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## INTERGOVERNMENTAL TAX IMMUNITY: DO WE NEED A CONSTITUTIONAL AMENDMENT?

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The recent decision of the federal Supreme Court in *Graves v. New York ex rel. O'Keefe*<sup>1</sup> is merely the culmination of a series of decisions which have tended to limit or perhaps completely repudiate the doctrine of tax immunity as between the two branches of our dual form of government. The decision is that an officer of the Home Owners' Loan Corporation, which is concededly a wholly-owned federal government agency, may be subjected to a non-discriminatory income tax by the state of his residence, with respect to his salary from that corporation. Since the immunity of federal income from state taxation established nearly a hundred years ago by *Dobbins v. The Commissioners of Erie County*<sup>2</sup> is thus definitely given up, there can be no doubt that the more doubtful and somewhat less ancient immunity of state salaries from federal taxation given by *Collector v. Day*<sup>3</sup> is likewise repudiated. Indeed both of these cases and also *New York ex rel. Rogers v. Graves*,<sup>4</sup> holding the general counsel of the Panama Railroad exempt from state taxation on his salary, on the ground that the railroad was a federal instrumentality, are explicitly overruled. The decision in *Brush v. Commissioner of Internal Revenue*,<sup>5</sup> holding the salary of a municipal officer exempt from federal taxation, was also unfavorably commented

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1. (1939) 306 U. S. 466. See also, *State Tax Commission v. Van Cott* (1939) 306 U. S. 511.

2. (U. S. 1842) 16 Pet. 435.

3. (U. S. 1871) 11 Wall. 113.

4. (1937) 299 U. S. 401.

5. (1937) 300 U. S. 352.

on by Mr. Justice Stone who wrote the prevailing opinion in the *O'Keefe* case; and it seems Mr. Justice Butler was correct in stating in his dissenting opinion that it too must be deemed to be overruled.

As already said, the *O'Keefe* case represents the culmination of a strong tendency during recent years to limit intergovernmental tax immunity, though with some interruptions, as in the *Rogers* and *Brush* cases just mentioned.<sup>6</sup> Indeed Mr. Justice Stone relied in that case particularly upon *Helvering v. Gerhardt*,<sup>7</sup> decided a year before, which held that engineers of the New York Port Authority were liable to federal income taxation. It does seem that this case, notwithstanding its rather dubious language, has actually gone the whole distance toward doing away with intergovernmental tax immunity, at least so far as salaries are concerned; but at least one state court refused to accept this proposition, and held that the immunity of federal officers from state income taxation still applied after the *Gerhardt* case.<sup>8</sup>

Two other recent cases are worth mentioning as showing the hostility of the Court toward intergovernmental tax immunity, even preceding the *O'Keefe* case. These are *James v. Dravo Contracting Co.*,<sup>9</sup> holding that a state may impose a non-discriminatory tax on the gross receipts of a contractor from work within the state, even though the work is done under a federal contract, and all payments are made by the federal government; and *Helvering v. Mountain Producers Corporation*,<sup>10</sup> holding that the lessee of state property is subject to a federal income tax on the income from the operation of the leased property. Both of these cases explicitly overruled several previous decisions directly or impliedly to the contrary.

It is necessary to give here a full resumé of the scope and history of intergovernmental tax immunity, especially since that history seems now to have about reached its end. It originated more than a century ago in the famous decision of Mr. Chief

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6. See the annotation to the *O'Keefe* case in (1939) 120 A. L. R. 1477.

7. (1938) 304 U. S. 405.

8. *Geery v. Minnesota Tax Commission* (1938) 204 Minn. 107, 282 N. W. 673.

9. (1937) 302 U. S. 134.

10. (1938) 303 U. S. 376. See also, *Helvering v. Bankline Oil Co.* (1938) 303 U. S. 362.

Justice Marshall in *M'Culloch v. Maryland*,<sup>11</sup> where it was stated as a matter of absolute reciprocal immunity from taxation.<sup>12</sup> This method of statement was extremely and sometimes unfortunately influential nearly up to the present, notwithstanding the fact, as has often been pointed out, that the *M'Culloch* case involved a state tax definitely discriminatory against a federal instrumentality, and therefore was correctly decided without the necessity of enunciating any such general propositions as the one here referred to. But this doctrinal immunity was given definite application so far as income taxes were concerned in *Pollock v. Farmers' Loan and Trust Co.*,<sup>13</sup> which invalidated the federal income tax of 1894 as a whole, but particularly with respect to income from state and municipal bonds, on the ground that this was a direct burden upon the states and their instrumentalities and therefore unconstitutional. Later, it was held that the adoption of the Sixteenth Amendment had not removed this immunity.<sup>14</sup>

The *O'Keefe* case has undoubtedly and avowedly changed the law with respect to salaries and other compensation for personal services; the previously existing immunity of state salaries from federal taxation and federal salaries from state taxation is now wholly done away with. The question remains whether the immunity with respect to interest on bonds and other securities is likewise ended. The Court expressly reserved this question, and properly so, since it was not directly involved; but the statement of Mr. Justice Stone in his opinion that "The theory, which once won a qualified approval,<sup>15</sup> that a tax on income is legally or economically a tax on its source, is no longer tenable"<sup>16</sup> would

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11. (U. S. 1819) 4 Wheat. 316. See also *Osborn v. United States* (U. S. 1824) 9 Wheat. 738; *Weston v. Charleston* (U. S. 1829) 2 Pet. 449.

12. The reasoning is largely based upon the announced proposition that "the power to tax involves the power to destroy." This theory, often criticised, is definitely repudiated by Mr. Justice Frankfurter, in his concurring opinion in the *O'Keefe* case.

13. (1895) 157 U. S. 429. On rehearing, reported in (1895) 158 U. S. 601, there was no further discussion of the problem of income from state and municipal bonds.

14. *Brushaber v. Union Pac. R. R.* (1916) 240 U. S. 1, holding that the Sixteenth Amendment had not increased the scope of the federal power to tax incomes, but had merely removed the necessity of apportionment of income taxes according to population.

15. The reference is to such decisions as the *Pollock* case (1895) 157 U. S. 429, and (1895) 158 U. S. 601.

16. (1936) 306 U. S. 466, 480.

seem to indicate that the Court would be prepared to repudiate its opinion on this point in the *Pollock* case and hold that interest on state and municipal bonds is subject to federal taxation, and conversely, that interest on federal bonds is subject to state taxation. The prevailing prediction of non-judicial authorities, some before the *O'Keefe* case but reflecting the already apparent disapproval of the Court of intergovernmental exemption, and some after that decision, is in favor of the theory that intergovernmental exemption is gone with respect to bonds as well as salaries;<sup>17</sup> though there is some dispute.<sup>18</sup> It must be confessed that such non-judicial authorities are distinctly unreliable, but they are the best we have; furthermore, such changes of judicial opinion as are discussed here indicate that reliance upon court decisions is not entirely safe either.

The matter cannot be brought before the Court under present conditions, at least so far as federal taxation is concerned, since Congress has thus far refused to change the statute which expressly exempts from federal income tax interest on state and municipal bonds.<sup>19</sup> The opinion of this writer is of course of no greater weight than that of any of the secondary authorities previously cited; but that opinion, for what it is worth, is that the Court is prepared to do away with intergovernmental tax immunities with respect to interest as well as salaries. For one thing, there is no logical or sensible ground for differentiating between these two kinds of income at least for the present purpose; besides (and this is more important) the Court shows, by the *O'Keefe* case, and its predecessors, that it regards the whole doctrine of intergovernmental tax immunity as working badly in encouraging the shirking of the burdens of government by those best fitted to bear them. This latter argument applies even more to the so-called tax-exempt bonds than it does to salaries.

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17. The strongest argument for wholly doing away with intergovernmental tax immunity is *Taxation of Government Bondholders and Employees; The Immunity Rule and the Sixteenth Amendment*. This is a study by the Federal Department of Justice published in 1938. See also, Shaw, Recent Cases on the Doctrine of Intergovernmental Tax Immunity (1938) 8 Brooklyn L. Rev. 38; Hatton, Reciprocal Immunity of Federal and State Instrumentalities (1939) 24 Bull. of Nat'l Tax Ass'n 146; Wenchel, Legal Aspects of Tax-Exempt Privileges (1939) 25 A. B. A. J. 205.

