School of Law
UNIVERSITY OF GEORGIA
Prepare. Connect. Lead.

Digital Commons @ University of Georgia School of Law

Presentations and Speeches

Faculty Scholarship

5-15-1991

The Effect of Interstate Branching on National, State and Local Economies

Walter Hellerstein
University of Georgia School of Law

Repository Citation
Hellerstein, Walter, "The Effect of Interstate Branching on National, State and Local Economies" (1991). *Presentations and Speeches*. 2.
https://digitalcommons.law.uga.edu/fac_presp/2

This Article is brought to you for free and open access by the Faculty Scholarship at Digital Commons @ University of Georgia School of Law. It has been accepted for inclusion in Presentations and Speeches by an authorized administrator of Digital Commons @ University of Georgia School of Law. Please share how you have benefited from this access For more information, please contact tstriepe@uga.edu.

Y 4.
B 22/1
102-34

THE EFFECT OF INTERSTATE BRANCHING ON NATIONAL, STATE AND LOCAL ECONOMIES

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC STABILIZATION

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

MAY 15, 1991

Printed for the use of the Committee on Banking, Finance and Urban Affairs

Serial No. 102-34

LAW LIBRARY
UNIVERSITY OF GEORGIA
SEP 25 1991
Government Depository

U.S. GOVERNMENT PRINTING OFFICE

42-838 ⇆ WASHINGTON : 1991

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

1013-A

CONTENTS

UNIVERSITY OF GEORGIA
SEP 25 1991
Government Depository

Testimony of Walter Hellerstein

on

State Tax Implications of Full Interstate Branching

Before the

Subcommittee on Economic Stability

of the

Committee on Banking
United States House of Representatives

May 15, 1991

I am Walter Hellerstein, Professor of Law at the University of Georgia and Of Counsel to the law firm of Morrison & Foerster. I have devoted most of my professional life to the study and practice of state and local taxation and, in particular, to the federal constitutional and statutory limitations on state taxation. For the Subcommittee's information, I have attached a resume, which summarizes my background and lists my publications. While I am appearing on behalf of the Financial Institutions State Tax Coalition, I can assure the Subcommittee that I would not be here today if the views I am about to express did not reflect my best professional judgment.

The principal question I wish to address is whether proposed federal legislation permitting state and national banks to establish branches in states in which they are not domiciled will curtail the states' existing power to tax the income from federal obligations. In my judgment, the answer to this question is "no."

Under existing law, there is one significant restraint on the states' power to tax income from federal obligations. Section 3124 of Title 31 of the United States Code provides:

> 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 . . . a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation.

This provision by its terms permits the states to tax income from federal obligations so long as they do so by means of a nondiscriminatory corporate franchise tax. There is nothing in the proposed federal legislation authorizing interstate branching that purports to limit the states' power to tax federal obligations. Consequently, unless there is some implicit prohibition on the states' imposition of nondiscriminatory franchise taxes on nondomiciliary banks,[1] the plain meaning of the statute compels the conclusion that the states retain the power to impose such taxes.[2]

The contention that the repeal of the McFadden Act will implicitly limit the states' power to tax the federal obligation income of nondomiciliary banks is advanced in a paper by Sandra McCray entitled "The Effect of the Repeal of the McFadden Act on

---

[1]As of September 12, 1976, Congress terminated all congressionally granted immunity of national banks from state taxation. Pub. L. 93-100, § 7, Aug. 16, 1973, 87 Stat. 347 (1973), as amended by Pub. L. 93-495, Title I, § 114, Oct. 28, 1974, 88 Stat. 1507; Pub. L. 94-222, §§ 1,4, Feb. 27, 1976, 90 Stat. 197, 198 (codified at 12 U.S.C. §548 (1988)). The only congressional restriction on state taxation of national banks is that "a national bank shall be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located." Id. The United States Advisory Commission on Intergovernmental Relations described the effect of this amendment as follows, in a congressionally authorized study of state taxation of out-of-state banks: "States other than the principal office state will be in a position to tax out of-State national banks which are engaged in the conduct of interstate banking transactions under . . . franchise taxes measured by net income in the same manner and to the same extent as any other foreign corporation." U.S. Advisory Commission on Intergovernmental Relations, State and Local "Doing Business" Taxes on Out-of-=State Financial Depositories, App. A-3, at 756 (1975).

