of the main purposes of the corporation. A distinction is to be drawn between the purposes of a corporation and its powers. (Floyd v. Perrin, 30 S. C. 1, 12, (S S. E. 14).)"

See also, Finance and Construction Co. of Cal. v. Sacramento (1928) 76 Cal. Dec. 73, 75, 269 Pac. 167.
any transaction of that kind is "doing business" within the statute and taxable if the holding purpose of the corporation is "financial, mercantile, manufacturing or business." Hence it seems clear that a domestic holding corporation would be taxable under the statute. The taxability of a foreign holding corporation will depend on whether stock-holding is considered "doing business," if done within the state, so as to be intrastate business taxable by the state. The federal court seems to take a similar view of the status of holding corporations under the Federal Capital Stock Act.\footnote{111}

A third use of the term "business" is found in the phrase "intra-state business" used in the second provision above quoted. The provision states, in effect, that corporate activities, in pursuance of the specified corporate purposes, are taxable when conducted by a domestic corporation or by a foreign corporation qualified to do, or doing, "intra-state business" in this state. Thus "business" used in this connection refers to those acts held as amounting to that degree and kind of corporate activity by a foreign corporation within a state sufficient to give the state jurisdiction to tax. What amounts to "intra-state business" depends upon the decisions of the federal courts. The rules established by the federal courts in this connection are found in an extensive line of cases.\footnote{112} An examination of these cases at this point is prevented by lack of space and is unnecessary for the purposes of this article.

An additional problem in respect to corporations taxable arises in


The wording of the statute making "doing business" any transaction "in the course of its business by a corporation" raises the question as to whether acts merely going to the maintenance of corporate existence as owning and holding property, paying taxes, etc., are included in this provision. To hold such acts as constituting "business" is a logical possibility. However, the decisions upon this point where it has been raised regarding statutory "doing business" provisions seem to express the better view. A typical expression is found in Von Baumbach v. Sargent Land Co. (1917) 242 U. S. 503, 516, 37 Sup. Ct. 201, 205, involving the interpretation of "doing business" as used in the Federal Corporation Tax Law of 1909. "It is evident, from what this court has said in dealing with the former cases, that the decision in each instance must depend upon the particular facts before the court. The fair test to be derived from a consideration of all of them is between a corporation which has reduced its activities to the owning and holding of property and the distribution of its avails and doing only the acts necessary to continue that status, and one which is still active and is maintaining its organization for the purpose of continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes." See also United States v. Emery, Bird, Thayer Realty Co. (1915) 237 U. S. 28, 35 Sup. Ct. 499.

determining the effect of the language of the amendment which states that the tax therein provided for is in lieu of the tax provided for in Section 14(d) of Article XIII. What, if any, corporations are still taxable under Section 14(d)? In the first place it has been observed that it is not certain whether the corporations other than banks which are subject to the new tax, namely, "all financial, mercantile, manufacturing, and business corporations," include all taxable corporations. If and in so far as it may be decided that there are some not included they will obviously still be subject to taxation under Section 14(d) if they were before. Secondly, the amendment takes only those corporations enumerated out of the operation of Section 14(d) that are "doing business within the limits of this state," and since some corporations will be subject to the franchise tax imposed by Section 14(d) that are not doing business "within the limits of this state" it is clear that any such corporation is both excluded from the corporations taxable under the new tax because not "doing business" and not included within the corporations excepted from the tax imposed by Section 14(d) for the same reason.

Another problem is raised by the fact that the tax provided for in subdivision 2(a) of Section 16 is in lieu of the tax provided for in Section 14(d) of Article XIII. Unlike the tax on banks under subdivision 1(a) of Section 16, it is in lieu of no other tax. Therefore it might be contended that, unless Section 16 be the exclusive authority for the taxation of corporation franchises, there is no constitutional prohibition against local taxation of such franchises.

The contention that they are so taxable may be based on the following arguments: (1) Section 14(d), which was adopted in 1910, made provision for a state tax upon franchises in addition to the tax then levied on franchises by the local authorities but did not preclude local taxation of such franchises for, although it states that the tax collected thereunder "shall be exclusively for the benefit of the state," it does not provide that it shall be in lieu of other taxes on franchises. Therefore, Section 16, which is a substitute for 14(d), which is in lieu of no other tax, does not preclude such taxation.\(^{113}\) (2) Even if Section

\(^{113}\)In response to a request for an opinion upon the local taxability of corporate franchises under the existing law, the State Attorney General said: "Subdivision (d) of Section 14, Article XIII, does not impose or provide for the imposition of a lieu tax. A corporation which has been subject thereto has also been subject to local taxation of its corporate excess. Chapter 13 of 1929 does not provide a lieu tax so far as the corporations described in Section 4 thereof are concerned, and their corporate excess may go on the local tax rolls." Opinion of the Attorney General No. 6747 (June 18, 1929). However, on later consideration he concluded that the corporate excess was assessable locally only for outstanding local bonded indebtedness under subdivision E of Section 14 of Article XIII. Opinion of the Attorney General No. 6747 (a). (June 27, 1929.)
14(d) precluded local taxation of corporate franchises, they are none the less taxable locally. The franchise tax provided for in Section 16 is not a property tax but a privilege tax. Since the state has ceased to tax this corporate excess, the local subdivisions have a right to tax it. The repeal by implication of Section 14(d), which alone stood in the way of local taxation of franchises, restores the full applicability to franchises of Sections 1 and 10 of Article XIII. Section 1 of that Article includes franchises in the definition of property and directs that all property be taxed in proportion to its value. Section 10 of the same Article provides that all property, except as otherwise in the Constitution provided, "shall be assessed in the county, city and county, town or township or district in which it is situated, in the manner prescribed by law." It is submitted that these arguments are unsound. The theory that franchises were properly taxable by the local authorities, while Section 14(d) was in full effect, seems contrary not only to the known history and purpose of that section, but is contrary to the express language of the constitution itself. The basic theory of the new system adopted in 1910, of which Section 14(d) is a part, was the separation of state and local subjects of taxation. This theory as applied to franchises has been closely adhered to since 1910 by both state and local taxing authorities and is supported by express language of the State Supreme Court. In fact, the theory received such definite expression in the first paragraph of Section 14 of Article XIII as conclusively to settle the question:

"Taxation upon all franchises of every kind and nature shall be entirely and exclusively for state purposes, and shall be levied, assessed and collected in the manner hereinafter provided."

14 See the Report of the California Commission on Revenue and Taxation 1910, p. 28, 37 et seq.
116 Miller & Lux, Inc. v. Richardson (1920) 182 Cal. 115, 119, 187 Pac. 411, 412. This case involved the interpretation of the word "franchise" as used in 14(d) and was particularly concerned with the method of evaluating franchises for purposes of taxation. In the course of the opinion the court reviewed the history of the taxation of franchises in this state and the effect of the new system set up in 1910: "The provision in question is part of an amendment to the constitution proposed by a special session of the legislature in 1910 and approved by the people in the fall of that year. The amendment was the result of the labors of a tax commission appointed some years before, and its primary purpose was to effect a separation of state and county taxes, and in that behalf to set off exclusively for taxation for state purposes certain particular subjects, consisting in a general way of the properties of public utility corporations other than their non-operative properties, of the properties of insurance companies and banks other than their real estate, and of franchises." (Italics added.)
Section 16, no doubt, repeals by implication Section 14(d) so far as the two are applicable to the same subjects together with the limitation that the tax provided for in 14(d) be exclusively for the benefit of the state but it cannot be said to have also repealed the express limitation contained in the first paragraph of Section 14 just quoted.

(b) Provisions of Questionable Validity.

Subdivision 2(a) of Section 16 provides that the tax therein provided for

"shall be subject to offset, in a manner to be prescribed by law, in the amount of personal property taxes paid by such corporations to the state or political subdivisions thereof, but the offset shall not exceed ninety per cent of such state tax."

If corporations are permitted to pay their franchise taxes in part with offsets, does that bring about an unreasonable classification of corporations for purposes of taxation when certain corporations, because of their small personal property holdings, are in no position to avail themselves to an equal extent of the advantages of the offset? This problem is discussed in detail below under the analysis of the parallel provisions of the Bank and Corporation Franchise Tax Act.

(c) Undesirable Results Probably Not Intended.

Subdivision 1(a) of Section 16 provides in part as follows:

"Banks, including national banking associations, located within the limits of this state, shall annually pay to the state a tax according to or measured by their net income, which shall be in lieu of all other taxes and licenses, state, county and municipal, upon such banks, or the shares thereof, except taxes upon their real property." (Italics added.)

The language italicized would seem clearly to make the tax in lieu of the tax provided for in Section 14(e) of Article XIII which reads in part as follows:

"Out of the revenues from the taxes provided for in this section together with all other state revenues, there shall be first set apart the moneys to be applied by the state, to the support of the public school system and the state university. In the event that the above named revenues are at any time deemed insufficient to meet the annual expenditures of the state, including the above named expenditures for educational purposes, there may be levied in the manner to be provided by law, a tax, for state purposes on all the property in the state including the classes of property enumerated in this section, sufficient to meet the deficiency." (Italics added.)
If the words "all other" as used in Section 16 mean not merely the other current forms of taxation but "any other" taxation so that emergency taxes are also prohibited, banks, except as to emergency taxes on their real property, will be given an exemption enjoyed by no other taxpayers in the state. In other words, if a deficiency occurred in the state revenues, there would be no means of imposing an additional tax on either the banks or their shares. Such taxes, however, may be levied upon other corporations, for the tax provided for in subdivision 2(a) of Section 16 is in lieu of the tax provided for in subdivision (d) of Section 14 of Article XIII, but unlike the tax on banks under subdivision 1(a) of Section 16, is in lieu of no other tax.