18. See Wood, Taxation of Tax-Exempt Securities (1939) 25 A. B. A. J. 201; Nichols, Intergovernmental Tax Immunities (1939) 24 Bull. of Nat'l Tax Ass'n 98.

19. See (1934) 48 Stat. 686, c. 277, 26 U. S. C. A. sec. 22 b (4).

At any rate, the chances of the Court's sustaining such a tax are so promising as to make it seem absurd to attempt to solve the problem by the arduous method of a constitutional amendment. If this were all, a constitutional amendment would certainly be unnecessary. But before considering this problem, the effect of the change of the Court's views as to other sorts of taxes than income taxes, which have up to now been exclusively referred to, should be briefly considered.

#### EFFECT AS TO OTHER SORTS OF TAXES

Our whole dual form of government has some disadvantages along with its undoubted advantages; and one of the disadvantages is the consequent complication and uncertainties which result from the division of governmental authority. This is most apparent and most troublesome with respect to taxation.<sup>20</sup> Indeed the Court has pointed out that taxation immunities resulting from our dual form of government are of broader scope and more rigidly applied than immunities of other sorts.<sup>21</sup> For example, it held in *United States v. California*<sup>22</sup> that a state which operates a railroad engaged in interstate commerce is fully subject to the federal regulatory power with respect to the safety of employees. The Court said:

The analogy of the constitutional immunity of state instrumentalities from federal taxation, on which respondent relies, is not illuminating. That immunity is implied from the nature of our federal system and the relationship within it of state and national governments, and is equally a restriction on taxation by either of the instrumentalities of the other. Its nature requires that it be so construed as to allow to each government reasonable scope for its taxing power, see *Metcalf & Eddy v. Mitchell*, 269 U. S. 514, 522-524, which would be unduly curtailed if either by extending its activities could withdraw from the taxing power of the other subjects of taxation traditionally within it. [Citing cases]. Hence we look to the activities in which the states have traditionally engaged as marking the boundary of the

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20. See Brown, *State Taxation of Interstate Commerce, and Federal and State Taxation in Intergovernmental Relations—1932-1935* (1936) 24 *Georgetown L. J.* 584, and articles cited.

21. *Federal Land Bank v. Priddy* (1935) 295 U. S. 229, holding that the express Congressional exemption of federal land banks from taxation did not exempt them from liability to attachment. The Court remarked that "Immunity of corporate government agencies from suit and judicial process, and their incidents, is less readily implied than immunity from taxation."

22. (1936) 297 U. S. 175.

restriction upon the federal taxing power. But there is no such limitation upon the plenary power to regulate commerce. The state can no more deny the power if its exercise has been authorized by Congress than can an individual.<sup>23</sup>

On the other hand, the Court has never, even in the days of its greatest enthusiasm for intergovernmental immunity, held that even tax immunity is absolute. It has generally been recognized as a practical problem,<sup>24</sup> with the immunity not extending further than is necessary for the reasonable protection of the continued existence and effectiveness of the states and nation respectively; though, as will presently appear, this principle does not always seem to have been properly applied in practice. Even where the tax exemption has been regarded as clearly within this doctrine, it has been recognized that it should not be carried so far as to compel the taxing government to actually give a bonus to the employees of bondholders of the other government.<sup>25</sup>

As to sales taxes, there was even quite recently a tendency to imply immunity in governmental relations with considerable rigidity. Thus in *Panhandle Oil Co. v. Mississippi*,<sup>26</sup> the Court was divided, but the majority held that a state could not impose a sales tax on gasoline sold to the federal government for use by the Coast Guard and a government hospital. The minority unsuccessfully argued that the burden upon the federal government was too remote and uncertain to justify the invalidation of the tax. However, the doctrine of this case was followed as late as 1936, when a state tax on the mere storing of gasoline later sold to the United States, was invalidated on the same basis.<sup>27</sup>

As respects a federal sales tax upon products sold to the states or their instrumentalities, the same doctrine seems to be applied, though perhaps with a trifle less severity. In *Indian Motorcycle Co. v. United States*,<sup>28</sup> a sale by the manufacturer of a motorcycle to a city, to be used by its police force, was held exempt from federal excise tax, on the authority of the *Panhandle Oil*

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23. 297 U. S. at 184-5.

24. *Burnet v. Jergins Trust* (1933) 288 U. S. 508.

25. See Brown, *Reduction of Tax Exemptions by Reason of the Receipt of Tax-Exempt Income* (1932) 80 U. of Pa. L. Rev. 534.

26. (1928) 277 U. S. 218.

27. *Graves v. Texas Co.* (1936) 298 U. S. 393.

28. (1931) 283 U. S. 570.

case.<sup>29</sup> But where the federal tax is on the manufacture<sup>30</sup> or transportation<sup>31</sup> rather than on the sale itself, the tax is sustained, even though the sale is made to a state or its agencies, on the ground that the tax is not directly upon the sale, and the burden of the tax is primarily upon the seller rather than on the purchasing state.

But all of these rather attenuated distinctions seem to disappear with *James v. Dravo Contracting Co.*<sup>32</sup> In this case the court upheld a state tax on the gross receipts of a contractor holding a federal contract. While this may not strictly be a sales tax, it is obviously at least equivalent, and constitutes a direct burden upon the federal government—at least as direct a burden as any sales tax could possibly impose. Indeed, the Court conceded that the effect of the tax might well be to cause the contractor to demand a higher fee. Yet this burden upon the federal government was held not to invalidate the tax, so long as it was non-discriminatory. It seems therefore that the decisions invalidating state taxes upon sales to the federal government, or federal taxes on sales to a state government, can no longer stand.

There has been a similar development with respect to the problem of taxing agents and the like of the other member of our dual system. Here the problem often involves income taxes; but the point on which most of the decisions turn is the relation of the person taxed to the government with which he is connected, rather than the nature of the tax; so this problem is appropriately considered here. There does not seem to be any doubt of the propriety of federal taxation of independent contractors with the state<sup>33</sup> or of state taxation of independent contractors with the federal government.<sup>34</sup> The Court has recognized that there is a possible burden upon the employing government in such a case, but regards it as too remote and attenuated to justify the invalidation of the tax.

The difference between a tax on an independent contractor and

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29. (1928) 277 U. S. 218.

30. *Liggett & Myers Tobacco Co. v. United States* (1937) 299 U. S. 383.

31. *Wheeler Lumber, Bridge and Supply Co. v. United States* (1930) 281 U. S. 572.

32. (1937) 302 U. S. 134.

33. *Metcalf & Eddy v. Mitchell* (1926) 269 U. S. 514.

34. *Trinityfarm Construction Co. v. Grosjean* (1934) 291 U. S. 466;  
*James v. Dravo Contracting Co.* (1937) 302 U. S. 134.

a tax upon an agent seems to be one merely of degree. This is not only because the distinction is by no means clear and definite in legal theory, but even more because the burden of the tax upon the employer of these two sorts of representatives is actually not very different. Nevertheless, the Court was inclined to draw a sharp distinction between these two sorts of cases, and to hold that a state tax upon a federal agent is invalid as a direct burden upon the federal government, and this irrespective of the nature of the tax.<sup>35</sup> The same rule undoubtedly applies to federal taxes on state agents,<sup>36</sup> except as this rule may be modified by the problem as to the nature of the function performed—a problem which will be considered later. If, however, the activity taxed is paid from funds supplied by the taxing government,<sup>37</sup> or the tax is a burden upon private interests rather than the governmental unit whose agent is supposed to be taxed,<sup>38</sup> the tax will be sustained.

Here too the intergovernmental tax immunity had thus been very greatly limited, even before the *O'Keefe* case.<sup>39</sup> Indeed, the limitation is much greater than is here indicated, at least so far as federal taxation is considered, because of the effect of state functions assumed to be non-governmental as reducing the immunity. But whatever was left of this immunity seems definitely wiped out by the *O'Keefe* case. That decision would seem to put an end to all implied immunity of state agents from federal taxation, and vice versa. So this problem also seems satisfactorily solved without any formal constitutional amendment.