[2]The U.S. Supreme Court has instructed that when construing federal statutory restraints on state taxation, "courts need not look beyond the plain language of the federal statute to determine whether a state statute that imposes such a tax is preempted." Aloha Airlines, Inc. v. Director, Division of Taxation, 464 U.S. 7, 12 (1983).

State Tax Revenue." Her essential thesis is that "states may include federal obligations in the measure of their franchise tax only when the tax is on a domestic corporation or when states have granted a special privilege to the corporation being taxed."[3] In her view, if the McFadden Act is repealed, banks will not need state permission to expand interstate; states will not be able to insist that out-of-state banks operate in the state through a locally-domiciled subsidiary; and, because the "states will not be the grantor of the privilege of interstate banking and the host state will not be the domiciliary state to the bank," the states will "no longer have the power to tax the income from federal obligations."[4]

Ms. McCray's thesis is based on the fundamentally misguided notion that the states' power to tax federal obligation income depends on the grant by the state of a "special privilege" that she equates with the power of a state to exclude the corporation from doing business in the state. Her argument reflects an antiquated and formalistic view of state taxing power that prevailed during the nineteenth century but which has been unequivocally repudiated by the U.S. Supreme Court in its modern

---

[3]Reply of Sandra McCray to the March 1, 1991 Letter of William F. Collins to Ms. Barbara Barrantes at the New York State Banking Department, March, 1991, p.1.

[4]McCray, The Effect of the Repeal of the McFadden Act on State Tax Revenue 1 (1991).

decisions.[5] Thus the Court's modern decisions permit states to tax out-of-state corporations so long as the tax is applied to an activity that has a substantial nexus with the state, is fairly apportioned, is nondiscriminatory, and is fairly related to services provided by the state.[6] State tax power does not depend, as Ms. McCray argues, on the states' power to exclude.

To be sure, with respect to state taxation of federal obligations, and, indeed, with regard to state taxation of the federal government and its instrumentalities generally, there is one formalism that remains. The states may not impose a tax "directly" on the federal government or its instrumentalities although they may do so "indirectly."[7] The long-standing rule that the states may not impose a direct net income tax on the income from federal obligations but may impose an indirect franchise tax on such income reflects this formalism, and this rule is embodied in 31 U.S.C. § 3124.

But this formalistic rule---that the states may tax federal obligations (or the income therefrom) so long as the legal incidence of the tax falls on some taxable subject that is

[5]See, e.g., Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) (overruling the doctrine that the states could not impose a "privilege" tax on an interstate business, because the states had no power to grant the "privilege" of doing interstate business); Western & Southern Life Ins. Co. v. State Bd. of Equalization, 451 U.S. 648 (1981) (overruling the doctrine that a state's power to exclude a foreign corporation justified a discriminatory tax for the "privilege" of conducting a local business in the state).

[6]See, e.g., Commonwealth Edison Co. v. Montana, 453 U.S. 609, 617 (1981).

[7]See, e.g., United States v. New Mexico, 455 U.S. 720 (1982).

distinct from the obligation (or the income) itself---is wholly consistent with state taxation of the federal obligations of out-of-state banks. Because the legal incidence of the typical state franchise tax falls on the privilege of doing business, owning property, maintaining employees, or conducting other specified activity in the state (rather than on the income itself),[8] it may be applied to the federal obligation income of an out-of-state bank that engages in such activity.[9]

Ms. McCray's argument is predicated on the premise that the only privilege for which states may impose a nondiscriminatory franchise tax is the power to exclude, and once this power has been wrested from the states by congressional repeal of the McFadden Act, the states will lack the power to impose such a tax. But this premise is false. In numerous cases, the Supreme Court has sustained state franchise taxes on "privileges" that are distinct from the power to exclude.[10] Indeed, the very cases

---

[8]See 1 J. Hellerstein, State Taxation: Corporate Income and Franchise Taxes ¶ 7.1 (1983).

[9]This assumes, of course, that the federal obligation income is derived from a unitary business being conducted in the state. See Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980).

