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Taxing the Chain Stores

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NOTES AND COMMENT

TAXING THE CHAIN STORES.

Chain-store growth has assumed phenomenal proportions during the past twenty years¹ and with their successful advent into the retail field there came a bitter protest from the independent merchant and his jobber. The latter carried their distress to the state legislature with the result that discriminatory chain-store tax laws were enacted to hamper this monopolistic growth and to reduce the extraordinary advantages possessed by chain stores.

For a clear understanding of chain-store taxation let us review the mile posts as laid down by the courts in decisions of momentous importance. The first attempt to discriminate against the chain store through the use of the taxing power was made by the city of Danville, Kentucky. The city levied an annual fee of fifty dollars against stores doing business by the cash-and-carry method while a fee of only twelve dollars was levied on stores advancing credit.² This attempt to discriminate on the basis of method of doing business was held to be an unreasonable classification by the courts of Kentucky, inasmuch as the details of credit and delivery alone are not enough to form a reasonable basis for the classification attempted.³ Equal protection of the law does not require that everyone be treated exactly alike;⁴ however, it is a requisite that all persons within a class shall be treated similarly and no arbitrary divisions be created. This being true, the legality of chain-store taxation depends on whether or not the chain store can be placed in a separate classification from the local store.

In 1929 Indiana passed a statute⁵ requiring all stores operating within the state to pay an annual license tax which gradually increased with the number of stores under one management. The first case to test the constitutionality of the statute in the United States Supreme Court was that of *State Board of Tax Commissioners of Indiana et al. v. Jackson*.⁶ The complainant contended that as the owner of two hundred and twenty-five stores doing a business of only one million dollars a year, he paid a \$5,443 tax while another department store did an eight-million-dollar business and paid \$3 tax a year—therefore the statute was a denial of equal protection of the laws, an arbitrary classification having been established. It was held that the statute was not a denial of equal protection of the laws because the

¹ NYSTROM, *ECONOMICS OF RETAILING* (1930) 227. From 1919 to 1928 sales of grocery chains increased 366%, five and ten cent stores 183%, candy chains 136%, drug chains 159%, while department stores gained 38%; U. S. BUREAU OF CENSUS, *CENSUS OF DISTRIBUTION—RETAIL CHAINS* (1933) 14.

² *City of Danville v. Quaker Maid, Inc.*, 211 Ky. 677, 278 S. W. 98 (1925).

³ *Ibid.*

⁴ *Singer Sewing Machine Co. v. Brickwell*, 233 U. S. 304, 58 L. ed. 974 (1914).

⁵ Ind. Act of 1929, c. 207, § 5.

⁶ 283 U. S. 527, 51 Sup. Ct. 540 (1931).

classification was reasonable; therefore the statute was constitutional.⁷ The constitutional restriction upon the power of the state to tax, that it shall not deny to any person the equal protection of the laws, requires that discrimination made against a particular class shall be based on substantial differences that reasonably distinguish such class from others not so taxed.⁸ The majority opinion stated that the difference is not one of ownership merely but also of organization, management and type of business transacted. Among the advantages possessed by the chain store over others are minimized danger of overstocking, quantity buying, centralized distribution, unified and therefore cheaper and better advertising, concentration of management, and standardization of sale policies and goods.⁹ These differences enable the chain store to secure a greater profit than a local store retailer. However, the dissent stated these same advantages accrue to big department stores as well as chain stores. In concluding his dissenting opinion Mr. Justice Sutherland aptly said:

"It may be that here the maximum tax of \$25, for each store while relatively high is not, if considered by itself excessive; to sustain it will open the door of opportunity to the state to increase the amount to an oppressive extent. This court frequently has said—and it cannot be too often repeated in cases of this character—that the power to tax is the power to destroy; and this constitutes a reason why that power, however moderately exercised in given instances, should be jealously confined to the limits set by the constitution."

As a result of this case, anti-chain-store statutes have grown in quantity¹⁰ and harshness.¹¹ The warning of the minority in the

⁷ *Ibid.*

⁸ *Brown Forman Co. v. Kentucky*, 217 U. S. 563, 30 Sup. Ct. 578 (1910); 3 WILLOUGHBY, CONSTITUTIONAL LAW (2d ed. 1929) 1948; TAYLOR, DUE PROCESS (1917) 611.