Subdivision 2(a) also provides:

"In any event, each such corporation shall pay an annual minimum tax to the state, not subject to offset, of twenty-five dollars." 1

This minimum can apparently never be raised or lowered without constitutional amendment. But if the legislature in pursuance of Section 2(b) provided for any other authorized method of taxation than a tax on corporate franchises according to or measured by net income, such method would apparently not be subject to the limited minimum tax set forth in Section 2(a). However, to set a fixed minimum even with regard to the tax contemplated by Section 2(a) seems to be an unnecessary and inadvisable restraint upon the discretion of the legislature and is not good constitutional practice.

The framers of the amendment seem unintentionally to have limited the power of the state to levy income taxes. Subdivision 4 of Section 16 providing for the taxation of notes, debentures, shares of capital stock, etc., provides that: "Said tax shall be in lieu of all other property taxes thereon . . ." If an income tax be considered a property tax and there is persuasive authority to that effect, the provision of Section 16 just quoted would seem to have repealed by implication, at least so far as income from intangibles is concerned, Section 11 of Article XIII of the Constitution, which reads:

"Income taxes may be assessed to and collected from persons, corporations, joint stock associations, or companies resident or doing business in this state, or any one or more of them, in such cases and amounts, and in such manner, as shall be prescribed by law."

1 It is interesting to observe that banks are not subject to a minimum tax. A minimum tax of $25 upon a national bank having no net income would, it seems, violate the provision of Section 5219 that such banks may be taxed according to or measured by their net income. A minimum tax, when there is no net income, would obviously not be measured by net income.

On March 1, 1929, the Governor approved the statute passed by the legislature to carry into execution the provisions of the new constitutional amendment, i.e., Section 16 of Article XIII of the State Constitution. Although the provisions of this amendment when analyzed in the following discussion will be quoted in the text or in the margin, there is not sufficient space available to print herewith the whole of the statute nor to discuss all the administrative details that it involves. The mechanics of the system set up by the statute are well explained by Norman L. McLaren and Vincent K. Butler Jr. in their book, "California Tax Laws of 1929." The present article will concern itself principally with questions of the validity of the statute and with the probable legal difficulties in the way of its being carried into effect.

Apart from the question of the inclusion of income from tax exempt securities in the tax base, discussed above, there are several grounds on which the statute may be thought to be invalid. (1) There is an apparent failure to comply with the provisions of the state constitutional amendment because of (a) the provisions for offset from bank taxes; (b) the provisions for the offset of real estate taxes from the franchise tax on other corporations. (2) It is arguable whether too much discretion has been given the franchise tax commissioner. (3) The validity of the method set forth for allocating net income for taxation in this state where part of such income is derived from extra-state business may be questioned. (4) The difficulty of understanding certain provisions for the administration of the tax may render the whole act incapable of enforcement.

(a) Do the Offset Provisions Invalidate the Statute?

It may be contended that the statute does not comply with the terms of the constitutional amendment by reason of the offset provisions found in Section 3 of the statute. Although the constitution provides for the offset of personal property taxes for corporations other than banks, it does not expressly provide for any offset whatever for banks, and furthermore, as to the tax on banks, it expressly states that "The amount of the tax shall be equivalent to 4% of their net income."

The statute in question was passed under this constitutional provision. Section 3 allows banks an offset of 10 per centum of the taxes paid upon their real property with the proviso that the total amount of the offset shall not exceed 75 per centum of the total tax under this section. That this provision violates the constitutional section cited above is arguable upon several grounds.
In the first place, if an offset is allowed banks, the tax is obviously not "4% of their net income" but something else, namely 4% of their net income less the deductions allowed, thus the form of taxation is clearly not that contemplated by the wording of subdivision 1(a) of the amendment. It must be noted, however, that subdivision 1(b) of the constitutional amendment provides:

"The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, in lieu of such tax, may provide by law for any other form of taxation now or hereafter permitted by the congress of the United States respecting national banking associations; provided, that such form of taxation shall apply to all banks located within the limits of this state,"

so that, although the statute might not conform with 1(a), it might still be valid if the tax is one "permitted by the congress of the United States respecting national banking associations."

The legislature was apparently acting to accomplish the tax permitted by the fourth alternative of Section 5219, namely, a tax upon national banks, "according to or measured by their net income," therefore, the validity of the statute under 1(b) and Section 5219, depends on whether or not the statute, with the offset provisions allowing deductions for real property taxes, provides for a tax "according to or measured by net income."

A contention that the statute does not provide a tax "according to or measured by net income" may be based upon the argument that to allow such offset is to levy a tax that is not strictly measured by net income but by net income less something else; for, although net income enters into the computation of the tax, the amount of the tax is, nevertheless, seriously affected by a deduction, whose amount is independent of income. Although the court might perhaps meet this objection with the simple proposition that the tax in question comes fairly within the meaning of the phrase, "according to or measured by net income," it is none the less true that net income measures not the tax but merely a sum intermediate the calculations thereof.

The offset provision may possibly render the statute invalid in that it results in such discrimination between banks as to be a denial of equal protection of the laws prohibited by the Fourteenth Amendment of the Federal Constitution. An example will clearly bring out the nature of the discrimination effected by the deduction provisions of the statute. Let us assume two national banks, Bank A and Bank B, with an equal net income of $100,000 a year so that upon this basis their franchise tax as 4% of that income would be $4,000 each. Bank A has real property upon which it pays $20,000 taxes. Bank B rents its
premises and has no real property and, therefore, pays no real property
taxes upon real estate owned by them, national banks may be taxed
property taxes to the amount of 10% thereof up to 75% of 4% of its
net income, so that Bank A has a deduction of $2,000 while Bank B
has none. As a result, Bank A pays a $2,000 tax, while Bank B pays
$4,000. According to their net income, these banks should be taxed
equally, yet Bank B is required to pay a tax twice as great as that
exacted from Bank A. It is no answer to say that Bank A has paid no
real estate taxes and that this factor should affect the comparison.
Section 5219 contemplates that, in addition to the usual ad valorem
taxes upon real estate owned by them national banks may be taxed
"according to or measured by" their net income. To inject the element
of real estate taxes paid as a direct offset from a tax calculated at a
percentage of net income seems not only an unwarranted variation
from the method prescribed but a denial of equal protection of the laws
as well.

Discrimination within the meaning of the equal protection of the
laws clause is defined as "the act of treating differently two persons or
things, under like circumstances." When different treatment is ac-
corded two persons and one invokes the equal protection clause, the
question to be decided is whether there is any dissimilarity between
their situations of a kind and degree which will justify the unlike treat-
ment complained of. In the case supposed the unlike treatment con-
sists of unequal franchise-taxes-measured-by-net-income imposed upon
two banks whose net incomes are identical. The dissimilarity of situa-
tion, which creates and must justify the inequality of taxation, is the
circumstance that one of the banks owns real property and the other
does not. It is submitted that there is no relation whatsoever between
the unlike treatment here involved and the dissimilarity of situation
upon which it rests. Ownership of real estate is surely no ground for
exemption from occupation taxes imposed upon others.

Another problem is raised by the offset provisions. The constitu-
tional provision for a tax offset for financial, mercantile, manufacturing
and business corporations, specifically mentions personal property taxes
and does not mention real property taxes, viz:

"Such tax shall be subject to offset, in a manner to be prescribed by law
in the amount of personal property taxes paid by such corporations to the
state or political subdivisions thereof, but the offset shall not exceed ninety
per cent of such state tax." (Italics added.)

110 Mr. Justice Brandeis, dissenting in National Life Insurance Co. v. United
120 See the discussion of the problem of equal protection of the laws as regards
taxation, supra p. 486-489.
And subdivision 3 of the constitutional provision reads:

"The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, may change by law the rates of tax, or the percentage, amount or nature of offset provided for in paragraphs 1 and 2 hereof." (Italics added.)

The question immediately arises whether the word "nature" as used in the preceding constitutional provision will be so construed by the courts as to justify the offset of real property taxes paid upon the corporations' property, as provided in Section 4 of the statute:

"Each such corporation [financial, mercantile, manufacturing, business] shall be entitled to an offset against said franchise tax, in the manner hereinafter provided [Section 26], in the amount of taxes paid upon its real and personal property to any county, city and county, town, city, or other political subdivision of the state, but the total offset shall not exceed seventy-five per centum of the said franchise tax, and in no case shall the taxpayer be entitled to offset more than ten per centum of its said real property taxes."\(^2\)

It should be noted that besides the provision for offset of a percentage of real property taxes the statute differs from the amendment

\(^2\)In prorating offsets, the Franchise Tax Commissioner has disregarded the method set forth in the act for the computation of the 1929 tax of corporations with a fiscal year ending in 1928 with the result that many corporations will pay a higher tax under his method than they are required by the act to pay. The act provides that fiscal year corporations with a fiscal year ending in 1928 shall pay a tax for the months of the year 1929 corresponding to the months of 1928 which fall within the fiscal year ended during 1928 "according to or measured by such proportionate part of the net income of that fiscal year as the number of months falling within the calendar year 1928 bears to the total number of months in the fiscal year ended during that calendar year." Cal. Stat. 1929, c. 13, § 13. Thus, in accord with this section the tax for the 1929 months is figured at 4% of their prorated 1928 income. In common with all other corporations subject to the act, such a corporation is entitled to an offset against this tax of 10% of its real property tax up to a total amount of 75% of its computed franchise tax. It is to be noted that Section 26 which provides the manner in which the offset is to be computed does not state that corporations taxed upon the basis of prorated incomes are to be treated differently. Section 26 reads in part as follows: "A corporation subject to the tax herein provided for, shall receive an offset against said tax, subject to the limitations provided in section 4 hereof, for real and personal property taxes paid upon its property to any county, city and county, city, town or other political subdivision of the state during the taxable year." (Italics added.) Since the act does not provide for the proration of the offset a corporation even though it pays a tax for only one month of 1929 is entitled to offset its entire deductible real and personal property taxes up to the 75% limit. The Tax Commissioner does not follow the terms of Section 26, for in addition to prorating the income of the corporations under discussion he also provides for the proration of the offset. This action of the commissioner seems contrary to the terms of the act.
in eliminating an offset for personal property taxes paid to the state, and allows an offset for taxes paid "upon" the corporation's property rather than taxes paid "by" the corporations as provided in the constitutional provision.

