Supplementary Material

Chapter 11: The Contemporary Era – Federalism

South Central Bell Telephone Company v. Alabama, 526 U.S. 160 (1999)

Alabama required that corporations doing business in the state pay a franchise tax. On Alabama-based firms, the tax was based on the par value of the firm's stock (the par, or face, value of stock is set by the corporation itself for bookkeeping purposes, and is often set at one penny). On out-of-state firms, the tax was based on the amount of capital employed within the state. In 1986, a group of out-of-state firms, including Reynolds Metals Company, sued for a refund in state court, contending that the tax unconstitutionally discriminated against out-of-state businesses. The state supreme court upheld the tax, contending that the franchise tax offset another state tax that was imposed by a domestic shares tax, which was levied on within-state shareholders of Alabama corporations based on the market value of the shares that they hold. South Central Bell Telephone Company, also an out-of-state corporation, had filed a similar suit in the state courts but had introduced evidence indicating that the domestic shares tax did not impose a similar cost as the franchise tax. The state courts dismissed the Bell Telephone suit on the grounds that the issue had already been decided in the Reynolds Metals case. Bell Telephone appealed to the U.S. Supreme Court.

As a procedural matter, the U.S. Supreme Court determined first that the Eleventh Amendment did not bar the appeals from the state courts in suits against state governments and declined to reconsider its key precedents on that issue and second that the state supreme court's decision rested primarily on an interpretation of federal constitutional law and not state law. On the merits, the Court unanimously ruled against Alabama on the ground that the tax system created discriminatory burdens on out-of-state firms in violation of the commerce clause. Alabama argued that the commerce clause precedents should also be overturned, but the Court declined to consider those arguments. In a concurrence, Justice Thomas implied that he would be open to reconsidering those negative commerce clause cases that constrained state laws even in the absence of a superseding federal statute.

Does the commerce clause require that state taxes treat in-state and out-of-state corporations the same? How should courts evaluate the varying effects of the myriad taxes that affect businesses operating within a state? Should it be possible for a state to offset a tax with differential effects with a tax that is explicitly discriminatory? Why would the Court not consider arguments challenging its earlier precedents? Should the justices be obliged to consider all plausible arguments that parties might wish to make to support their claims?

JUSTICE BREYER, delivered the opinion of the Court.

The basic question in this case is whether the franchise tax Alabama assesses on foreign corporations violates the Commerce Clause. We conclude that it does.

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. . . . Alabama law defines a domestic corporation's tax base as including only one item -- the par value of capital stock -- which the corporation may set at whatever level it chooses. A foreign corporation's tax base, on the other hand, contains many additional balance sheet items that are valued in accordance with generally accepted accounting principles, rather than by arbitrary assignment by the corporation. Accordingly, as the State has admitted, Alabama law gives domestic corporations the ability

to reduce their franchise tax liability simply by reducing the par value of their stock, while it denies foreign corporations that same ability. . . . The tax therefore facially discriminates against interstate commerce and is unconstitutional unless the State can offer a sufficient justification for it. . . . This discrimination is borne out in practice, as the record, undisputed here, shows that the average domestic corporation pays only one-fifth the franchise tax it would pay if it were treated as a foreign corporation. . . .

The State cannot justify this discrimination on the ground that the foreign franchise tax is a "complementary" or "compensatory" tax that offsets the tax burden that the domestic shares tax imposes upon domestic corporations. . . . Our cases hold that a discriminatory tax cannot be upheld as "compensatory" unless the State proves that the special burden that the franchise tax imposes upon foreign corporations is "roughly . . . approximate" to the special burden on domestic corporations, and that the taxes are similar enough "in substance" to serve as "mutually exclusive" proxies for one another. *Oregon State Waste Systems v. Department of Environmental Quality of Oregon* (1994).

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Rather than dispute any of these matters, the State instead says, with "respect to the merits," that "the flaw in petitioners' claim lies not in the application to Alabama's corporate franchise tax of this Court's recent negative Commerce Clause cases; the flaw lies rather in the negative Commerce Clause cases themselves." The State adds that the Court should "formally reconsider" and "abandon" its negative Commerce Clause jurisprudence. We will not entertain this invitation to reconsider our longstanding negative Commerce Clause doctrine, however, because the State did not make clear it intended to make this argument until it filed its brief on the merits. We would normally expect notice of an intent to make so far-reaching an argument in the respondent's opposition to a petition for certiorari, cf. this Court's Rule 15.2, thereby assuring adequate preparation time for those likely affected and wishing to participate. We are not aware of any convincing reason to depart from that practice in this case. And consequently we shall not do so.

For these reasons, the decision of the Alabama Supreme Court is *reversed*. . . .

JUSTICE THOMAS, concurring.

I join the opinion of the court. I agree that it would be inappropriate to take up the State's invitation to reconsider our negative Commerce Clause doctrine in this case because "the State did not make clear it intended to make this argument until it filed its brief on the merits."

JUSTICE O'CONNOR, concurring.

I join the opinion of the court, and I agree that the State's failure to properly raise its challenge to our negative Commerce Clause jurisprudence supports a decision not to pass on the merits of this claim. I further note, however, that the State does nothing that would persuade me to reconsider or abandon our well-established body of negative Commerce Clause jurisprudence.