⁹ For a more comprehensive list of distinctions see 283 U. S. 527, 51 Sup. Ct. 540 (1931).

¹⁰ Twenty-two states have enacted chain store legislation or legislation aimed primarily at chains: Ala. Laws, No. 369, superseded by H. B. 324, effective July 10, 1935; Cal. Laws of 1935, c. 849; Colo. (Prentice-Hall, 1934) par: 39, 501, effective Jan. 1, 1935; Fla. Comp. Gen. Laws Ann. (Supp. 1932) tit. 11, c. 84, superseded by Fla. Laws of 1935, S. B. 724; Idaho Laws of 1933, c. 113; Ind. Stat. Ann. (Burns, 1933) §§ 42-301 to 42-313 as amended by Ind. Acts of 1935, c. 176, 271; Iowa Laws of 1935, c. 75; Ky. Acts of 1930, c. 149, superseded by Ky. Acts of 1934, c. 26; La. Acts of 1932, act 19, as amended by La. Acts of 1934, act 51; Me. Pub. Laws of 1933, c. 260; Md. Ann. Code (Bagby, 1924) art. 56, as amended by Md. Laws of 1924, c. 26 and Md. Laws of 1933, c. 542; Mich. Pub. Acts of 1935, act 265, as amended by Mich. Pub. Acts of 1935, act 177; Minn. Laws of 1933, c. 213; Miss. Gen. Laws of 1930, c. 90; Mont. Laws of 1933, c. 155; N. M. Laws of 1934, c. 33; N. C. (Prentice-Hall, 1935) par: 41, 226; S. C. Code (Mitchie, 1932) § 2556; S. D. Laws of 1935, S. B. 154; Vt. Pub. Laws of 1933, c. 46, §§ 1123-1140, repealed by Vt. Pub. Acts of 1935, No. 36; W. Va. Laws of 1933, c. 36; Wisconsin Statute (1933) §§ 76, 75, superseded by Wis. Laws of 1935, c. 545.

¹¹ Note (1935) 21 IOWA L. REV. 93.

Jackson case,¹² that there was no limit to the power of legislatures to levy discriminatory taxes against chain stores once that power was admitted to exist, has proved to be more than mere theory by the case of *Fox v. Standard Oil Co. of N. J.*¹³ There the statute was identical with that of Indiana, but because of the extreme graduated tax the gasoline stations would be forced out of business. The court held where power to tax exists, the extent of burden is for the legislature to say;¹⁴ and unless it is so arbitrary as not to be the exercise of tax power but a design for something different, the courts may not interfere.¹⁵ If the people wish to encourage the increase of such discrimination as a mere incident to tax policy, their decision is final.

In *Liggett v. Lee*,¹⁶ the Florida statute provided for a graduated tax of units at a rate which placed a higher tax on units of a chain when the units were in more than one county, than when all were in the same county.¹⁷ The court held the statute unconstitutional on the ground that, simply because one operated stores in two or more counties was no reasonable basis for differentiating between two chains; and therefore the statute created an arbitrary classification—there being no reason to believe that mere geographical distribution of units allowed material economic advantage as regards local stores more closely knit. The court declared that, assuming the state had power to suppress by taxation a form of organization deemed inimical to the public interest, no such motive could be attributed to the present statute in the absence of legislative declaration or record proof. Mr. Justice Brandeis, dissenting, was of the firm opinion that the state may tax a corporation out of existence to effect a policy which is within the purview of state police power. He said:

“The presumption of constitutionality must prevail in the absence of some factual foundation of record for overthrowing the statute. The raising of revenue is obviously not the main purpose of the legislation but its chief aim is to protect the individual retail stores from the competition of chain stores. The statute seeks to do this by subjecting the latter to financial handicaps which may conceivably confine their withdrawal from the state. If a state believes that adequate protection against harm apprehended or experienced can be secured, without revoking the corporate privilege, by imposing thereafter upon

¹² See note 9, *supra*.