[10]See, e.g., Colonial Pipeline Co. v. Traigle, 421 U.S. 100 (1975) (corporate franchise tax as applied to nondomiciliary corporation validly predicated on the "privileges" of exercising a corporate charter in the state, owning or using property in the state, or doing business in the state in corporate form); Memphis Gas Co. v. Stone, 335 U.S. 80 (1948) (corporate franchise tax as applied to nondomiciliary corporation validly predicated on "privileges" of maintaining, keeping in repair, and otherwise manning facilities of an interstate pipeline); Coverdale v. Arkansas-Louisiana Pipe Line Co., 303 U.S. 604 (1938) (corporate franchise tax as applied to nondomiciliary corporation validly

that Ms. McCray cites for the proposition that the power to tax federal obligations was in some sense a quid pro quo for some "special privilege" granted by the state stand merely for the proposition that a state tax measured by federal obligations is valid when it is imposed on some taxable subject other than the federal obligations themselves.[11] It is the hoary "direct"-"indirect" distinction that still controls states' power to tax federal obligations but is in no sense tied to the states' power to exclude the corporation that is subject to the "indirect" levy. Indeed, Professor Paul Hartman, who Ms. McCray characterizes as "a leading state tax scholar,"[12] flatly declares that the validity of a state tax on federal obligations "turns on what the Court concludes is the statutorily styled subject of the tax, and not what gives value to the styled subject."[13]

Perhaps the most telling refutation of Ms. McCray's thesis is that virtually all states with franchise taxes impose their levies on the federal obligation income from out-of-state

---

predicated on "privilege" of producing power in the state).

[11]See, e.g., Pacific Co. v. Johnson, 285 U.S. 480, 490 (1932) (recognizing that a tax upon "a franchise" or "the privilege of doing business in corporate form" was distinct from a tax on federal obligations themselves); Educational Films Corp. v. Ward, 282 U.S. 379, 389-90 (1931) (recognizing that indirect "excise" tax on "corporate franchises" and other discrete subjects of taxation may be measured by federal obligations, "although the statutory measure of the tax included securities constitutionally immune from any form of direct taxation").

[12]Reply of Sandra McCray, note 3 supra, at 2.

[13]P. Hartman, Federal Limitations on State and Local Taxation 349 (1981).

corporations. If Ms. McCray's thesis were correct, there would be a serious constitutional problem with states taxing the federal obligation income of out-of-state general business corporation. Unlike out-of-state banks, which are granted a "special privilege" of conducting business in the state under the McFadden Act which allegedly justifies the states' taxing their federal obligations, the typical out-of-state corporation is granted no such privilege by the state because the Commerce Clause guarantees its right to conduct an interstate business without asking the state's permission. If the state's power to tax the federal obligation income earned by such corporations depended on the state's power to exclude such corporations from the state, the states would obviously be in constitutional difficulty in imposing such taxes.

Ms. McCray appears to recognize this problem in her response to a letter of William Collins, Deputy Commissioner and Counsel to the New York Department of Taxation and Finance. Mr. Collins took issue with her position that the Supreme Court's decisions did not permit states to include federal obligations in the franchise tax measure of a nondomiciliary corporation. He also observed that New York has taxed such income since at least 1944. In response, Ms. McCray declared:

> If New York does indeed impose a franchise tax on the income from federal securities held by nondomiciliary general business corporations, it may be the only state to do so. For general business corporations, income from federal securities is "nonbusiness" investment income. Under the Uniform Division of Income for Tax Purposes

> Act (UDITPA), such income is taxed solely by the state of domicile. Approximately 46 states use UDITPA or some variation thereof. Moreover, the U.S. Supreme Court has noted in connection with the unitary business principle that a state does not have jurisdiction to tax an apportioned share of the income from intangibles unless those intangibles are related to and an integral part of the business of the nondomiciliary corporation (i.e., the income from the intangibles must be business income). This reasoning may be applicable to the taxation of nonbusiness income of nondomiciliary general business corporations whether or not the state uses the unitary business principle. Thus, the New York practice with regard to the taxation of the nonbusiness income (from federal securities) may be questionable.[14]

Ms. McCray is wrong on the facts and wrong on the law. Far from being the only state with a franchise tax to impose its levy on the income from federal securities earned by nondomiciliary corporations, New York enjoys the company of many of her sister states that impose such taxes. Thus California,[15] Connecticut[16], Florida,[17] Massachusetts,[18] Minnesota,[19] Montana,[20] New Jersey,[21]

---

[14]See Reply of Sandra McCray, note 3 supra, at 3.