Another problem which has caused considerable difficulty is with respect to federal taxation of the lessees of state or municipal lands, and state taxation of lessees of land owned by the federal government. Here too the income tax is often involved, but again the problem is concerned less with the nature of the tax than with the effect upon the lessor government.

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35. *Western Union Tel. Co. v. Texas* (1881) 105 U. S. 460; *Williams v. Talladega* (1912) 226 U. S. 404 (taxes on telegraph messages); *Federal Land Bank v. Crosland* (1923) 261 U. S. 374; see also *Pittman v. Home Owners' Loan Corp.* (1939) 60 S. Ct. 15 (mortgage recording taxes); *Clallam County v. United States* (1923) 263 U. S. 341 (property tax).

36. See *Helvering v. Therrell* (1938) 303 U. S. 218.

37. *Helvering v. Therrell* (1938) 303 U. S. 218; *Hanson v. Landy* (D. C. D. Minn. 1938) 24 F. Supp. 535.

38. *Susquehanna Power Co. v. Maryland* (1931) 283 U. S. 291; *Fox Film Corp. v. Doyal* (1932) 286 U. S. 123.

39. *Graves v. New York ex rel. O'Keefe* (1939) 306 U. S. 466.

Where federal lands are involved, the chief controversy appears to be with respect to Indian lands. As to such lands, the federal government is not usually the owner; but it may control the lands, and have as to outsiders all the rights of an owner, but solely for the purpose of protecting the Indians. Here, however, the tendency is to liberalize the state taxing power as much as possible, it being recognized that extensive exemption of Indian lands from state taxation is undesirable from the standpoint of the Indians themselves, and still more undesirable from the standpoint of the welfare of the state.<sup>40</sup> Indeed, several states which have extensive Indian reservations within their borders have been very definitely hampered in the use of their taxing power by this situation; and accordingly, the Court has tended to construe such exemptions very strictly, and especially as not including lease interests or the products derived from such lands.<sup>41</sup> Nevertheless, it seems clear that express Congressional language may completely exempt Indian property from state taxation; and such statutes still occasionally appear.<sup>42</sup>

On the other hand, the application of the federal income tax to the lessees of state and municipal lands, originally quite restricted, has now become practically complete. This extension of the taxing authority of the federal government was started by construing mineral leases as essentially sales;<sup>43</sup> but it is now clearly settled that true lessees of state and municipal lands are fully subject to federal income or excise taxes with respect to their operation of such land.<sup>44</sup> The Court has repudiated its previous theory that such a tax would be an improper burden upon the state or its agency leasing the land, on the ground that such a burden is too unsubstantial and problematical to justify wiping out the federal taxing power. It may then be concluded that the problem of intergovernmental immunity with respect to leases is substantially solved, except possibly where Congress

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40. See *Brown, The Taxation of Indian Property* (1931) 15 *Minn. L. Rev.* 182.

41. *Indian Territory Illuminating Oil Co. v. Board of Equalization* (1933) 288 U. S. 325.

42. *United States v. Board of Commissioners* (D. C. N. D. Okla. 1939) 26 *F. Supp.* 270.

43. *Group No. 1 Oil Corp. v. Bass* (1931) 283 U. S. 279.

44. *Burnet v. Jergins Trust* (1933) 288 U. S. 508; *Helvering v. Mountain Producers Corp.* (1938) 303 U. S. 376; *Helvering v. Bankline Oil Co.* (1938) 303 U. S. 362.

claims immunity from state taxation by express language in the statute, but that this solution has been reached without any necessity of a constitutional amendment, and even without use of the revolutionary doctrine of the *O'Keefe* case.

Finally we should consider briefly the problem of corporation excise taxes, and the like. This is a problem largely, though not exclusively, of the validity of state taxes. It also involves a sometimes troublesome determination of whether a particular state tax is essentially an excise tax or a property tax upon the corporate franchise; but this last problem is not usually important, so far as the validity of the tax in intergovernmental relations is concerned.

One problem as to which there has been considerable litigation, and some change of view by the Supreme Court, is as to the necessity of a state making allowance in imposing such taxes for holdings by the taxed corporation of federal securities. Without hitherto questioning that such bonds or the interest therefrom are wholly exempt from state taxation, the Court now seems committed to the proposition that no such allowance needs to be made by the states, so that the tax may be computed without reference to the fact that part of the corporate assets consisted of such tax exempt bonds.<sup>45</sup> The same rule is applied even to national banks, so long as the state tax does not exceed the limitations set by the federal statute<sup>46</sup>—a problem which will be referred to later. On the other hand, the Court has insisted that a property tax imposed by a state upon national banks must make allowance for the federal bonds held by such bank, by deducting their value from the property taxed.<sup>47</sup> The Court conceded that a franchise tax could be imposed without this allowance, and also that the economic effect of such a franchise tax would be identical with a property tax, but insisted that "The question here is one of power, and not of economics."

It seems, however, that this last doctrine should not be taken too seriously. In the nearly forty years since the case above referred to was decided, the Court has come to recognize that the problem of taxation in intergovernmental relations is always

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45. *Cleveland Trust Co. v. Lander* (1902) 184 U. S. 111; *Pacific Co. Ltd. v. Johnson* (1932) 285 U. S. 480, which in effect overrules *The Macallen Co. v. Massachusetts* (1929) 279 U. S. 620.

46. *Van Allen v. The Assessors* (U. S. 1866) 3 Wall. 573.

47. *Home Savings Bank v. Des Moines* (1907) 205 U. S. 503.

primarily one of economics. Furthermore, the states can always avoid the effect of this doctrine, so far as it is still recognized, merely by designating their tax as an excise rather than a property tax.

Where federal bonds are not involved, no serious difficulties seem to have arisen. The federal government can impose an excise tax measured by income upon corporations formed under state laws;<sup>48</sup> and the states may similarly tax income derived in part from operation under federal privileges,<sup>49</sup> and may apparently actually impose a property tax upon at least some federal franchises.<sup>50</sup> The problem of corporate excise and similar taxes in governmental relations seems therefore essentially solved.

#### SITUATIONS WHICH ARE STILL UNSATISFACTORY

If the foregoing were all of the questions of intergovernmental taxation, there would clearly be no need to consider a constitutional amendment. Most of these problems were solved without the doctrine of the *O'Keefe* case; and that case has apparently solved all the others. Such immunity as still exists, like the freedom from federal income tax of interest on state and municipal bonds, is probably purely statutory, and can be readily ended by action of Congress and the state legislatures.

Nevertheless, certain problems still exist, and may become serious. They mostly concern federal taxation which might become unfairly retroactive, or worse still, might burden the states without permitting a corresponding burden upon the federal government, with the inevitable consequence of gradually strangling state governmental action or even existence. It is here, if anywhere, that the necessity of further protection of the individual taxpayers but more primarily of the states may appear.

First as to retroactivity. It seems to be well-settled law that claims for taxes are not subject to general statutes of limitations, and that they are not barred by lapse of time, unless so provided in the tax statute.<sup>51</sup>

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48. *Flint v. Stone Tracy Co.* (1911) 220 U. S. 107. While the tax here approved was essentially a corporate income tax, it was passed prior to the adoption of the Sixteenth Amendment, and was therefore sustainable only as an excise tax with respect to the corporate franchise.

49. *Educational Films Corp. v. Ward* (1931) 282 U. S. 379, holding that a state income tax may properly include in its measure, royalties derived from copyrights.

50. *Central Pac. R. R. v. California* (1896) 162 U. S. 91; but see, *California v. Central Pac. R. R.* (1888) 127 U. S. 1.

On this theory, there would seem to be nothing to prevent Congress from imposing an income tax retroactive to 1913<sup>52</sup> upon salaries paid by states and their agencies, and presumably exempt up to 1939. This would certainly be an intolerable burden, and would popularly be regarded as a denial of due process, contrary to the Fifth Amendment. Nevertheless, the chance of sustaining a legal argument to this effect would not be particularly promising. In the first place, all such salaries have always been taxable—or so the Supreme Court has now decided in the *O'Keefe* case. In the second place, a state income tax retroactive for more than two years was sustained in the recent case of *Welch v. Henry*,<sup>53</sup> even though this kind of income was clearly non-taxable when received. The Court in reaching this conclusion said,

If such changes are forbidden in the name of equal protection, legislatures in laying new taxes would be left powerless to rectify to any extent a previous distribution of tax burdens which experience had shown to be inequitable, even though constitutional.<sup>54</sup>

While this case involved the Fourteenth rather than the Fifth Amendment, it may at least be said that the requirements of due process with respect to the federal government are not more stringent than those applicable to the states.

