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# THE FEDERAL CONSTITUTION AND CONTRACT EXEMPTIONS FROM TAXATION

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Exemptions from taxation are found in two forms, either as written into the State Constitution or as enactments of the State legislature. Exemptions set forth in a State Constitution are always subject to amendment or repeal by action of the people in adopting a constitutional amendment or a new constitution. Those granted by a State legislature are also subject to amendment or repeal either by the legislature itself or by the people by amending the State Constitution or adopting a new one, with a single exception. The exception covers exemptions embodied in an act of the legislature which amounts to a contract between the State and the person or corporation to be benefitted, and enactments of the legislature which carry out a contract entered into by the State. Exemptions coming within said exception are not subject to amendment or repeal either by the State legislature or by the people adopting a constitutional amendment or a new constitution. That result follows from the provision of the Constitution of the United States which denies to the States the right to pass laws which impair the obligation of existing contracts.[1]

Claims of exemption from taxation based upon an act of the legislature which constitutes a contract of the State, present a preliminary question as to the power of the legislature to bind the State by such a contract. It is now settled that, in the absence of express constitutional limitation of its power in that

[1] Art. 1, Sec. 10.

respect, the legislature may bind the State by a contract exempting property of an individual or corporation entirely or partially, perpetually or for a limited time. As the early State constitutions contained no express limitations on the legislative power to so contract, the power was indiscriminately exercised in the older States, by special acts creating corporations for all kinds of purposes and granting to them total or limited exemptions from taxation. Then the people began to recognize the necessity of curbing the legislative powers. Constitutional amendments or new constitutions designed to remedy the evil were adopted and the State legislatures in many States attempted to undo their own work. But what had been done could not be undone, as the States cannot pass any laws that impair the obligation of existing contracts. The remedies invoked were effective only as safeguards against future legislative abuse. The efforts of the States to nullify exemptions resting on contracts with a State resulted in litigation for a century, which it is proposed here to trace through the United States Supreme Court Reports.

The first case is *New Jersey v. Wilson.*[2] The Colony of New Jersey having agreed to purchase from the Delaware Indians their lands, and to purchase other lands as a home for the Indians, the colonial legislature in 1758 passed an Act authorizing the purchase by the Colony of certain lands for a new home for the Indians. The Act provided that the lands so purchased for them "shall not hereafter be subject to any tax, any law, usage or custom to the contrary thereof in any wise notwithstanding." In 1801 the legislature of New Jersey passed an Act authorizing the lands so purchased for the Indians to be sold, which was silent as to taxation in case a sale thereof took place. Pursuant to that Act the lands were sold. In 1804 the State legislature repealed the colonial Act of 1758, and then proceeded to assess taxes against them in hands of the purchasers. The State Court held the repealing act of 1804 valid and declared said lands liable to taxation. The United States Supreme Court reversed that judgment, Chief Justice Marshall delivering the opinion, which re-affirmed the doctrine laid down in *Fletcher v. Peck,*[3] that the provision of the United States Constitution prohibiting

[2] (1812) 7 Cranch 164.
[3] (1810) 6 Cranch 87.

the States from enacting any law impairing the obligation of contracts applies to contracts to which a State is a party; and holding that the Act of 1758 constituted a binding contract annexing the exemption to the lands purchased for the Indians, which the State could not abrogate by the Act of 1804.

The great case of *Dartmouth College v. Woodward,*[4] although it involved no tax exemption, is of vital importance here because it established the doctrine, steadfastly adhered to since, that a special charter of incorporation, when accepted by the corporators, is a binding contract between the State and the corporation, and, therefore, protected by the contract clause of the Federal Constitution.

*Providence Bank v. Billings,*[5] holding that the Bank could be taxed by the State because its special charter conferred no immunity, is important for the principles laid down in the Court's opinion by Chief Justice Marshall, as follows:

> That the taxing power is of vital importance, that it is essential to the existence of the government, are truths which it cannot be necessary to re-affirm. They are acknowledged and asserted by all. It would seem that the relinquishment of such a power is never to be presumed. No one can controvert the correctness of these axioms. . . We will not say that a State may not relinquish it, that a consideration sufficiently valuable to induce a partial release of it may not exist; but as the whole community is interested in retaining it undiminished, the community has a right to insist that its abandonment ought not to be presumed in a case in which the deliberate purpose of a State to abandon it does not appear. . . Any privileges which may exempt the corporation from the burthens common to individuals do not flow necessarily from the charter, but must be expressed in it, or they do not exist.