[15]Cal. Rev. & Tax. Code § 24272 (West Supp. 1991).

[16][1] Multistate Corporate Income Tax Guide (CCH) ¶ 2352.

[17]Letter to CCH from Florida Department of Revenue, Corporate Income Tax Bureau, [1] Multistate Corporate Income Tax Guide (CCH) ¶ 303.27

[18][1] Multistate Corporate Income Tax Guide (CCH) ¶ 3108.02.

[19]Minn. Stat. § 290.01.19c(2) (1990).

[20]Schwinden v. Burlington Northern, Inc., 691 P.2d 1351 (Mont. 1984) (federal obligation income of nondomiciliary general business corporation includable in franchise tax base).

Oregon,[22] Tennessee,[23] Utah,[24] and Wisconsin[25] all impose their franchise taxes on the federal obligation income of nondomiciliary corporations.

Moreover, this widespread practice among the states of taxing the federal obligation income of nondomiciliary corporations is fully in accord with settled legal doctrine in this area. A leading treatise on state taxation states that "the immunity doctrine does not prevent the States from including in the measure of franchise or excise tax on the conduct of business in the State interest on federal securities."[26]

Ms. McCray further errs when she asserts that, under the Uniform Division of Income for Tax Purposes Act (UDITPA), "[f]or general business corporations, income from federal securities is "nonbusiness" investment income."[27] In fact, under UDITPA all

---

[21] N.J. Rev. Stat. Ann. §§ 54:10A-4(k)(2)(B) (West Supp. 1990).

[22] Pacific First Federal Savings Bank v. Department of Revenue, 308 Ore. 332, 779 P.2d 1033 (1989) (Oregon nondiscriminatory franchise tax properly applied to federal obligations of nondomiciliary federally-chartered stock savings bank doing business in Oregon); [1 Ore.] State Tax Rptr. (CCH) ¶ 10-305.

[23] [1] Multistate Corporate Income Tax Guide ¶ 4152.

[24] Letter to CCH from Karl Nelson, Managing Auditor, Auditing Division, Utah State Tax Commission, May 18, 1984, [1] Multistate Corporate Income Tax Guide ¶ 9726.10.

[25] Wis. Corp. Franch. Tax Rule 2.65, reported in [1 Wis.] State Tax Rptr. (CCH) ¶ 14-639.

[26] 1 J. Hellerstein, State Taxation: Corporate Income and Franchise Taxes 265 (1983).

[27] See text at note 14 supra.

"business income," which includes "income from . . . intangible property if the acquisition, management, and disposition of the property constitute integral part of the taxpayers' regular trade or business operations,"[28] is taxable in part by a nondomiciliary state. Not only is there no presumption, as Ms. McCray suggests, that income from federal securities constitutes "nonbusiness" investment income, but in fact the UDITPA regulations presume all "income of the taxpayer is business income unless clearly classifiable as nonbusiness income."[29] The case law arising under UDITPA likewise reveals that the income from federal securities earned by nondomiciliary taxpayers doing business in a state is routinely taxable as apportionable business income.[30]

Finally, it is worth noting that only a few years ago Ms. McCray herself squarely acknowledged the very proposition that she is now attacking: "As the law stands today, then, a state franchise tax measured by net income, including the income from federal obligations earned by a bank operating in interstate commerce, is valid if (1) the bank has, by means of regular and

---

[28]UDITPA § 1(a) (emphasis supplied).

[29]Multistate Tax Commission Reg. IV.1.(a), reported in [2] Multistate Corporate Income Tax Guide ¶ 8150.

