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First Union National Bank v. Florida Department of Revenue, 502 So. 2d 964 (Fla. 1st DCA 1987)

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NOTES

Tax—Corporate Franchise Taxation—A Tax in Search of an Identity—*First Union National Bank v. Florida Department of Revenue*, 502 So. 2d 964 (Fla. 1st DCA 1987)

In *McCulloch v. Maryland*,[1] the United States Supreme Court announced that the supremacy clause of the Federal Constitution forbids state taxation of the properties, functions, or instrumentalities of the federal government. Since then, the Supreme Court has repeatedly held on constitutional grounds that federal property, or income derived therefrom, may not be the direct object of taxation by a state.[2] Conversely, the Court has also held that states may include federal property, or the income derived from it, in taxing a corporate franchise.[3]

A "corporate franchise" is a grant by the state of the privilege to do business within the state.[4] A tax by the state on that privilege is a corporate franchise tax. Before 1959, these "franchise" taxes were upheld on the theory they were levied on a distinct interest, the corporate franchise, rather than on the property serving as the measure of the tax.[5] Any effect that the tax had on property composing the tax base was characterized by the Court as incidental, so long as the tax was truly on the corporate franchise. The Court focused on whether the franchise tax directly affected federal property. A finding that the tax did directly affect federal property invalidated the tax. The Court reasoned that a franchise tax directly affecting federal property must be aimed at the federal property, not the franchise.[6]

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1. 17 U.S. (4 Wheat.) 316 (1819).

2. *See* New Jersey Realty Title Ins. Co. v. Wisconsin, 338 U.S. 665 (1950); Macallen Co. v. Massachusetts, 279 U.S. 620 (1929); Northwestern Mut. Life Ins. Co. v. Wisconsin, 275 U.S. 136 (1927); Miller v. Milwaukee, 272 U.S. 713 (1927).

3. *See* Tradesman Nat'l Bank v. Oklahoma Tax Comm'n, 309 U.S. 560 (1940); Educational Films Corp. v. Ward, 282 U.S. 379 (1932); Home Ins. Co. v. New York, 134 U.S. 594 (1889); Provident Inst. v. Massachusetts, 73 U.S. (6 Wall.) 611 (1867).

4. Black's Law Dictionary 307 (5th. ed. 1979). A corporate franchise is defined as the "right or privilege granted by the state or government . . . to exist and do business as a corporation . . . ." *Id.*

5. *See* Werner Mach. Co. v. Director of Taxation, 350 U.S. 492, 493-94 (1956); Society for Sav. v. Bowers, 349 U.S. 143, 147-48 (1955); Des Moines Nat'l Bank v. Fairweather, 263 U.S. 103, 112 (1923); Home Sav. Bank v. Des Moines, 205 U.S. 503, 518-19 (1907).

6. American Bank & Trust Co. v. Dallas County, 463 U.S. 855 (1983).

In 1959, Congress enuciated a new standard of inquiry by amending the Public Debt Statute.[7] This amendment barred consideration of federal property either directly or indirectly in the assessment of a state tax with express exceptions for franchise taxes and estate and inheritance taxes. In *American Bank & Trust Co. v. Dallas County*, the Court concluded that whether the tax directly or indirectly affected federal property was no longer determinative; judicial inquiry would consider instead whether the tax fell within one of exceptions created by the 1959 amendment.[8]

The tax at issue in *American Bank* was levied on bank shares. The Court reasoned that if Congress had intended to include bank share taxes in the statute's exceptions it would have done so; since it did not, the tax was constitutionally invalid as tax exempt federal bonds were considered in its measurement.[9] Had the tax claimed to have been on corporate privilege, the Court would have had to determine whether it was a bona fide franchise tax, as the amendment grants an exception for "franchise" taxes. The Court, however, has not set forth criteria for making that determination; *American Bank* is only one of two Supreme Court cases on corporate franchise taxation decided since 1959.[10]

The 1959 amendment also required that a franchise tax be nondiscriminatory.[11] The Court has interpreted a franchise tax as nondiscriminatory when it remains consistent for all forms of taxable property.[12] A franchise tax which discriminates in favor of obligations issued by the state and against similar obligations of the federal government violates the implicit limitation placed on one government's power to tax the other.[13] Whether similar property refers to a class of property such as bonds or to specific property within the class is still unclear.