It might plausibly be argued that eliminating the offset for personal property taxes paid to the state and allowing an offset for taxes paid "upon" the corporation's property changed the "nature" of the offset within the authority of subdivision 3 of the amendment but, in providing for an offset of real property taxes, something additional is added which can hardly be considered the "offset provided for". The offset, the "nature" of which may be changed, is the offset provided for in paragraph 2. Real property tax offsets are not mentioned in that paragraph. Is it merely "changing the nature of the offset provided for" to add an entirely new offset? If "nature" is broad enough to cover the deduction of real property taxes paid in this state, it should be broad enough to cover the deduction of taxes paid in any other state, or, in fact, to cover any kind of deduction the legislature may see fit to grant. It may be then that the provision for offset of 10% of the real property taxes is in contravention to Section 16. If this be true, the question arises whether the whole statute is void. This raises the general problem of the effect of partial invalidity discussed above.

The offset provisions of the constitutional amendment and the recently enacted state statute raise another interesting question suggested by the reasoning of the court in National Life Insurance Company v. United States. The case involved a federal income tax on life insurance companies. In determining the "net income," i.e., the tax base, certain deductions were allowed including the following: (1) The amount of income from tax exempt securities; (2) a sum equal to 4 per cent of the company's legal reserve less the amount of the first deduction. The effect of these provisions may best be explained by an example. Assume two insurance companies, each with a reserve of $100,000, the first receiving no income from exempt securities and the

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122 The corporate franchise tax assessed under Section 14(d) of Article XIII would seem clearly to be a personal property tax paid to the state in view of the definition of "property" contained in Section 1 of Article XIII, namely: "... The word 'property' as used in this article and section, is hereby declared to include moneys, credits, bonds, stocks, dues, franchises, and all other matters and things, real, personal, and mixed capable of private ownership ..." To have permitted the franchise tax for 1929 to be offset by the 1928 franchise tax would have reduced the 1929 tax in most instances to a relatively insignificant amount and in many instances to nothing at all. If any substantial revenue was to be expected from the new franchise tax, it was absolutely necessary to eliminate the provision for offset of personal property taxes paid to the state.

second receiving $4,000 therefrom. The first company would be allowed a deduction of 4 per cent on its reserve, i.e. $4,000. The second company would be allowed as deductions; (1) income from tax exempt securities, i.e. $4,000; (2) a sum equal to 4 per cent of its reserve less the first deduction, i.e. $4,000 — $4,000, or nothing: total deduction $4,000. The effect of the statute, obviously, was that insurance companies deriving income from exempt securities amounting to not more than 4 per cent of their reserves, nevertheless, paid an income tax in an amount precisely the same as if they held no exempt securities. The court held the statute invalid, so far as it required the deduction of the tax exempt income from the sum of 4 per cent of the reserves. The court was of the opinion that to deny the full 4 per cent deduction to exempt security holders, allowed to those not holding such securities, was, in effect, unconstitutionally to tax such securities. In the words of the court, "One may not be subjected to greater burdens upon his taxable property solely because he owns some that is free."

It is at least arguable that the California statute violates the principle just discussed. The National Life Insurance case held invalid the statute there involved because tax exempt security holders, under the tax thereby imposed, were "accorded no advantage by reason of their ownership of tax-exempt securities." In other words, a denial of a deduction to tax exempt security holders (because of their securities) granted non-security holders, was in effect to tax the exempt securities. Under the recently enacted bank and corporation tax law, national and state banks and other corporations are subject to a franchise tax measured by their total net income. National banks are exempt from personal property taxes by virtue of the fact that, by not allowing such taxation, Congress has impliedly prohibited it. Other corporations are subject to personal property taxes. The newly enacted law allows an offset from the franchise tax of all personal property taxes and 10 per cent of real property taxes paid, up to 75 per cent of 4 per cent of the net income of such corporations. To allow a deduction of personal property taxes from the franchise tax to said corporations, whereas national banks are required to pay the full franchise tax (less, of course, 10% of their real property taxes), is in effect to "accord them no advantage by reason of their" exemption from personal property taxes and is in effect to require them to pay personal property taxes to the state. Of course the state could exempt all personal property from taxation and thus accord national banks no advantage by reason of their exemption from personal property taxes and the banks would have no complaint. But, it may be argued, when franchise taxes, or their equivalent, are imposed upon national banks, state banks and other
corporations, and a percentage of the amount of personal property taxes paid by the other corporations is allowed as an offset from the franchise tax, the national bank is deprived of its exemption from personal property taxes. To deny holders of tax exempt bonds an exemption to the extent of their bonds was held in the National Life Insurance case to be in effect a tax on the bonds. And in the instant case, to levy a franchise tax on banks and a franchise tax on other corporations and to allow the other corporations to deduct the amount of their personal property taxes (from which the banks are exempt) is to deprive the exemption, which the banks enjoy, of any effect whatsoever and in effect, as in the National Life Insurance case, to levy a tax which the law prohibits. If the foregoing parallel be sound, the California tax on national banks is invalid because it violates the prohibition implied in Section 5219 against taxing the personal property of national banks.

An argument that the parallel is not sound may be stated as follows: The purpose and effect of the California statute is not to discriminate against national banks in favor of other corporations but simply to permit the local subdivisions of the state to collect part of the taxes exacted of other corporations, the total tax burden imposed then being precisely the same as that imposed on the banks. The division of the tax of these other corporations into a franchise tax less than that imposed upon the banks and a personal property tax equal to the difference is simply a convenient administrative device for distributing tax receipts between the state and its subdivisions. The trouble with this argument, it might be contended, is that there are involved two limitations on the state's power to tax national banks and that the argument satisfies only one of them; (1) The states cannot impose a discriminatory tax burden on national banks; (2) the personal property of national banks is exempt from taxation. Only the first of these limitations is met by the argument just stated and the existence of the second seems to bring the statute clearly within the rule of the National Life Insurance case.

It is submitted, however (although a decision along the lines of the foregoing argument seems perfectly possible), that the rule of the National Life Insurance case is not violated by the California statute for the following reasons. The National Life Insurance case involved what was held to be an encroachment upon the exemption from taxation of the income from tax exempt securities, and this exemption is a real exemption: these securities are intended to be actually favored over other property in the matter of taxation. But the "exemption of the personal property of national banks" from taxation is a different matter. In enacting Section 5219, Congress did not intend that the personal property of national banks should actually be exempt from all
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taxation; it intended simply that the form of state taxes on national banks should be that prescribed in the statute. In order to insure against discriminatory tax burdens on national banks, Congress prescribed certain alternative methods of taxing them which should be in lieu of all other taxes. The exemption involved in the *National Life Insurance* case is an exemption from taxation either in form or in effect of the property exempted. The "exemption from taxation of personal property of national banks" on the other hand, was not intended to be an actual exemption from taxation but merely a substitution for any form of taxation except the forms expressly consented to. In this view the California statute is unexceptionable. So far as the present objection is concerned, the tax complies with the form prescribed and its substantial operation in no way violates the purposes of Congress. It may be said then that, although the rule of the *National Life Insurance* case may be rather plausibly invoked in this situation, to so invoke it would be a clear misreading of the intention of Congress and of the California legislature.

(b) *Has the Legislature Made an Unconstitutional Delegation of Power* to the Franchise Tax Commissioner?

One of the outstanding features of the Bank and Corporation Franchise Tax is the creation of the new office of Franchise Tax Commissioner. Section 22 of the statute provides that the commissioner "shall have power and it shall be his duty to administer this act, and to prescribe all such rules and regulations as are necessary and reasonable to carry out its provisions." It is difficult to see why the administration of this tax should not have been left in the hands of the State Board of Equalization along with the administration of other state taxes. As stated in a comment by Mr. Keaton printed in the Assembly Daily Journal for February 20, 1929, pp. 8, 9, relative to Assembly Bill No. 1047 (introduced by Mr. Keaton as a substitute for the bill which was finally adopted):

124 It is to be noted that in the provisions for deductions in computing net income (Section 8(f) ) it is provided that depreciation shall be determined on the basis provided for in Sections 113 and 114 of the 1928 Federal Revenue Act. Certain of the standards set forth in the Federal Act require determination by a federal commissioner. Since the state act adopts in prospect regulations to be determined by the federal legislature and by a federal officer it may be claimed that this provision amounts to an invalid delegation of the state's legislative authority. See *State v. Vino Medical Co. Inc.* (1922) 121 Me. 438, 442, 117 Atl. 538; *In re Opinion of Justices* (1921) 239 Mass. 606, 133 N. E. 452, where similar provisions were held to be an invalid delegation of legislative power. Compare, however, *Commonwealth v. Sweeney* (1915) 61 Pa. Sup. Ct. 367; *Commonwealth v. Alderman* (1923) 275 Pa. 483, 119 Atl. 551. See Note (1929) 17 *California L. Rev.* 555.
"If the State Board of Equalization is to be entrusted with the administration of other taxes aggregating in excess of $85,000,000 annually, it is preposterous to suggest that its organization is incapable of administering these taxes, which will in all likelihood not exceed $7,000,000 or $8,000,000. The Board of Equalization has the staff available to handle the routine work, all files and other necessary equipment, so that with the addition of possibly one or two experts in the matter of income tax, preferably men selected from the ranks of federal government agents, there is no reason to apprehend that the matter could not be handled by them with entire satisfaction at an additional cost to the state probably not in excess of $15,000 annually."

See also the following, taken from an address by Professor Plehn before a conference of the California Manufacturers Association:

"For the administration of this statute a new commissioner is to be appointed. That appears to be a political issue upon which perhaps I need make no comment. It might be in order, however, to say in this connection a good word for the present State Board of Equalization. If so one might point out that they and their staff have had years of experience in the administration of tax laws. The present Chairman has been on the Board over twenty years. As a result they probably know more about taxes in California than anybody else living. They know all the assessors and enjoy their confidence. They know property and property values in every nook and cranny of the state. They know all about the different lines of business in the state and know through many hearings, and through the assessment of the franchise tax a great deal about the corporations. They are experts in the best sense of that term in the intricacies of tax administration, and especially in what the tax authorities may, may not and must do to protect the legality of the taxes and the rights of the taxpayers. No new man or group of men could acquire like experience very quickly, and it seems a pity to discard all this acquired skill."

