GOVERNMENT-OWNED CORPORATIONS AND INTERGOVERNMENTAL TAX IMMUNITY*

WALTER FREEDMAN†

Until the World War the Government confined itself largely to incorporating private enterprises such as banks,[1] railroads,[2] telegraph companies,[3] bridge companies,[4] *et cetera.* During this period few corporations were formed over which the Government exercised management and control.[5] The first government venture into the revenue-producing corporation was in 1904 with the purchase of the Panama Railroad Company as an incident to the much more familiar project, the Panama Canal.[6] Then followed the purchase of the Alaska Railway.[7] In 1917 the Federal Land Banks were organized for the purpose of relieving the farm credit crisis.[8]

With the entry of the United States into the World War the government-owned corporation as an administartive unit appeared in aggrandized form.[9] Within sixteen months there were

* The substance of this article is taken largely from the writer's paper prepared last year under Professors Felix Frankfurter and Thomas Reed Powell of Harvard University Law School.

† A.B., Washington University, 1937; LL.B., 1937; LL.M., Harvard University, 1938. Attorney, Securities and Exchange Commission.

1. (1864) 13 Stat. 100, (1936) 12 U. S. C. A. sec. 21; (1885) 22 Stat. 162; (1902) 32 Stat. 102; (1922) 42 Stat. 767; (1936) 12 U. S. C. A. sec. 24; (1933) 48 Stat. 184, (1936) 12 U. S. C. A. sec. 24; Farmers' National Bank v. Deering (1875) 91 U. S. 29.

2. (1862) 12 Stat. 489; (1864) 13 Stat. 365; (1871) 16 Stat. 573; California v. Central Pacific Railroad (1877) 127 U. S. 1.

3. (1866) 14 Stat. 221, (1928) 47 U. S. C. A. sec. 1; Pensacola Telegraph Co. v. Western Union Telegraph (1877) 96 U. S. 1.

4. (1890) 26 Stat. 268, (1927) 31 U. S. C. A. sec. 592; Luxton v. North River Bridge (1894) 153 U. S. 525.

5. Smithsonian Institute (1846) 9 Stat. 103, (1929) 20 U. S. C. A. sec. 57; National Academy of Science (1863) 12 Stat. 806; National Soldiers' Home (1866) 14 Stat. 10, (1927) 24 U. S. C. A. sec. 71; Harvard University (1867) 18 Stat. 438.

6. (1904) 33 Stat. 429; (1902) 32 Stat. 481, (1928) 44 U. S. C. A. sec. 227; Wilson v. Shaw (1906) 204 U. S. 24; New York ex rel. Rogers v. Graves (1937) 299 U. S. 401. See Dimock, *Government Owned Enterprises in the Panama Canal Zone* (1934).

7. (1914) 38 Stat. 305, (1928) 48 U. S. C. A. secs. 301-308; (1915) 30 Ops. Att'y Gen. 332; (1915) 31 Ops. Att'y Gen. 597; (1924) 34 Ops. Att'y Gen. 232.

8. (1916) 39 Stat. 362, (1936) 12 U. S. C. A. secs. 671-683; Smith v. Kansas City Title & Trust Co. (1921) 255 U. S. 180.

9. Van Dorn, *Government-Owned Corporations* (1926) cc. 1-7, 10.

established the United State Emergency Fleet Corporation,[10] the United States Grain Corporation,[11] the United States Housing Corporation,[12] the War Finance Corporation,[13] the Sugar Equalization Board,[14] the Spruce Production Corporation,[15] and the Russian Bureau, Incorporated.[16] The Federal Intermediate Credit Banks[17] and the Inland Waterways Corporation[18] represent the only post-war federal-owned corporations organized before the business depression of 1929.

Nation-wide unemployment and financial collapse greeted the Roosevelt administration on March 4, 1933. The government-owned corporation[19] was one convenient[20] device selected to pro-

10. Incorporated in District of Columbia by United States Shipping Board. (1916) 39 Stat. 728, (1928) 46 U. S. C. A. sec. 801; (1917) 40 Stat. 182; Exec. Order No. 2664, July 17, 1917. The shipping Board has been abolished and its functions transferred to the Department of Commerce by authority of Exec. Order No. 6166, June 10, 1933, issued under the Reorganization Act of March 3, 1933. 47 Stat. 1517, (1938 Supp.) 5 U. S. C. A. sec. 124. Approved in (1933) 37 Ops. Att'y Gen. 238; Ostrandtsen Moller Co., Inc. v. United States (1937) 300 U. S. 139.