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7. 31 U.S.C. § 742 (1959), 31 U.S.C. § 3124's predecessor provided:

> [A]ll stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

8. 463 U.S. at 864.

9. *Id.*

10. *See also*, Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 397 (1983).

11. *See American Bank*, 463 U.S. at 855.

12. *Memphis Bank*, 459 U.S. at 397-98.

13. *See* United States v. County of Fresno, 429 U.S. 452 (1977); Tradesmens Nat'l Bank v. Oklahoma Tax Comm'n, 309 U.S. 560 (1940).

In this Note the author examines the recent decision of Florida's First District Court of Appeal in *First Union National Bank v. Florida Dept. of Revenue*.[14] The author examines that case and recent decisions by the Montana and New Jersey Supreme Courts to demonstrate the uncertainty in the area of corporate franchise taxation and recommends the United States Supreme Court eliminate this uncertainty by clarifying the definition of a nondiscriminatory franchise tax within the meaning of the current Public Debt Statute.[15]

I. Early Supreme Court Cases

States may generally tax all subjects over which the sovereign power of the state extends, but they "have no power by taxation, or otherwise, to retard, impede, burden, or in any manner control the constitutional laws enacted by Congress . . . ."[16] State tax laws that infringe on the federal government's ability to "borrow money on the credit of the United States"[17] could prevent the government from responding properly to a national crisis. Such laws are viewed by the Court as a potential threat to the nation's welfare.[18] A state tax on a franchise granted to a private corporation is not rendered invalid, however, merely because the tax includes federal property in its measure. The Court recognizes that the privilege of exercising the corporate franchise is a legitimate object of taxation by the states.[19] Conducting business in a corporate capacity has been deemed a valuable right allowing individuals to unite under a common name for business purposes, permitting succession of ownership without dissolution or suspension of business, and providing limited individual liability for corporate owners.[20] As a condition for granting the franchise, or for its continued exercise, the state

14. 502 So. 2d 964 (Fla. 1st DCA 1987).

15. 31 U.S.C. § 3124 (1982) provides in pertinent part:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax *except*—(1) *a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation*; and (2) an estate or inheritance tax. [emphasis added].

16. McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 435 (1819).

17. *See* Weston v. City Council of Charleston, 27 U.S. (2 Pet.) 449, 464 (1829).

18. Home Ins. Co. v. New York, 134 U.S. 594, 599 (1890).

19. *Id.* at 599-600.

20. *Id.* at 600.

may constitutionally require the corporation to pay a sum set by the state legislature.[21]

In 1890, in *Home Insurance Co. v. New York*, the Supreme Court concluded that the mode of assessing a corporate franchise tax was purely a matter of legislative discretion.[22] The Court declined to suggest a more equitable form of taxation when all artificial entities subjected to the tax receive similar treatment. Any remedy for hardship or oppression created by the payment of the tax "must be sought by appeal to the legislature of the State; it cannot be furnished by the federal tribunals."[23]

In *Home Insurance*, the insurance company claimed the New York tax was not a true franchise tax but was instead an income tax on the capital stock or property of the company. Therefore, it argued, the tax was invalid because a portion of its capital stock was invested in United States securities.[24] The franchise tax was imposed on any corporation doing business in New York State and was measured by the extent of dividends generated by the corporation during the current tax year. The Court, however, rejected the argument that inclusion of federal securities in the measure of the tax was constitutionally objectionable. The Court found nothing to contradict the statute's designation of the tax as being upon the capital stock of the corporation. Moreover, relying principally on two earlier decisions, *Society for Savings v. Coite*[25] and *Provident Institution v. Massachusetts*,[26] that examined whether the tax was on the corporate franchise or on the underlying property, the Court concluded that the tax's validity was unaffected by the mode of assessment chosen by the state.[27]