The contention may be made that the legislature in the Bank and Corporation Franchise Tax Act has given such discretion to the Franchise Tax Commissioner as to violate the provisions of the constitution. An analysis of the statute and the relevant decisions sufficiently full to cover this difficult problem adequately would require a lengthy article in itself. It is proposed here simply to outline the problems and express an opinion.

The Act in Section 8, subdivisions (d), (e), (g), and (l), and in Sections 12, 16, and 17 allows the Commissioner considerable power in the final determination of "net income" and in Sections 10 and

125 For other provisions of the statute in which power has been delegated to the commissioner, see Sections 13, 14, 15, 24, 25, 27, 28 and 34. There is not sufficient space to quote herewith these provisions of the statute.
The Commissioner is given power to allocate income in the tax base. It might be claimed that these grants of authority violate the terms of subdivision 5 of Section 16, which provides in part as follows:

"The Legislature shall define 'corporations' and 'doing business'; shall define 'net income' and may define it to be the entire income from all sources; shall provide for the allocation of income . . . " (Italics added.)

and Article III which provides:

"The powers of the government of the state of California shall be divided into three separate departments—the legislative, executive, and judicial; and no person charged with the exercise of powers properly belonging to one of these departments shall exercise any functions appertaining to either of the others, except as in this Constitution expressly directed or permitted."

Although the question is by no means free from doubt, it is submitted that the authority granted the Franchise Tax Commissioner is not in violation of the Constitution. In the first place, the power of allocation given the Commissioner seems to be permissible under the wording of the constitutional provision: for, while it states that the legislature "shall define 'corporations', shall define 'net income'" as to allocation, it reads, "the legislature . . . shall provide for the allocation of income." It would, therefore, seem that if the intent had been that the legislature should make the specific allocation the section would have read, "shall

126 Section 10 of the statute provides as follows: "If the entire business of the bank or corporation is done within this state, the tax shall be according to or measured by its entire net income; and if the entire business of such bank or corporation is not done within this state, the tax shall be according to or measured by that portion thereof which is derived from business done within this state. The portion of net income derived from business done within this state shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, payroll, value and situs of tangible property, or by reference to these or other factors, or by such other method of allocation as is fairly calculated to assign to the state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation.

"If the commissioner reallocates net income upon his examination of any return, he shall, upon the written request of the taxpayer, disclose to him the basis upon which his reallocation has been made."

Section 22 of the statute provides: "The franchise tax commissioner, herein referred to, shall be appointed by the director of the department of finance, the controller of the state and the chairman of the state board of equalization, who are authorized to provide him with such assistants as they may deem necessary, and he shall serve for such period, and for such compensation, and under such conditions as they may prescribe.

"He shall have power, and it shall be his duty to administer this act, and to prescribe all such rules and regulations as are necessary and reasonable to carry out its provisions; and said commissioner and the state board of equalization, for the purpose of administering their duties under this act, each shall have the powers conferred upon said board by section 3669e of the Political Code of this state."
allocate" instead of "shall provide for the allocation of." Therefore, it is submitted that in delegating to the Commissioner the power of determining upon the allocation under certain rules, the legislature was "providing" for the allocation of income within the meaning of the constitutional provision. However, if the words "shall allocate" had been used the problem would have been somewhat like that raised by the words, "the legislature . . . shall define 'net income'." The problem is not identical in the two situations for the legislature has defined "net income," defining it to be "the gross income less the deductions allowed." In the determination of some of the deductions, however, great discretion is given the Commissioner comparable to the discretion given in the allocation of income. Although the legislature may not delegate strictly legislative functions, yet, in the application of legislative measures a certain amount of administrative discretion must of necessity be granted to the executive agencies. The powers granted the Commissioner in the determination of the deductions allowable from gross income in arriving at net income, and the powers granted in the allocation of that income, are, it is submitted, no more than are required to carry into effect the objects of the constitutional provision, and are of such a nature as to be properly delegated under the authority of well established decisions.\footnote{See McCabe v. Carpenter (1894) 102 Cal. 469, 473, 36 Pac. 836, 838, in which the court held invalid an act which left the amount of a tax to be raised for the establishment of high schools wholly to the discretion of county superintendents of schools. The language of the court, however, is quite relevant to the problems discussed in the text: "The question as to whether, in a given case, there has been a delegation of the legislative power, is sometimes a very difficult question to determine. Executive officers are often required to exercise a large discretion in the performance of purely administrative acts. The legislature cannot always anticipate contingencies which may arise. So it has been sometimes said, as in People v. Reynolds, 5 Gilm. 12 (quoted with approval in Savings and Loan Society v. Austin, 46 Cal. 415), that there was a restricted sense in which legislative discretion may be delegated."

"'We see, then, that while the legislature may not divest itself of its proper functions, or delegate its general legislative authority, it may still authorize others to do those things which it might properly, yet cannot advantageously, do itself, . . . The object to be accomplished, or the thing permitted, may be specified, and the rest left to the agency of others, with better opportunities of accomplishing the object, or doing the thing understandingly.'

"This difficulty in drawing a precise line between legislative and administrative functions is noticed by Judge Cooley in his work on Taxation, page 62. He says: "'We conceive that the legislature must, in every instance, prescribe the rule under which taxation may be laid; it must originate the authority under which the tax-gatherer demands the contribution; but it need not prescribe all the details of action, or even fix with precision the sum to be raised, or all the particulars of its expenditure. If the rule is prescribed which, in its administration, works out the result, that is sufficient but to refer the rule to another would be in excess of legislative power.'" See also Esberg v. Badaracco (1927) 202 Cal. 110, 121, 259 Pac. 730; Nevada Nat. Bank of San Francisco v. Board of Supervisors of Kern County (1907) 5 Cal. App. 638, 649, 91 Pac. 122; Barnes v. Board of
A situation very similar to the instant one was presented in the case of *Utah Construction Company v. Richardson*. In that case the con-

Supervisors of Colusa County (1910) 13 Cal. App. 760, 766, 110 Pac. 820; McDon-


*128* (1921) 187 Cal. 649, 650, 203 Pac. 401. In holding that the powers granted to the Board of Equalization were valid under the constitution, the court said:

"In a statute expressly enacted for the purpose of carrying into effect the provisions of Section 14, Article XIII, of the state constitution, the legislature has, among other things, provided for the furnishing to the state board of equalization of information deemed important in ascertaining the value of franchises, that the board shall determine the value of the franchises from the information thus sup-
plied and that the apportionment of taxes shall be based upon the value obtained. . . . Consequently, in so far as the prescribing of the ‘manner’ in which assessments are to be made imports the regulation of details of administration, the legislature has left little to be desired in its compliance with the constitutional mandate that such administrative machinery for making assessments be provided by law. Therefore, appellant necessarily takes the position that the expression quoted from the constitution refers not only to the general procedure for assessing franchises, but that the term ‘manner’ also signifies the rule to be followed by the board in deter-

mining the value of the franchises, or, in other words, that the constitution places upon the legislature the duty of specifying the weight to be accorded the various facts required to be reported and the mathematical process to be adopted by the board in arriving at a valuation of a franchise from the information before it.”

"The legislature has provided for the filing by the owner or holder of every taxable franchise of a written report containing detailed information concerning capital stock, bonds, debts, property, and other matters which the legislature evidently regarded as essential to a proper assessment of the value of franchises, . . . No attempt was made to direct the board of equalization as to how it should employ such information in arriving at the value of the total assets and tangible property of the corporations; the selection of the method calculated to lead to the most accurate valuation was left to the discretion of the said board. As a general rule, it is not essential that the legislature prescribe the method of valuation to be employed, but it may delegate to its taxing officers the power to adopt a suitable method and, in the latter case, the assessors must value the property according to their best judgment and with honest purpose. (Western Union Tel. Co. v. Mis-

souri, 190 U. S. 412, 425 [47 L. Ed. 1116, 23 Sup. Ct. Rep. 730, 733, see, also, Rose’s U. S. Notes]; Mexican Petroleum Corp. v. Bliss (R. I.), 110 Atl. 867, 971; 1 Cooley on Taxation, 3d ed., p. 754.) The general requirement in the state con-

stitution that the legislature fix the ‘manner’ in which the assessment is to be made does not limit the power of the legislature to invest the taxing board with the right to choose a rule of valuation.”

The court at this point cited cases from other jurisdictions, about which it said in part: "Bearing in mind that these holdings were under state constitutions which required that the legislature ‘shall prescribe such regulations as shall secure a just valuation’ or that the ‘value’ is ‘to be ascertained as provided by law,’ there can be no doubt that under the less specific provision of our own constitution to the effect that the assessment shall be made ‘in the manner to be provided by law,’ it was permissible for the legislature to commit to the board of equalization the duty of selecting the mode of ascertaining the cash value of the different elements dealt with in determining corporate excess instead of requiring the board to com-

pute assessments according to a value-finding rule prescribed by the legislature."
stitution (Article XIII, Section 14(d)) in authorizing the old corporation franchise tax, declared that the assessment of franchises should be made "in a manner provided by law." Although the legislature in establishing the tax provided that the actual valuation of franchises for assessment purposes should be determined by the State Board of Equalization the court held that this delegation of power to the board was "in the manner provided by law" as required by the constitution. If the power delegated to the State Board of Equalization in that case is upheld as valid it is difficult to see how the delegation of power to the Franchise Tax Commissioner in the Bank and Corporation Franchise Tax Act can be invalid.

(c) Allocation of Net Income for Taxation in California When a Corporation's Business Extends Beyond the Limits of the State.