¹³ 294 U. S. 87, 55 Sup. Ct. 333 (1934).

¹⁴ *Magano Co. v. Hamilton*, 292 U. S. 40, 54 Sup. Ct. 599 (1934).

¹⁵ *Veizie Bank v. Fenno*, 8 Wall. 533 (U. S. 1869); *McRay v. United States*, 195 U. S. 27, 24 Sup. Ct. 769 (1904); *Alaska Fish Co. v. Smith*, 255 U. S. 44, 41 Sup. Ct. 219 (1921); *Fox v. Standard Oil Co.*, 294 U. S. 67, 55 Sup. Ct. 333 (1934) (resulted in forcing a change from an integrated to a voluntary chain business).

¹⁶ 288 U. S. 517, 53 Sup. Ct. 481 (1933).

¹⁷ Fla. Comp. Gen. Laws Ann. (Supp. 1932) tit. 11, c. 84.

corporations the handicap of higher, discriminatory license fees as compensation for the privilege, I know of nothing in the Fourteenth Amendment to prevent it from making the experiment."¹⁸

In *Stewart v. Lewis*,¹⁹ the Kentucky statute,²⁰ therein ruled on, imposed a gross sales tax in the form of a license tax on all retail merchants operating one or more stores in the state, graduated on a basis of gross sales. The court declared the statute unconstitutional, for the tax on gross sales was a tax on the sale itself; when graduated the tax on the later sale was greater than the tax on another exactly similar operation—therefore violative of the Fourteenth Amendment. The classification was unreasonable, for the fact one has performed an act a greater number of times, is no indication that he is more capable of bearing the tax. The court will not be bound by the name of a tax, but will ascertain for itself the nature and effect of the tax.²¹

In summation of these cases, the Supreme Court has found a difference between chain stores and local stores, discarding geographical distribution of outlets, and volume of sales as a tax base. Therefore, the number of stores is the only tax base left as a measure of difference.

In 1934 the Louisiana Legislature placed a license tax on all retail stores operating within that state at a specified rate per store, progressing upwards according to the number of stores in the entire chain regardless of location.²² This was a radical extension of the *Jackson* case,²³ because the tax base held constitutional in the latter was the number of stores in the state, and not inclusive of stores without the state. The complainant filed a class bill in which it was joined by twelve other foreign corporations that operated chain stores in Louisiana. They prayed that the tax officials be restrained from enforcing the Act; for the statute was a deprivation of due process and equal protection of the laws,²⁴ in addition to also violating the commerce clause.²⁵ The court, in a vigorous opinion, held the statute constitutional and reaffirmed the holding in the *Jackson* case that separate classification for chain stores from that of single retail stores is reasonable, and not based on arbitrary distinctions—that the use of stores within the state, as a tax base, is constitutional. A more serious question was ruled upon—namely, whether the state had jurisdiction to levy a graduated tax upon the number of stores both within and without the state. It is undeniable that a direct tax by a state on

¹⁸ See note 15, *supra*.

¹⁹ 294 U. S. 550, 55 Sup. Ct. 525 (1935).

²⁰ Ky. Acts of 1930, c. 149, p. 475.

²¹ *Mascaillen Co. v. Mass.* 279 U. S. 620, 49 Sup. Ct. 432 (1929).

²² La. Acts of 1934, §§ 1, 3.

²³ 283 U. S. 527, 51 Sup. Ct. 540 (1931).

²⁴ U. S. CONST. Amend. XIV.

²⁵ U. S. CONST. Art. I, § 8, cl. 3.

property outside its jurisdiction,²⁶ or a tax measured by such property²⁷ violates due process. But the court, in the instant case, held the measure was limited to property within the state, only the rate being affected by the existence of extra-territorial factors. The law rates the privilege of doing business in Louisiana according to the competitive ability of the chain stores in Louisiana recognizing the advantages accruing to units of interstate chains. Therefore the court concluded that no property without the state was being taxed. Despite the fact there is some precedent for such a decision in *Maxwell v. Bugbee*,²⁸ where the Supreme Court held a state transfer tax valid where the rate was determined by the decedent's entire estate, regardless of location within or without the state; that case is not decisive of the question, for doubt has been cast on the holding by the court itself, pointing out it was decided by a split court.²⁹ Furthermore, the formulae utilized by both statutes differed; one was a license tax, the other a transfer tax. Having viewed the statute solely as a revenue measure, can it be justified as a valid exercise of the police power? Police power consists of protection of good order, health, safety, morals and economic welfare.³⁰ Through *stare decisis* it is well settled that such power included regulations designed to promote public welfare as well as those in the interest of public health, safety or morals. In the exercise of its police power, the state may forbid as inimical to the welfare of the people the carrying on of a particular type of business,³¹ or to control a business in such a fashion as to destroy certain evils which arise from it.³² Whatever a state may forbid or regulate, it may permit to exist upon condition that a fee be paid in return for such privilege and such fee may be exacted to equalize competition.³³ Taxation may be made the tool to effect such

²⁶ *Union Refrigerator Transit Co. v. Kentucky*, 199 U. S. 194, 26 Sup. Ct. 36 (1905).

²⁷ 268 U. S. 473, 495, 45 Sup. Ct. 603 (1925).

²⁸ 250 U. S. 525, 45 Sup. Ct. 603 (1919).

²⁹ See comment on *Maxwell v. Bugbee* in *Frick v. Pennsylvania*, 268 U. S. 473, 495, 45 Sup. Ct. 603 (1923).

³⁰ See (1936) 49 HARV. L. REV. 756, 777, 781, 782.

³¹ License Cases: *Mugler v. Kansas*, 123 U. S. 623, 662, 663, 8 Sup. Ct. 273 (1887); *Williams v. Arkansas*, 217 U. S. 79, 30 Sup. Ct. 493 (1909); *Central Lumber Co. v. South Dakota*, 226 U. S. 157, 162, 33 Sup. Ct. 66 (1912).

³² *Ozan Lumber Co. v. Union County Bank*, 207 U. S. 521, 28 Sup. Ct. 89 (1911); *Engel v. O'Malley*, 219 U. S. 128, 137, 31 Sup. Ct. 190 (1911).

³³ *Wiggins Ferry Co. v. East St. Louis*, 107 U. S. 365, 373, 374-376, 2 Sup. Ct. 257 (1882); *American Sugar Refining Co. v. Louisiana*, 179 U. S. 89, 92-95, 21 Sup. Ct. 43, 45 L. ed. 102 (1900); *Reymann Brewing Co. v. Brister*, 179 U. S. 445, 453, 21 Sup. Ct. 201 (1900); *Williams v. Fears*, 179 U. S. 270, 276, 21 Sup. Ct. 128 (1900); *W. W. Cargill Co. v. Minnesota*, 180 U. S. 452, 469, 21 Sup. Ct. 128 (1900); *McCray v. United States*, 195 U. S. 27, 70, 24 Sup. Ct. 769 (1903); *Brown-Forman Co. v. Kentucky*, 217 U. S. 563, 573, 30 Sup. Ct. 578 (1909); *Quang Wing v. Kirkendall*, 223 U. S. 59, 62, 32 Sup. Ct. 192 (1911); *Braze v. Michigan*, 241 U. S. 340, 342, 36 Sup. Ct. 561 (1916); *Alaska Fish Salting Co. v. Smith*, 225 U. S. 44, 41 Sup. Ct. 219 (1915); *Liberty Warehouse Company v. Tobacco Growers' Ass'n*, 276 U. S. 71, 96,

equalization. The fundamental sociological beliefs of Mr. Justice Brandeis as shown in *Liggett v. Lee*³⁴ have now been taken up in the instant case as the backbone of the majority opinion; although the court distinguished the two relative statutes in such manner to leave with us the inference that on its peculiar set of facts *Liggett v. Lee*³⁵ is still the law. Therefore the Supreme Court concluded that, if in the interests of the public the legislature deems it necessary to neutralize the superior economic advantages of chain organizations in their competition with smaller stores, it is a valid exercise of police power.³⁶ It is not a denial of due process to adjust such license taxes as are herein involved to meet the local evil resulting from business practices and greater economic power, even though those advantages and that power are largely due to the fact that the taxpayer does business not only in Louisiana but in other states. However, I am of the firm opinion, despite the advantages now accruing to the local retailer, that the court has indulged in a bit of constrained judicial interpretation to fashion the holding to their sociological views, without regarding the statute in point with much scrutiny. In so far as the decision reaffirms the *Jackson* case and picks up the dissent of Justice Brandeis in *Liggett v. Lee*³⁷ it is logical. But Justice Roberts arrives at the conclusion that the taking into consideration of greater competitive ability of chains in Louisiana as members of a large interstate chain for the progressive increase of rates is constitutional by merely considering this membership as an *extraterritorial factor*. Yet it is undeniable that the effect of such a statute does indirectly penalize the operation of chain units in other states; for the larger the number of stores outside Louisiana, the greater the tax in that state. The dissenting opinion of Mr. Justice Sutherland sums it up:

"The exaction here involved is not a tax upon Louisiana property or business, but it is essentially a penalty imposed upon an operator of business wholly beyond the reach of the law of that state. We are not able to concede that it lies within the province of one state to thus indirectly penalize a method of doing business in another state which it may be the policy of the latter to permit or indeed encourage."

Justice Sutherland indicates if this law is valid, and all other states pass similar laws, then the chain store would be paying taxes forty-

48 Sup. Ct. 291, 296 (1927); *Sproles v. Binford*, 286 U. S. 374, 394, 52 Sup. Ct. 581, 587 (1931); *Magnano Co. v. Hamilton*, 292 U. S. 40, 43, 44, 54 Sup. Ct. 599, 601 (1933); *Fox v. Standard Oil Co.*, 294 U. S. 87, 100, 55 Sup. Ct. 333 (1934); *Sonzinsky v. United States*, 300 U. S. —, 57 Sup. Ct. 554 (1936).
³⁴ 288 U. S. 517, 53 Sup. Ct. 481 (1933).

³⁵ *Ibid.*

³⁶ *Great Atl. & Pac. Tea Co. v. Grosjean*, 300 U. S. —, 57 Sup. Ct. 772 (1937).

³⁷ 288 U. S. 517, 53 Sup. Ct. 481 (1933).

eight times on the entire chain, not only on those in individual states, resulting in a severe duplication of taxes.³⁸

The Federal Trade Commission spent seven years and over one million dollars to find out whether or not chain stores are worth while. Recently the Commission filed its final report with the United States Senate and the following paragraph from that report sums up the Commission's final conclusion :

"Such a policy (taxing away the chain's savings in prices), however would involve destruction of the chain's ability to make lower prices than independents and would provoke wide protest from consumers. Any tax on chain stores which substantially lessens their ability to undersell independents is open to the same practical objection. If ability to undersell based on greater efficiency or on elimination of credit and delivery costs is destroyed by taxation, it is the consuming public which will really pay the tax and not the chain."³⁹

Legislatures should be cautious lest a confiscatory tax placed on chain stores be too easily passed on to the consumer. It should however be indicated that the first expression of the people's desire at a public election in this oft mooted question of *chain store v. local store*, resulted in a definite majority vote against discriminatory chain-store taxation.⁴⁰

HENRY R. KAPLAN.

IMMUNITY FROM FEDERAL INCOME TAX BY STATE
INSTRUMENTALITIES.

"* * * an avalanche of decisions by tribunals great and small is producing a situation where a citation of precedent is tending to count for less, and appeal to an informing principle is tending to count for more."¹

Constantly expanding governmental needs, changes in the economic structure, and new ideals of social policy necessitate readjustment and experimentation in tax decisions. Ordinary difficulties of obtaining funds to operate governmental machinery are complicated

³⁸ *Ibid.*

³⁹ Final Report of the Federal Trade Commission, under Senate Resolution 224. 70th Cong., 1st Sess., Government Printing Office.

⁴⁰ California Election of 1936—Chain store statute, passed 1935, rejected in public referendum.

¹ BENJAMIN N. CARDOZO, *THE GROWTH OF THE LAW* (1924) 4.