11. Created by Exec. Order No. 2681, Aug. 14, 1917, pursuant to Food Control Act (1917) 40 Stat. 276.

12. (1918) 40 Stat. 550, (1928) 34 U. S. C. A. sec. 1042.

13. (1918) 40 Stat. 506, (1927) 15 U. S. C. A. sec. 331; (1920) 32 Ops. Att'y Gen. 181. The War Finance Corporation was ordered liquidated in 1925. 43 Stat. 14, (1927) 15 U. S. C. A. sec. 371. By the Act of March 1, 1929, 45 Stat. 1442, (1938 Supp.) 15 U. S. C. A. sec. 374, the liquidation of the remaining assets and the winding up of the affairs of the Corporation were transferred to the Secretary of the Treasury.

14. Incorporated in Delaware by the Food Administrator with the approval of the President. No formal executive order was issued.

15. (1918) 40 Stat. 888, (1928) 50 U. S. C. A. sec. 172.

16. Incorporated in Connecticut by the War Trade Board.

17. (1923) 42 Stat. 1454, (1936) 12 U. S. C. A. secs. 1021-1026. This corporation is now under the control of the Farm Credit Administrator. Executive Order No. 6084, March 27, 1933.

18. (1924) 43 Stat. 360, (1929) 49 U. S. C. A. secs. 151, 152; Dimock, *Developing American Waterways* (1935).

19. Brief mention should be made of the difficult problem of selecting a term fitting to connote the corporations. The word "corporation" describes their structure. It is more difficult to find the appropriate word to describe their activities. The terms "proprietary," "business," or "private" are faulty because they presuppose a commercial functioning, and because these obfuscating catch-words are likely to be confused with their use in the field of governmental tort liability. Sheer convenience, then, prompts the use of the term "government-owned" or simply "government corporation." Substitution of the word "federal" or "state" for "government" is not unjustified.

A survey of the relevant statutes, executive orders, and charters reveals that structurally the corporations are of essentially three types. Some of the corporations are wholly government-owned: Reconstruction Finance Corporation (1932) 47 Stat. 5, (1927) 15 U. S. C. A. sec. 601; R. F. C. Mortgage Co. (1935) 49 Stat. 3, (1938 Supp.) 15 U. S. C. A. sec. 606i; Tennessee Valley Authority (1933) 48 Stat. 58, (1938 Supp.) 15 U. S. C. A.

mote the administration's effort to advance industrial recovery. The role of officialdom as the regulator of industry was sup-