If a corporation's business extends beyond the limits of this state a difficult problem arises in determining the amount of its net income that can fairly be said to be taxable in this state. At one time it could be declared with some assurance that if the tax in question was an excise tax, no difficult legal problem regarding allocation was involved in view of the well-established rule that an excise tax could be measured by elements themselves not taxable.\textsuperscript{129} But under the existing law, whether a direct net income tax or an excise tax is levied, the state cannot, without running the risk of having its tax rendered invalid, include within the tax base elements of value not taxable \textit{per se}.\textsuperscript{130} Where the business is spread out over different states the problem arises whether the state is taxing values beyond its jurisdiction. The unit rule of assessment\textsuperscript{131} is designed to allocate to the state for taxation its fair share of the taxable values of the taxpayer. In other words, the business is treated as a "unit" when that portion of the corporation's business done within the state cannot be physically segregated from that done outside the state. The courts are aware of the inherent difficulties in the way of segregating income for purposes of taxation in this kind of situation, and the general rule seems to be that, unless the state's

\textsuperscript{129} Horn Silver Mining Co. v. New York (1892) 143 U. S. 305, 12 Sup. Ct. 403. For other cases and a discussion of the measurement of excise taxes, see the preceding installment of this article, 17 \textit{Calif. L. Rev.} 232.

\textsuperscript{130} See Macallen Co. v. Massachusetts (1929) — U. S. —, 49 Sup. Ct. 432, \textit{ supra} p. 456; Western Union Telegraph Co. v. Kansas (1910) 216 U. S. 1, 30 Sup. Ct. 190, and subsequent cases discussed in 17 \textit{Calif. L. Rev.} 232 \textit{et seq}.

\textsuperscript{131} For cases sustaining the use of the unit rule in property taxation, see State Railroad Tax Cases (1875) 92 U. S. 575; Pullman's Palace Car Co. v. Pennsylvania (1891) 141 U. S. 18, 11 Sup. Ct. 876; Adams Express Co. v. Ohio State Auditor (1897) 165 U. S. 194, 166 U. S. 185, 17 Sup. Ct. 305, 604.
method of apportionment can be shown by the taxpayer clearly and substantially to reach non-taxable values, it will be upheld.\footnote{Underwood Typewriter Co. v. Chamberlain (1920) 254 U. S. 113, 41 Sup. Ct. 45; Atlantic Coast Line R. Co. v. Doughton (1923) 262 U. S. 413, 416, 43 Sup. Ct. 620, 621; Bass Ratcliff & Gretton v. State Tax Commission (1924) 266 U. S. 271, 45 Sup. Ct. 82.}

A typical situation in which the unit rule seems clearly applicable arises when the corporation has a factory located in one state and maintains selling agencies in other states. How much of the income of the company is due to manufacturing? How much to the company's sales? The entire business of such a corporation is so clearly unitary as to require a fair system of apportionment in order to prevent over-taxation to the corporation or undertaxation by the state.\footnote{Underwood Typewriter Co. v. Chamberlain (1920) 254 U. S. 113, 41 Sup. Ct. 45.}

A different situation, however, is presented where the business is not unitary in character (as may be true in the case of certain personal service corporations), but is of such a nature that the corporation can present accounts which clearly show the income derived from business done within the state as distinguished from the income derived from extra-state business. The unit rule seems hardly applicable to such a corporation and it is submitted that the income from business done without the state should not enter into the calculations by which the tax is assessed.\footnote{Standard Oil Co. of Indiana v. Thoresen (C. C. A. 8th, 1928) 29 F. (2d) 708; Standard Oil Co. of Indiana v. Wisconsin Tax Commission (1929) — Wis. ____, 223 N. W. 85.}

Another situation arises where the business is unitary but the corporation receives income from sources or activities that have no connection with the business done within the state. If the corporation is a domestic corporation this income is probably taxable.\footnote{Kansas City, M. & B. R. Co. v. Stiles (1916) 242 U. S. 111, 37 Sup. Ct. 58.} If the corporation is a foreign corporation there can hardly be said to be just grounds for including such income in the tax base.\footnote{See People ex rel Alpha Portland Cement Co. v. Knapp (1920) 230 N. Y. 48, 129 N. E. 202. See also Air-way Electric Appliance Co. v. Day (1924) 266 U. S. 71, 45 Sup. Ct. 12. See the following cases involving allocation in property taxation: Wallace v. Hines (1920) 253 U. S. 66, 40 Sup. Ct. 435; Meyer v. Wells Fargo & Co. (1912) 223 U. S. 298, 300, 32 Sup. Ct. 218, 219; Fargo v. Hart (1904) 193 U. S. 490, 24 Sup. Ct. 498.}

\footnote{The problem raised in the text is of particular importance in regard to the inclusion in the tax base of dividends received on stocks. Section 8(h) of the statute provides that in arriving at "net income" there shall be deducted from the "gross income," "Dividends received during the taxable year from income arising out of business done in this state; but if the income out of which the dividends are declared is derived from business done within and without this state, then
If the corporation is engaged in interstate commerce several problems arise particularly with regard to foreign corporations. Several rules on the subject may be stated somewhat dogmatically as follows:

Foreign corporations: (1) If the corporation is a foreign corporation and its business is exclusively interstate in character, an excise on its right to do business is invalid and obviously no question of allocation can arise. (2) If a direct net income tax rather than a franchise tax measured by net income is levied, the income derived from business done within the state seems clearly taxable, even though the corpora-

so much of the dividends shall be allowed as a deduction as the amount of the income from business done within this state bears to the total business done.

"The burden shall be on the taxpayer to show that the amount of dividends claimed as a deduction has been received from income arising out of business done in this state." The statute provides, therefore, that dividends that represent non-California business shall be included in the tax base. It is submitted that in the case of foreign corporations doing business in this state these dividends are beyond the taxing jurisdiction of the state, and should be excluded entirely from the tax base on which the allocation calculations are made. The Franchise Tax Commissioner in Schedule C of the Bank and Corporation Franchise Tax Return has excluded them from the tax base which is to be allocated, but in adding them back to the amount allocated to the state has subjected them to greater taxation even than would have been the case had allocation of them been made. Surely if apportionment of a part of such dividends to this state for taxation is improper the inclusion of the whole of them is unwarranted. It is submitted that this procedure by the Commissioner is of doubtful constitutionality and is contrary to the provisions of Sections 8(h) and 10 of the statute. Section 13 of the act provides that every corporation shall transmit to the "Commissioner a return in a form prescribed by him, specifying . . . all such facts as he may by rule, or otherwise, require in order to carry out the provisions of this Act." It would seem to follow from the language italicised that the Commissioner could not require in the return information which was not necessary "in order to carry out the provisions of the act." In view of the direction in Section 10, that in case the corporation's business is not entirely done in California, the "tax shall be according to or measured by that portion thereof which is derived from business done within this state," it is difficult to see why a return of income derived from dividends representing non-California business, or income from extra-state business having no relation to that done in California would be necessary "in order to carry out the provisions of this Act." On the contrary, it would seem that such income is impliedly excluded by the language of Section 10. Another objection to the inclusion of dividends representing non-California business is the double taxation resulting therefrom because of the fact that the shares of stock on which the dividends are paid will be subject to personal property taxes by the city and county in which the corporation holding them is located. See comment by Mr. Keaton relative to Assembly Bill No. 1047, Cal. Assembly Daily Journal, Feb. 20, 1929, p. 8, 9.

tion's business is exclusively interstate in character.\textsuperscript{138} (3) If the corporation combines some intra-state business with its interstate business, an excise tax measured by net income properly attributable to business done within the state whether intra or inter-state in character, seems clearly valid.\textsuperscript{139}

Domestic corporations: (4) If the corporation is a domestic corporation, even though engaged exclusively in interstate commerce, income properly attributable to business done within the state may be included in the tax calculations,\textsuperscript{140} and probably, although the question is by no means free from doubt, its entire net income (less that derived from exempt securities) may be so included.\textsuperscript{141}

Section 10 of the Bank and Corporation Franchise Tax Act in providing for the allocation of net income, states:

"... and if the entire business of such bank or corporation is not done within this state, the tax shall be according to or measured by that portion thereof which is derived from business done within this state. The portion of net income derived from business done within this state shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, payroll, value and situs of tangible property, or by reference to these or other factors, or by such other method of allocation as is fairly calculated to assign to the state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation."

The most important part of this provision seems to be the direction that the method of allocation adopted by the Commissioner "be fairly calculated to assign to the state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation." The formula adopted by the Commissioner is set forth in Schedule C of the Bank and Corporation Franchise Tax Return, and is explained in his instructions relating to allocation as follows:

"Allocation of Income and Dividends: The allocation formula in Schedule 'C' fixes the percentage of business done in California by giving equal weight to the amount and location of three factors: (1) property, (2) payroll, and (3) gross sales. The percentage so fixed is applied to net

\textsuperscript{138} United States Glue Co. v. Oak Creek (1918) 247 U. S. 321, 38 Sup. Ct. 499; Shaffer v. Carter (1920) 252 U. S. 37, 40 Sup. Ct. 221 (taxpayer in this case was a non-resident individual); Atlantic Coast Line R. Co. v. Doughton (1923) 262 U. S. 413, 416, 43 Sup. Ct. 620, 621.


\textsuperscript{140} United States Glue Co. v. Oak Creek (1918) 247 U. S. 321, 38 Sup. Ct. 499.

income, other than dividends (Items 10 and 26) from income arising out of business done without the state, the full amount of which is required to be included in net income (Schedule ‘C’ Item (i)). If, in the opinion of the taxpayer, the prescribed formula or the inclusion of all taxable dividends is not fairly calculated to assign to the state the portion of its net income reasonably attributable to the business done within this state, the taxpayer may use such other method of allocation of income or treatment of dividends as is fairly calculated to determine such portion of net income. If the taxpayer departs from the prescribed method of computation, it shall set out in a schedule attached to the return the reason for the departure and full details of its recomputation. In any event, the information called for in Schedule ‘C’ must be submitted by all taxpayers. The taxpayer’s allocation, whether or not the prescribed method be used, is subject to review and re-allocation by the Commissioner.