The Court held in *Coite* that a Connecticut franchise tax law requiring savings banks to pay a sum equal to three fourths of one per cent of the total deposits held on a certain date in each year, was a tax on the franchise of the corporation, not upon its property.[28] Reasoning that "[n]othing can be more certain in legal decision than that the privileges and franchises of a private corporation, and all trades and avocations by which the citizens acquire a

21. *Id.*
22. *Id.*
23. *Id.* at 597.
24. *Id.* at 595.
25. 73 U.S. (6 Wall.) 594 (1867).
26. 73 U.S. (6 Wall.) 611 (1867).
27. *Home Ins.*, 134 U.S. at 600.
28. *Coite*, 73 U.S. (6 Wall.) at 610.

livelihood, may be taxed by a State for the support of the State government,"[29] the Court found the validity of the tax "unaffected by the fact that the corporation or individual has or has not made investment in Federal securities."[30] The amount of deposits was not the subject matter of the tax, but instead served as the basis for computing the tax to be paid.[31]

Similarly, in *Provident Institution*, the Court distinguished a franchise tax from a property tax by noting "the amount of a franchise tax depends upon the business transacted by the corporation and the extent to which [it has] exercised the privileges granted in [its] charter."[32] One half of the challenged tax was levied on the average amounts of deposits for the six months preceding the first day of May, and the other half on the average amount of deposits for the six months preceding the first day of November. The Court held that because no nexus existed between the average amount of the deposits and the amount of property owned by the corporation, the tax was a franchise tax on the corporation for the privileges it enjoyed pursuant to it's charter being approved by the State of Massachusetts; it was not a tax on the corporate property.

A. Macallen v. Massachusetts

Forty years after the *Home Insurance* decision, the Court in *Macallen Co. v. Massachusetts*, struck down an excise tax levied annually on domestic corporations doing business in Massachusetts.[33] The Court found that the act authorizing the tax was, in substance and effect, a tax on federal bonds and securities. In reaching this conclusion, the Court appears to have retreated from, or at least limited, its holding in *Home Insurance* that a tax upon the exercise of corporate privilege may be based on income derived from federal property.

The Court in *Macallen* concluded that the controlling principle in evaluating a franchise tax statute "is that the state cannot tax the instrumentalities or bonds of the United States, or . . . the income derived therefrom, directly or indirectly—that is to say, it cannot tax *them* in any form."[34] Apparently, the Court feared a state legislature could circumvent prohibitions on directly taxing

29. *Id.* at 606-07.
30. *Id.* at 607.
31. *Id.* at 611.
32. *Provident Inst.*, 73 U.S. (6 Wall.) at 632.
33. 279 U.S. 620 (1929).
34. *Id.* at 629 (emphasis in original).

federal property by deceptively characterizing or naming the tax. Such legislation would destroy the implicit constitutional limitations placed on the power of the state to tax property of the federal government.

Particularly indicative of the Massachusetts Legislature's desire to tax federal property were amendments deleting that portion of the original act which expressly excluded interest received from bonds, notes and certificates of indebtedness of the United States in measuring the tax. This distinct change indicated to the majority that the legislature sought to subject previously exempt federal securities to state taxation.[35]

Writing for the dissent, Justice Stone disagreed with the majority's finding that the Massachussetts Legislature intended to tax federal securities. He reasoned that Massachusetts was simply seeking to implement what the Court had said on numerous occasions it could constitutionally do, include tax exempt federal property in the measure of a franchise or excise tax.[36] Because both federal and state bonds were included in the assessment of the tax, he concluded the purpose was to tax corporations for doing business in the state, not to tax previously exempt federal property. He also reasoned that neither the state nor federal government can exercise its taxing power without affecting the other. The Court should apply a practical construction to a challenged franchise taxing statute so both governments may function with a minimum of interference.

B. Educational Films Corp. v. Ward *and* Pacific Co. v. Johnson

Three years after *Macallen*, the Court in *Educational Films Corp. v. Ward*[37] and *Pacific Co. v. Johnson*,[38] adopted the rationale of Stone's dissent in *Macallen* and reaffirmed earlier Court decisions upholding the validity of franchise taxes that incidentally affect tax exempt property. The inclusion of tax exempt state bonds in the measure of a franchise tax was challenged in *Pacific Co.*, while state taxation of federal property was at issue in *Educational Films*. The character of the exempt property, however, does not alter the analysis; the corporate franchise must be the object of taxation.

