Yale Law Journal

Volume 20
Issue 8 *Yale Law Journal*

Article 4

1911

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Recommended Citation
CHARLES W. PIERSON, *THE CORPORATION TAX DECISION*, 20 YALE L.J. (1911).
Available at: https://digitalcommons.law.yale.edu/ylj/vol20/iss8/4

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THE CORPORATION TAX DECISION

By Charles W. Pierson.

The immediate consequences of the decision affirming the constitutionality of the Federal Corporation Tax are so slight that its profound significance is likely to be overlooked. At its present rate the tax is not burdensome and has proved easy of collection. The thing upon which it falls—the privilege of doing business in a corporate capacity—is an abstraction which makes little appeal to the sympathies or the moral sense. The public, more concerned with present conditions than with the passing of a theory, is indifferent.

Thus it has sometimes been with the turning points in the affairs of nations. They came quietly and without observation, and it remained for the historians to mark the actual parting of the ways.

The Supreme Court holds, and in its opinion reiterates many times, that the tax is upon the *privilege of doing business in a corporate capacity.*

Right here is the crux of the matter. Corporate capacity is not a right granted by the National Government. It is something which Congress can neither give nor take away. In the division of powers which marked the creation of our dual government the power to confer corporate capacity was reserved to the States. The decision, therefore, comes to this: Congress can by taxation burden the exercise of a privilege which only a State can grant. And the power to tax, it must be remembered, involves the power to destroy.

This seems a long step from the theory of the men who founded the republic. Forty years ago the Supreme Court, in a memorable case denying the right of the National Government to tax the salary of a State official, stated the theory as follows:

"The General Government, and the States, although both exist within the same territorial limits, are separate and distinct sovereignties acting separately and independently of each other within their respective spheres. The former in its appropriate sphere is supreme; but the States within the limits of their powers not granted, or, in the language of the Tenth Amendment, 'reserved,' are as independent of the General Government as that Government within its sphere is independent of the States."[1]

The court buttresses its recent decision by the argument *ex necessitate*—that to hold otherwise would open the way for men to withdraw their business activities from the reach of Federal taxation and thus cripple the National Government. The Court says:

"The inquiry in this connection is: How far do the implied limitations upon the taxing power of the United States over objects which would otherwise be legitimate subjects of Federal taxation, withdraw them from the reach of the Federal Government in raising revenue, because they are pursued under franchises which are the creation of the States ?* * * Let it be supposed that a group of individuals, as partners, were carrying on a business upon which Congress concluded to lay an excise tax. If it be true that the forming of a State corporation would defeat this purpose, by taking the necessary steps required by the State law to create a corporation and carrying on the business under rights granted by a State statute, the Federal tax would become invalid and that source of national revenue be destroyed, except as to the business in the hands of individuals or partnerships. It cannot be supposed that it was intended that it should be within the power of individuals acting under State authority to thus impair and limit the exertion of an authority which may be essential to national existence."

This argument will not bear scrutiny. It apparently loses sight of the vital distinction between a tax on the mere doing of business and a tax on the privilege of doing that business in a corporate capacity. These are two very different things. The right of Congress to tax the doing of business was not disputed. It had been expressly upheld in the well-known case of Spreckels Sugar Refining Co. v. McClain,[2] which involved a tax on the business of refining sugar, whether done by a corporation or by individuals. The present tax, however, goes further and fastens upon something new—something which in the case of individuals or partnerships has no existence at all—which comes into being only by the exercise of the sovereign power of a State. The opponents of the tax, far from attempting to narrow the existing field of Federal taxation, were in fact resisting an encroachment by Congress on an entirely new field, created by and theretofore reserved exclusively to the separate States. It was conceded that Congress could tax a business when done by individuals and could tax the same business when done by a corporation. The inquiry was; does the act of a State in clothing the individuals with corporate capacity create a new subject matter for taxation by the

general Government? That was the real question before the Court, and the decision answers it in the affirmative.

Other illustrations of the same apparent confusion of thought are to be found in the opinion. For example, it is said (citing various cases involving a tax on business where the party taxed was a corporation):

"We think it is the result of the cases heretofore decided in this Court that such *business activities,* though exercised because of State created franchises, are not beyond the taxing power of the United States."

Here again the Court seems to lose sight of the distinction between a tax on "business activities" and a tax on the privilege of conducting such activities in a corporate capacity.

It is futile, however, to quarrel with the logic of the opinion. The question is closed and the Court, by affirming the judgments appealed from, has committed itself to the theory that the Federal Government may, by taxation, burden the exercise of a privilege which only a State can confer. With the expediency of that theory as applied to present-day political conditions we are not now concerned. The object of this paper is to point out that the decision marks a distinct departure from the earlier doctrine that the two sovereignties, Federal and State, are upon an equality within their respective spheres.

In view of the centralizing forces which are tending to transform these sovereign States into mere political subdivisions of a nation, the decision is of vital significance. Moreover in a very practical way it touches the right of each State under the compact evidenced by the Federal Constitution to manage its internal affairs free from compulsion or interference by the other States. To illustrate: In some parts of the country the anti-corporation feeling runs high. Many men if given their way would tax the larger corporations out of existence. Under this decision the way is open whenever a majority can be secured in Congress. An increase in the tax rate is all that would be necessary. Make the rate ten per cent. or twenty per cent. instead of one per cent. and the thing is accomplished.

New York may deem it good policy to encourage the carrying on of industry in a corporate form. Texas may take a different view and conclude that the solution of the Trust problem lies in suppressing certain classes of corporations altogether. Under this

decision it lies within the power of Texas and her associates if sufficiently numerous to impose their view on New York and make it impossble for her domestic industries to be carried on profitably in a corporate form. And yet the possibility of impressing the will of one State or group of States upon another State with respect to her internal affairs is the very thing which the founders of the Republic sought most carefully to avoid. to the general Government involved such a curtailment of State independence, few States, in all probability, would have been ready Had it been understood in 1787 that the grant of taxing powers to ratify the Constitution.

Charles W. Pierson.