[30]See, e.g., Great Lakes Pipe Line Co. v. Commissioner of Taxation, 272 Minn. 403, 138 N.W.2d 612 (1965), appeal dismissed, 384 U.S. 718 (1966); Appeal of R.H. Macy & Co., Inc., Cal. State Bd. of Equalization, July 26, 1988, [3 Cal.] St. Tax Rtpr. (CCH) ¶ 401-639; American Telephone & Telegraph Co. v. State Tax Appeals Board, ___ Mont. ___, 787 P.2d 754 (1990); American Telephone & Telegraph Co. v. Director, Division of Taxation, 4 N.J. Tax 638 (1982), aff'd, 194 N.J. Super. 168, 476 A.2d 800 (1984).

deliberate contacts with the state, earned income from sources therein, and (2) the tax is fairly apportioned and does not discriminate against banks operating in interstate commerce."[31] There is not a hint of Ms. McCray's current thesis that a state franchise tax on an out-of-state bank is permissible only if the state has granted a "special privilege" to the corporation being taxed.

In closing, I wish to emphasize that I am not here either to support or oppose federal legislation authorizing interstate branch banking. My sole purpose is to assure that your deliberations on the merits of interstate branching not be distracted by disinformation regarding the imagined effect that such legislation would have on the states' power to tax federal obligations.

---

[31] McCray, State Taxation of Interstate Banking, 21 Ga. L. Rev. 283, 326 (1986) (emphasis supplied).

WALTER HELLERSTEIN

Office Address

University of Georgia Law School
Athens, GA 30602
(404) 542-5175

Home Address

239 Westview Drive
Athens, GA 30606
(404) 353-0865

PERSONAL DATA

Birth Date: June 21, 1946
Place of Birth: New York, New York
Marital Status: Married, two children

EDUCATION

Harvard College, A.B., 1967
Magna cum Laude in Government
Phi Beta Kappa

University of Chicago Law School, J.D., 1970
Cum Laude
Order of the Coif
Editor-in-Chief, University of Chicago Law Review

MILITARY SERVICE

Captain, United States Air Force, 1970-76
(Active service obligation fulfilled through participation in the Honors Program of the Air Force General Counsel's Office from September 1971 through June 1973)

LEGAL EXPERIENCE

January 1986 - present: Of Counsel, Morrison & Foerster, Washington, D.C. Office

April 1984 - present: Professor, University of Georgia School of Law

September 1978 - April 1984: Associate Professor, University of Georgia School of Law

January 1976 - August 1978: Assistant Professor of Law, University of Chicago

July 1973 - December 1975: Associate, Covington & Burling, Washington, D.C.

WALTER HELLERSTEIN
Resumé
Page 2

LEGAL EXPERIENCE (cont'd)

July 1971 - September 1971: Summer Associate, Cleary, Gottlieb, Steen & Hamilton, Paris, France

July 1970 - July 1971: Law Clerk to the Hon. Henry J. Friendly, Chief Judge, United States Court of Appeals for the Second Circuit

PROFESSIONAL ACTIVITIES

Member, Board of Directors, National Tax Association - Tax Institute of America (1981-83)

Affiliated Scholar, American Bar Foundation (1982)

Member, Editorial Advisory Board, National Tax Journal

Member, Editorial Advisory Board, Multistate Tax Analyst

Fellow, American College of Tax Counsel

Shell Foundation Lecturer, Tulane University Law School

Faculty Member, American Law Institute - American Bar Association, Courses on State and Local Taxation and Financing

Faculty Member, Georgetown University Law Center Annual Institute on State and Local Taxation

Faculty Member, Tax Executives Institute Courses on State and Local Taxation

Faculty Member, Lincoln Institute of Land Policy Seminar for State Tax Court Judges

Faculty Member, New York University Institute on State and Local Taxation

Faculty Member, World Trade Institute Seminar on State and Local Taxation

Faculty Member, International Association of Assessing Officers Legal Seminar

Faculty Member, Georgia Association of Assessing Officers Mineral Rights Seminar

PROFESSIONAL ACTIVITIES (cont'd)

Faculty Member, Heart of America Tax Institute

Faculty Member, American Mining Congress, State Tax Workshop

Faculty Member, Eastern Mineral Law Foundation, Basic Taxation of Natural Resources

Faculty Member, National Institute on State and Local Taxation

BAR MEMBERSHIPS

Admitted, District of Columbia, 1970; Illinois, 1976; New York, 1989

PUBLICATIONS

Books and Monographs

With J. Hellerstein, 1989 Cumulative Supplement to 1 J. Hellerstein, State Taxation: Corporate Income and Franchise Taxes (Warren, Gorham and Lamont 1983)