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35. *Id.* at 631-32.
36. *Id.* at 636 (Stone, J., dissenting).
37. 282 U.S. 379 (1931).
38. 285 U.S. 480 (1932).

Writing for the majority in *Educational Films*, Justice Stone concluded that *Macallen* did not represent a departure from the Court's prior rulings doctrine upholding corporate franchise taxes; rather the state tax in *Macallen* was invalidated because it was specifically intended to impact on exempt federal property.[39] If the avowed purpose or self-evident operation of a statute is to directly tax bonds of the United States, then the statute must fail.[40] However, a state tax may be upheld despite any incidental effect it may have upon the federal bonds if it was passed with an intent other than to specifically tax such bonds.[41]

The New York franchise tax in dispute in *Educational Films* was assessed annually on every domestic corporation for the privilege of exercising its franchise in the state. Payable in advance, it was levied at a rate of four and one-half percent on the corporation's entire net income for the previous fiscal year.[42] "Entire net income" included all income received on stocks and all interest received from federal, state, municipal or other bonds.[43] The corporation argued that the tax was invalid to the extent that it included royalties received by the corporation from motion picture copyrights obtained from the United States government. These copyrights were alleged to be federal property and, as such, implicitly excluded from state taxation by the United States Constitution.[44]

While implicitly agreeing with Educational Film's argument that the copyrights were federal property, the Court rejected the thrust of the corporation's argument. Looking at the operation of the New York statute, the Court found the tax to be "for the privilege of doing business in one year measured by the allocated income accruing during the preceding year."[45] The Court reasoned that if the corporation had ceased to do business before the date of assessment:

> [I]t would not have been subject to any tax under [the] statute, although it had received, during its preceding fiscal year, income which the statute makes the measure of the tax. Since it can be levied only when the corporation both seeks or exercises the privi-

39. *Educational Films*, 282 U.S. at 392.
40. *Id.* at 393 (quoting Miller v. Milwaukee, 272 U.S. 713, 715 (1927)).
41. *Miller*, 272 U.S. at 715.
42. *Educational Films*, 282 U.S. at 385.
43. *Id.* at 386.
44. *Id.* at 388.
45. *Id.* (quoting New York v. Jersawit, 263 U.S. 493, 496 (1922)).

> lege of doing business in one year and has been in receipt of net income during its preceding fiscal year, the tax, whatever descriptive terms are properly applicable to it, obviously is not exclusively on income apart from the franchise.[46]

Likewise, in *Pacific Co. v. Johnson*, a California franchise tax on corporate income earned during the preceding fiscal year was upheld even though tax exempt property was within its measure.[47] Pacific Company claimed tax exempt state bonds acquired before the enactment of the statute authorizing the tax were immune from state taxation. The inclusion of interest derived from these bonds in the tax's assessment allegedly impaired the bonds' contractual obligation to be free from state taxation in contravention of the Constitution's contract clause.

Adhering to the rule followed earlier that term in *Educational Films*, "that a tax upon a franchise, measured by net income, including that from tax immune property, is not an infringement of the immunity,"[48] the Court held the tax exempt status of the bonds did not embrace the corporate franchise. The owners of the bonds were free to enjoy the tax exempt status of their bonds until they asked for and received from the state the benefit of the taxable corporate privilege. At that point, the corporate owners committed themselves to the payment of the tax which the state exacted as its price for the corporation's receipt and exercise of the privilege to do business in the state.

A statute authorizing a franchise tax "must be read as a whole . . . and the legislative purpose in enacting it must be taken, regardless of forms of words, to envisage the obvious consequences which flow from its operation."[49] While apparently determining that the California statute was specifically adopted to reach exempt property, the Court concluded that in operation it placed an equal burden on owners of exempt and nonexempt property. The absence of discriminatory treatment resulted in the Court's ruling that the statute did not impair the bonds' contractual obligation to be free from state taxation.