It seems safe to say, with the exceptions noted in the margin, that the formula is at least as fair and equitable as others which have been examined and approved by the United States Supreme Court. In the situations where the general formula set forth in Schedule C is not found applicable, it is submitted that if the Commissioner carefully follows the directions of the statute (that the method of allocation "be fairly calculated to assign to the state the portion of net income reasonably attributable to the business done within this state, and to avoid subjecting the taxpayer to double taxation") in accordance with the rules discussed in the preceding paragraphs, corporations will have no grounds for complaint because of improper allocation.


Under the act, corporations subject to its provisions are taxed upon the basis of the “taxable year” — and this may be a “calendar year” or a “fiscal year” if the corporation closes its twelve-months accounting period upon a date other than December 31, or it may be a fraction of either if the return is made for a fractional period. Although the corporation may choose either the fiscal or calendar basis for its taxable year, if no selection is made, it is taxed upon the calendar year basis.

A corporation coming under the statute is taxed according to, or measured by, its net income “computed” upon the basis of its net

142 Supra n. 135.
143 See cases cited supra n. 131.
144 "Sec. 11 (a). The term ‘taxable year’, as herein used, means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed herein. ‘Taxable year’ includes, in the case of a return made for a fractional part of a year, the period for which such return is made.
(b) The term ‘fiscal year’, as herein used, means an accounting period of twelve months ending on the last day of any month other than December." Cal. Stat. 1929, c. 13.
income for the next preceding fiscal or calendar year. This tax accrues "on the first day after the close of the taxable year." Within two months and fifteen days after the close of its taxable year, the corporation must make a return to the Commissioner. Half of the tax disclosed by the return is "due and payable on or before the fifteenth day of the third month following the close of the taxable year," the balance is "due and payable on or before the fifteenth day of the ninth month following the close of the taxable year."

It is now proposed to discuss certain ambiguities in the statute with regard to several situations of importance that may arise in the course of its operation.

(1) Is the Act retroactive? The Act went into effect March 1, 1929. The Franchise Tax Commissioner has issued the forms for the 1929 returns with the requirement that they be filed on or before May 15, 1929, by all corporations coming under the Act. The return form provides that a return must be filed for "each period ending between January 31, 1928, and February 28, 1929." Apparently as the Act is being administered, corporations taxable are to be taxed from the first of the year 1929. This fact raises three questions of importance: (1) Was it intended that the Act should operate retroactively? (2) If so, is such retroactive operation valid? (3) What is the effect of the double taxation produced in the case of corporations that have paid for a part of the year 1929 under the old corporation franchise tax act?

The new act does not clearly state that the tax provided for is to relate back to January 1, 1929. It may be criticized for this omission, especially in view of the holding that it is to be presumed that no statute is to operate retrospectively unless the contrary clearly appears. That the Act is intended to be retrospective must be inferred from certain other provisions. The provision contained in Section 13 granting an extension of time for returns required to be filed March 15, 1929, is evidence of retroactive intent, for unless a tax accrued under the new Act on January 1, 1929, there would be no returns due on March 15, which is two months and fifteen days after January 1.

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148 The statute may be criticised for scattering through many different sections provisions which must be read together. For example, definitions of terms used are found scattered in Sections 6, 7, 8, 11, and 36; provisions relating to the method of taxation are found in Sections 1, 2, 3, 4, and parts of Sections 8, 9, 10, 11, 12, 16, 17, 19, 26; provisions relating to returns are found in Sections 9, 13, 14, 15, and portions of other sections; the provisions relating to penalties are also badly scattered. Cal. Stat. 1929, c. 13.
Further evidence is found in the provision for prorating found in Section 13, providing that the tax for fiscal year corporations, for the months of 1929 corresponding to the parallel months which fell within the fiscal year ending in 1928, should be determined upon a proportional basis.\textsuperscript{151} These provisions give support to the view that the Act was intended to operate from the first day in 1929, and it is being administered in accord with this intention.

The question whether such retroactivity is valid must be considered, first in relation to the Constitutional amendment (Article XIII, Section 16) in pursuance of which the Act was passed, and secondly in relation to general constitutional limitations as they may affect retroactive taxation.

A consideration of the wording of the Constitutional provision and the features of the tax system\textsuperscript{5} set up in Article XIII of the Constitution,\textsuperscript{182} to which it was added as an amendment, leads to the conclusion that the retroactive feature of the Bank and Corporation Franchise Tax Act is contrary to the intention of the constitutional section in question. The amendment does not state that the tax should be effective from January 1, 1929, so that the statute, in providing that it should be so effective, went upon the assumption that this matter was unprovided for by the amendment and hence open for legislative determination. It would seem more reasonable to hold, however, that a constitutional provision adding a new tax to a general tax system adopts the basic features common to the whole system; for if it were intended to authorize the legislature to establish a tax at variance in fundamental particulars with the established procedure such intention would have been expressed. The outstanding characteristic of the state's tax system is that taxes are annual with the tax period beginning at a uniform date, the common date taxes accrue being the first Monday in March of each year. A further feature of that system is the provision that the lien for those taxes shall attach upon the first Monday in March of each year, i.e. upon the same date the taxes accrue. In other words under our system of taxation the accrual of a tax and the attachment of its lien are coincident.\textsuperscript{183} Not only does the constitutional amendment fail

\textsuperscript{151} "On or before May 15, 1929, every bank or corporation with a fiscal year ended during the calendar year 1928 shall file a return covering such fiscal year, and its tax for the months of the year 1929, corresponding to the months of 1928 which fall within the fiscal year ended during 1928, shall be according to or measured by such proportionate part of the net income of that fiscal year as the number of months falling within the calendar year 1928 bears to the total number of months in the fiscal year ended during that calendar year." Cal. Stat. 1929, c. 13, § 13.

\textsuperscript{182} Cal. Const. Art. XIII.

\textsuperscript{183} State v. Royal Cons. Mining Co. (1921) 187 Cal. 343, 202 Pac. 133.
to provide specifically that this tax is to be at variance with the established system, but certain provisions of the amendment show a clear intention that the customary system was intended to be followed. The provision that the lien of the new tax should attach upon “the first Monday in March of 1929 and of each year thereafter” seems to evidence a definite intention to integrate the tax provided for with the taxes imposed under other sections of Article XIII.

It is also significant that the provision in the amendment, “Said taxes shall become a lien on the first Monday in March of 1929 and of each year thereafter” relates to the taxes imposed on solvent credits and other forms of intangible personality as well as to the new taxes on banks and corporations. The apparent intent is to provide for methods of taxation for these subjects which would be complete substitutes for the taxes previously imposed, and to make the new methods effective on the same date that additional taxes would have accrued under the former laws save for this substitution. In other words, it is recognized that payment of taxes levied in 1928 against these subjects discharged the lien for taxes between the first Monday in March of 1928 and 1929. All of the taxes sought to be replaced were annual and the most fair and natural construction of the amendment is that all the substitutes were intended to be annual. The retroactive provision in the franchise tax act seems a clear violation of this intention.

The retroactive feature of the act might also be called into question under the due process provisions of the State and Federal Constitutions. It is not likely, however, that the act is invalid upon this ground. If the tax provided for be regarded as analogous to an income tax, it is within the rule that neither retroactivity covering months within a year prior to the passage of the taxing act nor measurement of income by the year previous to that of the act are sufficient to invalidate taxes otherwise valid. Since an income tax is a direct tax and the franchise tax is an excise tax it may be claimed that, although a retroactive direct tax is valid, a retroactive excise tax should be invalid in that the privilege taxed is one that has already been exercised. This argument for holding a retroactive excise tax invalid seems to be lacking in judicial support. The decisions from the standpoint of due process of law would seem to indicate that the retroactivity involved does not amount


to that degree of arbitrariness constituting a taking of property without due process of law.\textsuperscript{156}

As the new act operates (assuming the retroactive feature to be valid) there is an overlapping of taxes in certain cases. Many corporations in business in 1928 made their last payments under the old corporation franchise tax. It is uncertain whether the period covered by these taxes ended March 4, 1929, or June 30, 1929,\textsuperscript{157} but in either case there is an overlapping for corporations that made this payment are also taxed from January 1, 1929, under the new act. The problem arises only for the initial period of the act but is nevertheless of importance to the corporations subject to such double taxation. While the overlapping may involve double taxation, a tax will not be held invalid for that reason alone.\textsuperscript{158} The most important point is that the overlapping

\textsuperscript{156} Even granting, despite the language of McCray v. United States (1904) 195 U. S. 27, 24 Sup. Ct. 769; Billings v. United States (1914) 232 U. S. 261, 34 Sup. Ct. 421; Brushaber v. Union Pacific R. Co. (1916) 240 U. S. 1, 36 Sup. Ct. 236; and Barclay & Co. v. Edwards (1924) 267 U. S. 442, 45 Sup. Ct. 348, that the fifth amendment does limit the taxing power of Congress (a result achieved by the engaging logical device of saying that an exaction which is arbitrary is not a tax, hence is a prohibited taking—Nichols v. Coolidge (1927) 274 U. S. 531, 47 Sup. Ct. 710; Blodgett v. Holden (1927) 275 U. S. 142, 48 Sup. Ct. 105; Untermyer v. Anderson (1928) 276 U. S. 440, 48 Sup. Ct. 535; Tyler v. United States (D. Md. 1928) 28 F. (2d) 887 and that the fourteenth amendment should be similarly interpreted, it is not every retrospective tax which is held to be too arbitrary. The retroactive operation of paragraph 37 of the Tariff Act of 1909, imposing a tax on the use of foreign built yachts, was upheld in Billings v. United States (1914) 232 U. S. 261, 289, 34 Sup. Ct. 421, 428, and United States v. Bennett (1914) 232 U. S. 299, 34 Sup. Ct. 433; the retroactive application of an estate tax imposed by certain sections of the Revenue Act of 1918 was upheld in Cleveland Trust Co. v. Routzahn (N. D. Ohio 1922) 7 F. (2d) 463, and Farmers' Loan and Trust Co. v. Bowers (S. D. N. Y. 1926) 15 F. (2d) 706. Moreover, in Continental Oil Co. v. Walker (C. C. A. 9th, 1923) 285 Fed. 729, a license tax, of one cent per gallon sold, on dealers in gasoline passed in March, was upheld as valid even though applied to all gasoline sold during the year, including the months prior to passage. It was thus held that such a tax was not in fact retroactive, inasmuch as the privilege taxed was a present and continuing privilege, the amount of tax being measured by transactions in the prior period. Similar reasoning had been used, also, in People ex rel Connecticut Mutual Life Insurance Co. v. Kelsey (1906) 116 App. Div. 97, 101 N. Y. Supp. 902, aff'd. 188 N. Y. 541, 80 N. E. 1116, and American Refrigerator Transit Co. v. Adams (1900) 28 Colo. 119, 63 Pac. 410; both privilege taxes. The California act would seem to be clearly within the rule of these cases and hence valid.