Mr. Justice Butler in his dissenting opinion in the *O'Keefe* case clearly brought out this point by saying,

Thus now it appears that the United States has always had power to tax salaries of state officers and employees and that similarly free have been the States to tax salaries of officers and employees of the United States. The compensation for past as well as for future service to be taxed and the rates prescribed in the exertion of the newly disclosed power depend on legislative discretion not subject to judicial revision.<sup>55</sup>

It may be said that Congress has since the decision in the *O'Keefe* case definitely removed this danger and shown its unwillingness to impose the tax retroactively by passing the "Public Salary Tax Act of 1939," which imposes a federal income tax upon state salaries only beginning January 1, 1939. Undoubtedly

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51. See 3 Cooley, *Taxation* (4th ed. 1924) 2640, sec. 1338.

52. The date of the coming into effect of the Sixteenth Amendment.

53. (1938) 305 U. S. 134.

54. 305 U. S. at 145.

55. (1939) 306 U. S. 492, 493.

this is a fair solution; but just as clearly it may be changed by a later Congress. Nevertheless, it may perhaps be conceded that the danger of this is not sufficient to justify undertaking the burden necessarily involved in drafting a constitutional amendment and getting it adopted.

Not so satisfactory, however, is the situation with respect to federal income tax upon interest on state and municipal bonds. These have for more than a quarter of a century been regularly issued as exempt from federal income tax. Furthermore the statute so provided, and still so provides.<sup>56</sup> Congress has been urged to change the law, and sooner or later it probably will—and probably should.

There is perhaps no serious danger that Congress will attempt to impose a tax upon the interest already received from such bonds. The excellent precedent of the statute with respect to salaries will not improbably be followed. But if Congress should do so, what has already been said makes it extremely doubtful whether the courts could interfere.

But the real danger is that Congress may attempt to impose a federal income tax upon interest received in the future on outstanding state and municipal bonds. Indeed one academic authority has urged that this be done,<sup>57</sup> admitting that it is unethical, but claiming that it is economically desirable.

The author is not prepared to argue against the economic desirability of such a procedure, and, for reasons already stated, he is still less inclined to attack its validity. He does feel, however, that such a procedure would be not merely unethical, but, to use a blunter word, definitely dishonest. That governments can be dishonest, and that there is little judicial remedy for governmental dishonesty has been demonstrated again and again, and not merely in recent years. It is submitted therefore that temptation to such dishonesty should be removed by a constitutional amendment definitely permitting state salaries to be taxed by the federal government and federal salaries to be taxed by the state governments from and after January 1, 1939, only; and permitting the taxation of interest on state and municipal bonds by the federal government only with respect to bonds issued

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56. Internal Rev. Code (1939) 53 Stat. 10, sec. 22b (4).

57. Schultz, Tax Exemption of Government Securities (1939) 17 Tax Mag. 331.

after the adoption of the amendment, with a corresponding provision as to taxation by states of interest on federal bonds.

But the dangers of retroactivity, as real as they seem to be, are not so great, nor so menacing, as the danger that the federal government's power of taxation will be extended to state salaries and securities, whereas the states' power of taxation will not be correspondingly extended to federal salaries and securities. In the discussion thus far, it has been assumed that the states and the national government have been correspondingly limited in their respective taxing powers by the intergovernmental doctrines, and that the extension of the federal taxing power to reach state functions would necessarily involve a corresponding extension of state taxing power to reach federal functions. However, an examination of the authorities shows that this assumption is by no means dependable or accurate.

It is obvious that constitutional grants to the federal government necessarily involve a corresponding diminution of the sovereign power of the states.<sup>58</sup> It may well be that this will involve state taxing power as well as other functions. Nevertheless, one would naturally assume that whatever immunities from state taxation are granted to the federal government would be reflected in a corresponding immunity of state functions from federal taxation; otherwise the federal government may be able through the use of its taxing power to destroy the states.

The doctrine that the immunities of taxation are not mutual but are primarily for the benefit of the federal government began, like many of the doctrines with regard to taxation in intergovernmental relations, with Mr. Chief Justice Marshall's opinion in *M'Culloch v. Maryland*.<sup>59</sup> He argued that the federal taxing power was more extensive than that of the states, since when Congress imposes a tax it acts upon its own constituents (which include, of course, all the citizens of the states), whereas when a state taxes in such a way as to affect the national government, it is burdening others than its own constituents—to wit, citizens of other states. This argument is certainly more theoretically correct than justified by experience; and it was a pure dictum, the case not in the least involving this question.<sup>60</sup> Nevertheless,

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58. *United States v. California* (1936) 297 U. S. 175.

59. (U. S. 1819) 4 Wheat. 316.

60. The state tax there invalidated was certainly unconstitutional, as discriminating against federal agencies.

it has had frequent, though indecisive, recognition by the Court, and was so recognized even in the *O'Keefe* case, where the question whether Congress could, by explicit language, protect the employees of this or any other federal governmental agency from state taxation was explicitly reserved, the Court merely holding that Congress had not sought to do so.

As already said, there appears to be little definite authority in the decisions of the Supreme Court in favor of this theory. Perhaps the decision in *University of Illinois v. United States*,<sup>61</sup> holding that the federal government can impose custom duties upon articles imported by states for educational purposes, might be regarded as an assertion of federal supremacy; but the Court purports to rest upon the theory that custom duties are not a tax but a regulation of commerce. This reasoning does not seem impressive, but it at least prevents the case being cited as a square authority for federal supremacy. Nevertheless, the assertion of such federal supremacy is occasionally made by federal administrative officers;<sup>62</sup> and the overruling by the *O'Keefe* case of *Collector v. Day*<sup>63</sup> might possibly be regarded as an implied argument in favor of judicial assertion of federal supremacy, in view of the fact that that case definitely disapproved the doctrine, as is shown by the reliance on it in the dissenting opinion of Mr. Justice Bradley.

As against this very dubious assertion of such federal supremacy, at least as inherent and irrespective of congressional statutes, there are a number of court decisions which expressly or by clear inference disregard Marshall's alleged distinction. An excellent example of the usual attitude of the court is shown in the following quotation from *Metcalf & Eddy v. Mitchell*.<sup>64</sup>

But neither government may destroy the other nor curtail in any substantial manner the exercise of its powers. Hence, the limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both to function with the minimum of interference each with the other; and that limitation cannot be so varied or extended as seriously to impair either the taxing power of the government imposing the tax [citing

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61. (1933) 289 U. S. 48.

62. See Shaw, Recent Cases on the Doctrine of Intergovernmental Tax Immunity (1938) 8 Brooklyn L. Rev. 38.

63. (U. S. 1871) 11 Wall. 113.

64. (1926) 269 U. S. 514.

cases] or the appropriate exercise of the functions of the government affected by it.<sup>65</sup>

There is similar language in *Brush v. Commissioner of Internal Revenue*,<sup>66</sup> which, while probably overruled, has never been criticized on this basis. And in *Willcuts v. Bunn*,<sup>67</sup> holding that the federal government may impose an income tax upon the profits of sale of municipal bonds, Mr. Chief Justice Hughes remarked that several states had filed briefs arguing for the validity of such a tax, in order that they might severally have the power to impose a similar tax upon profits from the sale of federal bonds. The Court seems clearly to have recognized the propriety of the position taken by these states, and therefore to have impliedly but rather definitely repudiated Marshall's contention. If it were not then for the difference which arises, or seems to arise, when Congress expressly claims such immunity, this doctrine might probably be safely dismissed.