Justice Sutherland relied on *Macallen* in his dissent.[50] A report from a special commission appointed by the California Legislature

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46. *Id.*
47. 285 U.S. 480 (1932).
48. *Id.* at 490.
49. *Id.* at 495.
50. *Id.* at 496 (Sutherland, J., dissenting).

to investigate taxation of banking institutions recommended adopting net income as the base of the tax since it was "the only practicable method of securing revenue from the banks."[51] According to Justice Sutherland, this report served as the impetus for the legislature's passage of the franchise tax statute and clearly evidenced the legislature's desire to tax exempt property.

The majority, however, did not evaluate legislative intent to determine whether the tax was on the corporate franchise although they did look at legislative intent in evaluating whether the tax had a discriminatory effect. The majority did not rest its decision on the precise language in the statute, the commission report or the order of provisions incorporated into the statute.[52] Those factors could neither enlarge nor diminish the constitutional power of the state to tax the corporate franchise.

The Court concluded in *Pacific Co.* and *Educational Films* that the operation of a franchise tax statute determines the tax's nature.[53] Both cases were decided prior to congressional action which created an exception to the general judicial rule that state taxes cannot directly consider federal property. Before the 1959 amendment to the Public Debt Statute, which allowed the consideration of federal property in the measurement of franchise taxes and estate and inheritance taxes, the Court was concerned with the statute's effect on tax exempt property. Therefore, the Court would look to either the treatment afforded exempt versus nonexempt property or the mode of assessment to determine the effect. It is unclear whether the rationale applied by the Court to franchise taxation prior to 1959 may be used to determine the nature of state franchise taxes challenged under the current Public Debt Statute.

II. Recent Supreme Court Decisions

Recent decisions of the Supreme Court do not clarify the characteristics of a franchise tax. In 1956, in *Werner Machine Co. v. Director of Division of Taxation*, the Court accepted the finding of the New Jersey Supreme Court that a state franchise tax imposed on a corporation's net worth was a "bona fide" franchise tax despite the inclusion of federal bonds in the tax's measurement.[54]

51. *Id.* at 497-98.
52. *Id.* at 498.
53. *Id.* at 495.
54. 350 U.S. 492, 493 (1956).

Furthermore, the New Jersey Legislature's express declaration that the tax was a franchise tax weighed heavily in the Court's decision.[55] Did the Court in *Werner Machine* reject the conclusion in *Educational Films* that the nature of a franchise tax is determined by the statute's operation? The only two Supreme Court decisions relating to state taxation of the corporate franchise issued after *Werner Machine* and the 1959 amendment, *American Bank & Trust Co. v. Dallas County*[56] and *Memphis Bank & Trust Co. v. Garner*,[57] do not anwser this question.

In *American Bank*, the Court held that a Texas property tax on bank shares, computed on the basis of the bank's net assets without deduction for exempt federal securities, violated 31 U.S.C. § 742.[58] The 1959 amendment extended the tax exempt status of federal securities to "every form of taxation that would require that either . . . [federal] obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes."[59]

Prior to the amendment, the method of computing the tax was irrelevant so long as the tax did not directly affect federal property.[60] The Court reasoned that the tax was imposed on a "transaction separate from the ownership of federal obligations."[61] Still, the Court recognized that "the practical impact of such a tax is indistinguishable from that of a tax imposed directly on corporate assets that include federal obligations."[62] The amendment made the method of assessment relevant to a determination of the tax's constitutionality. A tax is invalidated by the consideration of federal property either directly or indirectly in assessing the tax, unless it falls within one of the amendment's exceptions.

The amendment's exception for franchise taxes implies that the tax must be a bona fide franchise tax. The Court in *American Bank*, however, did not define a bona fide franchise tax. If the rationale used in *Educational Films* applies to the successor to 31

55. *Id. See also* Society for Sav. v. Bowers, 349 U.S. 143 (1955).
56. 463 U.S. 855 (1983).
57. 459 U.S. 392 (1983).
58. *American Bank*, 463 U.S. at 865.
59. 31 U.S.C. § 742 (1959).
60. *American Bank*, 463 U.S. at 864.
61. *Id.* at 863-64.
62. *Id.* at 862.