\textsuperscript{157} The receipts, given those paying under the old share and corporate franchise tax act, read: "Being one-half of the tax for 1928 assessed to said company as shown by the assessment roll on file in controller's office and being State Tax for Eightieth Fiscal Year, July 1, 1928, to June 30, 1929." See McClaren and Butler, California Tax Laws of 1929, p. 51.

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may be held to violate provisions of the constitutional amendment other than those already mentioned. The amendment provides regarding national and state banks, that the tax “shall be in lieu of all other taxes, and licenses, state, county and municipal,” and as to other corporations subject to the act, that the new tax is to be in lieu of the franchise tax provided for in Section 14(d) of Article XIII of the State Constitution. Inasmuch as the tax paid under the old act for this period was replaced by the new tax it would seem, if the new tax is to operate retroactively, that payment of the old tax was excused by virtue of the substitution and should not have been paid. It is difficult to see, however, how it can be recovered, as in most cases it was paid before the new act in fact was passed and no doubt was not paid under protest. The argument may be restated as follows: (1) the statute as interpreted by the Commissioner imposes a new tax which is retroactive and overlaps into a period for which many corporations have already paid taxes under Section 14(d); (2) the Constitution by providing that the new tax on corporations other than banks shall be in lieu of the tax imposed by Section 14(d) seems clearly to mean that the corporations dealt with shall not be required to pay both the new tax authorized and also the old tax imposed by Section 14(d). If for example the legislature had provided that the new tax should operate from and after March 4, 1929, and that the old tax should continue to operate for a period of say six months after that date the statute would clearly have been invalid since it would have been squarely in the face of the constitutional provision that the new tax shall be “in lieu” of the old. Yet it is difficult to see any distinction in principle between the case just supposed and the statute enacted in fact, if the retroactive construction which has been given it by the commissioner is correct. If the foregoing construction of the constitutional provision is correct two conclusions are possible: the new statute must, in order to preserve its constitutionality, either be interpreted (1) as being an implied retroactive repeal (for the overlapping period) of the tax imposed under the authority of Section 14(d) or (2) as not having been intended to operate retroactively at all. The former construction would be obviously unreasonable since the legislature must be presumed to have known that many corporations had, at the time the statute was passed, already paid the tax for the overlapping period imposed by Section 14(d) and that these taxes could not be recovered. On the other hand the statute itself seems, as has been seen, to require the conclusion that it was intended to operate retroactively. It may be suggested, therefore, that if the courts interpret the “in lieu” provision of the Constitution in accordance with the foregoing discussion they must either hold that the legislature intended the
first of the possible constructions above suggested in spite of its unreasonableableness or else hold the statute void.

As to national banks an additional objection is presented. Section 5219 provides that the states may tax national banks in one of four ways and stipulates that the “imposition by any State of any one of the . . . four forms of taxation shall be in lieu of the others.” One of the permitted methods was followed under the old share tax on national banks. The new act follows a different method. Thus, while the state may choose between one of the four methods, it does not seem that a strict reading of the terms of the section would allow an overlapping which would amount to taxation under the two methods simultaneously.159

(2) When does the tax become a lien? As explained above, the constitutional amendment apparently intended that the new tax should accrue upon a fixed date which, if in accord with the general tax system set up in the constitutional article of which it is a part, would be the first Monday in March of each year. Apparently with this in mind the framers of the constitutional amendment provided, as we have seen, that “Said taxes shall become a lien upon the first Monday of March of 1929 and of each year thereafter,” thus establishing a lien date in accord with the lien date of the other taxes provided for by Article XIII. As was pointed out above, one of the outstanding characteristics of the tax system set up by Article XIII is the fact that the accrual of a tax and the attachment of its lien are coincident.160 Thus, under that Article, the fixing of the tax obligation on the subject of the tax and the creation of the tax lien must be regarded as occurring simultaneously, although, of course, the amount of the tax may not be ascertained until later, in which case there is a relation back to the date when the tax first accrued and became a lien.161 The attachment of the lien at the date of the accrual of the tax is an essential feature of a sound tax system, for no practical object could be served by having a lien attach before any tax had accrued, or by having the lien attach at a date after the tax had accrued.

Notwithstanding these basic propositions, the Bank and Corporation Franchise Tax Act provides for an accrual date which shall be “the first day after the close of the taxable year” and defines “taxable year” as the “calendar year or the fiscal year . . . upon the basis of which

159 Supra n. 28.
160 Supra n. 152.
161 Estate of Backesto (1923) 63 Cal. App. 265, 218 Pac. 597.
the net income is computed." As a result instead of providing for one accrual day, the act establishes January 1 as the accrual date for calendar year corporations and the first day of any of the other eleven months as the date for fiscal year corporations. By reason of the constitutional provision, the act could not provide that the lien should attach at the varying date of accrual, and instead was forced to provide for a single fixed lien date. The provision is found in Section 29 of the act:

"The taxes levied under this act shall constitute a lien upon all property of the taxpayer, which lien shall attach on the first Monday in March of each year. Every tax herein provided for has the effect of a judgment against the taxpayer and every lien has the effect of a judgment duly levied against all property of the delinquent . . ."

The language of this section is ambiguous. If the tax is to be a lien on the first Monday in March the provision that every tax has the effect of a judgment is superfluous if it means no more than that every tax is to have the effect of a lien. The provision that every tax is to have the effect of a judgment might be read as providing that every tax should have the effect of a lien upon accrual; however, this interpretation is precluded by reason of the constitutional stipulation that the lien attach on the first Monday in March.

Section 29 apparently, therefore, provides that the lien shall only attach on the first Monday in March. Since under the act taxes accrue before and after the lien date, it is pertinent to ask, on what March does the lien attach if the tax accrues after the first Monday in March? Does the lien relate back to the preceding March, or must the attachment of the lien be delayed until the March following? The provision must operate in one way or the other and the act leaves this important question in doubt.

In so far as the language of the act is concerned, the view that the lien relates back to the preceding March is as tenable as the view that the lien attaches the March following. From the standpoint of their effect one is as undesirable as the other. If the lien is considered as

162 Cal. Stat. 1929, c. 13, § 11. Applied, this might result in the accrual of the first tax imposed under the law on February 1, 1928, or January 1, 1929, or any first day of an intermediate month. But the Constitution says the first lien shall attach on March 4, 1929. There seems to be, as brought out above, a fundamental divergence between the constitutional and legislative scheme. Nor can they be reconciled by attributing no significance so far as tax burden is concerned to the fact that the accrual of the tax is expected to antedate its lien. The tax is conceived as one for the privilege of doing business from January 1, 1929 (the first accrual date for corporations with calendar year accounting, which are in the vast majority). By the device of making the accrual date on or before January 1, 1929, it is clear that the act seeks to avoid the logical intendment of the Constitution that the new tax should become effective on March 4, 1929, and not before.
attaching on the March following the accrual a bad situation results, for it means that after a corporation becomes liable for taxes a period intervenes before the lien will attach. The corporation may sell its property within that period free from any lien for the taxes due against it. For example, suppose a fiscal year corporation ended its taxable year on June 30, 1929; on the next day its tax for the next fiscal year accrued; however, the lien for that tax will not attach until the following March, i.e. March, 1930. Thus the corporation has a period within which it may sell its property free of a lien for the accrued taxes. Such procedure is fundamentally contrary to sound tax policy.

The other possibility is to have the lien relate back to the prior March; for example if a corporation's taxable year ended June 30, 1929, its tax accrued on July 1, 1929, and the lien for the tax attached on March 4, 1929, four months before the tax accrued. Thus, if the lien always related back to the preceding March the objection that the tax might be avoided could not be raised. However, the effect of such procedure upon the securing of a clear marketable title from a corporation selling its property would be extremely important for a purchaser might find his property subject to a lien for taxes subsequently accruing against the corporation, of which he could have no knowledge without examining into the accounting system of the corporation in question. A purchaser in May might subsequently find that a lien had attached the month before for taxes accruing against the corporation, perhaps as late as the December following his purchase.

From the foregoing it is evident that the lien provisions of the act create a situation of doubt, with a choice between undesirable alternatives. As discussed above this condition seems to be the result of the statute's disregard of the intent of the amendment that there be a single date for tax accruals; for a fixed lien date is a workable provision only if the accrual date is also fixed. The situation created by the statute can only be remedied by a change of the lien provision of the amendment allowing the lien to attach upon the date the tax accrues, or by changing the act to provide for a uniform accrual date coincident with the first Monday in March.

(3) Are the Provisions Respecting Returns Exclusive? The Act makes certain provisions in respect to the returns to be filed under it. These provisions are especially important in view of the fact that returns by two classes of corporations are unprovided for. Under the Act, a calendar year corporation is required to file a statement of its income from January 1, 1928, to December 31, 1928, that is, for the

calendar year of 1928, and upon the basis of this return, its tax for the
calendar year of 1929 will be computed. The Act requires returns by
corporations whose fiscal years ended in 1928, and their tax for the
months of the year 1929, corresponding to the months of 1928 which fall
within the fiscal year ended during 1928, shall be according to, or
measured by, such proportionate part of the net income of that fiscal
year as the number of months falling within the calendar year 1928
bears to the total number of months in the fiscal year ended during that
calendar year.