With J. Hellerstein, State and Local Taxation, Cases and Materials, 5th ed. (West Publishing Co. 1988)

State and Local Taxation of Natural Resources in the Federal System: Legal, Economic, and Political Perspectives (American Bar Association Section of Taxation 1986)

With S. Davidson, D. Green, A Madansky, and R. Weil, Financial Reporting by State and Local Government Units (Center for Management of Public and Nonprofit Enterprise of the University of Chicago 1977)

Articles

State Taxation and the Supreme Court, 1989 Sup. Ct. Rev. 223 (1990)

Preliminary Reflections on McKesson and American Trucking Associations, Tax Notes, July 16, 1990, p. 325

Federal Constitutional Limitations on State Taxation, State and Local Taxation Portfolio Series (1990)

PUBLICATIONS (cont'd)

<u>Articles</u> (cont'd)

Are Days of World-Wide Unitary Taxation by States Limited?, 72 J. Tax'n 172 (1990)

With Smith, State Taxation of Federally-Deferred Income: The Interstate Dimension, 44 Tax L. Rev. 34 (1989)

Equal Protection Run Amok?: An Analysis of the Nebraska Supreme Court's Decision in the <u>Northern Natural Gas</u> Case, <u>Tax Notes</u>, Nov. 20, 1989, p. 995

With Peters, Recent Supreme Court Decisions Have Far-Reaching Implications, 70 J. Tax'n 306 (1989)

Is "Internal Consistency" Foolish?: Reflections on an Emerging Commerce Clause Restraint on State Taxation, 87 Mich. L. Rev. 138 (1988)

Testimony on H.R. 1242, H.R. 1891, and H.R. 3521, the Interstate Sales Tax Collection Act of 1987 and the Equity in Interstate Competition Act of 1987: Hearing Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary 100th Cong., 2nd Sess. 344 (1988).

State and Local Property and Production Taxation of Minerals, Title XVII, American Law of Mining (2d ed. 1988)

With Levine, Utility Gross Receipts Taxes and Interexchange Telecommunications Carriers, Tax Notes, Aug. 1, 1988, p. 529

Florida's Sales Tax on Services, 41 Nat'l Tax J. 1 (1988)

State Taxation of Interstate Business: Perspectives on Two Centuries of Constitutional Adjudication, 41 Tax Law. 37 (1987)

Commerce Clause Restraints on State Taxation: Purposeful Economic Protectionism and Beyond, 85 Mich. L. Rev. 758 (1987)

WALTER HELLERSTEIN
Resumé
Page 5

PUBLICATIONS (cont'd)

Articles (cont'd)

A Primer on Florida's Sales Tax on Services, Tax Notes, June 22, 1987, p. 1219

Current Legal Issues in State Taxation of Telecommunications: A Preliminary Inquiry, 1986 Procs. of the Nat'l Tax Ass'n - Tax Inst. of Am. 69 (1987)

Extending the Sales Tax to Services: Notes from Florida, Tax Notes, Feb. 23, 1987, p. 823

Selected Issues in State Business Taxation, in Symposium on State and Local Taxation, 39 Vand. L. Rev. 1033 (1986)

Legal Perspectives on the Interstate Incidence and Shifting of State and Local Taxes, 10 Int'l Regional Sci. Rev. 67 (1986)

Complementary Taxes as a Defense to Unconstitutional State Tax Discrimination, 39 Tax Law. 405 (1986)

Recent Judicial Developments in State Income Taxation of the Oil and Gas Industry, 34 Oil & Gas Tax Q. 533 (1986)

Discrimination in the State Tax Arena, 4 N.Y.U. Inst. on State and Local Taxation 1-1 (1986)

State Taxation and the Supreme Court, 1983-84 Term, 3 N.Y.U. Inst. on State and Local Taxation 13-1 (1985)

With Leegstra, Supreme Court in Metropolitan Life Strikes Down Discriminatory State Insurance Tax, 63 J. Tax'n 108 (1985)

Political Perspectives on State and Local Taxation of Natural Resources, 19 Ga. L. Rev. 31 (1984)