U.S.C. § 742, 31 U.S.C. § 3124, then the method of assessment may determine whether the tax is a bona fide franchise tax. However, as previously noted, it is unclear whether the rationale of cases decided before *American Bank* can define corporate franchise taxes within the meaning of the current Federal Public Debt Statute.

The 1959 amendment to 31 U.S.C. § 742 also required a state tax to be nondiscriminatory.[63] In *Memphis Bank*, the Court concluded that "nondiscriminatory" within the context of § 742 meant that a state tax whose economic but not legal incidence falls on federal property must impose an equal burden on holders of similar state property.[64] The Court found the Tennessee bank tax was discriminatory as income from federal obligations was included in the tax base but income from comparable state obligations was not.[65]

When a state taxing statute operates discriminatorily, it violates the rule that states cannot directly tax property of the federal government. Consequently, the Court has interpeted a finding of discriminatory effect to demonstrate that the purpose of a tax is to reach otherwise tax exempt federal property despite legislative language to the contrary.[66]

III. State Court Decisions

State courts have struggled to reconcile *American Bank* with Supreme Court decisions issued prior to the 1959 amendment to 31 U.S.C. § 742. In *Schwinden v. Burlington Northern Inc.*,[67] the Montana Supreme Court reversed an earlier decision in *First Federal Savings and Loan Association v. Department of Revenue*,[68] finding the state's corporate license tax was in conflict with the Federal Public Debt Statute. The tax provided that when the corporate taxpayer computes allowable deductions from gross income, those deductions are decreased by a ratio of federal interest income to all income earned by the corporation.[69] The court concluded the net effect of the tax was to add back to taxable income interest income from federal obligations for the purpose of determining the tax.[70] Under 31 U.S.C. § 3124, the successor to 31

63. *See supra* note 7.
64. *Memphis Bank*, 459 U.S. at 397.
65. *Id.* at 398-99.
66. *See* Werner Mach. Co. v. Director of Taxation, 350 U.S. 492, 493-94 (1956).
67. 691 P.2d 1351 (Mont. 1984).
68. 200 Mont. 358, 654 P.2d 496 (Mont. 1982), *cert. denied*, 462 U.S. 1144 (1982).
69. *Schwinden*, 691 P.2d at 1354.
70. *Id.* at 1355.

U.S.C. § 742, Montana could not impose such a tax unless the tax was a nondiscriminatory franchise tax.

Originally, the Montana court found the tax in *First Federal* to be on the corporate privilege *and* on net income.[71] The state's argument that the tax was imposed for the privilege of doing business in the state and was measured by net income was rejected as being a distinction without a difference. The court reasoned that the tax could not simultaneously be both a nonproperty and a property tax and found that the state was attempting to tax federal debt obligations through indirect means.[72]

After reexamining *First Federal*, the court in *Schwinden*, concluded that *American Bank* approved state consideration of interest income from federal property either directly or indirectly in the measure of a nondiscriminatory franchise tax.[73] While the court recognized that a distinction exists between a tax on a privilege measured by federal property and a tax on the property itself, the court did not identify how it determined this distinction.

Similarly, in *Garfield Trust Co. v. Director, Division of Taxation*, the New Jersey Supreme Court failed to explain how it concluded that the state's corporation business tax was a tax on corporate privilege.[74] The court merely stated that it was upholding the tax for the same reasons as it had in *Werner Machine*.[75] In *Werner Machine*, the court found that the New Jersey corporation business tax was intended by the legislature to be a bona fide franchise tax and did not tax property in the commonly accepted sense.[76]

The absence of factors other than intent indicates that the New Jersey court and the Montana court relied primarily on intent to determinine whether the tax was imposed on the corporate franchise. Legislative declarations of intent, however, should not determine if a tax is a bona fide franchise tax. As the Supreme Court concluded in *Educational Films*, the nature of the tax should be determined by the statute's operation.