As already indicated, the Court has very much limited the immunity of the states and their agencies from federal taxation, even in the days of fullest recognition of such immunity, by decisions that it was not applicable to business as distinguished from governmental activities of the states. While the possibility of this limitation has long been recognized,<sup>68</sup> it does not appear to have been actually applied until the beginning of the present century, when the Court held in *South Carolina v. United States*<sup>69</sup> that a state was subject to the federal excise tax upon liquor used in a state dispensary system which had a monopoly of liquor distribution within the state. The Court conceded that this was a lawful exercise of state powers, but insisted that it was not strictly a governmental activity. The soundness of this contention is rendered somewhat questionable by a later decision<sup>70</sup> holding that the same state could not be sued for liquor supplied to it by the plaintiff for use in the state dispensary, on the ground that such a suit would be against the state, and so contrary to the Eleventh Amendment. *South Carolina v. United States* must

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65. 269 U. S. at 523, 524.

66. (1937) 300 U. S. 352.

67. (1931) 282 U. S. 216.

68. See *United States v. Baltimore & O. R. R.* (U. S. 1873) 17 Wall. 322; *Ambrosini v. United States* (1902) 187 U. S. 1.

69. (1905) 199 U. S. 437.

70. *Murray v. Wilson Distilling Co.* (1909) 213 U. S. 151.

rest primarily upon the argument that any other result would unreasonably hamper the federal taxing power; but at any rate, its doctrine is in good standing, having recently been reiterated by the Court.<sup>71</sup>

The decision in *Helvering v. Powers*<sup>72</sup> that trustees operating an interurban railroad for a state, were subject to federal income tax upon their salaries rests upon similar grounds. Of course, there would be no argument as to this case under the *O'Keefe* decision; but the *Powers* case was decided when the court assumed that salaries paid by a state to employees in strictly governmental functions were exempt. The theory upon which the decision rests is that the state was operating a private business. While the operation of a railroad or other utility seems to be less strictly a governmental function than a liquor monopoly—which is clearly operated primarily for the protection of public safety and morals—yet there seems an obvious impropriety in the state's carrying on a purely private business. It is obvious that where a state validly operates a utility, it acts for the public benefit,<sup>73</sup> and that here again the justification, if any, of the federal tax is that otherwise there would be danger of too great a limitation on the federal taxing power.

Perhaps this doctrine is best explained in the recent decision of *Allen v. Regents of the University System of Georgia*,<sup>74</sup> holding that a federal admission tax could be collected on admissions to athletic contests of state universities. Here the Court conceded, as it clearly was compelled to, that education is a usual and probably necessary state function, but it contends that athletic activities constitute a private business conducted in competition with private interests. Again the Court pointed out that to prohibit the tax would unduly limit the federal taxing power.

This is all very well so far as the federal taxation of state activities is concerned; but does the rule work both ways? In other words, do the states have the same power to tax the non-governmental activities of the federal government that the latter government has to tax the non-governmental activities of the

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71. *Ohio v. Helvering* (1934) 292 U. S. 360.

72. (1934) 293 U. S. 214.

73. See *Brush v. Comm'r of Int. Rev.* (1937) 300 U. S. 352, holding that a city in operating a water system acts in a strictly governmental function.

74. (1938) 304 U. S. 439.

states? This is simply another way of asking the question whether there can be any constitutional activities of the federal government which the Court will be willing to recognize as non-governmental?

It is not easy to give a categorial answer to these questions, especially in this period of radical change of supposedly fundamental constitutional doctrines with respect to this whole matter.<sup>75</sup> Nevertheless, such data as we have indicates at least a strong possibility that these questions are to be answered in the negative, and therefore that there will be no such extension of the state taxing power as has been given through this theory to the federal taxing power. This is extremely important, since, as has been shown, the only real justification for this extension of the federal taxing power is its protection from destruction by expanding state activities. If the states are deprived of the same protection from the destruction of their taxing power through expanding federal activities—which obviously no one can contend is a mere theoretical danger at present—the state taxing powers are in even greater danger. Certain it is, that the Court has never subjected the federal government or its agencies to state taxation upon the avowed theory that the particular federal activity concerned was non-governmental. This is perhaps not completely decisive, since it could perhaps be said that it is only comparatively recently that the federal government has engaged in activities which can reasonably be argued to be non-governmental. But the Court has frequently used language which has indicated that this problem was being considered by it, and that it was of the opinion that all valid federal activity is necessarily governmental and therefore at least potentially free from state taxation. Thus in invalidating a state tax upon property bought in by the federal government on sales for delinquent federal taxes, the Court said “The United States do not and cannot hold property, as a monarch may, for private or personal purposes.”<sup>76</sup> Even more specifically, Mr. Justice Bradley in his dissenting opinion in *Union Pacific R. R. v. Peniston*,<sup>77</sup> after quoting from the opinion of Mr. Chief Justice Marshall in *M'Culloch v. Maryland*,<sup>78</sup> said:

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75. See Note (1936) 49 Harv. L. Rev. 1323.

76. *Van Brocklin v. Tennessee* (1886) 117 U. S. 151, 158.

77. (U. S. 1873) 18 Wall. 5.

The suggestion of Chief Justice Marshall in the above quotation, that Congress cannot create any corporations except for public and national purposes, is worthy of particular notice. The inference is obvious, that any corporation rightfully created by Congress, being necessarily public and national in its object, is beyond the reach of State taxation. That suggestion, it is true, was made in reference to a corporation established for business purposes within the States of the Union. And in such a case, it is evident that the proposition must be true, namely, that Congress cannot create a corporation except for a public and national purpose.<sup>79</sup>

The majority opinion in this case did not in any way controvert this language, but merely held that the railroad company, whose immunity from state property tax was asserted on the ground that it was an agent of the United States, was actually subjected to state taxation by the applicable Congressional statute.

In *New York ex rel. Rogers v. Graves*<sup>80</sup> the Court invalidated a state income tax upon the general counsel of the Panama railroad, all the stock of which was owned by the government. The railroad was operated by the government primarily in connection with the Panama Canal, but did a large amount of transportation business for private interests. It would seem that this was a case which approached much nearer to ordinary commercial activity than the South Carolina liquor dispensary already referred to.<sup>81</sup> Yet the Court held that the commercial business of the railroad was purely incidental and that it must be regarded as a governmental activity, so that its employees were wholly exempt from state taxation on their salaries. Furthermore, the overruling of this case by the *O'Keefe* case does not in any way effect the force of the holding that the federal operation of the road was a strictly governmental function.<sup>82</sup> The inference

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78. (U. S. 1819) 4 Wheat. 316.

79. (U. S. 1873) 18 Wall. 5, 43.

80. (1937) 299 U. S. 401.

81. *South Carolina v. United States* (1905) 199 U. S. 437, cited *supra*, note 69.

82. It is stated that this case, and *Collector v. Day* (U. S. 1871) 11 Wall. 113, "are overruled so far as they recognized an implied constitutional immunity from income taxation of the salaries of officers and employees of the national or a state government or their instrumentalities." (1939) 306 U. S. 466, 486. Thus no point is made of any supposed difference in the nature of federal functions.

is permissible that all federal activities are at least potentially governmental.<sup>83</sup>

As has been stated, the Court does incline to construe against immunity even of federal agencies from state taxation and other state-imposed liabilities;<sup>84</sup> but there is a far stronger tendency to hold that Congress may completely exempt all federal agencies (and even their securities and employees) from state taxation, at least so far as the agencies are engaged in governmental activity—and this, in the light of the previous discussion, is a condition which is probably always complied with.

The problem was early considered in connection with national banks. Such banks were by federal statute exempted from all state taxation except such as was explicitly permitted. The scope of permitted state taxation has been somewhat extended in recent years; but the Court has steadily adhered to the idea that the immunity is complete except where done away with by express permission of Congress.<sup>85</sup> Thus in the early case of *Van Allen v. The Assessors*,<sup>86</sup> where the Court sustained a state tax on national banks because expressly permitted by Congress, it reasoned as follows:

It is said that Congress possesses no power to confer upon a State authority to be exercised which has been exclusively delegated to that body by the Constitution, and, consequently, that it cannot confer upon a State the sovereign right of taxation; nor is a State competent to receive a grant of any such power from Congress. We agree to this. But as it respects a subject-matter over which Congress and the States may exercise a concurrent power, but from the exercise of which Congress, by reason of its paramount

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83. The language of Mr. Justice Stone in the O'Keefe case is pertinent on this point, and seems to support this theory. He said: "As that [i. e. the federal] government derives its authority wholly from powers delegated to it by the Constitution, its every action within its constitutional power is governmental action, and since Congress is made the sole judge of what powers within the constitutional grant are to be exercised, all activities of government constitutionally authorized by Congress must stand on a parity with respect to their constitutional immunity from taxation." (1939) 306 U. S. 466, 477. And see for a discussion of the extreme claims of immunity from state taxation and of power to tax the states themselves, made in behalf of the federal government, Tobin, *Federal Taxation of State and Local Bonds* (1939) 17 Tax Mag. 621.

84. *Federal Land Bank v. Priddy* (1935) 295 U. S. 229. See also *Alward v. Johnson* (1931) 282 U. S. 509 holding that a state gross receipts tax may be imposed upon receipts from carrying mails.

85. *Owensboro Nat'l Bank v. Owensboro* (1899) 173 U. S. 664.

86. (U. S. 1866) 3 Wall. 573.

authority, may exclude the States, there is no doubt Congress may withhold the exercise of that authority and leave the States free to act. \* \* \* The power of taxation under the Constitution as a general rule, and as has been repeatedly recognized in adjudged cases in this court, is a concurrent power. The qualifications of the rule are the exclusion of the States from the taxation of the means and instruments employed in the exercise of the functions of the Federal Government.<sup>87</sup>

The same rule has been applied to an island possession of the United States in *Domenech v. National City Bank of New York*,<sup>88</sup> where the Court, in invalidating certain taxes imposed by Puerto Rico on a branch of a national bank said with reference to taxation by United States possessions:

Like a state, though for a different reason, such an agency may not tax a federal instrumentality. A state, though a sovereign, is precluded from so doing because the Constitution requires that there be no interference by a state with the powers granted to the federal government. A territory or a possession may not do so because the dependency may not tax its sovereign. True the Congress may consent to such taxation; but the grant to the Island of a general power to tax should not be construed as a consent.<sup>89</sup>

It seems clear therefore that the Court still adheres to its position that the states have no power to tax national banks, their securities or their employees, except with the permission of Congress. The same rule has been applied to the securities of banks organized under the Federal Farm Loan Act.<sup>90</sup> And the Court has gone so far as to sustain the congressional exemption of United States notes from state taxation, though admitting that these notes were equivalent in economic effect to money, and further admitting that there was no doubt of the power of the states to tax ordinary currency.<sup>91</sup>

In *Federal Land Bank v. Crosland*<sup>92</sup> the Court sustained a federal statute providing that mortgages to federal land banks are exempt from taxation by the states, and applied it so as to invalidate a state recording tax with respect to such mortgages.

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87. 3 Wall. 535.

88. (1935) 294 U. S. 199.

89. 294 U. S. 205.

90. *Smith v. Kansas City Title & Trust Co.* (1921) 255 U. S. 180.

91. *Bank v. Supervisors* (U. S. 1869) 7 Wall. 26.

92. (1923) 261 U. S. 374

This doctrine was reiterated as to the Home Owners' Loan Corporation in *Pittman v. Home Owners' Loan Corporation*,<sup>93</sup> decided in November, 1939, several months after the decision in the *O'Keefe* case. The Court pointed out, what has already been stated here, that the *O'Keefe* case explicitly reserved the question of the power of Congress to exempt employees of this corporation from state income taxes, and was so decided only because Congress had not exercised this power. As respects mortgages to federal land banks and the Home Owners' Loan Corporation, the Congressional power of exemption had been exercised, and the Court again directly held that such an exemption is entirely within the power of Congress. Accordingly there appears to be no reason why Congress cannot exempt all federal agencies, their employees, and their securities, from state taxation.

Furthermore, such extension of federal exemption has been by no means unheard of in the past—including the rather immediate past. The most striking example appears in connection with the decision of *Baltimore National Bank v. State Tax Commission of Maryland*.<sup>94</sup> This case decided that the Reconstruction Finance Corporation was clearly a federal agency, but it further held that express subjection by Congress of national bank stock to state taxation included all such stock by whomsoever held. However, since the Court conceded that its holdings could be exempted from state taxation, Congress promptly passed a statute<sup>95</sup> exempting national bank stock held by the Reconstruction Finance Corporation from state taxation, thereby extending the exemption beyond that decided by the Court to already exist; and the validity of this statute seems indisputable.

The result is that there is at least a strong argument that Congress has power to wholly exempt all federal agencies, their securities, and their employees, from state taxation. While it does not seem probable that Congress will, at least immediately, exercise this power to the full, past Congressional practice indicates that it will be availed of to a considerable, and perhaps to an alarming, extent.<sup>96</sup> And on the other hand, the present point

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93. (1939) 60 S. Ct. 15.

94. (1936) 297 U. S. 209.

95. (1936) 49 Stat. 1185, c. 160, 12 U. S. C. A. sec. 51d.

96. See *United States v. Board of Commissioners (D. C. N. D. Okla. 1939)* 26 F. Supp. 270.

of view of the Supreme Court is to invalidate any attempt by the states to exempt from federal taxation even direct state activities, at least so far as they are what is regarded as non-governmental, and their employees and possibly securities even when the activities are strictly governmental.<sup>97</sup> To be sure, it seems probable that the federal government cannot in taxing such state functions formally discriminate against the states; that it to say, the tax upon the states and their agencies cannot be at a higher rate than that applicable to private interests engaged in comparable activities. But this protection against discrimination is largely nugatory if, as seems to be the case, the federal government can completely exempt its own instrumentalities. It is not solely a matter of fairness; it is a matter which involves the efficiency of state action, and indeed the very existence of the states. Subjection of state activities to federal taxation coupled with federal immunity from state taxation, if it is carried to the full and lasts long enough, would mean such limitation of state taxing power as to make it impossible for state governments to continue. All of the recent activity of the Supreme Court to extend state taxing power by permitted multiple taxation will not save them,<sup>98</sup> particularly as such multiple taxation can for the most part be readily avoided by taxpayers. This is an impasse from which it appears that only a constitutional amendment can save us. It is submitted therefore that a constitutional amendment is needed, not to subject state activities to non-discriminatory federal taxation, for this seems to be the law now and probably should be, but rather to prohibit the federal government from exempting its own agencies, employees, and securities from non-discriminatory state taxation. Whatever theoretical justification there may be for federal supremacy must give way to its practical incompatibility with the continued activities and even existence of the states.

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97. See Stokes, *State Taxation and the New Federal Instrumentalities* (1936) 22 *Iowa L. Rev.* 39; Freedman, *Government-owned Corporations and Intergovernmental Tax Immunity* (1938) 24 *WASHINGTON UNIVERSITY LAW QUARTERLY* 43. An excellent argument (but of questionable validity) against the power of Congress wholly to exempt federal corporations and their securities from state taxation is Walsh, *Taxation of Governmental Corporations Engaged in Business Within the States* (1939) 17 *Tax Mag.* 570.

98. See *Curry v. McCanless* (1939) 307 U. S. 357; *Graves v. Elliott* (1939) 307 U. S. 333.

One other problem remains in the matter of governmental taxation; and this problem is becoming extremely insistent in this period of extending federal activities. This is the problem of property taxes.

At first sight, it may seem that there is actually no problem of the relation between the states and nation as respects this form of taxation. This is because the federal government has practically no power to impose property taxes at all. The reason is that a property tax is a direct tax and must be apportioned according to population;<sup>99</sup> a requirement which is practically impossible to comply with.<sup>100</sup>

It would seem then that since the federal government has really no power to impose property taxes, whereas the states have virtually unlimited power to impose them, there is no unfairness to the states in being compelled to exempt the property of the federal government and its agencies from state taxation. It may thus be urged that this exemption is only a partial one, whereas the exemption from federal taxation is substantially total. The answer that the limitation inheres in the constitutional powers of the federal government rather than as an aspect of intergovernmental relations, does not seem very convincing. But when one looks at the actual facts as to how this exemption of federal property is working, he is forced to conclude that it is in fact an even more serious menace to effective state government than the possibility of exemption of federal agencies from state taxation of other forms, which has already been discussed.