*Gordon v. Appeal Tax Court,*[6] and *Cheston v. Appeal Tax Court,*[7] presented the question whether a Maryland Statute of 1841, for the general valuation and assessment of property, providing among other things for the assessment and taxation of "all stocks or shares in any bank, institution or company incorporated by this State," impaired the obligation of the contract between the State and certain Baltimore banks, arising out of

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[4] (1819) 4 Wheat. 518.
[5] (1830) 4 Pet. 514.
[6] (1845) 3 How. 132.
[7] *Ibid.*

the acceptance by said banks of certain acts of the legislature extending the corporate existence of the banks upon their compliance with terms prescribed in said acts. An act of 1813 extended the corporate existence of the banks to 1835, on condition of the several banks subscribing, in proportion to the paid in capital of each, for as much stock in a certain turnpike road company as might be necessary to complete the road. The 7th section of the Act provided that each of the banks should pay annually into the State treasury twenty cents on every hundred dollars of its stock actually paid up; and the 11th section provided: "That upon any of the aforesaid Banks accepting of and complying with the terms and conditions of this act, the faith of the State is hereby pledged not to impose any further tax or burden upon them during the continuance of their charters under this Act."

By an act of 1821, incorporating another turnpike company, the charters of the banks were extended to 1845, upon condition of their subscribing in same manner to the new turnpike company. Sections 7 and 11 of the Act of 1813 were repeated in this act. By an act of 1834, the charters of the banks were again extended to 1859, but this act required them to pay a school tax, and did not contain any stipulations corresponding to sections 7 and 11 of the Act of 1813.

The Maryland Court of Appeals held that the tax imposed by the Act of 1841 was not a violation of the contract created by the Act of 1821 between the State and the banks which had accepted and complied with its conditions.

But the United States Supreme Court, in an opinion by Mr. Justice Swayne, reversed that judgment, holding that the stockholders in the banks were exempt from the tax imposed by the Act of 1841, during the continuance of their charters under the Act of 1821 (*i. e.*, until 1845), but were not entitled to any exemption under the Act of 1834 which merely extended their charters to 1859, but did not continue the immunity conferred by the earlier act.

A group of cases known as the *Ohio Bank Tax cases* comes next in order. The first Ohio Constitution (1802) contained a general grant of legislative authority to the General Assembly, unlimited and unrestricted unless the following clause operated

as a limitation, *viz.*: "To guard against the transgression of the high powers which we have delegated, we declare that all powers not hereby delegated remain with the people." The Constitution of 1802 remained in force, unchanged in that particular, until superseded by the new Constitution, September 1, 1851. In 1829 The Commercial Bank of Cincinnati was created by special charter, which provided that the State of Ohio should be entitled to receive 4 percent on all dividends made by the Bank, to be paid in the manner prescribed by an act of 1825, the latter being the first Ohio statute in terms levying a tax upon banks. In 1831 an act to tax banks and certain kinds of other corporations at the rate of 5 percent on dividends was enacted. But the Supreme Court of Ohio in 1835 decided that the charter of The Commercial Bank constituted a contract which prevented the State from exacting a higher tax than 4 percent on its dividends.[8]

In 1845 the Ohio legislature passed an act to incorporate the State Bank of Ohio and other banks, section 60 of which provided that each banking company under the act, on accepting and complying with its provisions, should semi-annually, on the days designated for declaring dividends, set off to the State 6 percent on its profits, etc., which sum so set off should be in lieu of all taxes to which the bank or its stockholders would otherwise be subject. Some fifty banks, branches of the Ohio State Bank or independent institutions were organized under the Act of 1845.

In 1851 the legislature passed an act to tax banks and other stocks the same as other property was then taxable under the laws of the State; and in 1852, in accordance with the mandate of the Constitution of 1851, the legislature passed an act for the taxation of all the property in the State, including that of the banks incorporated under the Act of 1845. Both these Acts were resisted by the banks and corporations created by certain other special acts. But the Supreme Court of Ohio overruled its decision in the case of The Commercial Bank, and held that the Act of 1845, incorporating the banks, contained no pledge by the State not to change the method or rate of taxation, and did not constitute a contract between the banks and the State;

[8] State v. Commercial Bank (1835) 7 Ohio, pt. 1, 125.

but that, if it could be so construed, it amounted to a surrender of the sovereign power of taxation and was void for want of power in the legislature to make it. These cases reached the United States Supreme Court, and the judgments of the Ohio Court were reversed in 1853, with one exception, namely, that of the Ohio Life Insurance and Trust Company, created by special act in 1834. The United States Supreme Court overruled all three propositions asserted by the Ohio Court; but the latter refused to yield, holding that the Ohio legislature had not the constitutional authority under the Constitution of 1802 to surrender or abridge in any manner the right of taxation, and that the Ohio Supreme Court had so solemnly adjudged, so that the question was no longer an open one in Ohio.[9] Then in 1857 the Ohio Supreme Court again retraced its steps, holding that the charters of two universities incorporated under the old constitution created valid contracts for exemptions,[10] and that the Act of 1852 did not deprive the Athens Branch Bank of its right of exemption under the Act of 1845.[11] However, if was not yet ready to surrender, as in 1858 it once more held[12] that section 60 of the Act of 1845 did not constitute an irrepealable contract with the banks organized under that act.

The first of the Ohio cases to reach the United States Supreme Court was *Piqua Branch Bank v. Knoop*.[13] The Bank was organized in 1847 under the Act of 1845 and was, therefore, entitled to the limited exemption provided by Section 60 of that Act (*supra*). The State officers proceeded to tax it under the Act of 1851 (*supra*), and the State Supreme Court held it taxable under the Act of 1851. The United States Supreme Court reversed the judgment, holding that the Act of 1845 was the special charter of the banks created by it or created afterward in pursuance of its provisions, and constituted a contract between the State and each of said banks fixing the amount of taxes to be paid during the life of each of the banks; that as

[9] Milan and Richland Plank Road Company v. Husted (1854) 3 Ohio St. 578.

[10] Matheny v. Golden (1856) 5 Ohio St. 361; Kumber v. Traber (1856) 5 Ohio St. 442.

[11] State v. Moore (1856) 5 Ohio St. 444.

[12] Sandusky City Bank v. Wilbur (1858) 7 Ohio St. 481.

[13] (1853) 16 How. 369.

the operation of the law of 1851 would increase the tax to be paid by the banks, it violated the contract clause of the United States Constitution. In the argument of the case counsel for the defendant in error referred to *Providence Bank v. Billings*,[14] which prompted Mr. Justice McLean, who delivered the opinion of the Court, to say:

> This reference impresses me with the shortness and uncertainty of human life. Of all the judges on this bench, when that decision was given, I am the only survivor. From several circumstances the principles of that case were strongly impressed upon my memory; and I was surprised when it was cited in support of the doctrines maintained in the case before us. The principle held in that case was, that where there was no exemption from taxation in the charter, the bank might be taxed. This was the unanimous opinion of the judges, but no one of them doubted that the Legislature had the power, in the charter or otherwise, from motives of public policy, to exempt the bank from taxation, or by compact to impose a specific tax on it. And this is clear from the language of the Court.

Chief Justice Taney filed a separate concurring opinion, saying:

> I think that by the 60th section of the Act of 1845, the State bound itself by contract to levy no higher tax than the one therein mentioned, upon the banks or stocks in the banks which organized under that law during the continuance of their charters. In my judgment the words are too plain to admit of any other construction.

Justices Catron, Daniel and Campbell filed dissenting opinions.

*Ohio Life Insurance and Trust Company v. Debold*[15] is unique, inasmuch as there was no opinion of the Court, as such, although six opinions were delivered. Justices McLean, Curtis and Nelson were for reversing the judgment, holding that the provision relating to taxation in the charter (granted in 1834), made the 60th section of the State Bank Act of 1845 part of that charter. The remaining judges were in favor of affirming the judgment, some construing the charter provisions as not amounting to an irrevocable contract, while others held they were bound by the construction of the Ohio Constitution and Statutes by the

[14] N. 5 above.
[15] (1853) 16 How. 416.

Supreme Court of the State, although they might not personally agree with the construction thereof. Chief Justice Taney voted with the majority to affirm the judgment, basing his vote, however, upon the proposition that the charter of the company contained no pledge by the State that the method or rate of taxation would not be altered or changed during its existence, and that section 60 of the Act of 1845 did not become part of its charter. He rejected the reasoning on which the State Court based its judgment, and formulated the principles which must control the Court in such cases, if the integrity of the contract clause of the Federal Constitution is to be maintained, as follows:

> This brings me to the question more immediately before the court: did the Constitution of Ohio authorize its Legislature, by contract, to exempt this Company from its equal share of the public burdens during the continuance of its charter. The Supreme Court of Ohio, in the case before us has decided that it did not. But this charter was granted while the constitution of 1802 was in force; and it is evident that this decision is in conflict with the uniform construction of that constitution during the whole period of its existence. It appears from the Acts of Legislature, that the power was repeatedly exercised while that constitution was in force, and was acquiesced in by the people of the State. It was distinctly sanctioned by the Supreme Court of the State in the case of The State v. The Commercial Bank of Cincinnati, 7 Ohio, 125.
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> And when the Constitution of a State, for nearly half a century, has received one uniform and unquestioned construction by all the departments of the government, legislative, executive and judicial, I think it must be regarded as the true one. It is true that this Court always follows the decision of the State Courts in the construction of their own constitution and laws. But where those decisions are in conflict, this Court must determine between them. And certainly a construction acted on as undisputed for nearly fifty years by every department of the government, and supported by judicial decision, ought to be regarded as sufficient to give to the instrument a fixed and definite meaning. Contracts with the State authorities were made under it. And upon a question as to the validity of such a contract, the Court, upon the soundest principles of justice, is bound to adopt the construction it received from the State authorities *at the time the contract was made.*[16] . .

[16] Writer's italics.

The duty imposed upon this Court to enforce contracts honestly and legally made, would be vain and nugatory, if we were bound to follow those changes in judicial decisions which the lapse of time, and the change in judicial officers, will often produce. . . The sound and true rule is, that if the contract, when made, was valid by the Laws of the State, as then expounded by all the departments of its government, and administered in its Courts of justice, its validity and obligation can not be impaired by any subsequent act of the Legislature of the State, or decision of its courts, altering the construction of the law. . .

It has been contended, on behalf of the Treasurer of the State, that the construction given to these Acts of Assembly by the State Courts ought to be regarded as conclusive. It is said that they are laws of the State, and that this Court always follows the construction given by the State Courts to their own constitution and laws.

But this rule of interpretation is confined to ordinary acts of legislation, and does not extend to the contracts of the State, although they should be made in the form of a law. For it would be impossible for this court to exercise any appellate power in a case of this kind, unless it was at liberty to interpret for itself the instrument relied on as the contract between the parties. It must necessarily decide whether the words used are words of contract, and what is their true meaning, before it can determine whether the obligation the instrument created has or has not been impaired by the law complained of. . .

It is very true, that if there was any controversy about the construction and meaning of the Act of 1851, this court would adopt the construction given by the State Court. And if that construction did not impair the obligation of the contract as interpreted by this court, there would be no ground for interfering with the judgment. For then the contract, as expounded here, would not be impaired by the state law. But if we were bound to follow not only the interpretation given to the law, but also to the instrument claimed to be a contract, and alleged to be violated there would be nothing left for the judgment and decision of this court. There would be nothing upon which a writ of error or appeal could bring here for consideration and judgment; and the duty imposed upon this Court under this clause of the Constitution would, in effect, be abandoned.

*Dodge v. Woolsey*[17] was a bill by a stockholder of an Ohio bank organized by the Act of 1845, to enjoin collection of a tax as-

[17] (1855) 18 How. 331.

sessed by the State of Ohio against said bank under the Act of 1852. The United States Circuit Court granted a perpetual injunction and the Supreme Court affirmed that decree. The only difference between this case and the *Piqua Branch Bank*[18] case is that the latter arose under the Ohio Act of 1851, while here the Statute which it was alleged violated the bank's charter was the Act of 1852, passed pursuant to the Constitution of 1851. The Court held, Justice Swayne delivering the opinion, that the provision for taxation in the bank's charter was a relinquishment of the power to tax beyond the amount therein fixed; that it was a contract binding subsequent legislatures during the charter period; that a change in the State constitution cannot release a state from contracts made under a constitution which permitted them to be made; and that the Ohio Constitution of 1802 clearly did permit the legislature to make the contract in question.

Justice Campbell delivered a dissenting opinion, concurred in by Justices Daniel and Catron, denying the power of one legislature to make contracts which limit the powers of subsequent legislatures, and insisting upon the right of the people of a sovereign State at any time to nullify any act of a legislature which curtails the taxing power of the State.

In *Mechanics' and Traders' Bank v. Debold*[19] and *Same v. Thomas,*[20] judgments of the Ohio Supreme Court were reversed, as these cases grew out of the same facts and were ruled by the *Piqua Branch Bank*[21] case and *Dodge v. Woolsey.*[22]

*Jefferson Branch Bank v. Skelly*[23] and *Franklin Branch v. State of Ohio,*[24] were the last of the *Ohio Bank Tax* cases to reach the United States Supreme Court. Again the judgments of the Ohio Supreme Court were reversed, Justice Swayne delivering the opinions, which were unanimous.

*McGehee v. Mathis*[25] arose out of the following facts. The State of Arkansas, by a legislative act in 1851, provided for the sale of the swamp and overflowed lands within the State, which had been granted to the State by Act of Congress, to be sold or used in reclaiming said lands for cultivation. One section of the Act provided that "to encourage by all just means to progress

[18] N. 12 above.
[19] (1855) 18 How. 380.
[20] (1855) 18 How. 384.
[21] N. 12 above.
[22] N. 16 above.
[23] (1862) 1 Black 436.
[24] (1862) 1 Black 474.
[25] (1866) 4 Wall. 143.

and the completing of the reclaiming such lands by offering inducements to purchasers and contractors to take up such lands, all said swamp and overflowed lands shall be exempt from taxation for the term of ten years, or until they shall be reclaimed." In 1855 that section of the Act of 1851 was repealed and provision was made for the taxation of swamp and overflowed lands, sold or to be sold, precisely as of other lands. Before that repeal McGehee had become the owner, by transfer from contractors, of a large amount of scrip issued under the Act of 1851 and with that scrip, after the repeal, took up and paid for large tracts of said lands in Chicot County. By an act of 1857 the legislature provided for the building of levees and drains in Chicot County, and authorized a special tax against lands benefitted to meet the cost. The special tax was assessed against McGehee's unreclaimed swamp lands and McGehee resisted payment. The State Court held the repealing Act of 1855 and the Act of 1857 valid, and refused relief.

The United States Supreme Court reversed the judgment, and held, in an opinion by Chief Justice Chase from which there was no dissent, that the Act of 1851 constituted a contract between the State and the holders of the land scrip issued thereunder by which the State bound itself to convey the land for the scrip and to refrain from taxation for the time specified; that the exemption from taxation was the principal element in the value of the land conveyed, which the repeal of the exemption would destroy and thus impair the contract made by the State; and that in view of the purpose and scope of the Act of 1851, the exemption applied not merely to general taxes but also to special taxes for improvements benefitting the land.

*Home of The Friendless v. Rowse*[26] and *Washington University v. Rowse*,[27] arose under special charters granted by the State of Missouri in 1853, when there was no constitutional limitation upon the legislature's power to grant tax exemptions. The charters of these corporations provided that "all property of said corporation shall be exempt from taxation, and the 6th, 7th and 8th sections of the first article of the Act concerning corporations, approved March 19, 1845, shall not apply to this corporation." The 7th section referred to provided "that the

[26] (1869) 8 Wall. 430.

[27] (1869) 8 Wall. 439.

charter of every corporation that shall hereafter be granted by the Legislature shall be subject to alteration, suspension and repeal, in the discretion of the Legislature." In 1865 a new State Constitution was adopted, which provided that no property, real or personal, shall be exempt from taxation, except such as may be used exclusively for public schools, and such as may belong to the United States, the State of Missouri, Counties or municipal corporations." Following that change in the organic law, taxes were assessed against the property of both said corporations, and they sought to enjoin the collection thereof. The State Supreme Court ruled against the claim of exemption, holding that the legislature had no power, even under the Missouri Constitution of 1820, to grant away or curtail the power to tax. But the United States Supreme Court reversed the judgments, holding that the charters constituted contracts, when accepted and acted upon by the corporations, between the State and the corporations that the property given for the charitable uses specified should, so long as it was applied to those uses be exempt from taxation, and that any attempt to tax such property impaired the obligation of that contract.

Justice Davis, delivering the Court's opinion in the case of the Home of The Friendless, said:

> The validity of this contract is questioned at the bar on the ground that the Legislature had no authority to grant away the power of taxation. The answer to this position is, that the question is no longer open for argument here, for it is settled by the repeated adjudications of this court, that the State may, by contract based on a consideration, exempt the property of an individual or corporation from taxation, either for a specified period, or permanently. And it is equally well settled that the exemption is presumed to be on sufficient consideration, and binds the State if the charter containing it is accepted.

In Washington University's case he said:

> The charter of the University having been accepted, and the Corporation since its acceptance, having been actively employed in the specific purpose for which it was created, the exemption from taxation became one of the franchises of the Corporation of which it would not be deprived by any species of State legislation.

Justice Miller dissented and Chief Justice Chase and Justice Field concurred in the dissent.

*Wilmington and Raleigh Railroad Company v. Reid*[28] is another case of a special charter of incorporation, granted by the State of North Carolina in 1833. The charter provided that "the property of said Company and the shares therein shall be exempted from any public charge or tax whatsoever." By a later statute the State attempted to levy taxes upon the franchise, rolling stock and real estate owned by the Railroad. The State Court sustained that attempt, but the Supreme Court reversed the judgment. Justice Davis again wrote the Court's opinion (no dissent being recorded) saying:

> It has been so often decided by this court that a charter of incorporation granted by a State creates a contract between the State and the Corporators, which the State can not violate, that it would be a work of supererogation to repeat the reasons on which the argument is founded. It is true that when a corporation claims an exemption from taxation, it must show that the power to tax has been clearly relinquished by the State, and if there be a reasonable doubt about this having been done, that doubt must be solved in favor of the State. . . If, however, the contract is plain and unambiguous, and the meaning of the parties to it can be clearly ascertained, it is the duty of the court to give effect to it, the same as if it were a contract between private persons, without regard to its supposed injurious effects upon the public interest. . . If there be no constitutional restraint on the action of the Legislature on this subject, there is no remedy, except through the influence of a wise public sentiment, reaching and controlling the conduct of the law making power.

In *Raleigh and Gaston Railroad Company v. Reid*[29] the judgment of the North Carolina Supreme Court was reversed for the reasons stated in *Wilmington and Raleigh Railroad Company v. Reid.*[30] The only point of difference in the cases is that in this case the exemption was only a limited one.

In *Humphrey v. Peques*[31] the lower court sustained the claim of exemption, and its decree was affirmed by the Supreme Court on the authority of *Wilmington and Raleigh Railroad Company v. Reid.*[32]

The facts of *Pacific Railroad Company v. Maguire*[33] were:

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[28] (1872) 13 Wall. 264.
[29] (1872) 13 Wall. 269.
[30] N. 27 above.
[31] (1873) 16 Wall. 244.
[32] N. 27 above.
[33] (1873) 20 Wall. 36.

The Pacific Railroad Company was incorporated in 1849 by a special act, granted by the Missouri Legislature. In 1852, its charter was amended in several particulars and it was exempted from taxation until its road was completed and put in operation and until it should declare a dividend on its capital stock, not, however, extending longer than two years after completion. The road was completed and put in operation on April 1, 1866. The new Missouri Constitution, requiring taxation of all property in the State, took effect on July 4, 1865, and the tax in question was levied in accordance with its mandate. The State Court held the exemption was abrogated by the new constitution; but the United States Supreme Court reversed the judgment, holding that the State was bound by the contract contained in the charter of the Company.

*Farrington v. State of Tennessee*[34] was an action by a stockholder in a bank incorporated by special act in 1858, to enjoin collection of a tax assessed against plaintiff on stock in the bank owned by him under the general revenue law of the State. The charter of the bank provided "that the said Company shall pay to the State an annual tax of one-half of one percent on each share of capital stock subscribed, which shall be in lieu of all other taxes." The State Supreme Court held the taxes so assessed valid, but the United States Supreme Court reversed that judgment, holding that the charter of the bank was a contract between the bank and the State, by which the imposition of any tax other than that specified therein was expressly forbidden.

Justice Swayne delivered the opinion of the Court, saying:

> A compact lies at the foundation of all national life. Contracts mark the progress of communities in civilization and prosperity. They guard, as far as is possible, against the fluctuations of human affairs. They seek to give stability to the present and certainty to the future. They gauge the confidence of man in the truthfulness and integrity of his fellow-man. They are the springs of business, trade and commerce. Without them society could not go on. Spotless faith in their fulfillment honors alike communities and individuals. Where this is wanting in the body politic, the process of descent has begun, and a lower plane will be speedily reached. To the extent to which the defect exists among individuals, there is decay and degeneracy. As are

[34] (1878) 5 Otto 679.

the integral parts, so is the aggregated mass. Under a monarchy or aristocracy, order may be upheld and rights enforced by the strong arm of power. But a republican government can have no foundation other than the virtue of its citizens. When that is largely impaired, all is in peril. It is needless to lift the veil and contemplate the future of such a people. . . History but repeats itself. The trite old aphorism, that "Honesty is the best policy," is true alike of individuals and communities. It is vital to their highest welfare.

The Constitution of the United States wisely protects this interest, public and private, from invasion by State laws. It declares that "No State shall . . . pass any . . . law impairing the obligation of contracts." This limitation no member of the Union can overpass. It is one of the most important functions of this tribunal to apply and enforce it upon all proper occasions.

Referring to the *Dartmouth College*[35] case, he said:

The question decided in that case has since been considered as finally settled in the jurisprudence of the entire country. Murmurs of doubt and dissatisfaction are occasionally heard; but there has been no re-argument here, and none has been asked for. The same doctrine has been often re-affirmed in later cases.

On the question of the construction of the bank's charter, it was pointed out that the capital stock and the shares might both be taxed, and yet not be double taxation; that in addition its franchise, accumulated earnings, profits and dividends, and real estate were all proper subjects of taxation. But, said the Court, "When this charter was granted, the State might have been silent as to taxation. In that case, the power would have been unfettered. . . It might have reserved the power as to some things, and yielded it as to others. It had the power to make its own terms, or to refuse the charter. It chose to stipulate for a specified tax on the shares, and declared and bound itself that this tax should be 'in lieu of all other taxes.' "

In *Northwestern University v. Illinois*,[36] the University was incorporated by special act of the Illinois General Assembly, and its charter was amended in 1855, one of the amendments providing that "All property of whatever kind or description, belonging to or owned by said Corporation, shall be forever free

[35] N. 4 above.
[36] (1879) 9 Otto 309.

from taxation for any and all purposes." The Constitution of 1848, then in force, provided that "The property of the State and counties, both real and personal, and such other property as the General Assembly may deem necessary for school, religious and charitable purposes, may be exempt from taxation." The Constitution of 1870 provided that "the property of the State, counties and other municipal corporations, both real and personal, and such other property as may be used exclusively for agricultural and historical societies, for school, religious, cemetery and charitable purposes, may be exempted from taxation . . . by general law." In 1874 the State assessed taxes against a large number of city lots and lands owned by the University, which were claimed to be exempt although not used directly for educational purposes.

The State Supreme Court denied the claim of exemption, as to the lots and lands in question, holding that the quoted provision of the Constitution of 1848, permitted exemption only of property directly and immediately used for schools. The United States Supreme Court reversed the judgment, Justice Miller (who, it will be recalled, had dissented in some earlier cases) delivering the opinion of the Court, from which there was no dissent. The Court held that the charter provision of 1855 was a contract binding upon the State, because the Constitution of 1848 empowered the Legislature to exempt "such property as they might deem necessary [not for the use of schools, but] for school purposes."

The Court said:

> The distinction is, we think, very broad between property contributing to the purpose of a school, made to aid in the education of persons in that school, and that which is directly or immediately subjected to use in the school. The purposes of the School, and the school are not identical. The purpose of a college or university is to give youth an education. The money which comes from the sale or rent of land dedicated to that object aids this purpose. Land so held and leased is held for school purposes, in the fullest and clearest sense.

In *St. Anna's Asylum v. New Orleans*,[37] the Asylum was incorporated by special legislative act in 1853, for charitable pur-

[37] (1882) 15 Otto 362.

poses, the charter providing that its property, real and personal should be exempt from all taxation either by the State, parish, or city in which it is situated, any law to the contrary notwithstanding. In 1874 a valuable cotton gin was devised to the Asylum, against which the City of New Orleans thereafter assessed City taxes, claiming authority to do so under the State Constitution of 1868. The Asylum leased the property, but applied the income derived therefrom to its charitable purposes. The State Supreme Court denied the Asylum's claim of exemption, and its judgment was reversed by the United States Supreme Court. Justice Bradley delivered the opinion of the Court, from which we quote the following:

> The language of the exemption is so explicit and so broad, and comes in after so many allusions to property which it is supposed the Corporation might acquire, other than that which would be directly used for food and shelter to the destitute and helpless persons under its care, that no doubt can be entertained as to its literal application to all the property of the Society which it would be lawful and proper for it to possess. The funds on which it relies for carrying on its work, however invested, whether in stock, real estate, or otherwise, no less than the asylum building itself, are clearly embraced in the terms of the exemption; and to exclude them from its operation would require the insertion or addition of words which the Legislature did not see fit to express. Undoubtedly, if the Corporation should acquire property not needed or used for carrying on the Institution, it would be an act outside of the objects and purposes of the charter and ultra vires; and, as to such property, it could not, in its own wrong, justly claim the benefit of the exemption. But the property in question is not obnoxious to this objection; it directly contributes to the support of the Institution, and is held for that purpose alone.

*Louisville and Nashville Railroad Company v. Palmes*[38] holds that immunity from taxation granted to a railroad company does not pass by virtue of a conveyance of the railroad and its franchises, but requires for its transfer some particular and express description, indicating unequivocally the intention of the Legislature that it might pass by an assignment. It is here referred

[38] (1883) 109 U. S. 244.

to because it re-affirms the rule laid down in several of the *Ohio Bank Tax* cases, *viz.:*

> The question we have to consider is, whether, in the judgment under review, the Supreme Court of Florida gave effect to a law of the State which, in violation of the Constitution of the United States, impairs the obligation of a contract. In reaching a conclusion on that point, we decide for ourselves, independently of the decision of the State Court, whether there is a contract, and whether its obligation is impaired; and if the decision of the question as to the existence of the alleged contract requires a construction of State Constitutions and laws, we are not necessarily governed by previous decisions of the State Courts, upon the same or similar points, except where they have been so firmly established as to constitute a rule of property. Such has been the uniform and well settled doctrine of this court. Bank v. Knoop, 16 How., 369.