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sec. 831; Commodity Credit Corp., Exec. Order No. 6340, Oct. 16, 1933, (1935) 49 Stat. 3, (1938 Supp.) 15 U. S. C. A. secs. 606a, 606j; (1937) 50 Stat. 5, (1938 Supp.) 12 U. S. C. A. sec. 1020i; Electric Home and Farm Authority, successor to Electric Home and Farm Authority, Inc., of Delaware, Exec. Order No. 6514, Dec. 19, 1933; Exec. Order No. 7139, Aug. 12, 1935, (1936) 49 Stat. 1186, (1938 Supp.) 15 U. S. C. A. sec. 702; (1937) 50 Stat. 3; Disaster Loan Corp. (1937) 50 Stat. 19, (1938 Supp.) 15 U. S. C. A. secs. 605k, 6051; Federal Intermediate Credit Banks (1923) 42 Stat. 1454, (1936) 12 U. S. C. A. sec. 1021; (1933) 48 Stat. 271, (1936) 12 U. S. C. A. secs. 1022, 1031; Federal Farm Mortgage Corporation (1934) 48 Stat. 344, (1936) 12 U. S. C. A. sec. 1020; Home Owners' Loan Corp. (1933) 48 Stat. 128, (1936) 12 U. S. C. A. secs. 1461, 1462; Export-Import Bank of Washington, Exec. Order No. 6581, Feb. 2, 1934, (1935) 49 Stat. 4, (1938 Supp.) 15 U. S. C. A. secs. 605e, 606b; (1937) 50 Stat. 5, (1938 Supp.) 15 U. S. C. A. sec. 702 note; Federal Surplus Commodities Corp., successor to Federal Surplus Relief Corporation (1937) 50 Stat. 27; Farmers' Home Corp. (1937) 50 Stat. 527, (1938 Supp.) 7 U. S. C. A. sec. 1014; Federal Crop. Ins. Corp., Pub. No. 430, 75th Cong. 3d Sess. (Feb. 16, 1938); Federal Prison Industries, Inc. (1934) 48 Stat. 1211, (1938 Supp.) 18 U. S. C. A. sec. 744i; Textile Foundations (1930) 46 Stat. 539, (1938 Supp.) 15 U. S. C. A. secs. 501-503; Chemical Society (1937) 50 Stat. 798; Inland Waterways Corporation (1924) 43 Stat. 360, (1929) 49 U. S. C. A. secs. 151, 152; Panama Railroad Corp. (1904) 33 Stat. 429; Alaska Railroad Corp. (1914) 38 Stat. 305, (1928) 48 U. S. C. A. secs. 301-308. Some are partially government-owned and partially private-owned: Federal Land Banks (1916) 39 Stat. 362, (1936) 12 U. S. C. A. secs. 671-683; Exec. Order No. 6084, March 27, 1933; (1933) 48 Stat. 269, (1936) 12 U. S. C. A. sec. 678; Federal Home Loan Banks (1932) 47 Stat. 725, (1936) 12 U. S. C. A. secs. 1421, 1422; Federal Savings and Loan Insurance Corp. (1934) 48 Stat. 1256, (1936) 12 U. S. C. A. sec. 1725; Federal Deposit Insurance Corp. (1933) 48 Stat. 168, (1936) 12 U. S. C. A. secs. 263, 264. Others are completely privately owned but federally chartered and supervised: National Farm Loan Associations (1916) 39 Stat. 365, (1936) 12 U. S. C. A. secs. 711-722; Central Bank and Banks for Cooperatives (1933) 48 Stat. 261, 264, (1936) 12 U. S. C. A. sec. 1134b, c, f, j, m; Production Credit Corporations and Associations, (1933) 48 Stat. 259, (1936) 12 U. S. C. A. secs. 1131c-d; Joint Stock Land Banks (1916) 39 Stat. 374, (1936) 12 U. S. C. A. secs. 811-823; Federal Credit Unions (1934) 48 Stat. 1216, (1936) 12 U. S. C. A. secs. 1751-1752; Federal Savings and Loan Corporations (1933) 48 Stat. 132, (1936) 12 U. S. C. A. sec. 1464. On a functional basis classification is more hazardous. Many treatises dealing solely with the activities of the corporations will undoubtedly soon make their appearances. Much literature dealing with the problem generally has already been published. Thurston, *Government Proprietary Corporations* (1937); Van Dorn, op. cit. supra, note 9; Dimock, op. cit. supra, note 18; Field, Government Corporations: A Proposal (1935) 48 Harv. L. Rev. 775; McDiarmid, Government Corporations and Federal Funds (1937) 31 Amer. Pol. Sci. Rev. 1094; McIntire, Government Corporations as Administrative Agencies (1936) 4 Geo. Wash. L. Rev. 161; Wehle, Government Controlled Business Corporations (1935) 10 Tulane L. Rev. 94; Pinney, Government Commercial Corporations (1937) 11 U. of Cin. L. Rev. 481.

20. Holmes, J., in Clallam County v. United States (1923) 263 U. S. 341, 345: "The incorporation [of a government-owned corporation] and formal erection of a new personality was only for the *convenience* of the United States to carry out its ends."

planted to a large extent by the role of officialdom as the director of activities.[21] The mushroom growth of government corporations, designed to advance relief and reconstruction, has required a revealingly high investment of $5,211,033,941.14 of government money.[22] By June 30, 1937, the amount was only slightly reduced.[23]

Among the states the corporation has had a less exciting history. State-owned banks are the oldest type of state-owned corporation which still persists.[24] The twentieth century has witnessed state-owned corporations operating toll roads, bridges, and transportation systems. Of the latter, the most notable and enviable examples are the Port of New York Authority[25] and the Boston Elevated Railway.[26]

The mere ownership of stock by a government in a corporation does not metamorphose the corporation into a hybrid organization deserving unique treatment.[27] The persuasive consideration is the activities the corporation performs. Essentially the function of government-owned corporations is largely one of administration and falls within the orbit of administrative law and those common law rules that apply to American governmental administration generally.[28] Clearly the fundamental char-

21. United States News, Aug. 13, 1934, p. 5: 4.

22. *Annual Report of United States Treasury* (1936).