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71. *First Fed. Sav.*, 200 Mont. 358, 654 P.2d 496 (1982).

72. *Schwinden*, 691 P.2d at 1351.

73. The court reasoned that 31 U.S.C. § 3124 (1983), expressly distinguishes between nondiscriminatory franchise taxes and property taxes. *Id.* at 1358.

74. 102 N.J. 420, 508 A.2d 1104 (N.J. 1986).

75. *Id.* at 1107.

76. *See* Werner Mach. Co. v. Director of Taxation, 17 N.J. 121, 110 A.2d 89 (1954), *aff'd*, 350 U.S. 492 (1956).

IV. First Union National Bank of Florida

Recently, in *First Union National Bank v. Florida Department of Revenue*,[77] Florida's First District Court of Appeal was faced with determining the factors distinquishing a franchise tax from an income tax. The challenged statute imposed a franchise tax, in lieu of the corporate income tax, on banks for the privilege of doing business in the state.[78] The tax was based on net income of the current fiscal year including interest income earned from federal debt obligations. The bank argued that the tax was not a true franchise tax as the tax was substantively indistinquishable from the Florida corporate income tax. The Florida bank tax was alleged by First Union to be no more than a mislabeled income tax.[79]

Focusing on the operation and practical effect of the statute, the First District Court held that, because the bank tax operated in the same manner as the Florida corporate income tax, the bank tax *was* an income tax.[80] Both taxes were measured by adjusted federal income for the current tax year, both were imposed on corporations for the privilege of doing business in the state and both possessed identical tax rates. The only difference the court found was the statutory label.[81]

The court also implicitly rejected legislative intent as a factor distinquishing franchise taxation from other forms of taxation. The court focused instead on similarites between the Florida bank tax and the state's corporate income tax. Because the Florida bank tax and the Florida corporate income tax were substantively indistinquishable, the bank tax was found to be an income tax.[82] This rationale is similar to that adopted by the Montana Supreme Court in *First Federal*, which was later rejected by that court in *Schwinden*.

The mode of assessment also contributed to the Florida district court's finding that the Florida bank tax and the Florida corporate income tax were substantively indistinquishable. The Florida bank tax was levied on adjusted federal income for the *current* tax

77. 502 So. 2d 964 (Fla. 1st DCA 1987).

78. *See* Fla. Stat. § 220.63 (1979). This section imposed a five percent tax that was increased to five and one-half percent applicable to years beginning on or after Sept. 1, 1984. The Florida corporate income tax rate is five percent. *Id.*

79. *First Union*, 502 So. 2d at 965.

80. *Id.* (citing Educational Films Corp. v. Ward, 282 U.S. 379 (1931)).

81. *Id.*

82. *Id.*

year.[83] In a footnote, the court cited United States Supreme Court cases which expressly approved franchise taxes measured by *preceding* year's net income.[84]

In contrast to the New Jersey and Montana Supreme Courts' reliance on legislative intent, the view implicitly adopted by the Florida district court in *First Union*, that the exercise of the franchise and imposition of the tax should coincide, is logical given the absence of a United States Supreme Court ruling on the issue. If the tax is imposed on income as earned, the corporation can never pinpoint the value of the franchise; it can only estimate what value it believes the franchise will acquire in the future. On the other hand, if the tax is imposed on preceding year's net income or on corporate net worth, the corporation will know in advance the value of the franchise. For example, if Corporation A decides to do business in State X and State X imposes a corporate franchise tax on the preceding year's net income, Corporation A will not pay a franchise tax during its first year of doing business in the state. It will pay a franchise tax only if it decides to do business for a second year and that decision will be influenced by the value the franchise acquired during the previous year. By contrast, if Corporation A decides to do business in State Y, which levies a franchise tax on income as earned, Corporation A must pay a tax on a franchise that has no intrinsic value until it is exercised.

As with the payor of an estate or inheritance tax, taxes which may constitutionally include federal debt securities in their measure, the payor of a franchise tax should be able to value the franchise before choosing to do business. If the amount of the tax is indeterminable until action *is* taken, then the tax should be properly classified as a property tax. A true corporate franchise tax would not require that a business speculate as to the value of the corporate franchise.