There can be no question that property of the United States government is entirely exempt from state taxation of any sort.<sup>101</sup> The rule applies irrespective of any Congressional statute; indeed there might be some question as to whether such property could be subjected to state taxation even with the express consent of Congress.<sup>102</sup> Where the property is owned by private interests,

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99. See U. S. Const. Art. I, sec. 2, par. 3; Art. I, sec. 9, par. 4.

100. During the Civil War and Reconstruction Period, this limitation seems to have been partly evaded in the South. See *Van Brocklin v. Tennessee* (1886) 117 U. S. 151. It is probable that such a "tax," if sustainable at all, must rest on the war rather than the taxing power.

101. *McGoon v. Scales* (U. S. 1870) 9 Wall. 23; *Van Brocklin v. Tennessee* (1886) 117 U. S. 151.

102. But cf. the quotation from *Van Allen v. The Assessors* (U. S. 1866) 3 Wall. 573, cited note 87, *supra*.

but the United States has a lien or other security interest in the property, the property is taxable, but the taxes cannot be a lien upon the interest of the federal government.<sup>103</sup> Even where the property is being retained by the federal government after its own use of the property has been abandoned, and is being leased to private interests, the immunity from state taxation still continues.<sup>104</sup>

As to Indian lands, where the federal title, if still maintained, is merely for the protection of the Indians, the rules are not so rigid. It seems clear that such property is not necessarily exempt from federal taxation, in the absence of express provision in a federal statute providing for such exemption.<sup>105</sup> The Court has frequently pointed out that states having a large Indian population would be distinctly embarrassed by having all such property non-taxable; and accordingly has tended to construe federal statutes according such exemption rather strictly.<sup>106</sup> Nevertheless, there is no doubt of the power of Congress to fully exempt Indian land and other property from federal taxation; and such power is occasionally still exerted.<sup>107</sup>

Still less rigid is the rule as to immunity of agents of the United States from the burden of property taxation. This problem arose many times in connection with the property of trans-continental railroads, which were constructed with government subsidies, and might well be regarded, at least for some purposes, as federal government agencies.

The court early took the position that the property of such agencies was not exempt from federal taxation in the absence of express Congressional statutes. The reasoning of the court is very similar to that with respect to Indian property and is well shown in the following quotation from an early case:<sup>108</sup>

We perceive no limits to the principle of exemption which the complainants seek to establish. It would remove from the reach of State taxation all the property of every agent

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103. *Forbes v. Gracey* (1877) 94 U. S. 762.

104. *Springfield v. United States* (C. C. A. 1, 1938) 99 F. (2d) 860, cert. den. (1939) 306 U. S. 650.

105. *Shaw v. Gibson-Zahniser Oil Corp.* (1928) 276 U. S. 575.

106. See *Brown, The Taxation of Indian Property* (1931) 15 Minn. L. Rev. 182.

107. *United States v. Board of Commissioners* (D. C. N. D. Okla., 1939) 26 F. Supp. 270.

108. *Thomson v. Union Pac. R. R.* (U. S. 1870) 9 Wall. 579.

of the government. Every corporation engaged in the transportation of mails, or of government property of any description, by land or water, or in supplying materials for the use of the government, or in performing any service of whatever kind, might claim the benefit of the exemption. The amount of property now held by such corporations, and having relations more or less direct to the National government and its service, is very great. And this amount is continually increasing; so that it may admit of question whether the whole income of the property which will remain liable to State taxation, if the principle contended for is admitted and applied in its fullest extent, may not ultimately be found inadequate to the support of the State governments.<sup>109</sup>

The same rule applied even though the railroad corporation was formed under a federal statute rather than under state law.<sup>110</sup>

Even though federal property has not yet been conveyed to the railroad corporation, but the railroad has completely fulfilled the conditions under which the land has been promised to it, the land is subject to state taxation. The title of the United States under these conditions is a bare legal title.<sup>111</sup> If, however, the government has some interest in the property, even though it has been already conveyed to the railroad, the government's interest is non-taxable and cannot be affected by the lien of delinquent taxes on the interest of the railroad.<sup>112</sup> The same rules have been applied to homestead land, where the homesteader had received a conveyance, but had not yet fulfilled the conditions necessary for receiving an absolute title.<sup>113</sup> And it has been held that where the United States Housing Corporation, a wholly owned federal agency, had sold residence property to private individuals, and these individuals were entitled to a deed, such property was subject to city taxes; but the lien of such taxes could not affect or encumber the right of the governmental agency to recover the balance of the purchase price.<sup>114</sup>

Several cases just cited indicate that property taxes on gov-

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109. 9 Wall. at 591, 592. As will presently appear, this language is even more apposite to present conditions than to those when the decision was rendered.

110. *Union Pac. R. R. v. Peniston* (U. S. 1873) 18 Wall. 5.

111. *Tucker v. Ferguson* (U. S. 1875) 22 Wall. 527.

112. *Wisconsin Cent. R. R. v. Price County* (1890) 133 U. S. 496.

113. *Irwin v. Wright* (1922) 258 U. S. 219.

114. *New Brunswick v. United States* (1928) 276 U. S. 547.

ernmental agencies may be sustained in so far as they burden only private interests, including individual investors in such agencies; but they are not sustained when they are a direct burden upon the federal agency itself.<sup>115</sup> Perhaps this is not an invariable rule, at least in the absence of an express provision in a federal statute. But the court has held that a tax upon the property of a governmental agency which is regarded as a mere instrumentality of the government itself is invalid even without express Congressional claim of exemption.<sup>116</sup> The court suggested that a mere agent might not perhaps be entitled to such an absolute exemption.

The distinction between an "instrumentality" and a "mere agent" is obviously somewhat tenuous. Perhaps it might give some hope of sustaining such a distinction between governmental and non-governmental purposes as has been used to limit state exemption from federal taxation; but this seems rather improbable.<sup>117</sup> Certain it is that the Court has hitherto held, with apparent invariability, that any agent of the United States may be wholly exempted by Congress from state taxes of any sort, including property taxes.<sup>118</sup> This doctrine has been emphatically reiterated by the Court in a decision<sup>119</sup> the opinion in which expressly considers the *O'Keefe* case and holds that it has not changed the old rule.

Furthermore, Congress has been expanding the scope of this property tax immunity almost as rapidly as it has been expanding federal instrumentalities in the past few years. Recent Congresses have apparently almost lost sight of the embarrassment to the states in heavy losses of their taxing power through the acquisition by such agencies of the large amounts of their property. A conspicuous example is the Tennessee Valley Authority which has well-nigh wiped out taxable property in large

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115. See cases cited in notes 112-114, *supra*.

116. *Clallam County v. United States* (1923) 263 U. S. 341.

117. No distinction of this sort seems to be made as to independent contractors, *James v. Dravo Contracting Co.* (1937) 302 U. S. 134.

118. The suggestion by Freedman, *Government-owned Corporations and Intergovernmental Tax Immunity* (1938) 24 WASHINGTON UNIVERSITY LAW QUARTERLY 46, that the states could tax bonds of the federal government and its agencies as property, seems very doubtful, even under existing law. At any rate such bonds are usually explicitly exempted from state taxation, and will no doubt continue to be.

119. *Pittman v. Home Owners' Loan Corp.* (1939) 60 S. Ct. 15, following *Federal Land Bank v. Crosland* (1923) 261 U. S. 374.

areas in eastern Tennessee and adjoining states where its operations are carried on, even in one or two cases taking practically entire counties.<sup>120</sup> The United States Housing Authority has deliberately encouraged many cities to give up their taxing powers on new dwellings, in consideration of grants from it; an exchange which is submitted to be shortsighted, and may well turn out to be ruinous.

These examples are conspicuous, but are by no means the whole story. The present position of the federal government apparently is that all such property of federal agencies is necessarily, and without express Congressional provision, exempt from state taxation.<sup>121</sup> Whether this is so or not seems of little importance, if such exemption can be obtained by Congressional provision therefor; since such provisions are usual and if accidentally omitted can probably readily be obtained.