23. As of June 30, 1937, the Treasury held securities in the amount of $4,837,172,459.95 in the corporations considered in this report. *Annual Report of the United States Treasury* (1937) 449-50. This total is divided as follows: Reconstruction Finance Corporation (exclusive of sum disbursed to other government corporations), $3,303,389,546.17; Home Owners' Loan Corporation, $125,000,000; Federal Savings and Loan Insurance Corporation, $100,000,000; Federal Home Loan Banks, $120,514,000; Regional Agricultural Credit Corporations, $15,000,000; Federal Farm Mortgage Corporation, $200,000,000; Export-Import Bank, $21,000,000; R. F. C. Mortgage Corporation, $25,000,000; Disaster Loan Corporation, $6,000,000; Production Credit Corporation, $120,000,000; Commodity Credit Corporation, $100,000,000; Electric Home and Farm Authority, $850,000; Federal Savings and Loan Ass'n, $48,183,700; Federal Deposit Insurance Corporation, $150,000,000; Federal Subsistence Homesteads Corporation, $10,000; Federal Land Banks, $262,225,213.78; Federal Intermediate Credit Banks, $100,000,000; Central Bank for Cooperatives, $50,000,000; and Banks for Cooperatives, $90,000,000. The Treasury Report for the fiscal year ending June 30, 1938, has not been published at this writing.

24. United States v. Planters' Bank (1825) 9 Wheat. 904.

25. N. J. Rev. Stats. (1937) tit. 32: 1-66, 90, 113, 131; N. Y. Laws of 1925, c. 210, sec. 7; N. Y. Laws of 1926, c. 761, sec. 7; N. Y. Laws of 1927, c. 300, sec. 7.

26. Mass. Special Acts of 1918, c. 159.

27. 1 Morawetz, *Private Corporations* (2d ed. 1886) sec. 3.

28. Field, Government Corporations: A Proposal (1935) 48 Harv. L. Rev. 775, 783.

acteristics of a private corporation—the group of persons with mutual interests, their voluntary combination, their common search for gain—are not present. What we have is really a public agency created by the legislature, forming a part of the government, and managed by persons who are servants of the state. A government-owned corporation is an instrumentality established in order to render a particular service.[29] As such it is necessarily a legal hybrid.[30]

I

The most fervent enthusiasts of the advent of government-owned corporations are less jubilant when faced with realization of the harsh effect which the expansion of one government's economic activity has upon the tax revenue of other governments. It is axiomatic that as the proportion of tax-free properties increases, the burden of the charges which must be levied against the general taxpayer becomes proportionally heavier.[31] Today both national and state governments are faced with the necessity of raising increasingly larger amounts of revenue. At the same time there is a need that they enlarge the number and scope of their activities. As the latter need is accomplished, the former becomes more difficult to obtain.

From the standpoint of both policy and law, the relation of the government corporation to the doctrine of the immunity of federal instrumentalities from state taxation presents perplexing problems. The purchase of millions of dollars of property, the issuance of billions in securities, the employment of thousands of persons, *et cetera,* have placed millions in revenue beyond the reach of the state.[32] The time is propitious to discuss the relation between the contemporary movement toward corporateness and the doctrine of intergovernmental tax immunity.[32a]

29. Thurston, Government and Proprietary Corporations (1935) 21 Va. L. Rev. 465, 498-499.

30. For the purposes of this paper the constitutionality of the corporations will be presumed. See McCulloch v. Maryland (1819) 4 Wheaton 316; Smith v. Kansas City Title & Trust Co. (1921) 255 U. S. 180; Ashwander v. Tennessee Valley Authority (1936) 297 U. S. 288; Baltimore National Bank v. Tax Comm. (1936) 297 U. S. 209; United States v. Kay (1938) 58 S. Ct. 468; Culp, Creation of Government Corporations by the National Government (1935) 33 Mich. L. Rev. 473.

31. Moulton, *Income and Economic Progress* (1936) 99.

32. Rohlfing, et al., *Business and Government* (1935) 237-240.

32a. Attacks made against the doctrine by legal savants in by-gone years are dwarfed by the recent agitation which has descended upon the

When in 1916, the Federal Farm Loan Act, which provided for the incorporation of the federal land banks, was being debated, numerous senators, including the later Mr. Justice Sutherland, vigorously denounced the provision extending tax-exemption privileges to the corporations, on the grounds of both policy and legality.[33] In the debates creating the many New Deal corporations, with one notable exception,[34] the congressmen voiced little or no objection to granting tax-exemption privileges to the new organizations.[35]

The typical provision exempts from state taxation the franchises, capital, reserve, surplus, and income of corporations and the principal and interest of all notes, debentures, bonds or other obligations, except as to surtaxes, estate, inheritance, and gift taxes. The states are, however, given the power to tax the realty of the corporations to the same extent as other real property is taxed. There are some variations from the typical formula. In the case of the production credit corporations, production credit associations, banks for cooperatives, and central banks, Congress

now politically-important principle in avalanche-like proportions. See President Roosevelt's Message to 75th Cong., 3d. Sess., April 25, 1938, reprinted in N. Y. Times, April 26, 1938, p. 2: 3; Sen. Res. 303, 75th Cong., 3d. Sess. (1938); Magill, Interview by Cotten, Washington Post, Sept. 11, 1938, p. 4B: 1; Department of Justice, *Taxation of Government Bondholders and Employees: The Immunity Rule and The Sixteenth Amendment* (1938). We have already been warned that the 16th Amendment might receive an interpretation which would effectively end the states' immunity from federal taxation. See Black, J., concurring in Helvering v. Gerhardt (1938) 58 S. Ct. 969, 977. The federal government is probably ready to waive its immunity from state taxation. See President Roosevelt's Message to 75th Cong., 3d. Sess., supra.

33. (1916) 53 Cong. Rec. 6963, 6966, 7021, 7245, 7305, 7317, 7372.

34. Section 13 of the T. V. A. Act directs the Authority to pay state taxes based upon a percentum of gross proceeds derived from the sale of power generated at certain dams in Tennessee and Alabama. During the period 1933-1937, inclusive, the Authority paid to the two states a total tax of $175,217.22. Letter of Mr. W. L. Sturdevant, Director of Information. July 22, 1938.

35. The following corporations enjoy tax-exemption privileges in one form or another: Reconstruction Finance Corporation, Federal Deposit Insurance Corporation, Tennessee Valley Authority, Home Owners' Loan Corporation, Federal Savings and Loan Insurance Corporation, Federal Home Loan Bank, Federal Savings and Loan Associations, Farmers' Home Corporation, Federal Land Bank, Federal Intermediate Credit Banks, National Farm Loan Association, National Mortgage Association, United States Housing Authority, Commodity Credit Corporation, Production Credit Corporation, Central Bank for Cooperatives, Production Credit Associations, Banks for Cooperatives, Crop Insurance Corporation, Federal Prison Industries, Inc., Inland Waterways Corporation, Panama Railroad Co., Alaska Railroad Co.

has provided that the personalty as well as the realty of the organizations be subject to non-discriminatory state taxation.[36] This is to be contrasted with the provision in the Federal Farm Loan Act which exempts from state taxation first mortgages executed to federal land banks and joint stock land banks,[37] while granting to the states the right to tax realty acquired by the corporations through the foreclosure of securities.[38] Banks organized by the Federal Deposit Insurance Corporation to replace defunct institutions are exempt from *all* taxation.[39] In the housing field, it has been customary to include a provision that all of the property shall be completely tax-exempt, qualified by a provision giving the corporate agency authority to "enter into agreements to pay annual sums in lieu of taxes to any State or political subdivision thereof" which do not exceed the taxes that would be paid upon such property if it were not tax exempt.[40] Of the privately owned federally-incorporated and -controlled corporations only one fails to enjoy the privilege of tax-exemption.[41]

II

The plethora of literature on the problems of intergovernmental tax immunity serves but to demonstrate the umbrageous bounds of this doctrine which rests only upon "necessary implication."[41a] It was the country's first policy-shaping Chief Jus-

36. (1933) 48 Stat. 267, (1936) 12 U. S. C. A. sec. 1138c.

37. The provision has been ruled constitutional. (1917) 31 Ops. Att'y Gen. 103.

38. The policy behind this provision seems clear. It would be working at cross purposes to withdraw the property from the taxrolls by foreclosure and increase the taxes on other borrowers in the same community.

39. Sec. 12B(1) (9) of Banking Act of 1935, 49 Stat. 696.

40. *E. g.*, sec. 13(c) of United States Housing Act (1937) 50 Stat. 888, (1938 Supp.) 42 U. S. C. A. secs. 1401-1402. See also (1936) 49 Stat. 2025, (1938 Supp.) 40 U. S. C. A. sec. 421; (1936) 49 Stat. 2035, (1938 Supp.) 40 U. S. C. A. sec. 431. The Federal Subsistence Homesteads Corporation exercised similar authority. (1934) 38 Ops. