CONCLUSION

The remedial equation between mortgages and installment land sales contracts is almost complete. In granting the remedy of specific performance under its facts, *MacFadden* recognized an unqualified equity of redemption for the willfully defaulting vendee. The court's treatment of the case, analytically and remedially, coupled with its acknowledgement of Professor Hetland's arguments,[73] indicates that the installment land contract is dead as a remedially distinctive security device.[74] Explicit judicial confirmation of this death will have to await the vendee who demands a judicial sale, and forces the court to consider this "other remedy."[75]

Charles R. Farrar, Jr.

XIII

STATE AND LOCAL GOVERNMENT

A. *Deductibility of Dividends for Franchise Tax*

Safeway Stores, Inc. v. Franchise Tax Board;[1] *Great Western Financial Corp. v. Franchise Tax Board.*[2] The court grappled with the deductibility of intercorporate dividends[3] and dividend collection expenses[4] in determining a recipient corporation's net income subject to

73. *Id.* at 816, 488 P.2d at 1357, 52 Cal. Rptr. at 541.

74. *See* HETLAND §§ 3.59, 3.81; Hetland, *The California Land Contract, supra* note 4, at 729-30, 760-62, 773-75. *See* Warren, *California Installment Sales Contracts, supra* note 4 at 632-33.

75. 5 Cal. 3d at 816, 488 P.2d at 1357, 52 Cal. Rptr. at 541. The other remedy referred to by the court could be none other than forcing a judicial sale. There are simply no other remedies that are still denied the defaulting vendee under an installment land sale contract used as a security device. HETLAND §§ 3.58-3.81.

1. 3 Cal. 3d 745, 478 P.2d 48, 91 Cal. Rptr. 616 (1970) (Burke, J.) (unanimous decision).

2. 4 Cal. 3d 1, 479 P.2d 993, 92 Cal. Rptr. 489 (1971) (Mosk, J.) (5-2 decision).

3. CAL. REV. & TAX. CODE ANN. § 24401 (West 1970):

> In addition to the deductions provided in Article 1, there shall be allowed as deductions in computing taxable income the items specified in this article.

CAL. REV. & TAX. CODE ANN. § 24402 (West 1970) then declares one of such deductions to be:

> Dividends received during the income year declared from income which has been included in the measure of the taxes imposed under . . . this part upon the taxpayer declaring the dividends.

4. CAL. REV. & TAX. CODE ANN. § 24343(a) (West 1970):

> There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the income year in carrying on any trade or business. . . .

state franchise taxation.[5] In the *Safeway* case, the court was unanimous in reiterating that the dividend deduction provisions of section 8(h) of the Bank and Corporation Franchise Tax Act[6] were designed specifically to prevent the imposition of a double tax at the corporate level on dividend income that had previously been subjected to California taxation in the hands of the dividend-declaring corporation. Nevertheless, since the dividend income in question had come from corporate sources either wholly or partially outside California, the court found that only a portion of such income had previously been taxed by California and that, consequently, the untaxed balance could not be deducted under section 8(h).

The *Great Western* case, on the other hand, held that, although dividends declared from previously taxed income are deductible by the corporate recipient, costs and expenses incurred in collecting the deductible sums are nondeductible, despite the fact that such expenses appear to fall within the business expense deduction provisions of section 24343(a) of California's Revenue and Taxation Code.[7] Although at first glance these holdings appear to be based on technical points, the court's rationale in the two cases may well augur a substantial shift in state court tax policy regarding intercorporate dividend deductions, an area in which the law was previously thought to be well settled. In order to determine the extent of this change, it is necessary to review the prior case law on dividend deductions under state franchise tax laws.

I. PRIOR CASE LAW

Perhaps the first significant pronouncement on intercorporate dividend deductions in California was *Burton E. Green Investment Co. v. McColgan.*[8] In that case, three-fourths of the corporate plaintiff's

5. CAL. REV. & TAX. CODE ANN. § 23501 (West 1970):

> There shall be imposed upon every corporation for each taxable year, a tax at the rate of 7 percent upon its net income derived from sources within this state. . . .

CAL. REV. & TAX. CODE ANN. § 24341 (West 1970) further declares:

> "Net income" means the gross income . . . less the deductions allowed under this article and Article 2 of this chapter.

Both deductions noted previously fall within the deduction provisions of § 24341.

6. Section 8(h)(1) of the former act contained provisions for dividend deductions substantially identical to those now found in section 24402 of the Revenue and Taxation Code. Section 8(h)(1) provided for the deduction of

> [d]ividends received during the income year declared from income which has been included in the measure of the tax imposed by this act upon the bank or corporation declaring the dividends, or from income which has been taxed under the provisions of the Corporation Income Tax Act to the corporation declaring the dividends.

CAL. GEN. LAWS ANN. act 8488, § 8(h)(1) (Deering 1943).

7. See note 4 *supra.*

8. 60 Cal. App. 2d 224, 140 P.2d 451 (2d Dist. 1943).

annual income consisted of dividends received from another California corporation engaged in the business of oil production. The declarant itself had reported gross income of more than $7,000,000 for the previous year, but because of oil depletion deductions of more than $1,760,000 and other deductions of nearly $2,500,000, had paid a franchise tax computed as a percentage of a net income of only about $3,000,000. Its dividend distributions, however, had been derived from income in excess of this net income figure.

At that time, section 8(h) of the Bank and Corporation Franchise Tax Act allowed corporations to deduct dividends declared from "income which has been included in the measure of" the declarant's franchise tax. Whether amounts deducted by the declarant in determining its franchise tax had nonetheless been "included in the measure of" its tax so as to permit the recipient to deduct dividends declared therefrom was the central issue.

In *Green*, statutory percentage depletion deduction allowed the declarant for tax purposes far exceeded its actual production costs. Arguing that dividends declared from this excess represented dollars that had not been included in the measure of the declarant's tax, and that the plaintiff therefore should not be able to deduct such portions of its dividend income, the tax commissioner sought to tax the recipient on dividends declared from such amounts deducted by the declarant. The court of appeal, however, sided with the plaintiff.

> If the declaring corporation properly deducted depletion at 27½ percent of the gross income then any dividends paid out of the net income after such deduction are declared from income which had been "included in the measure of the tax" and are properly deductible by the recipient corporation.[9]

The rationale advanced by the court in reaching this conclusion can be reduced to two major contentions. First of all, the court stressed the strong policy of section 8(h) to avoid multiple taxation of income at the corporate level.[10] Although recognizing that the declarant's franchise tax was calculated on the basis of net income, the court felt that gross income was the amount included in the measure of the tax because, when coupled with the specified deductions, it was the factor that ultimately determined net income.[11] Additionally, said the court, in view of the legislature's express desire to prevent multiple taxation of corporate

9. 60 Cal. App. 2d at 231, 140 P.2d at 455.

10. *Id.* at 231-33, 140 P.2d at 455-56. *See also* 12 A. MARSHALL, CALIFORNIA PRACTICE, STATE AND LOCAL TAXATION 168 (1969).

11. 60 Cal. App. 2d at 233, 140 P.2d at 456. The court's initial assumption that the word "income" could refer only to either gross income or net income [60 Cal. App. 2d at 231, 140 P.2d at 455] is discussed in the text accompanying note 14 *infra*.

income, any intention to limit this immunity to net income would have been stated in express language.[12] Since this had not been done, implied legislative intent bolstered the court's own semantic determination that gross income was necessarily the measure of the tax.

As a second reason for reaching its conclusion, the court noted that section 9(d) of the Bank and Corporation Franchise Tax Act[13] disallowed deductions of normally deductible amounts that were allocable to income not included in the measure of the tax imposed by the franchise tax act. The court reasoned:

> "Net income" could not have been in the mind of the legislature in the phrase, "allocable to . . . income not included in the measure of the tax imposed . . . ." Deductions are not *allocable* to net income. A deduction expires the moment it is subtracted from the gross income. . . . In view of the use of the word income in section 9 subdivision (d) in the sense of gross income we are convinced that it has the same significance in section 8 subdivision (h).[14]

Assuming that the word "income" in the statute could refer only to either gross or net income, the court thus deduced its meaning in section 8(h) from a technical analysis of section 9(d).

The court's reasoning on both grounds, however, contains obvious flaws. First, it is not clear in what way double taxation of any funds received as dividends by the plaintiff would have resulted from the commissioner's proposed method of taxation. The commissioner intended to tax only dividends paid out of the non-expense portions of the declarant's depletion deductions, which had been excluded from the net income figure used to calculate the declarant's franchise tax. Since these sums represented profits in the hands of the declarant that had not yet been subjected to state franchise taxation, double taxation simply could not occur. Moreover, what the court considered to be the natural meaning of the statutory language in fact violates the rule that deductions are to be narrowly construed against the taxpayer.[15]

But even further difficulties arise from the court's analysis. For example, the court stated that "[i]f the same dividend is included in the

12. 60 Cal. App. 2d at 233, 140 P.2d at 456.

13. Section 9, the statutory predecessor of current sections 24421 and 24425 of the Revenue and Taxation Code had provided:

> In computing net income no deduction shall be allowed for: . . . (d) Any amount otherwise allowable as a deduction which is allocable to one or more classes of income (regardless of whether such income was received or accrued during the income year) not included in the measure of the tax imposed by this act.

14. 60 Cal. App. 2d at 233, 140 P.2d at 456 (emphasis in the original).

CAL. GEN. LAWS ANN. act 8488, § 9 (Deering 1943).

15. Great W. Financial Corp. v. Franchise Tax Bd., 4 Cal. 3d 1, 5, 479 P.2d 993, 995, 92 Cal. Rptr. 489, 491 (1971).

measure of the tax paid by two taxpayers successively under the Franchise Tax Act, the result is multiple taxation."[16] But if the *oil depletion deduction* is included in the measure of the tax imposed on the declarant, logically the *dividend deduction* is also included in the measure of the tax of the recipient. But this, the court told us, is multiple taxation. Again, if, as the court asserted, *all* income is included in the measure of the tax,[17] what is to be made of section 9(d)'s reference to classes of income that have *not* been included in the measure of the tax?[18] The court totally ignored such difficulties, concluding simply that

> since gross income is the original source of all dividends and since all of the [declarant's] income was reported as gross income, all of its dividends were from a fund which had been flailed by the tax master which fund was itself the measure of the tax.[19]

The supreme court denied the tax commissioner's petition for a hearing in the *Green* controversy, but the commissioner soon gained access to the high court in another case involving nearly identical facts, *Rosemary Properties, Inc. v. McColgan.*[20] There, too, though, the commissioner's contentions were rejected, as the majority incorporated nearly all of the reasoning and conclusions of the *Green* case. In *Rosemary,* the plaintiff was again a California corporation that had received a sizeable portion of its gross income as dividends from another California corporation whose principal source of income was royalties from California oil and natural gas properties it owned and leased to others. In *Rosemary,* however, the declarant had, in prior years, deducted the full amount of its actual cost depletion, so that its depletion deductions for the taxable years in question were attributable solely to the statutory percentage allowance.[21] As in *Green,* the tax commissioner fully disallowed plaintiff's proposed deduction of the dividends. On this occasion, though, his disallowance was predicated on a slightly refined theory: since the declarant's total earnings and profits exceeded its net income, the ratio of net income to total earnings and

16. 60 Cal. App. 2d at 232, 140 P.2d at 455.
17. *Id.* at 231, 140 P.2d at 455.
18. See note 13 *supra.*
19. 60 Cal. App. 2d at 235, 140 P.2d at 457.
20. 29 Cal. 2d 677, 177 P.2d 757 (1947).
21. "Cost depletion" refers to depletion deductions in an amount representing the actual cost of acquiring wasting-asset properties and, thus, to a statutory compensation for an exhaustion of capital invested. "Percentage depletion," however, continuing as it does for an indefinite period at a steady rate of 27½ percent of the annual gross income from the property, may well result, after a period of years, in the tax-free recovery of sums far in excess of the original cost of such property, the sum represented by cost depletion. *Rosemary* presented just such a case: the initial capital investment had already been fully recovered, and dividend deduction by the 703-04, 177 P.2d at 773 (Traynor, J., dissenting).

profits represented the percentage of the plaintiff's dividend receipts that had already been taxed; the remaining percentage, the commissioner asserted, had not yet been taxed, and the imposition of the franchise tax on that percentage could not in any way violate section 8(h)'s intended prohibition of double taxation.

The commissioner's position was compelling. At the time of the *Rosemary* decision, the Bank and Corporation Franchise Tax Act restricted the permissible source of dividends as follows:

> The term "dividend" when used in this act means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its *earnings or profits* . . . .[22]

Moreover, the term "earnings and profits" was generally conceded to refer to gross receipts less the expense of producing them.[23] However, this fund from which dividends are declared is clearly quite different from the net income fund against which the franchise tax is levied, since the latter is composed of gross income less statutory deductions that often bear no relationship to the costs of producing income.[24] As a result, the portion of earnings and profits that exceeds net income escapes the imposition of the franchise tax burden in the hands of the declarant, since that burden falls only on net income. Consequently, all portions of dividend distributions from earnings and profits in excess of net income represent corporate *income* that has never been subjected to the franchise tax, and the imposition of that tax on such portions in the hands of the recipient cannot result in double taxation in violation of the conceded intention of section 8(h).

Justice Traynor's dissenting opinion in *Rosemary* stressed these accounting and policy realities, insisting that the word "income" as used in section 8(h) referred to neither gross income nor net income but rather to earnings and profits, since only this definition would truly effectuate legislative intent without expanding the deduction's coverage beyond the prohibition of double taxation.[25] Consequently, he asserted that " 'net income' is the measure of the tax,"[26] and that "income not included in the measure of the tax" constitutes earnings and profits in the excess of the net income.[27]

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22. CAL. GEN. LAWS ANN. act 8488, § 6(c)(1) (Deering 1943) (emphasis added). The current statute, while expanding the range of permissible dividend sources, still permits dividends to be declared only out of earned surplus, net profits or capital reduction surplus. CAL. CORP. CODE ANN. § 1500 (West 1970).

23. Mobile & O.R.R. v. Tennessee, 153 U.S. 486, 497 (1894); R.M. Weyerhaeuser, 33 B.T.A. 594, 597 (1935); Charles F. Ayer, 12 B.T.A. 284, 287 (1928). This concept is now included in the statutory references to net profits and earned surplus. See note 22 *supra*.

24. See note 5 *supra*.

25. 29 Cal. 2d at 700, 177 P.2d at 771.

26. *Id.* at 695, 177 P.2d at 769.

27. *Id.* at 689, 177 P.2d at 764-65.

The majority, however, ignored these arguments.[28] Extracting entire sections of the *Green* opinion, Justice Spence, writing for the majority, reiterated the *Green* rationale, point by point, and approved the *Green* test.[29] As a result of *Green* and *Rosemary*, the rule that gross income constitutes the measure of the corporate franchise tax became the law of California.

II. THE SAFEWAY DECISION

Although the court did not directly assail the rule of *Green* and *Rosemary* in *Safeway Stores, Inc. v. Franchise Tax Board*,[30] its rationale was inconsistent with their holdings in several respects. *Safeway* may thus mark a belated and tentative reversal of those earlier cases.

Safeway involved a Maryland corporation domiciled in California that operated, either directly or through subsidiaries, a chain of retail food markets, warehouses, and other related organizations inside and outside the state. Although comprised of numerous corporate entities, the entire Safeway operation was unitary, and all members filed a consolidated tax return reflecting the group's total gross income and

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28. The majority did advance one new argument in favor of its position, namely that, subsequent to the *Green* decision, an attempt was made in the legislature to amend section 8(h) to read as follows:

> (2) The portion of the dividend deductible under subdivision (1) of Section 8(h) shall be determined by ascertaining the ratio which the net income of the corporation declaring the dividend bears to the earnings and profits of such corporation for the same income year.

That the proposed change was stricken, said the majority, indicated that the legislature had approved the holding in *Green*. 29 Cal. 2d at 697-88, 177 P.2d at 764. However, as Justice Traynor noted in his dissent, administrative construction antedating *Green* had contradicted it; yet, year after year, the legislature had reenacted the same section without material change, thereby, according to the majority position, approving that construction as well. *Id.* at 707, 177 P.2d at 775-76. Additionally, he quoted from *Cleveland v. United States*, 329 U.S. 14, 22-23 (1946):

> [T]here are many reasons, other than to indicate approval of what courts have done, why Congress may fail to take affirmative action to repudiate their misconstruction of its duly adopted laws. Among them may be the sheer pressure of other and more important business. . . . And . . . there may be a strong and proper tendency to trust to the courts to correct their own errors. . . .

29 Cal. 2d at 708, 177 P.2d at 776.

29. 29 Cal. 2d at 683, 177 P.2d at 761.

30. 3 Cal. 3d 745, 478 P.2d 48, 91 Cal. Rptr. 616. In *Safeway*, the supreme court interpreted the same statute involved in both *Green* and *Rosemary*, section 8(h) of the Bank and Corporation Franchise Tax Act. This situation arose because the tax years in question in *Safeway* were 1947 through 1950, at which time section 8(h) was the governing law; current section 24402 of the Revenue and Taxation Code was not to be applied retroactively. Since the *Safeway* decision thus presents a current judicial response against a much older statutory backdrop, it represents a particularly appropriate vehicle for determining whether or not judicial attitudes toward tax policy in particular and taxation in general have changed during the past two decades.

total deductions. Thereafter, to determine the portion of the group's net income attributable to California sources,[31] a standard three-factor apportionment formula was applied to the consolidated net income remaining after total deductions had been subtracted from total gross income.[32] The franchise tax was levied on the portion so computed.

Later, certain of Safeway's subsidiaries declared dividends to Safeway out of their *total* earnings and profits, not merely those attributable to California sources. Relying on the holdings of *Green* and *Rosemary*, Safeway asserted that the income from which the dividends had been declared had already been included in the measure of the state franchise tax and attempted to deduct the full amount of all dividends so received in computing its own net income for the subsequent tax year. But the tax commissioner disallowed the deduction, permitting instead a deduction for each dividend only in the ratio that each declarant's earnings and profits attributable to California sources bore to its total earnings and profits. This time, a unanimous court sustained the commissioner.

Declaring that section 8(h) was intended "to avoid double taxation *at the corporate level* of income which has already been subjected to California taxation in the hands of the dividend-declaring corporation,"[33] the court concluded that the taxation proposed by the commissioner would not constitute double taxation in violation of section 8(h):

> The fact that the combined or consolidated report of the group of corporations reflected total gross income and total deductions of all of the corporations, in order to arrive at the group's total net operating income to which the apportionment formula was applied, does not mean that the total gross income was included in the measure of the tax within the holding of *Rosemary Properties, Inc. v. McColgan* . . . . That case dealt with income "attributable to California sources" . . . , and nothing found therein supports the view that income attributed to non-California sources, and thus not subject to taxation under the act, has nevertheless been included in the measure of the California tax.[34]

31. The state franchise tax applies only to net income derived from sources within California [see note 5 *supra*], and several of the corporations involved had engaged in business both within and without California.

32. CAL. REV. & TAX. CODE ANN. § 25101 (West 1970 provided the statutory authority:

> When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2. . . .

33. 3 Cal. 3d at 749-50, 478 P.2d at 50, 91 Cal. Rptr. at 618 (emphasis in the original).

34. *Id.* at 750-51, 478 P.2d at 51, 91 Cal. Rptr. at 619 (citations omitted).

While the *Safeway* court purported to leave the rule of *Rosemary* intact, its reasoning tends to undermine both *Green* and *Rosemary*. For a consolidated group return is essentially identical to an individual corporate return for franchise tax purposes in that, in both cases, the total gross income initially reported serves as the financial pool from which the net income to which the state franchise tax applies is derived. In each case the total fund represents the maximum "measure" of the income that may be subjected to state franchise taxation; if no deductions, such as those for statutory depletion or out-of-state income,[35] are allowed, the entire amount is subjected to the franchise tax levy. If such deductions are allowed, the remaining amount that *is* subject to franchise taxation still has been included in the original total income pool.[36] *Rosemary* held that the total income pool, including amounts later deducted, is the measure of the franchise tax. *Safeway*, however, considered only the amount remaining after statutory deductions and out-of-state net income had been subtracted to be the measure of the tax. This inconsistency cannot be reconciled, as the *Safeway* court supposed, merely by asserting that *Rosemary* dealt with statutory depletion while *Safeway* was concerned with out-of-state income. On the other hand, the court could, of course, decide to interpret the statute differently in the two instances, but without more compelling reasons than those expressed in *Safeway*, such a distinction would be completely arbitrary.

The *Safeway* court's implicit rejection of *Rosemary* was based on a similarly implicit recognition of the validity of the principles that motivated Justice Traynor's dissent in *Rosemary*. Directing its entire effort not toward the narrow task of pure statutory interpretation undertaken in *Rosemary*, but rather toward a more general effectuation of legislative intent—the prevention of double taxation—the *Safeway* court was necessarily led to a consideration of precisely what constitutes double taxation. In this regard, the court concluded:

> Clearly income attributed to sources outside California when the apportionment formula was applied *has never been included in the measure of the tax imposed* by the California act upon either

35. Of course, to speak of an out-of-state income "deduction" is not technically accurate. However, the functions served by deductions on one hand and out-of-state income eliminations on the other, are identical: each serves to reduce the total income pool by amounts that the law deems to be nontaxable. After each has been applied, the remaining income from the pool constitutes the fund to which the tax percentage is applied.

36. Indeed, since the consolidated group return reflects total gross income and total deductions, the only real difference between it and the individual corporate return is the additional "deduction" allowed for out-of-state net income after total net income has been determined by subtracting total deductions from total gross income. See note 35 *infra*.

> the "corporation declaring the dividends" (in the language of § 8, subd. (h)), or upon any other corporation, and it is only dividends received by Safeway from such income *not previously taxed by* California that the board now proposes to tax.[37]

Apparently, actual taxation, rather than inclusion in a fund that the taxmaster had in some vague manner already flailed, was what the *Safeway* court demanded for dividend deductibility. Consequently, since the income in question had not actually been taxed,[38] no deductions for dividends paid from it were allowed, even though, according to the *Rosemary* rationale, such income had "entered into the computation of the tax" finally assessed on the unitary business conducted by Safeway and had thus been included in the measure of that prior tax.[39]

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37. 3 Cal. 3d at 750, 478 P.2d at 51, 91 Cal. Rptr. at 619 (emphasis added).

38. In an effort to return to Justice Traynor's "earnings and profits" test of income that had been subjected to previous state franchise taxation, the *Safeway* court recognized the validity of the commissioner's proposed deduction allowances:

> The method employed in the present case would allow a section 8, subdivision (h), deduction for each dividend in the ratio that the earnings and profits of each payor attributable to California bears to its total earnings and profits. No error is shown.

3 Cal. 3d at 753, 478 P.2d at 53, 91 Cal. Rptr. at 621. In principle, at least, the test strove to determine, in accordance with Justice Traynor's accounting realities, what proportion of the total dividend pool had already been taxed. Indeed, the proportion so established—income that has been taxed divided by the total income available for dividends—is the precise measure advocated by Justice Traynor in his *Rosemary* dissent. However, the notion that all California earnings and profits had been taxed is clearly fallacious, since only *net income* attributable to California had been included in the fund to which the franchise tax levy had been applied. Obviously, the proper proportion, given such a consideration, would have been net income attributable to California sources divided by total earnings and profits. See text accompanying notes 22-24 *supra*.

39. In 1967, section 25106 was added to the Revenue & Taxation Code. That section provided:

> In any case in which the tax of a corporation is or has been determined under this chapter with reference to the income and apportionment factors of another corporation with which it is doing or has done a unitary business, all dividends paid by one to another of such corporations shall, to the extent such dividends are paid out of such income of such unitary business, be eliminated from the income of the recipient and shall not be taken into account under Section 24344 or in any other manner in determining the tax of any such corporation.
>
> In view of pending litigation concerning the proper treatment of intercompany dividends, it is not intended by enactment of this section that any inference be drawn from it in such litigation.

CAL. REV. & TAX. CODE ANN. § 25106 (West 1970).

While expressly made inapplicable to the *Safeway* dispute, the section appears to reverse the *Safeway* outcome insofar as future *Safeway*-type contests are concerned. The rationale of *Safeway*, however, especially as regards its definition of "included in the measure of the tax," remains unaffected for two reasons. First, the applicability of section 25106 is expressly limited to corporations engaged in a *unitary* business operation, a limitation that acknowledges the inequity of treating corporations operating through subsidiaries differently from those doing business through branch of-

III. THE GREAT WESTERN DECISION

Although the question whether *Safeway* inmplicitly overruled *Green* and *Rosemary* remains arguable, the court's decision in *Great Western Financial Corp. v. Franchise Tax Board*[40] lends additional support to the position that these cases have been rejected. *Great Western* involved a Delaware corporation, doing business in California, a large portion of whose income was derived from dividends declared by other California corporations in which it owned stock. In reporting its income for the taxable years in question, the taxpayer properly deducted all such dividend payments, since they represented disbursements from income that had been subjected to state franchise taxation in the hands of the declarants.[41] However, when the taxpayer also sought to deduct general and administrative expenses incurred in collecting the deductible dividends, the tax commissioner disallowed the deduction. In upholding the commissioner, the court relied on section 24425 of the Revenue and Taxation Code, which prohibits the deduction of expenses allocable to income "not included in the measure of" the franchise tax.[42] Asserting that the purpose of the section is to prevent a double deduction by the taxpayer, the court concluded:

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fices of the same corporation:

> [T]he board agrees that if Safeway had operated its unitary business as one corporation only, instead of through subsidiary corporations, then transfers of funds to the head office in California from branches or divisions doing business outside this state, would not constitute taxable transfers.

3 Cal. 3d at 749, 478 P.2d at 50, 91 Cal. Rptr. at 618. Although the statute creates a special exception for unitary operations, the *Safeway* reasoning, involving the broader question of the meaning of "included in the measure of the tax," should remain unaffected since the statute in no way purports to overturn that aspect of the decision.

Second, although section 25106 allows a corporation to deduct dividends declared from income of another corporation "with reference to" which the original franchise tax of the unitary operation had been determined, still it is not clear that this language is inconsistent with *Safeway,* since the exempt dividend fund specified by the statute comprises not only income, but apportionment factors as well. This language was probably intended to exempt only income that, as a result of an application of apportionment factors, has been determined to be California income and is includible in the net income to which the franchise tax percentage is applied. Such a reading would preclude double taxation without unduly extending the coverage of the deduction provision.

40. 4 Cal. 3d 1, 479 P.2d 993, 92 Cal. Rptr. 489 (1971).

41. See note 3 *supra* and accompanying text.

42. CAL. REV. & TAX. ANN. CODE § 24421 (West 1970) provides:

> In computing "net income" of taxpayers under this part, no deduction shall be allowed for the items specified in this article.

In enumerating one of these nondeductible items, CAL. REV. & TAX. CODE ANN. § 24425 (West 1970) lists:

> Any amount otherwise allowable as a deduction which is allocable to one or more classes of income not included in the measure of the tax imposed by this part, regardless of whether such income was received or accrued during the income year.

See note 17 *supra.*

> [E]xpenses incurred by a taxpayer in producing or receiving dividend income are properly deductible only when that taxpayer's dividend income is taxable.[43]

From the double-deduction standpoint, the court's decision stood on a firm foundation: at least one learned treatise had previously espoused the court's interpretation of the purpose of section 24425;[44] a comparable federal revenue statute[45] had been interpreted as prohibiting the deduction of expenses incurred in producing exempt income;[46] and a prior decision of the court had condemned such deductions, sensing from the realties of corporate accounting that an effective double deduction would result if the taxpayer were allowed to deduct such expenses.[47] However, in construing the language of section 24425 to reach this result, the court once again implicitly rejected *Rosemary*:

> Section 24425 is operative whenever income is eliminated from the measure of the tax under any authority or for any purpose; it states with incontestable clarity that items are nondeductible when allocable to income "not included in the measure of the tax." *The dividends in question were not included in income used to measure plaintiff's tax.* It follows that the expense items are nondeductible.[48]

In the final analysis, though, the deductions that *Great Western* excluded from the measure of the tax are logically indistinguishable from

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43. 4 Cal. 3d at 7, 479 P.2d at 996, 92 Cal. Rptr. at 492.

44. 12 A. MARSHALL, *supra* note 10, at 180.

45. 26 U.S.C. § 265 (1970):

No deduction shall be allowed for—

> (1) Expenses.—Any amount otherwise allowable as a deduction which is allocable to one or more classes of income . . . [whether or not any amount of income of that class or classes is received or accrued] wholly exempt from the taxes imposed by this subtitle. . . .

46. Treas. Reg. § 1.265-1(a)(1) (19):

No amount shall be allowed as a deduction under any provision of the Code [including § 212 (relating to expenses for production of income)] for any expense or amount which is otherwise allowable as a deduction and which is allocable to a class or classes of exempt income . . . .

47. Security-First Nat'l Bank v. Franchise Tax Bd., 55 Cal. 2d 407, 423, 359 P.2d 625, 633-34, 11 Cal. Rptr. 289, 297-98 (1961), relied on by the majority in *Great Western*, states:

> The determination of net income . . . is important primarily for the purpose of ascertaining the franchise tax. . . . The method of calculation urged by plaintiffs would give . . . [them] an unwarranted benefit closely akin to a double deduction because they would be entitled to deduct, in addition to gross income from . . . nonprofit business, all operating expenses, which would include those attributable to the production of that income. Thus . . . [they] would always have a loss from their . . . [nonprofit] business in the amount that expenses were incurred in carrying on that business, and this loss would substantially, if not entirely, offset income from profit-making activities, which should be taxable.

48. 4 Cal. 3d at 6, 479 P.2d at 995, 92 Cal. Rptr. at 491 (emphasis added).

the deductions included by *Rosemary:* essentially, *Great Western* declared that deductible dividends are not included in the measure of the corporation's franchise tax, while *Rosemary* had asserted that deductible depletion *is* included in the measure of the tax. The *Great Western* court gave no reason for treating the two deductions differently—indeed, it failed even to acknowledge the existence of a difference—and the implication seems to be that it would not. If the court intended to adhere to the rule of *Rosemary,* the fact that it was determining the measure of tax of the dividend recipient rather than that of the dividend declarant should make no difference, for the language of *Rosemary* was unequivocal:

> Since "net income" means "gross income less the deductions allowed," these factors necessarily enter into the computation and are included in the measure of the tax. The income involved is *all* income . . . .[49]

And if, as this language indicates, the dividends deducted by the recipient in *Great Western* had already been included in the measure of its tax when dividend receipts were included in gross income, section 24425 could not possibly decree the disallowance of deductions for expenses incurred in collecting the dividends, since that section applies only when items of income have *not* been so included.

Unless "included in the measure of the tax" is to have radically different meanings in complementary code sections,[50] the rationale of the *Rosemary* case would compel a result quite the opposite of that reached by the *Great Western* majority. However, the outcome in *Great Western* is fully consistent with both the Traynor dissent in *Rosemary* and the court's rationale in *Safeway*: income[51] that has not been subjected to the state's franchise tax levy has *not* been included in the measure of the tax. Unfortunately, the *Great Western* court did not indicate which of these alternatives it would espouse, but its categorical statement that "[t]he dividends in question were not included in income used to measure plaintiff's tax,"[52] suggests that it accepted a single interpretation of that phrase, an interpretation that wholly re-

49. 29 Cal. 2d at 681-82, 177 P.2d at 760.

50. The two sections are complementary in that section 24402 is intended to preclude double taxation, while section 24425 is intended to prohibit double exemption.

51. Since section 24425 disallows deductions of all amounts allocable to *one or more classes of income* not included in the measure of the tax, "income" in that section refers to *any* type of income (gross, net, or earnings and profits) not included in the tax measure. In this case, the dividends that the dividend-recipient sought to deduct represented gross income to it; however, since that gross income was excluded from the measure of its tax, via deduction, the expenses attributable to collecting that income could not be deducted in light of section 24425.

52. 4 Cal. 3d at 6, 479 P.2d at 995, 92 Cal. Rptr. at 491.

jected the *Rosemary* rationale. Whether the court intended such an outcome—indeed, whether it has reached the point at which it will consider a rational alternative to *Rosemary*—remains to be seen in future cases. At present, though, it seems that the continuing validity of the *Rosemary* rule is open to serious question.

John F. Davis

B. Delegation to Regional Agencies

People ex rel Younger v. County of El Dorado.[1] The supreme court held constitutional the Tahoe Regional Planning Compact, which delegates certain regional planning powers to the Tahoe Regional Planning Agency and requires the counties of the Lake Tahoe Basin to contribute to the maintenance of that agency. El Dorado and Placer Counties were ordered to pay assessments that they had withheld on the grounds that the Compact grants to the Agency powers reserved exclusively for the counties under the California constitution and that, under the Compact, residents of these counties were denied equal protection of the law.

The Lake Tahoe Basin is a geographic entity artificially divided by the California-Nevada border and the boundaries of five counties;[2] its pollution problems are those of the geographic unit, and they defy solution by independent efforts of the area's various political subdivisions.[3] It was recognition of this need for regional planning[4] that

1. 5 Cal. 3d 480, 487 P.2d 1193, 96 Cal. Rptr. 553 (1971) (Sullivan, J.) (unanimous decision).

2. The Lake Tahoe Basin includes parts of El Dorado and Placer Counties in California and Washoe, Douglas and Ormsby Counties in Nevada.

3. 5 Cal. 3d at 493-94, 487 P.2d at 1200-01, 96 Cal. Rptr. at 560-61. See also Comment, *Lake Tahoe: The Future of a National Asset—Land Use, Water, and Pollution*, 52 CALIF. L. REV. 563, 656-72 (1964):

> The unwillingness of the five counties to subordinate sectarian economic interests in rapid growth and development of the lake basin to the national interest in preserving the lake as a natural resonrce has been manifested not only in deficiencies of the present zoning laws, but also in frequent departures from existing controls.

Id. at 618. Factors contributing to this irresponsibility include local pressures, competitive jealousy arising from lack of guarantees of restraint by neighboring counties, and commercialism promoted for county tax reasons. *Id.* at 565-75. See also Goldman & Carter, *An Investigation of Rapid Carbon-14 Bioassay of Factors Affecting the Cultural Eutrophication of Lake Tahoe, California-Nevada*, 37 WATER POLLUTION CONTROL FEDERATION J. 1044 (1965).

4. See S. REP. No. 510, 91st Cong., 1st Sess. (1969), *printed in* 115 CONG. REC. 33068-69 (1969); Ayer, *Water Quality Control at Lake Tahoe*, 1 ECOLOGY L.Q. 3, 50-57 (1971); Note, *Regional Government for Lake Tahoe*, 22 HAST. L.J. 705, 708-715 (1971).

brought about the Tahoe Regional Planning Compact,[5] an agreement, approved by Congress,[6] between California and Nevada. As the court stated in *El Dorado*,

> The basic concept of the Compact is a simple one—to provide for the region as a whole the planning, conservation and resource development essential to accommodate a growing population within the region's relatively small area without destroying the environment.[7]

With this goal in mind, the Compact created the Tahoe Regional Planning Agency.[8] The Agency is given broad authority to formulate a comprehensive regional plan and to effectuate that plan by adopting ordinances and regional standards regulating such matters as water purity, subdivision, zoning, waste disposal, air pollution, watershed protection and shoreline development.[9] The Compact states that violation of an Agency ordinance is a misdemeanor[10] and provides for county contributions to the maintenance of the Agency apportioned on the basis of the full cash value of taxable property within each of the five counties.[11] Upon failure of El Dorado and Placer Counties to pay the amounts assessed them by the Agency, the California Attorney General brought this suit directly in the supreme court to obtain a writ of mandate compelling payment.

I. DELEGATION OF POWERS TO REGIONAL BODIES

After determining that mandamus is an appropriate remedy,[12] the supreme court considered the counties' contention that the Compact unconstitutionally grants the Agency powers reserved exclusively for local governments by former sections 11, 12, and 13 of article XI of the California constitution.[13] The court agreed that these sections confer broad powers upon the specified local governmental bodies to

5. CAL. GOV'T CODE ANN. §§ 66801 (West Supp. 1971).
6. Pub. L. No. 91-148 (Dec. 18, 1969).
7. 5 Cal. 3d at 487, 487 P.2d at 1196, 96 Cal. Rptr. at 556.
8. CAL. GOV'T CODE ANN. § 66801 art. III (West Supp. 1971). The Agency was established on March 19, 1970.
9. *Id.* art. VI(a).
10. *Id.* art. VI(f).
11. *Id.* art. VII(a).
12. 5 Cal. 3d at 490-92, 487 P.2d at 1198-99, 96 Cal. Rptr. at 558-59.
13. These sections were repealed on June 2, 1970. Section 11 was readopted without substantial change as section 7 of article XI; section 12 was readopted as section 37 of article XIII; section 13 was amended and readopted as section 11 of article XI. The court pointed out that since former sections 11 and 12 are not violated by the Compact, neither are their substantially identical successors. The same is true of former section 13, since the only significant change is removal of a prohibition on delegation of powers to "special commissions." 5 Cal. 3d at 492 & n.14, 494 n.17, 499 n.21, 500 n.22, 487 P.2d at 1200 & n.14, 1201 n.17, 1204 n.21, 1205 n.22, 96 Cal. Rptr. at 560 & n.14, 561 n.17, 564 n.21, 565 n.22.

deal with "purely local affairs,"[14] but it further decided that the Compact did not infringe upon local government rights because the Compact was concerned with regional rather than local matters.[15]

The distinction between regional and local concerns, however, is seldom clearly defined. "Regional" is a term that has meaning only with reference to a particular governmental concern, such as water pollution, the region being a convenient unit within which to deal with that concern, such as a particular river system. In this respect a region is determined without regard to existing political boundaries. But a regional agency (or state government) has a wide range of effects on the localities that compose the region, and, conversely, it would be hard to imagine a local enactment whose effects were confined entirely to the locality. Thus, strictly speaking, there are probably no "purely local affairs" that are not conceivable in terms of a broader perspective or regional plan and no regional plans devoid of extensive local effects. The supreme court has indicated in *El Dorado*, however, that extensive local effects will not prevent characterization of a governmental function as regional if its purpose would be frustrated by leaving it in the hands of fragmented political units.[16]

Such an approach is extremely flexible, and the court expressly recognized that the border between local and regional is everchanging.[17] Built into the grant of power is the reservation that the grant is valid only as long as the problem remains local, which is to say, as long as local administration can handle the job.[18] The role of tradition in allocating functions is minimized, therefore, when it impedes the development of new governmental forms better designed to deal with modern problems.

Having concluded that the Compact delegates only regional powers,[19] the court found no conflict between the Compact and the delegation of local powers by former article XI of the California constitution. Former section 12 of that article prohibited the legislature from imposing "taxes upon counties . . . or upon the inhabitants or

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14. 5 Cal. 3d at 492, 487 P.2d at 1200, 96 Cal. Rptr. at 560.

15. *Id.*

16. *Id.* at 501-02, 487 P.2d at 1207, 96 Cal. Rptr. at 567. The court repeatedly emphasized the inability of local governments to cope with regional planning in the Tahoe Basin. *Id.* at 493-94 & nn. 15-16, 501, 506, 487 P.2d at 1201 & nn. 15-16, 1206-07, 1210, 96 Cal. Rptr. at 561 & nn. 15-16, 566-67, 570.

17. *Id.* at 497-98, 487 P.2d at 1204, 96 Cal. Rptr. at 564.

18. *Cf.* Pixley v. Saunders, 168 Cal. 152, 160, 141 P. 815, 818 (1914):

> [W]hile generally the question of sanitation is a municipal affair, in many instances it is one of broader scope, which cannot be adequately handled by the municipal authorities of a single town. Therefore it cannot be said to be a "local" or "municipal" affair within the inhibition of sections 12 and 13 of the constitution . . . .

19. 5 Cal. 3d at 492-94, 487 P.2d at 1200-01, 96 Cal. Rptr. at 560-61.

property thereof, for county . . . purposes,"[20] but the indirect taxation of counties authorized by the Compact[21] does not violate this section because it is for regional, not county, purposes.[22] Similarly, former section 13 prohibited the legislature from delegating "to any special commission . . . any power to . . . in any way interfere with any county, city, town or municipal improvements . . . or perform any municipal functions whatsoever."[23] This section has been construed to prohibit only attempts by the state to create agencies for the purpose of controlling purely local matters.[24] Accordingly, *El Dorado* held that interference with municipal functions that is only "incidental to the execution of the Agency's regional duties" does not violate this section.[25]

The court's discussion of former section 11, however, requires closer examination. That section provided that "[a]ny county, city, town or township may make and enforce within its limits all such local, police, sanitary and other regulations as are not in conflict with the general laws."[26] Literally, the distinction between "local" and "police, sanitary and other" regulations suggests the delegation of some extralocal powers to the enumerated local bodies. California courts, however, have generally disregarded the comma after "local" and have deemphasized "sanitary and other," thereby limiting municipal power to "local police" regulations.[27]

The *El Dorado* court disclaimed involvement in this controversy by pointing out that the powers exercised by the counties are for local purposes, within the territorial limits of the county; hence, there was no conflict with the Agency's powers, the purposes of which are regional rather than local.[28] Under a literal interpretation, however, former section 11 may authorize local bodies to exercise regional powers on a cooperative basis, as, for example, by participating in an association to

20. CAL. CONST. art. XI, § 12 (now art. XIII, § 37). See note 13 *supra*.

21. CAL. GOV'T CODE ANN. § 66801 art. VII(a) (West Supp. 1971). This article provides that the Agency is to be supported by assessing contributions from the counties of the Tahoe Basin in proportion to the full cash valuation of taxable property within each county. The total of assessments against the counties is not to exceed $150,000 per year. This article also permits each county to pay such assessments by levying taxes on property within its jurisdiction.

22. 5 Cal. 3d at 499, 487 P.2d at 1205, 96 Cal. Rptr. at 565. *See* Santa Barbara County Water Agency v. All Persons, 47 Cal. 2d 699, 708, 306 P.2d 875, 881 (1957), *rev'd on other grounds*, 357 U.S. 275 (1958).

23. CAL. CONST. art. XI, § 13 (now art. XI, § 11). See note 13 *supra*.

24. *In re* Pfahler, 150 Cal. 71, 87, 88 P. 270, 277 (1906).

25. 5 Cal. 3d at 501, 487 P.2d at 1206, 96 Cal. Rptr. at 566.

26. CAL. CONST. art. XI, § 11 (now art. XI, § 7). See note 13 *supra*.

27. Peppin, *Municipal Home Rule in California III: Section 11 of Article XI of the California Constitution*, 32 CALIF. L. REV. 341 (1944).

28. 5 Cal. 3d at 497, 487 P.2d at 1203, 96 Cal. Rptr. at 563.

prescribe regional standards for waste disposal.[29] Delegation of this same power to the Agency would conflict with the exclusive delegation to the municipal corporations enumerated in the section. The court's refusal to consider this interpretation of former section 11 suggests that the scope of that section would only have been relevant had the counties in fact attempted regional planning, but that the local bodies had forfeited their constitutionally delegated powers by inaction. It is more likely, however, that the court no longer considers a literal interpretation of former section 11 to be part of the controversy. Its earlier reference to former sections 11, 12, and 13 as conferring "broad powers over purely local affairs"[30] indicates that the longstanding acceptance of special bodies exercising extralocal powers has as a practical matter superseded whatever logical force might be claimed for a literal interpretation of former section 11.

A more vital issue in *El Dorado* was that of limitations on the legislature's ability to delegate the power to enact legislation having a local effect.[31] Implicit in such a discussion are two distinct questions that the court confused in its discussion of delegation under former section 11. The first question is whether the powers granted the Agency conflict with those already exclusively granted to the local bodies enumerated in the section. The second question asks whether it is beyond the power of the legislature to delegate such powers regardless of whether local governments are constitutionally empowered to act in the area.

The merger of these two questions began with *In re Werner*.[32] In *Werner*, a statute creating sanitary districts with certain power over licensing liquor sales, including the power to enforce its regulations by imposing penalties up to $100 and 30 days in jail, was held unconstitutional as an infringement on exclusively municipal concerns.[33] The *Werner* majority concentrated exclusively on detecting conflict between the powers delegated to the district and those reserved to other local bodies by former section 11. However, the argument that even in the absence of such conflict a delegation of that type cannot be made was interjected by the concurring opinion of Justice McFarland, who stated that the legislature could under no circumstances delegate the power of enacting penal legislation to a special district.[34]

29. *See, e.g.*, Comment, *Regional Planning and Local Autonomy in Washington Zoning Law*, 45 WASH. L. REV. 593 (1970); Comment, *Interlocal Cooperation: the Missouri Approach*, 33 MO. L. REV. 442 (1968).

30. 5 Cal. 3d at 492, 487 P.2d at 1200, 96 Cal. Rptr. at 560.

31. *Id.* at 494-98, 487 P.2d at 1201-04, 96 Cal. Rptr. at 561-64.

32. 129 Cal. 567, 62 P. 97 (1900).

33. *Id.* at 574, 62 P. at 100.

34. *Id.* at 575, 62 P. at 100.

Gilgert v. Stockton Port District[35] expressly incorporated both reasons in striking down a statute authorizing a port district to enact regulations governing port facilities and "to prescribe fines, forfeitures and penalties for the violation of any provision of the ordinance . . . ."[36] The court relied on *Werner* in finding the delegation void as usurping the powers granted exclusively to the bodies enumerated in former section 11[37] and cited Justice McFarland's opinion, among others,[38] for the proposition that under no circumstances may the legislature delegate to special districts the power to declare penalties for violation of the rules or ordinances the districts enact.[39]

The *El Dorado* court distinguished *Werner* and *Gilgert* on both grounds,[40] but it did so while purporting to discuss only "the proposition that no power to make regulations having a local effect may be conferred upon public corporate bodies not enumerated in section 11."[41] Consolidation of the two issues in this manner obscures the constitutional issue of how much power the legislature can delegate, which must be answered independently of any conflicts with former section 11.[42] Nevertheless, under its discussion of former section 11, the *El Dorado* court limited the *Werner* and *Gilgert* holdings of unconstitutionality to delegations of the power both to adopt regulations and to prescribe penalties for violations thereof.[43] The Tahoe Regional Planning Compact therefore does not violate the *Werner* and *Gilgert* standard because, although the Compact does give the Agency power to adopt necessary ordinances and to ensure compliance with those ordinances by policing the Basin,[44] the legislature has prescribed the penal sanction by declaring that violations of Agency ordinances is a misdemeanor.[45]

That such a minimal legislative pronouncement suffices to bestow upon agencies the power to determine what acts constitute misde-

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35. 7 Cal. 2d 384, 60 P.2d 847 (1936).

36. Ch. 1028, § 6, [1931] Cal. Stat. 2138.

37. 7 Cal. 2d at 387-89, 60 P.2d at 848-49.

38. Schecter Poultry Co. v. United States, 295 U.S. 495 (1945); Board of Harbor Comm'rs v. Excelsior Redwood Co., 88 Cal. 491, 26 P. 375 (1891); *Ex parte* McNulty, 77 Cal. 164, 19 P. 237 (1888); *Ex parte* Cox, 63 Cal. 21 (1883).

39. 7 Cal. 2d at 389-91, 60 P.2d at 849-50.

40. See note 19 *supra* and accompanying text; note 43 *infra* and accompanying text.

41. 5 Cal. 3d at 496, 487 P.2d at 1202, 96 Cal. Rptr. at 562.

42. Indeed, none of the authorities cited by the court on the question of what legislative functions may be delegated involved a conflict with the jurisdiction of any other governmental body. See the cases cited 5 Cal. 3d at 496, 487 P.2d at 1203, 96 Cal. Rptr. at 563.

43. 5 Cal. 3d at 496, 487 P.2d at 1203, 96 Cal. Rptr. at 563.

44. CAL. GOV'T CODE ANN. § 66801, art. VI (West Supp. 1971).

45. *Id.* art. VI(f).

meanors is well established for federal agencies[46] and was anticipated by lower California courts,[47] but *El Dorado* is the first California supreme court case explicitly extending the legislature's power of delegation this far.[48] After *El Dorado*, delegation of the power to enact penal legislation that is for most practical purposes identical to the delegations prohibited by *Werner* and *Gilgert* is a simple matter of careful drafting.[49] Instead of giving an agency power to impose penalties up to 6 months in jail and a fine of $500 for violations of its ordinances, the legislature can give the agency essentially the same power by providing that violation of any agency regulation shall be a misdemeanor.[50]

II. EQUAL PROTECTION

The governing body of the Agency is composed of 10 members: The governors of California and Nevada each appoint one member to "represent the public at large."[51] One member each is appointed by the Boards of County Commissioners of the three Nevada counties, the Boards of Supervisors of the two California counties and the City Council of the City of South Lake Tahoe, California. The remaining members are the Administrator of the California Resources Agency and the Director of the Nevada Department of Conservation and Nat-

46. United States v. Grimaud, 220 U.S. 506 (1910).

47. Moore v. Municipal Court, 170 Cal. App. 2d 548, 339 P.2d 196 (1st Dist. 1959):

> [S]o long as the Legislature determines the penalty, it may leave the administrative body the actual making of the multiple rules called for by the specific subject matter regulated.

48. This case overrules *Ex parte* Cox, 63 Cal. 21 (1883), in which the supreme court held that the legislature could not confer upon the Board of State Viticultural Commissioners the power to declare what acts should constitute a misdemeanor. Since *Cox,* cases holding certain legislative delegations unconstitutional have suggested that their primary vice lay in combining the power to make a rule with discretion over what penalty to impose. *See, e.g.,* Harbor Comm'rs v. Excelsior Redwood Co., 88 Cal. 491, 493, 26 P. 375, 375-76 (1891). Other cases have allowed the agency discretion, within limits, in fixing the penalty if the legislature defines the offense. *E.g.,* L.B. Foster Co. v. County of Los Angeles, 265 Cal. App. 2d 24, 27, 71 Cal. Rptr. 16, 18-19 (2d Dist. 1968). Nardoni v. McConnell, 48 Cal. 2d 500, 507, 310 P.2d 644, 649 (1957), upheld the authority of the Insurance Commissioner to promulgate rules for which violations were punishable by suspensiou, revocation or denial of licenses. But in *El Dorado* the supreme court for the first time explicitly stated that, if the legislature prescribes that violation of an agency regulation shall be a misdemeanor, the agency can define the offeuse. 5 Cal. 3d at 496, 487 P.2d at 1203, 96 Cal. Rptr. at 563.

49. Even legislative pronouncement of the penal sanctions would not have validated the *Werner* and *Gilgert* statutes, however, since they were unconstitutional on the additional ground of conflict with section 11. See note 37 *supra* and accompanying text.

50. Unless otherwise provided by statute, the maximum penalty for a misdemeanor is 6 months in jail and a fine of $500. CAL. PENAL CODE § 19 (West 1970).

51. CAL. GOV'T CODE ANN. § 66801 art. III(a) (West Supp. 1971).

ural Resources, or their designees.[52] The counties asserted that this organization of the Agency violates equal protection of the laws, guaranteed by the California constitution[53] and the fourteenth amendment to the United States Constitution, for two reasons: (1) the Compact makes no provision for initiative, referendum and recall; and, (2) appointment of the governing body of the Agency violates the "one person, one vote" rule.

The counties asserted that since their citizens have the rights of initiative, referendum and recall with respect to county government, equal protection of the laws requires that similar procedures be provided with respect to the Agency. The court rejected this equal protection argument by noting that the statutory provision that determines whether these rights are available applies uniformly to all districts, including regional agencies.[54] The Elections Code provides that no district "formed under a law which does not provide a procedure for elections" is subject to initiative, referendum or recall.[55] This was held to satisfy the requirement of *Purdy & Fitzpatrick v. State*[56] that persons in similar positions with respect to the purpose of a law receive equal treatment. To end the inquiry at that point, however, leaves an extremely superficial examination of equal protection. To be sure, the rights of the residents of the Tahoe Basin are determined by reference to the same law which determines these rights for all other districts. But the Elections Code clearly prescribes different treatment for the residents of different districts, depending on whether the governing body of that district is elected or appointed. When a law discriminates on its face between districts, it is not enough to say that all districts are uniformly subject to that discrimination. The basis for that discrimination must be examined. The *El Dorado* court stopped short when it failed to inquire beyond the uniform application of the law which determines whether initiative, referendum, and recall are to be available.

Any statutory discrimination is unconstitutional to the extent that it is unreasonable or irrational.[57] But voting is a "fundamental right," the

52. *Id.*

53. CAL. CONST. art. 1, §§ 11, 21. These sections of the California constitution are essentially equivalent to the equal protection clause of the fourteenth amendment to the United States Constitution. 5 Cal. 3d at 502 n.23, 487 P.2d at 1207 n.23, 96 Cal. Rptr. at 567 n.23.

54. 5 Cal. 3d at 502-03, 487 P.2d at 1207-08, 96 Cal. Rptr. 567-68.

55. CAL. ELECTIONS CODE ANN. §§ 5150, 5200, 5203 (West 1961); § 5150.5 (West Supp. 1971).

56. 71 Cal. 2d 566, 578, 456 P.2d 645, 653, 79 Cal. Rptr. 77, 85 (1969).

57. See, e.g., McGowan v. Maryland, 366 U.S. 420, 425-26 (1961):

> [T]he Fourteenth Amendment permits the States a wide scope of discretion in enacting laws which affect some groups of citizens differently than others. The constitutional safeguard is offended only if the classification rests on grounds wholly irrelevant to the achievement of the State's objective. State

discriminatory denial of which can be justified only by compelling state interests.[58] *Purdy* itself required that when "fundamental interests" are involved "the state must bear the burden of establishing that the classification constitutes a necessary means of accomplishing a legitimate state interest . . . ."[59] This burden could easily have been borne under the facts of *El Dorado*, making the court's apparent categorical affirmation of the legislature's discretion in creating appointive bodies entirely unnecessary. As the court indicated, an appointive governing body was probably a necessary result of the Agency's interstate nature[60] However, such a limited justification would narrow considerably the applicability of the *El Dorado* holding. There are broader justifications for making regional agencies appointive rather than elective that would apply to agencies that do not straddle state borders. In fact, the court mentioned two such justifications in defending appointment of the governing board from attack under the "one person, one vote" rule: the

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> legislatures are presumed to have acted within their constitutional power . . . . A statutory discrimination will not be set aside if any state of facts reasonably may be conceived to justify it.

58. Cipriano v. City of Houma, 395 U.S. 701, 704 (1969); Kramer v. Union Free School Dist., 395 U.S. 621, 627 (1969); Westbrook v. Mihaly, 2 Cal. 3d 765, 785, 471 P.2d 847, 860, 87 Cal. Rptr. 839, 852 (1970), *cert. granted and judgment vacated*, 403 U.S. 915 (1971). *See also* Reynolds v. Sims, 377 U.S. 533, 562:

> [S]ince the right to the franchise in a free and unimpaired manner is preservative of other basic civil rights, any alleged infringement of the right of citizens to vote must be carefully and meticulously scrutinized.

Furthermore, the general presumption of constitutionality of state statutes does not apply when fundamental rights are involved. Kramer v. Union Free School Dist., 395 U.S. 621, 627-28; Harper v. Virginia Bd. of Elections, 383 U.S. 663, 670 (1960).

A question exists, however, as to whether the compelling interest standard should extend beyond the right to vote and apply also to initiative, referendum and recall. The latter are corollaries of the right to vote to the extent that limitations upon them restrict the right to vote by reducing the issues which may be voted upon. Finding a similar relationship between the right to vote and candidate residence requirements, the California supreme court recently required that the compelling interest standard of review be applied to candidacy restrictions, apparently elevating the opportunity to be a candidate to the level of a fundamental right. Zeilenga v. Nelson, 4 Cal. 3d 716, 484 P.2d 578, 94 Cal. Rptr. 602 (1971). *See also* Powell v. McCormack, 395 U.S. 486, 547 (1969); Landes v. Town of North Hempstead, 20 N.Y.2d 417, 421, 231 N.E.2d 120, 122-23, 284 N.Y.S.2d 441, 445 (1967); Gengemi v. Rosengard, 44 N.J. 166, 170, 207 A.2d 667 (1965). No less exacting scrutiny should be permitted in preserving initiative, referendum and recall.

59. 71 Cal. 2d at 579, 456 P.2d at 654, 79 Cal. Rptr. at 86. *Purdy* involved the equal protection of aliens against discriminatory public employment and had nothing to do with voting rights. It is, however, the only case relied on by the court in its discussion of initiative, referendum and recall.

60. 5 Cal. 3d at 503, 487 P.2d at 1208, 96 Cal. Rptr. at 568. The court cites this necessity and the existence of other similar agencies, [*Id.*] such as the San Francisco Bay Conservation and Development Commission [CAL. GOV'T CODE ANN. § 66620, *et seq.* (West 1966)], as justifying appointment rather than election of the Governing Board of the Agency. These reasons elucidate the state's interests, but without being related to a specific standard of review they shed little light on the Agency's constitutionality.

need for flexibility and the need to represent the interests of *all* state residents.[61] Explicit recognition of the existence and satisfaction of this compelling interest standard would have enhanced the constitutional consistency of the court's intuitively meritorious holding. And, perhaps even more importantly, explicit judicial recognition that the state's interest in local environmental irresponsibility is "compelling" would have served as an unmistakable warning to local governments and would have facilitated future expanded state involvement in preventing environmentally destructive local self-interest.

After rejecting the argument that the Compact unconstitutionally denied initiative, referendum and recall to residents of the Tahoe Basin, the court considered whether the unequal populations of the agency's constituent units violated the equal protection principle of "one person, one vote." Because of the vastly unequal county populations, double representation of the City of South Lake Tahoe, and representation of the public at large, the state conceded that the various members of the governing body of the Agency did not represent equal numbers of residents of the region and that the "one person, one vote" test was not met.[62] After discussing relevant federal cases, however, the court concluded that such a test does not apply to appointed bodies.[63]

The court relied on the leading case of *Sailors v. Board of Edcation*,[64] in which the United States Supreme Court held that the "one person, one vote" principle does not apply to an appointed county school board exercising primarily administrative powers. The Court specifically reserved, however, the question of its applicability to an appointed body performing quasi-legislative functions.[65]

Since the Tahoe Regional Planning Agency does possess broad legislative powers, including the power to enact ordinances, the defendant counties in *El Dorado* attempted to distinguish *Sailors*. The court, however, rejected as irrelevant the distinction between administrative bodies exercising legislative powers and those merely performing administrative duties. It drew support from *Hadley v. Junior College District*,[66] in which a similar distinction with respect to elective bodies was rejected. *Hadley* considered whether the "one person, one vote" principle of *Reynolds v. Sims*,[67] applied by *Avery v. Midland County*[68] to local elective bodies possessing general governmental powers, applied

61. 5 Cal. at 506, 487 P.2d at 1210, 96 Cal. Rptr. at 560.
62. *Id.* at 504, 487 P.2d at 1208, 96 Cal. Rptr. at 568.
63. *Id.* at 504-05, 487 P.2d at 1208-09, 96 Cal. Rptr. at 568-69.
64. 387 U.S. 105 (1967).
65. *Id.* at 109-10.
66. 397 U.S. 50 (1970).
67. 377 U.S. 533 (1964).
68. 390 U.S. 474 (1968).

also to local elective bodies exercising only administrative powers. *Hadley* held that *Reynolds'* guarantee of equal voting strength for each voter applies in all elections of governmental officials, for two primary reasons: (1) unequal voting weight debases the voting right regardless of the particular officials being elected[69] and (2) drawing such distinctions on a case-by-case basis is a judicially unmanageable task.[70] Since neat classification of the functions of appointive bodies as legislative or administrative is equally difficult, the *El Dorado* court similarly refused to attempt categorization.[71]

Such a use of the *Hadley* reasoning is inappropriate in two respects. First, the effect in *Hadley* of not making the legislative-administrative distinction concerning elective offices was to expand the coverage of the "one person, one vote" principle, while not making the distinction in *El Dorado* meant adopting a uniform rule that the principle applies to no appointive bodies, which restricts the principle's coverage. Judicial reluctance to grapple with difficult classifications is less persuasive when the effect of not categorizing is to restrict rights than when it has the opposite effect. Second, the absolute immunity of appointive boards from the "one person, one vote" standard to some extent undermines what has been accomplished by strictly enforcing it with respect to elective bodies. Opponents of equal apportionment have long argued that there are many "historical, geographical, economic, or social considerations, or . . . many other practical and subtle factors that have always been recognized as playing a legitimate part in the practice of politics"[72] and that strict adherence to a population standard of representation is therefore undesirable. Should such factors continue to be important to state legislators, the "one person, one vote" obstacle can easily be hurdled by creating appointive rather than elective agencies.

For these reasons, *El Dorado*'s broad denial of the right to equal representation on appointive bodies should be strictly limited to the facts before it. The court pointed out that there are significant state interests in appointment of the governing body of the Tahoe Regional Planning Agency without regard to equal representation.[73] Perhaps the

69. 397 U.S. at 54-55.

70. *Id.* at 55-56.

71. 5 Cal. 3d at 505, 487 P.2d at 1209, 96 Cal. Rptr. at 569.

72. Hadley v. Junior College Dist., 397 U.S. 50, 59 (1970) (Harlan, J., dissenting).

73. These interests include the unique interstate nature of the Agency and the welfare of nonresidents of the Tahoe Basin. 5 Cal. 3d at 506, 487 P.2d at 1210, 96 Cal. Rptr. at 570. Indeed, an appointed, non-representative agency is almost demanded under the circumstances of this case. Where local self-interest has created the problem, it can only be solved if the responsible agency is to some degree insulated from local pressures.

fact that no right to equal representation exists with regard to this agency does not preclude the possibility that a future court may find grossly disproportionate representation on an appointive body unconstitutional in the absence of significant state interests.

The court's apparent total exemption of appointive bodies from the "one person, one vote" rule is especially dangerous in combination with its holding that the creation of an appointive agency without provision for election, initiative, referendum or recall does not violate equal protection.[74] Thus the court failed to explicitly recognize any state interest test with which to temper the discretion of the state legislature in creating agencies that are neither elective nor representative. Considering the increasingly important state interest in far-sighted, cohesive planning in the Tahoe Basin, such unqualified affirmation was totally unnecessary; the court could have included such a test as a prerequisite for creating appointive offices or as a test to determine which appointive offices must be apportioned by population, or both, without jeopardizing the constitutional status of the Tahoe Regional Planning Compact.

CONCLUSION

In view of the urgent need for new and effective measures to protect the environment,[75] it is not surprising to find the court eager to uphold the constitutionality of the Tahoe Regional Planning Compact. If this regional plan proves successful, it is almost certain to foster many similar plans in other parts of the state where local efforts have proved inadequate to protect natural resources. Such progress, however, is not without its costs. Local autonomy is sacrificed by sanctioning the creation of an agency not controlled by local residents[76] that can enact rules vitally affecting local interests and enforce them with penal sanctions. The agency's power to infringe on local government is limited only by the elusive distinction between regional and local concerns. Moreover, this body is not elected by local residents,[77] and no attempt is made to apportion representatives on its board according to the population they purport to represent.[78] But extraordinary problems require decisive, imaginative solutions, and, although its equal protection conclusions may have been stated unnecessarily broadly, the court's clear consciousness of the need for environmental foresight is extremely reassuring.

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74. See text accompanying notes 54-56 *supra.*

75. See notes 3-4, 16 *supra.*

76. Though a loss to the local residents, "remote control" is a necessity of regional planning. See note 73 *supra.*

77. See notes 51-55 *supra* and accompanying text.

78. See notes 51-53, 62-71 *supra* and accompanying text.

C. *Local Taxation of Multi-City Corporations*

City of Los Angeles v. Shell Oil Co.,[1] *General Motors Corp. v. City of Los Angeles.*[2] In two cases involving the incidence of the Los Angeles business license tax,[3] as construed by ruling 14,[4] on enterprises doing business both within and without the City of Los Angeles, the supreme court held that the tax must reflect the proportion of the taxed activity that actually occurs in the taxing jurisdiction. The court thus gave intercity commerce protection from unfair discrimination similar to that given interstate commerce by the commerce clause of the Federal Constitution.

In *Shell Oil*, Los Angeles sought to tax[5] Shell's total gross revenues from wholesale sales[6] of gasoline delivered from its Los Angeles bulk terminal to retailers outside the city. Shell introduced evidence that the receipts were due in substantial part to selling activities outside the city and contended that the tax could be based only upon that portion of its gross receipts that were attributable to selling activities within the city. The court ruled that the situs of the goods upon shipment bears no relationship to the taxed activity—the business of selling—that actually took place within the jurisdiction and thus cannot be used as the decisive factor in apportioning the tax.[7]

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1. 4 Cal. 3d 108, 480 P.2d 953, 93 Cal. Rptr. 1 (1971) (Sullivan, J.) (unanimous decision).
2. 5 Cal. 3d 229, 486 P.2d 163, 95 Cal. Rptr. 635 (1971) (Sullivan, J.) (unanimous decision).
3. Los Angeles, Cal., Code §§ 21.03, 21.50-21.198. See note 5 *infra*.
4. See text accompauying notes 30-34 *infra*.
5. *See* 4 Cal. 3d at 112, 480 P.2d at 954-55, 93 Cal. Rptr. at 3, *citing* Los Angeles, Cal., Code § 21.03:

> (a) Subject to the provisions of this Article, a business tax registration certificate must be obtained and a business tax paid by every person engaged in any of the businesses or occupations specified in Sections 21.50 to 21.198, inclusive, of this Article; and a business tax is hereby imposed in the amount prescribed in the applicable section. No person shall engage in any business or occupation subject to tax under the provisions of this Article without obtaining a registration certificate and paying the tax required thereunder.

6. *See* 4 Cal. 3d at 112-13, 480 P.2d at 955, 93 Cal. Rptr. at 3, *citing* Los Angeles, Cal., Code § 21.166:

> (a) Every person manufacturing and selling any goods, wares or merchandise at wholesale, or selling any goods, wares or merchandise at wholesale, and not otherwise specifically taxed by other provisious of this Article, shall pay for each calendar year or portion thereof the sum of $8.00 for the first $20,000 or less of gross receipts, and, in addition thereto, the sum of 40 cents per year for each additional $1,000 of gross receipts or fractional part thereof in excess of $20,000 . . . .

Effective January 1, 1960, the rate was increased.

7. 4 Cal. 3d at 125-27, 480 P.2d at 965, 93 Cal. Rptr. at 13. *See also* Security Truck Line v. City of Monterey, 117 Cal. App. 2d 441, 454, 256 P.2d 366, 375 (1st Dist. 1953).

The *General Motors* case consisted of four separate rulings. First, the court upheld application of the tax to the total gross receipts derived from sales of vehicles assembled, although arguably not wholly manufactured, within the city.[8] Second, the court held that the city could not tax unapportioned gross receipts from sales of cars assembled outside the city and shipped to dealers within the city pursuant to orders placed at an in-city zone office, because General Motors was able to show that the receipts were produced in substantial part by sales outside the city.[9] Third, the court held that the gross receipts from retail sales[10] of GMC trucks delivered from an out-of-city retail outlet to in-city customers must similarly be apportioned to reflect the proportion of in-city and out-of-city selling activities.[11] Finally, the court upheld the tax as applied by the city to 15 percent of the total gross receipts of wholesale sales of cars assembled outside the city and sold to out-of-city dealers pursuant to orders placed within the city, because General Motors was unable to show that this was not a fair apportionment of the selling activity.[12]

The United States Supreme Court has relied primarily on the commerce clause,[13] with assistance from the due process clause,[14] to preserve the free flow of commerce among the states by protecting interstate enterprises from the multiple burdens of unfairly apportioned state taxes.[15] Although the policy of preserving the free flow of intercity commerce within a state is equally strong,[16] the California constitution contains no comparable commerce clause. The state constitution does, however, forbid the extraterritorial application of local ordinances[17] and require uniform application of laws.[18] *Shell Oil* and *Gen-*

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8. 5 Cal. 3d at 239-40, 486 P.2d at 170, 95 Cal. Rptr. at 642.

9. *Id.* at 240-44, 486 P.2d at 170-73, 95 Cal. Rptr. at 642-45.

10. *See* 5 Cal. 3d at 235 n.4, 486 P.2d at 166, 95 Cal. Rptr. at 638, *citing* Los Angeles, Cal., Code § 21.167:

> (a) For every person manufacturing and selling any goods, wares or merchandise at retail, or selling any goods, wares or merchandise at retail, and not otherwise specifically taxed by other provision of this Article, the tax shall be $12.00 per year or fractional part thereof for the first $15,000.00 or less of gross receipts, plus $0.80 per year for each additional $1,000.00 of gross receipts or fractional part thereof in excess of $15,000.00. . . .

Effective January 1, 1967, the rate of tax was increased.

11. 5 Cal. 3d at 244, 486 P.2d at 173, 95 Cal. Rptr. at 645.

12. *Id.* at 244-45, 486 P.2d at 173-74, 95 Cal. Rptr. at 645-46.

13. U.S. Const. art. I, § 8.

14. U.S. Const. amend. XIV, § 1.

15. *See, e.g.*, Standard Oil Co. v. Peck, 342 U.S. 382 (1952); Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938); Hans Rees' Sons v. North Carolina, 283 U.S. 123 (1931).

16. Sato, *Municipal Occupation Taxes in California: The Authority to Levy Taxes and the Burden on Intrastate Commerce*, 53 Calif. L. Rev. 801, 818 (1965).

17. Cal. Const. art. XI, § 7, *formerly* art. XI, § 11: "A county or city may

eral Motors are the latest and clearest in a series of cases giving effect to this policy by reading these clauses, together with the equal protection of the Federal Constitution,[19] to prohibit, as unfairly discriminatory, local taxes on intercity businesses unless such taxes are fairly apportioned to the amount of business actually carried out in the jurisdiction of the taxing entity.[20]

As long ago as 1942, the court of appeal stated that a license tax could be computed by the amount of business done within the taxing jurisdiction and that the amount could be determined indirectly by looking to the number of employees rather than directly by dollar volume.[21] The court, however, invalidated the application of the tax as to the plaintiff because it had improper territorial application and denied equal protection by unreasonably discriminating against outside business by improper apportionment.[22] The court of appeal in *Security Truck Line v. City of Monterey*[23] established a two-step test for due process validity of a business license tax: If the tax falls basically upon an event occurring outside the city or if it is discriminatory as to the plaintiff, then it is invalid.[24] The court of appeal found the tax in question invalid because it was governed by a factor which had no relationship to the actual amount of business done in the city.[25]

The Los Angeles tax involved in *Shell Oil* and *General Motors* was also involved in the previous leading case in this area. In *City of*

make and enforce within its limits all . . . ordinances and regulations not in conflict with general laws." *See generally* South Pasadena v. Los Angeles Terminal Ry., 109 Cal. 315, 41 P. 1093 (1895).

18. CAL. CONST. art. I, § 21: "[N]or shall any citizen, or class of citizens, be granted privileges or immunities which, upon the same terms, shall not be granted to all other citizens." This clause has been interpreted as substantially equivalent to the federal equal protection clause. Whittaker v. Superior Court, 68 Cal. 2d 357, 367 n.16, 438 P.2d 358, 366-67 n.16, 66 Cal. Rptr. 710, 718-19 n.16 (1968).

19. U.S. CONST. amend. XIV, § 1.

20. 4 Cal. 3d at 124, 480 P.2d at 963, 93 Cal. Rptr. at 11. *See also* City of Los Angeles v. Belridge Oil Co., 42 Cal. 2d 823, 271 P.2d 5 (1954).

21. Ferran v. City of Palo Alto, 50 Cal. App. 2d 374, 382, 122 P.2d 965, 970 (3d Dist. 1942).

22. *Id.*

23. 117 Cal. App. 2d 441, 256 P.2d 366 (1st Dist. 1953).

24. *Id.* at 451, 256 P.2d at 373.

25. *Id.* at 453, 256 P.2d at 375. The tax was measured by the weight of each vehicle used for hauling fish from outside the city to canneries within the city. Because plaintiff rotated the use of his trucks in making deliveries within Monterey, measuring the quantum of business with reference to individual trucks produced an artificially high indication of business actually transpiring within the city. *Compare* Willingham Bus Lines, Inc. v. Municipal Court, 66 Cal. 2d 893, 428 P.2d 602, 59 Cal. Rptr. 618 (1967), where the court upheld, as avoiding discrimination against multi-city business, a tax on the gross receipts attributable to the portion of the trip traveled within the city limits by charter vehicles.

Los Angeles v. Belridge Oil Co.,[26] the supreme court held that while the city could tax persons engaged in selling by reference to gross receipts from transactions having extraterritorial elements, it could only include those gross receipts that were directly attributable to selling activities within the city for this purpose.[27] On retrial, the parties stipulated that all of the company's gross receipts were attributable in part to sources within the city, but that not more than 20 percent of its gross receipts were fairly attributable to selling activities within the city.[28]

After *Belridge*, the city clerk of Los Angeles stated that the decision made it necessary to devise a method for the apportionment of business done within and without the city that avoided the difficulties of weighing various factors.[29] Pursuant to authority granted him in the municipal code,[30] he adopted ruling 14. The ruling provides that "only those gross receipts which are directly attributable to the business engaged in within the City of Los Angeles shall be included within the measure of the tax," and goes on to describe what gross receipts should be considered directly attributable.[31] Another section of ruling 14 provides that only 15 or 25 percent of the receipts from certain transactions shall be considered directly attributable depending upon the presence of certain business functions within the city.[32]

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26. 42 Cal. 2d 823, 271 P.2d 5 (1954), *appeal dismissed*, 348 U.S. 907 (1955).

27. *Id.* at 831-32, 271 P.2d at 10.

28. 48 Cal. 2d at 321, 309 P.2d at 417. The stipulation reserved the city's right to maintain on appeal that there need be no allocation of gross receipts attributable in part to selling activities within the city. In its second decision in the case, the supreme court reaffirmed that only those gross receipts attributable to in-city selling activities could be considered and upheld the 20 percent formula as a fair method of allocation. 48 Cal. 2d 320, 324, 309 P.2d 417, 419 (1954).

29. 4 Cal. 3d at 114-15, 480 P.2d at 956-57, 93 Cal. Rptr. at 4-5.

30. *See Shell*, 4 Cal. 3d at 114-15 n.4, 480 P.2d at 956, 93 Cal. Rptr. at 4, *citing* LOS ANGELES, CAL., CODE § 21.5:

> (h) When, by reason of the provisions of the Constitution of the United States or the Constitution of California, the business tax imposed by this Article cannot be enforced without there being an apportionment according to the amount of business done in the City of Los Angeles . . . the City Clerk may make such rules and regulations for the apportionment of the tax as are necessary or desirable to overcome the constitutional objections.

31. Ruling 14, part I, continues in paragraph 1(c) to provide:

> (c) If the person engaged in such business owns, leases, occupies or otherwise maintains within the City a place or premises upon which or from which he engages in such business, all receipts resulting from sales of goods, wares or merchandise which are in any manner attributable to business functions carried on, at, or from that place of business, and which goods, wares or merchandise are either sold for shipment into the City of Los Angeles to the purchaser or his agent or designee, or are shipped from a place within the City of Los Angeles to a place within the City, or from a place within the City to a place outside the City but within the State of California, shall be considered directly attributable to the business engaged in within the City.

32. Ruling 14, paragraph 1(d), specifies the following functions as indicating

One specific application of ruling 14 was considered in *Carnation Co. v. City of Los Angeles*,[33] where the court upheld the tax upon one engaged in manufacturing and selling as to those goods manufactured in the city without regard to the place of sale. In *Belridge*, the court had said that the tax was constitutionally limited to the extent of selling activities within the city. In *Carnation* the activity of manufacturing provided contact with all subsequent sales, and this was constitutionally sufficient to uphold a privilege tax based on *all* gross receipts derived from such sales.[34]

The court in *Shell Oil* found the apportionment formula of ruling 14 capable of being applied in violation of the constitutional principles set forth in *Belridge*, because the tax rested in part upon a fortuitous event having no relation to the taxable event occurring in the city or to the amount of business conducted there.[35] Ruling 14 distinguishes between receipts derived from sales of goods shipped from or into the city and receipts derived from the sale of goods that are not. All of the receipts in the former category are classified under paragraph 1(c) as "directly attributable" to business engaged in within the city if they are "in any manner attributable to in-city business,"[36] while only 15 or 25 percent of receipts in the latter category are so classified under paragraph 1(d).[37] The situs of goods at the time of shipment or delivery was thus made a decisive factor in allocation of the gross receipts.[38]

Since the taxable event in *Shell* was "selling," the court found unconstitutional the inclusion in the tax base of the total gross receipts from sales resulting in part from substantial out-of-city sales activity.[39] This result is sound under the provisions of the state and federal con-

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whether a business activity should be considered within the taxing jurisdiction: negotiating or soliciting, displaying of samples, processing orders, accepting orders, arranging delivery, billing, and collecting. An application of paragraph 1(d) was upheld in City of Los Angeles v. Moore Business Forms, Inc., 247 Cal. App. 2d 353, 55 Cal. Rptr. 820 (2d Dist. 1966).

33. 65 Cal. 2d 36, 416 P.2d 129, 52 Cal. Rptr. 225 (1966).

34. 4 Cal. 3d at 117-18, 480 P.2d at 959, 93 Cal. Rptr. at 7.

35. 4 Cal. 3d at 125, 480 P.2d at 964, 93 Cal. Rptr. at 12, *citing* Security Truck Line v. City of Monterey, 117 Cal. App. 2d 441, 454, 256 P.2d 366, 375 (1st Dist. 1953). The court emphasized that a party challenging an apportionment formula has the burden of showing by "clear and cogent evidence" that it *results* in extraterritorial values being taxed. *Id.* at 126, 480 P.2d at 965, 93 Cal. Rptr. at 13.

36. See note 31 *supra*.

37. See note 32 *supra*.

38. Justice Burke concurred with the majority opinion on the understanding that the fact that Shell was making deliveries to out-of-city points from the in-city bulk terminal can be taken into account in making the apportionment, even though it could not be the controlling factor. 4 Cal. 3d at 128-29, 480 P.2d at 966-67, 93 Cal. Rptr. at 14-15.

39. 4 Cal. 3d at 127, 480 P.2d at 965, 93 Cal. Rptr. at 13.

stitutions and the policy of protecting the free flow of commerce,[40] but it does not offer any guidance in determining the proper allocation of gross receipts from sales resulting from selling activity both within and without the taxing jurisdiction. Thus, the court reaffirmed the *Belridge* case and explained more clearly the reasoning behind it while invalidating in large part the formula Los Angeles had devised to determine which receipts were directly attributable to selling activities within the city. The case was remanded to the trial court to make a proper apportionment of Shell's gross receipts.[41]

The *General Motors* case involved four applications of ruling 14. The question in each instance was whether General Motors had sustained its burden of showing that the particular application of the ruling resulted in the taxation of "significant extraterritorial values."[42] First, relying on its decisions in *Carnation* and *Shell,* the court held that the city could tax the unapportioned gross receipts from the sale of automobiles assembled in the city without regard to the location of selling activity,[43] characterizing the tax[44] as fundamentally a tax upon the privilege of manufacturing.[45] In addition, the fact that the automobiles asembled in the city were not "wholly manufactured" there does not require an apportionment of gross receipts.[46]

In the second and third parts of the opinion, the court found that General Motors had sustained its burden of showing that the inclusion of unapportioned gross receipts from the sale of cars and trucks from out-of-city plants to in-city customers resulted in taxation of significant extraterritorial values because "substantial elements of the sales process which produces these receipts takes place outside the City."[47] Application of ruling 14 to these transactions was therefore

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40. See notes 16-18 *supra.*

41. 4 Cal. 3d at 128, 480 P.2d at 966, 93 Cal. Rptr. at 14. In *Belridge* the court on retrial, faced with the same directions, held that the method of allocation should be "fair" and approved an allocation formula that had been stipulated to by the parties. *Id.* at 114, 480 P.2d at 956, 93 Cal. Rptr. at 4.

42. 5 Cal. 3d at 239, 486 P.2d at 170, 95 Cal. Rptr. at 170. See text accompanying note 35 *supra.*

43. *Id.* See text accompanying note 32 *supra.* The selling activities can also be taxed in the jurisdiction in which they take place by reference to the same gross receipts. *Id.* at 242-43, 486 P.2d at 172, 95 Cal. Rptr. at 644. See note 50 *infra.*

44. LOS ANGELES, CAL., CODE §§ 21.03, 21.166, 21.167. See notes 5, 6 & 10 *supra.*

45. 5 Cal. 3d at 240, 486 P.2d at 170, 95 Cal. Rptr. at 642.

46. *Id.* "It is only when the final operation yielding the finished product is inappreciable in comparison with the extraterritorial activities producing the component parts" that the gross receipts must be apportioned. *Id. Shell* had left open the question whether an apportionment of gross receipts was required in the case of products not wholly manufactured in the taxing jurisdiction. 4 Cal. 3d at 128, 480 P.2d at 966, 93 Cal. Rptr. at 14.

47. 5 Cal. 3d at 244, 486 P.2d at 173, 95 Cal. Rptr. at 645. This is the con-

unconstitutional.[48] The court rejected the contention that a manufacturer should not be taxed at all on its selling activities unless it is also engaged in "merchandising" activities whereby it seeks to take a dealer's profit.[49] General Motors argued that it could otherwise be taxed on the same gross receipts as a manufacturer in one jurisdiction and as a seller in another. The court held that there is no constitutional impediment to the taxation of manufacturing in one jurisdiction by reference to the total gross receipts and the taxation of selling activities in the same or another jurisdiction by reference to the same or total gross receipts, because the type of multiple taxation proscribed in *Belridge* is duplicate taxation of the same activity.[50]

The fourth category in issue involved paragraph 1(d)[51] of ruling 14 under which the city sought to include in its tax base 15 percent of the gross receipts derived from sales to out-of-city dealers of cars assembled at out-of-city plants pursuant to orders placed at an in-city office. General Motors did not sustain its burden of showing that this was an unfair apportionment of the selling activity.[52]

In *General Motors*, the law laid out in *Belridge* and *Shell* was thus used to test four applications of the Los Angeles business license tax, but, as in *Shell*, it offers little guidance in determining the proper standards for apportionment. In the absence of a uniform business license tax, perhaps pursuant to legislative mandate, it appears that the applications of each city's tax will have to be tested on a case-by-case basis in the trial courts.

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verse situation from that in *Shell*, where the goods were shipped to locations outside the city from a bulk terminal within the city. 4 Cal. 3d at 111, 480 P.2d at 954, 93 Cal. Rptr. at 2.

48. 5 Cal. 3d at 245, 486 P.2d at 174, 95 Cal. Rptr. at 646. The court recognized that its interpretation of the state constitution creates a more stringent requirement of apportionment than might be necessary in interstate commerce. In General Motors v. Washington, 377 U.S. 436 (1964), the Supreme Court upheld a tax on the unapportioned gross receipts from the sale of goods delivered to Washington dealers while condemning multiple burdens on interstate commerce. It is not clear whether the Court found the selling activities in the state sufficient to meet a fair apportionment test or whether the decision rested on lack of sufficient evidence of multiple taxation.

49. *Id.* at 244, 486 P.2d at 173, 95 Cal. Rptr. at 645.

50. *Id.* at 241-43, 486 P.2d at 171-72, 95 Cal. Rptr. at 643-44. Although the court found no constitutional limitation that would preclude the City from taxing manufacturing activities and selling activities with regard to the same production, it pointed out that the ordinance in question did not attempt to do so. *Id. See* Universal Consol. Oil Co. v. City of Los Angeles, 202 Cal. App. 2d 771, 21 Cal. Rptr. 61 (2nd Dist. 1962).

51. See note 32 *supra*.

52. 5 Cal. 3d at 244-45, 486 P.2d at 173-74, 95 Cal. Rptr. at 646-47.