Testimony on S. 463, The Severance Tax Equity Act of 1982, in State Severance Taxes: Hearing Before the Subcommittee on Energy and Agricultural Taxation of the Senate Committee on Finance, 98th Cong., 2nd Sess. 119 (1984)

PUBLICATIONS (cont'd)

Articles (cont'd)

Dividing the State Corporate Income Tax Base: Developments in the Supreme Court and Congress, in C. McLure, ed., The State Corporation Income Tax: Issues in Worldwide Unitary Combination 288 (Hoover Press 1984)

Legal Constraints on State Taxation of Natural Resources, in C. McLure and P. Mieszkowski, eds., Fiscal Federalism and the Taxation of Natural Resources 135 (Lexington Books 1983)

Federal Constitutional and Statutory Constraints on State Taxation of Natural Resources, 1 N.Y.U. Inst. on State and Local Taxation 245 (1983)

State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on ASARCO and Woolworth, 81 Mich. L. Rev. 157 (1982)

The Commerce Clause and State Severance Taxes, in Fiscal Disparities, Part II: The Commerce Clause and the Severance Tax, Hearings Before the Subcommittee on Intergovernmental Relations of the Senate Committee on Government Affairs, 97th Cong., 1st Sess. 19 (1982)

State Income Taxation of Multijurisdictional Corporations and the Supreme Court, 35 Nat'l Tax J. (1982)

Federal Limitations on State Taxation of Interstate Commerce, in T. Sandalow and E. Stein, eds., Courts and Free Markets: Perspectives from the United States and Europe 431 (Oxford University Press 1982)

With Kaufman, Sales and Use Taxation of Movable Property in Interstate Commerce, 1981 Procs. of the Nat'l Tax Ass'n - Tax Inst. of Am. 69 (1982)

With McGrath, Reflections on Commonwealth Edison Co. v. Montana, 43 Mont. L. Rev. 165 (1982)

Constitutional Limitations on State Tax Exportation, 1982 Am. Bar Found. Research J. 1 (1982)

PUBLICATIONS (cont'd)

Articles (cont'd)

State Taxation in the Federal System: Perspectives on Louisiana's First Use Tax on Natural Gas, 55 Tul. L. Rev. 601 (1981)

Supreme Court Bars Louisiana's First Use Tax, Upholds California's Retaliatory Insurance Tax, 55 J. Tax'n 106 (1981)

State Income Taxation of Multijurisdictional Corporations: Reflections on Mobil, Exxon, and H.R. 5076, 79 Mich. L. Rev. 113 (1980)

With Wells, The Governmental-Proprietary Distinction in Constitutional Law, 66 Va. L. Rev. 1073 (1980)

Hughes v. Oklahoma: The Court, the Commerce Clause, and State Control of Natural Resources, 1979 Sup. Ct. Rev. 51 (1980)

State's Power to Tax Foreign Commerce Dominates Supreme Court's 1978 Agenda, 51 J. Tax'n 106 (1979)

Construing the Uniform Division of Income for Tax Purposes Act: Reflections on the Illinois Supreme Court's Reading of the "Throwback" Rule, 45 U. Chi. L. Rev. 768 (1978)

Constitutional Constraints on State Taxation of Energy Resources, 31 Nat'l Tax J. 245 (1978)

State Taxation and the Supreme Court: Toward a More Unified Approach to Constitutional Adjudication?, 75 Mich. L. Rev. 1426 (1977)

Michelin Tire Corp. v. Wages: Enhanced State Power to Tax Imports, 1976 Sup. Ct. Rev. 99 (1977)

State Taxation and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline, 62 Va. L. Rev. 149 (1976)

Some Reflections on the State Taxation of a Nonresident's Personal Income, 72 Mich. L. Rev. 1309 (1974)

PUBLICATIONS (cont'd)

Articles cont'd)

Body-Snatching Reconsidered: The Exhumation of Some Early American Legal History, 39 Bklyn. L. Rev. 350 (1972)

Book Reviews

Review of W. Newhouse, Constitutional Uniformity and Equality in State Taxation, 5 Prop. Tax J. 52 (1986)

Forthcoming

Justice Scalia and the Commerce Clause: Reflections of a State Tax Lawyer, in Symposium on the Jurisprudence of Justice Scalia, ____ Cardozo L. Rev. ____ (1991)

With J. Hellerstein, State Taxation (Rev. ed. 1991)

RESPONSE OF WALTER HELLERSTEIN
TO THE REPLY OF SANDRA B. McCRAY
TO THE TESTIMONY OF WALTER HELLERSTEIN
BEFORE THE SUBCOMMITTEE ON ECONOMIC STABILIZATION
OF THE
HOUSE COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS

MAY 21, 1991

Sandra McCray's further attempt to sustain her thesis that the repeal of the McFadden Act will deprive states of the power to impose nondiscriminatory franchise taxes on the federal obligation income of out-of-state banks is no more compelling than her original argument.

First, she continues to rest her case on the false premise that a state's power to impose a franchise tax on an out-of-state corporation depends on the state's power to exclude a corporation from doing business in the state. The settled law is to the contrary. The Supreme Court has squarely held that a state may impose a "franchise" or "privilege" tax on an out-of-state corporation, whether or not the corporation has qualified to do business in the state and whether or not the state could exclude the corporation from engaging in such business. See, e.g., Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977); Memphis Natural Gas Co. v. Stone, 335 U.S. 80 (1948). A state's power to tax an out-of-state business depends only on whether the tax is applied to an activity that has a substantial nexus with the state, is fairly apportioned, is nondiscriminatory, and is fairly related to services provided by the state. It does not depend on whether the state had the power to exclude the corporation or to exact a "special privilege" from it. Hence Ms. McCray's effort to distinguish between two categories of corporations---those which the state may exclude and those which it may not exclude---is beside the point. Since the state's power to tax does not depend on its power to exclude, it hardly matters whether in a particular instance a state may have had greater power over a corporation than was necessary to permit it to impose a nondiscriminatory franchise tax.

Second, conceding that there are cases in which a state may not exclude a foreign corporation, Ms. McCray declares that "[t]he real question is: is there any constitutional doctrine that would require states to treat a foreign corporation's income from federal obligations differently than they treat its income from other sources.?" Ms. McCray answers the "real question" by reference to Weston v. City of Charleston, 27 U.S. (2 Pet.) 449 (1829), which stands for the unexceptional proposition that the states may not impose a direct tax---there an ad valorem property tax---upon federal obligations. From this Ms. McCray deduces that there is a distinction between federal obligation income and other income of foreign corporations and, "having settled that crucial question" to her own satisfaction, she repeats her conclusion that "not every state in which a foreign corporation has nexus can tax a portion of the income from federal obligations."

The problem with Ms. McCray's analysis is that she has asked only half of the "real question." The real "real question" is whether there is "any constitutional doctrine that would require states to treat a foreign corporation's income from federal obligations differently than they treat its income from other sources under a nondiscriminatory franchise tax." Weston cannot answer that question because it involved a direct property tax. A century and half of case law following Weston, however,---not to mention 31 U.S.C. § 3124---makes it clear that federal obligations can be taxed under a nondiscriminatory franchise tax. Since states can impose nondiscriminatory franchise taxes on out-of-state corporations with a substantial nexus with the state, and since they can include federal obligations in the base of such a tax, it necessarily follows that out-of-state banks will be subject to nondiscriminatory franchise taxation of their federal obligation income by states with which they have a substantial nexus. Once banks are permitted to engage in business in states other than their domicile, they will be treated no differently from other out-of-state corporations whose federal obligation income is routinely taxed by many states under nondiscriminatory franchise taxes.

Ms. McCray's current thesis has been unequivocally repudiated by none other than Ms. McCray herself. Ms. McCray has declared that once Congress lifted its ban on state taxation of national banks in 1976, "states were free to tax out-of-state banks as they do other corporations." McCray, State Taxation of Interstate Banking, 21 Ga. L. Rev. 283, 327 (1986). More to the point, she explicitly acknowledged that "states can tax an apportioned share of the income of those out-of-state banking businesses that transact business within their borders," and "[b]y using a franchise tax measured by net income, these states may include the value of federal obligations in the apportionable tax base." Id. (emphasis supplied).

In sum, there is no merit to the assertion that the repeal of the McFadden Act and the Douglas Amendment jeopardizes state franchise tax revenues.