The facts in *Wright v. Georgia Railroad and Banking Company*[39] were: The charter of the Company, granted by special act long before any restrictions upon the legislature by the State Constitution, provided that "the stock of said Company and its branches shall be exempt from taxation for and during the term of seven years from and after completion of said railroads, or any of them; and after that, shall be subject to a tax not exceeding ½ of one percent per annum on the net proceeds of their investments." Long after expiration of the seven year period of entire exemption the State of Georgia undertook to levy a tax upon the excess value of the Company's property, over the amount of authorized capital fixed by its charter, and to levy a franchise tax against it. The United States Circuit Court held that the taxes so imposed were void, being in violation of the contract of exemption, which provided an exclusive tax of one-half of one percent on the net income of the Company. The Supreme Court affirmed that judgment, upholding the exemption as construed by the Circuit Court.

In the case of *Wright v. Central of Georgia Railway,*[40] the Augusta and Savannah Railroad and the Southwestern Railroad were built under special charters containing irrepealable contracts, by which their property was not to be taxed higher than

[39] (1909) 216 U. S. 420.
[40] (1915) 236 U. S. 674.

one-half of one percent upon the annual income. Their charters also empowered them, whenever they saw fit to do so, to rent or farm out all or any part of their exclusive right of transportation. In 1862 both companies leased their respective roads and franchises to the Central Railroad etc., Company of Georgia, which by an amendment of its charter in 1852 had been authorized to lease the two railroads above mentioned. The Central Railroad and Banking Company was later re-organized as the Central of Georgia Railway Company, and new leases were in 1895 made to it of their respective roads for 100 years from November 1, 1895, renewable for like terms forever. In 1912 executions were issued against the Central of Georgia Railway to collect ad valorem taxes, as provided by general state law, on the real estate, roadbed and franchise value, after crediting one-half of one percent of the net income, on that portion of its property known as the Augusta and Savannah Railroad and the Southwestern Railroad. The United States District Court granted a permanent injunction, holding that such additional tax must be regarded as a violation of the irrepealable contract exemption in the charters of the lessor companies; and the Supreme Court affirmed that judgment.

The case of *Wright v. Louisville and Nashville Railroad Company*[41] also arose under the charter of the Georgia Railroad and Banking Company. That Company leased one of its lines of railroad to the Louisville and Nashville Railroad and the Atlantic Coast Line Railroad, and the State of Georgia undertook to tax the lines so leased, under the general law of the State, as the property of the lessees. The Court adhered to its decision in the original case that the taxing provision in the charter of the Georgia Railroad and Banking Company constituted a contract binding the State not to tax the property of that Company beyond the limit therein mentioned; from which it would necessarily follow that the tax here in question could not be levied on the lessor. It further held that inasmuch as the charter of the lessor further authorized it to lease or rent all or portions of its railroad, the property of the lessor while in possession of its lessees under leases so authorized by its charter, could not be taxed otherwise than as provided in the contract of exemption.

[41] (1915) 236 U. S. 687.

In *Central of Georgia Railway Company v. Wright*[42] and same case on rehearing,[43] Mr. Justice Holmes delivering the Court's opinion, reversing the judgment of the State Supreme Court, said:

> It presents another attempt to accomplish, by a change in form, what in *Wright v. Central of Georgia Ry. Co.*, 236 U. S. 674, was held to be an unconstitutional result. . . In that decision . . . an attempt had been made to tax the lessee for the property, the leases being for one hundred and one years, renewable for like periods upon the same terms forever. The tax was laid upon the real estate, roadbed, and franchise value (with a certain deduction) of the two lessors. It was held that the statutes [Special Charter] made the fee exempt from other taxation than that provided for, in favor as well of the lessee as of the lessor. The taxes now attempted to be levied are upon the leasehold interests of the lessee in the same roads, and it is argued that, if the leases produce a profit in excess of the rental, the value is required to be taxed by the Constitution of the State. But the Constitution was subsequent to the charters that created the exemption, and must yield to them if they apply to the present attempt. We are of the opinion that although the decision in the former case was necessarily confirmed to the question before the court, the reasoning applies with equal force to that now before us.

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[42] (1919) 248 U. S. 525.
[43] (1919) 250 U. S. 519.