It is to be noted that the statute contains no provision as to fiscal
year corporations that began business in 1928 but whose fiscal year
does not end in 1928, nor as to calendar year corporations that began
business in 1929 before the effective date of the Act, although the Act
provides for corporations beginning business after March 1, 1929.

Suppose a corporation, doing business on a fiscal year basis, started
business July 1, 1928. Obviously, its fiscal year did not end in 1928.
Its taxable year does not end until June 30, 1929, and its tax does not
accrue, nor is it required by the statute to file a return, until July 1,
1929, which will be the tax for July 1, 1929, to July 1, 1930. Is that
corporation not to be taxed at all for doing business during the first six
months of 1929? If not, why the discrimination?

Suppose a corporation commencing business in January, 1929, elects
to do business on a calendar year basis. Its taxable year does not end
until December 31, 1929, and its tax does not accrue until January 1,
1930. Does that corporation escape taxation for the year 1929?164

164 The following language of Section 23 raises an additional problem as to
returns: “One-half the amount of tax disclosed by the return, after allowing the
offset herein provided for, shall be due and payable on or before the fifteenth
day of the third month following the close of the taxable year, as defined in Section 11
hereof. The balance of the tax shall be due and payable on or before the fifteenth
day of the ninth month following the close of the taxable year.” Cal. Stat. 1929,
c. 13, § 23.

Section 11 defines “taxable year” as follows: “The term ‘taxable year’ as
herein used, means the calendar year, or the fiscal year ending during such calendar
year, upon the basis of which the net income is computed herein. ‘Taxable year’
includes, in the case of a return made for a fractional part of a year, the period for
which such return is made.” Cal. Stat. 1929, c. 13, § 11.

What is the first taxable year of a corporation with a fiscal year ended June
30, 1928? By virtue of the Section 13 of the statute, it is clearly not June
30, 1929. Taken literally, the tax is due before the act went into effect. One-half
of the tax of a corporation whose fiscal year ended June 30, 1928, would seem to
be due September 15, 1928, several months before the law was in existence or the
constitutional amendment submitted for adoption. If the corporation’s fiscal year
ended in March, 1928, the first half of the tax would be due June 15, 1928, when
as a matter of fact, the old franchise tax, for which this one takes the place, was
not itself due until July 1, 1928. The statute should have provided an exception
in Section 23 of the act to the effect that, in the case of a corporation whose first
(3) Do Certain Corporations Partially Escape Taxation?

Under the Act certain corporations may have their taxable year computed upon the basis of a preceding fractional period with the result that they pay for a full twelve-months year upon a fractional, and not upon a twelve-months, period, and thus, apparently, escape taxation for that period between the fractional months and a full year. For example: Suppose a corporation commences business July 1, 1929, on taxable year was a fiscal period ending in 1928, the tax shall not be due until the date for its return is due under Section 13 of the act.

It might be contended that the extension provisions of the statute meet the situation and that such corporations should have filed returns on or before May 15, 1929. These provisions might very well be construed to meet the situation as regards the first installment of the tax due, but as brought out in the discussion following since they apply to first installments only it is difficult to see how they can adequately solve the problem raised.

Section 13 of the statute provides that an extension of two months shall be granted in the case of returns required to be filed March 15, 1929, and one month in the case of those to be filed April 15, 1929. Section 15 allows the commissioner to grant extensions for cause not to exceed ninety days. When extensions are granted for cause corporations must make first payment before extended time expires. Thus it seems that while extensions are made for returns, the statute makes no provision for extended time of payment for taxes subject to returns in March and April 15, 1929. This is important in that a penalty is provided for delinquent payment under the section. Return forms were not available to taxpayers to make their reports on March 15, or April 15, 1929. It would none the less appear that the 15% penalty imposed by Section 23 for failure to pay one-half of the tax on or before its due date had already accrued in the case of all such corporations before they could even make a return. Can the Franchise Tax Commissioner provide by rule that this penalty will not be exacted? It is doubtful if he can thus make such a gift of public moneys to the corporations affected.

In fact, there is some doubt because of the wording of Section 13 whether or not the general extension of time of two months has been granted. The section reads: "... there shall be granted a general extension of time of two months." Cal. Stat. 1929, c. 13, § 13. It is not clear whether "shall be" means "is" or whether it is contemplated that the Commissioner shall make a blanket order of extension pursuant to its direction. If Section 13 by its own terms grants an extension, then it is obviously not one granted by the Commissioner under Section 15, and the relief from penalties in cases of extensions provided for in Section 23 refer expressly to extensions made under Section 15.

The interest provision in Section 24b to the effect that interest shall run on the extension granted applies only in the case of extensions granted by the Commissioner. The corporations filing returns in pursuance of the extension granted in Section 13 would appear not to be liable for interest during the period of the extension as would be true if the extension had been granted by the commissioner.

It should also be observed that the extension is only effective for the first installment and has nothing whatever to do with the second installment. Time for paying the balance is totally unaffected by grant of an extension. Section 23 provides that "at the time of the delinquency of the second installment an additional penalty of 5 per centum shall be added to the first installment unless that installment has theretofore been paid." Cal. Stat. 1929, c. 13, § 23. Thus though the time for paying of the first installment be extended, 5% will be added to it if the second installment becomes due before the extended time for paying the first.
a calendar year basis, taxable year ending December 31, 1929. On January 1, 1930, the tax for the calendar year 1930 accrues. Suppose the tax amounts to $500.00 on the basis of net income from July 1, 1929, to December 31, 1929. A $25.00 minimum tax was paid at the time of commencing business; $475.00 is due for the 1929 tax. The return on which this is determined is supposed to be filed by March 15, 1930, and the 1929 tax is adjusted on the basis of that return. The $475.00 for the 1929 tax is due as well as half of $500.00 or $250.00 on the 1930 tax. The tax for the entire year 1930 is apparently figured on the corporation's income for six months only. No subsequent adjustment is made as the tax for 1931 is calculated merely on the income for the year 1930.

(e) Recovery of Taxes Illegally Collected Under the Act.

The Bank and Corporation Franchise Tax Act, in contrast with prior California tax laws, contains in Sections 23, 27 and 30 provisions establishing a regular method for the recovery of taxes illegally collected under the Act. A special fund called the bank and corporation franchise tax fund is established and this fund may be subjected to warrants of the controller for the purpose of paying the refunds provided for under the Act. Such refunds with six per cent interest will be allowed where the claim for a refund has been approved by the proper administrative officer as set forth in Section 27, or where there is a favorable judgment in a suit for the recovery of taxes illegally collected.

In providing for refunds under a judgment the statute is not as clear as it should be upon the point that the fund is to be subject to the judgment; for to authorize the court to enter a judgment for the amount of wrongfully collected taxes and interest is not exactly equivalent to the authorization of the controller to draw his warrant upon the fund in favor of a corporation obtaining a judgment. However, the sections in question must be read together, and as so read they may possibly be construed as expressing the legislative intent that under the judgment provision taxpayers were to be reimbursed by payment from the special fund through warrants drawn by the controller.

An objection might be raised to the refund provisions upon the ground that they violate Article IV, Section 22 of the State Constitution which provides that "No money shall be drawn from the treasury but in consequence of appropriation made by law" in that the refund

166 Cal. Stat. 1929, c. 13, § 27.
provisions of the statute are not in terms of appropriation. However, this objection does not seem to be serious, in view of the holding that no set form of words is necessary to constitute an appropriation if the legislative intent is clearly expressed.\footnote{168}

Another objection to the refund provisions may be raised under Article IV, Section 34 of the constitution which provides that "No bill making an appropriation of money, except the budget bill, shall contain more than one item of appropriation, and that for one single and certain purpose to be therein expressed." Under this constitutional provision it has been held that a statute is unconstitutional that provides for the issuance of warrants by the controller for the payment of judgments rendered against the state in tax cases. The court declared that the statute there involved, "does not contain but one item of appropriation; it embraces as many items as there may be persons having such claims and obtaining final judgment therefor."\footnote{169} In that case, however, the court was concerned with an appropriation from the general fund. There is an intimation in the case that if the money was to be drawn from a special fund the rule would not be the same. The more recent case of Ryan v. Riley\footnote{170} gives support to this view. That case upheld Section 30 of the Motor Vehicle Act appropriating money in the motor vehicle fund for the expenses of maintaining the motor vehicle department and the expenses incurred in carrying out the provisions of the Motor Vehicle Act and providing that after deduction of such expenses the balance of the fund was to be used as county and state highway maintenance funds. This statute was objected to on the ground that it was not one item of appropriation nor was it for a single purpose. While the reasoning of the court is not convincing it reached the conclusion that inasmuch as the money was to be taken from a special fund and not from the general fund there need be no specific designation either as to purpose or amount.

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\footnote{168}{Ingram v. Colgan (1895) 106 Cal. 113, 38 Pac. 315, 39 Pac. 437, 46 Am. St. Rep. 221, 28 L. R. A. 187; Proll v. Dunn (1889) 80 Cal. 220, 22 Pac. 143; Stratton v. Green (1872) 45 Cal. 149.}

\footnote{169}{Westinghouse Electric & Mfg. Co. v. Chambers (1915) 169 Cal. 131, 145 Pac. 1025.}

\footnote{170}{(1924) 65 Cal. App. 181, 223 Pac. 1027.}

* The writer wishes to acknowledge his indebtedness to Professor Evan Haynes, Editor-in-Chief of the California Law Review; Professor D. O. McGovern; Mr. Dixwell L. Pierce, Secretary of the State Board of Equalization; Mr. Anthony J. Kennedy, of the California Bar; and Miss Harriet Feinberg, Mr. John Harrell and Mr. Jack C. Peppin, of the editorial staff of the California Law Review, without whose careful and painstaking assistance this article could not have been written.