The question as to property taxes thus comes ultimately to pretty much the same problem as to other forms of state taxation; that is to say, can Congress wholly exempt itself and its agents from the burden of such taxes? The only difference is that the danger of exemption from other forms of taxation, while undoubtedly very real, has not yet done much actual harm; the exemption from property taxes is already embarrassing and is in some instances almost completely wiping out property taxation in some localities. This is a situation which demands an immediate remedy, and a constitutional amendment seems to be the only solution.

It may be urged that the states and their local agencies have depended too much upon property taxes, and should develop other forms. This is undoubtedly true; but states and localities must at best continue to depend quite largely upon the property tax, since this is the only tax which is not subject to the competition of the federal government. Furthermore, there is no assurance that any other form of tax will be any safer from being injured by federal immunity than is the property tax.

In his concurring opinion in the *O'Keefe* case, Mr. Justice Frankfurter suggested that the question whether Congress could

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120. See the *New York Times*, Dec. 5, 1939, p. 30.

121. See the summary of the report of the Conference on State Defense in (1939) 24 *Bull. of Nat'l Tax Ass'n* 102. See also, Tobin, *Federal Taxation of State and Local Bonds* (1939) 17 *Tax Mag.* 621.

give the total exemption to its "functionaries," denied in that case because of the absence of an express statutory provision, "is matter for another day."<sup>122</sup> It is suggested, however, that the court has in *Pittman v. Home Owners' Loan Corporation*,<sup>123</sup> already reached that other day and answered the question. Even if this is not so, it still appears that there is every probability that the Court will answer the question in the way suggested by that case, and will hold that Congress may exempt its "functionaries," individual or otherwise, from all forms of state taxation. Furthermore, it is evident that Congress in its present mood, is not unlikely to exercise this power to an extent which, while probably not complete, will be sufficient to ruin state activity. If this is accomplished, no efforts to preserve the states will be successful; for a government without taxing power cannot govern, and (since government must go on) the function will necessarily be taken over by the national government.

#### CONCLUSION

It must be concluded that a constitutional amendment is unnecessary if Congress could be depended on to maintain a reasonable equivalency between federal and state taxing power. But Congress cannot be depended on for this; in fact we have some rather menacing situations already. As it now stands, the Supreme Court has (probably wisely) taken away most, if not all, of the implied tax immunities of both states and nation; but it seems unable, at least under any doctrine which has yet appeared, to prevent the destruction of state taxing power by federal immunities expressly provided for and which are no longer available to the states.

It must be conceded that the drafting of a constitutional amendment to cover this situation would be extremely difficult.<sup>124</sup> However, this is all the more reason why work on this task should be begun very promptly. The longer we wait, the more serious the situation is likely to become, and the poorer the chance of saving effective state taxing power.

It is submitted that the proposed constitutional amendment should cover three separate points, as follows:

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122. (1939) 306 U. S. 466, 492.

123. (1939) 60 S. Ct. 15. See discussion of this case *supra*, p. 179.

124. See Shaw, Recent Cases on the Doctrine of Intergovernmental Tax Immunity (1938) 8 Brooklyn L. Rev. 38.

- (1) prevention of retroactivity;
- (2) definite permission to the states to impose non-discriminatory taxes on the activities and securities of the federal government and its agents and the salaries paid by them; and similar permission to the federal government to tax state operations, securities and salaries; and
- (3) permission to the state to impose non-discriminatory property taxes upon the property of the federal government and its agents.

The problem of retroactivity is concerned mostly with the income tax, and, as already said, is probably not serious enough of itself to justify a constitutional amendment. However, if, as seems probable, a constitutional amendment is necessary to handle other aspects of this problem, the amendment should certainly cover this point. It should be so drafted as to prevent federal income taxes upon salaries paid by the states and their agencies for periods prior to 1939, and should prevent the taxation of interest on securities of states and their local subdivisions, except those issued subsequent to the date of coming into effect of the amendment. The states should be similarly restricted as to activities, salaries and securities of the federal government and its agencies.

The second matter with which the amendment should deal is closely connected with the first, and may undoubtedly be covered in the same paragraph with it; but it is actually more fundamental. An interesting suggestion<sup>125</sup> has recently been made that the proposed amendment be restricted to income taxes, and be drawn in such a way that all taxes collected by the states with respect to federal salaries and securities be returned to the federal treasury. Similarly, all taxes collected by the federal government with respect to state salaries and securities be returned by that government to the respective state treasuries.

There is much to be said for this suggestion. It would certainly prevent any undue burdening of the states, as seems possible under the present situation. But the author of this suggestion admits that it would give rise to serious difficulties in administration, in view of the differences in rates of tax, and the problems of segregation of taxes to be returned as distinguished from those which are to be kept, where, as frequently happens, a particular taxpayer would have a substantial amount of both kinds

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125. See Bennett, *Income Tax Immunities* (1939) 17 *Tax Mag.* 451.

of income. Furthermore, it would not cover the problem of excise taxes, which are rapidly increasing in importance. It is submitted, therefore, that the more simple solution previously outlined would be preferable. Any attempt by a state to discriminate against federal activities or of the federal government to discriminate against the states would readily be invalidated by the courts even at present; though express provision against discriminatory taxation should undoubtedly be included in the amendment. The real purpose of the amendment is to take away from Congress the power which it apparently now has to exempt federal activities, employees and securities from state taxation.

Perhaps the suggestion that the states should be permitted to tax federal operations may seem a bit startling. It is noticeable, however, that the federal government already claims the right to tax state operations, at least so far as the income tax is concerned.<sup>126</sup> But this problem can perhaps best be considered in connection with the next item which it is contended that the proposed constitutional amendment should cover.

This is the proposition that the states should be permitted to impose a non-discriminatory tax upon the property of the federal government and its agencies. This is not only startling, but, as already admitted, is subject to the theoretical objection that since the federal government has no power to impose any property taxes at all, it would be unfair to it to subject its property to state taxation.

Nevertheless the position is adhered to that such permission of the states to tax federal property would be conducive to actual equality. No one will seriously contend that the federal taxing power is at present unduly limited. If it is, and a property tax is needed, the constitution can be amended on this point, and such an amendment would include power to tax state property. But the federal government seems to be getting along very well (at least so far as raising revenue is concerned) without the power to impose a property tax.

On the other hand, the states and their subdivisions are, and must necessarily be, largely dependent upon the property tax. And the power to lay that tax is not merely menaced, but in many localities largely wiped out, by enormous acquisitions of property by agencies of the federal government, in connection

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126. See Tobin, *Federal Taxation of State and Local Bonds* (1939) 17 *Tax Mag.* 621.

with some of its latest excursions into functions previously regarded as non-governmental. As already pointed out, unless this destruction of state property taxing power is soon checked, local government will completely break down in many areas, and the states themselves will gradually lose the power of operating.

It may still be argued that this power of the states to tax federal property should be limited to property used in functions not admittedly governmental, and should not include such as is used for traditionally federal purposes, such as post-offices, court-houses, military and naval purposes, and others. No doubt there is a reasonable distinction on this ground. It is submitted, however, that any attempt to draft the amendment so as to make this distinction would lead to an insuperable problem of both language and administration. What are traditionally federal functions and what are not is a matter as to which there would be almost as many opinions as the people considering the question; and the burden upon the courts, which would ultimately have to decide such problems, would be almost impossible. Where the property is non-income producing, the property tax burden would not usually be extremely heavy, since the market value of such property would seldom be very great; and where the property earns income, there seems no reason why the federal government should be exempt from the burden of taxes imposed upon private business interests.

It is believed that the steps which the Court has taken to do away with tax immunities in intergovernmental relations are desirable and that no such immunities should exist, provided, of course, that discriminatory taxation should not be permitted. But it seems clear that fairness requires that such changes should not be retroactive. More important, the present situation gives a power to the federal government to retain and even extend the exemption which it has previously enjoyed with respect to state taxation, and thus destroy that equality which the doing away with intergovernmental immunity was supposed to effectuate. Worse still, such a tendency, if unchecked, would ultimately result in the destruction of the state and local governments. If these latter are worth preserving, they are certainly worth the trouble of drafting and putting through a constitutional amendment; this is the only method by which they can certainly, or even probably, be saved from the growing and ultimately destructive effect of federal immunity from taxation.