The Public Debt Statute's requirement that the tax be nondiscriminatory was not addressed by the Florida court in *First Union* because the court found that the tax was not a franchise tax.[85] If the Florida Supreme Court disagrees with the First District Court of Appeal's determination that the Florida bank tax is a property tax, it must then apply the United States Supreme Court's ambiguous definition of a nondiscriminatory tax to the statute. The

83. *See* FLA. STAT. § 220.63 (1979).

84. *First Union*, 502 So. 2d at 965 n.4 (citing Bass, Ratcliff & Gretton v. State Tax Comm'n, 266 U.S. 271 (1924), and Educational Films Corp. v. Ward, 282 U.S. 379 (1931)).

85. *Id.* at 965 n.3.

United States Supreme Court has defined a nondiscriminatory franchise tax as a tax that treats federal property and similar state property the same.[86] It is unclear, however, whether "similar property" refers to specific kinds of property or to general classes of property.

For instance, in *First Union*, the bank argued that the Florida franchise tax discriminated against tax exempt federal property by providing certain exemptions and tax credits to in-state investments.[87] Section 348.94(2) Florida Statutes provides for an exemption from taxation for bonds issued by the Pasco County Highway Authority.[88] Although no such bonds had been issued, the bank argued that the legislature's enactment of the exemption gave rise to the possiblity of discrimination against tax exempt federal property.[89] The Supreme Court has stated that any discrimination whatsoever will invalidate a franchise tax.[90]

If "similar property" refers to a class of property such as bonds, then the bank's argument is correct and the tax is discriminatory. The exemption for Pasco County Highway bonds does favor those bonds over federal bonds generally. However, if "similar property" refers to identical state and federal property, then the bank's argument has no merit since the federal government does not issue highway bonds.[91]

The bank also argued that the Florida Legislature's extension of tax credits to users of gasohol and providers of financial assistance for public redevelopment, and granting a tax deduction for construction of hazardous waste facilities discriminated against tax exempt federal property and favored in-state property.[92] Contrary to the bank's argument, however, neither the tax credits nor the deduction discriminate against tax exempt federal property. The federal government does not issue bonds for gasohol use, public redevelopment or the construction of hazardous waste facilities.[93] Since

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86. Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 397 (1983).

87. Brief for First Union National Bank at 29, First Union Nat'l Bank v. Florida Department of Revenue, 502 So. 2d 964 (Fla. 1st DCA 1987).

88. *See* FLA. STAT. § 348.94(2) (1979).

89. *Memphis Bank*, 459 U.S. at 397.

90. *Id.*

91. The federal government funds highway construction through congressional appropriations.

92. Brief for First Union National Bank at 29, First Union Nat'l Bank v. Florida Department of Revenue, 502 So. 2d 964 (Fla. 1st DCA 1987).

93. *See* 26 U.S.C.A. § 40 (1982) (tax credit on gasohol use); 41 U.S.C.A. § 3142 (1982) (financial assistance for public redevelopment); 26 U.S.C.A. § 468 (1982) (tax deduction for certain hazardous waste facilities).

the federal government extends tax credits in these areas, the state's extension of the credits and the deduction does not conflict with federal policy but rather supplements its purposes. Moreover, for purposes of 31 U.S.C. § 3124, tax credits and deductions do not create property.

IV. CONCLUSION

As demonstrated by the recent decisions of Florida's First District Court of Appeal, the Montana Supreme Court and the New Jersey Supreme Court, lower courts have encountered difficulty in deciding the constitutionality of state franchise tax statutes under 31 U.S.C. § 3124. The United States Supreme Court should set specific criteria distinguishing a franchise tax from a property tax. The Court should also clarify the meaning of "similar property." Unless the Court addresses these issues in a timely fashion, those states implementing corporate franchise tax statutes will be unable to determine whether their statutes comply with 31 U.S.C. § 3124. As a result, substantial amounts of state revenue could be lost if the state statute cannot withstand a constitutional challenge.

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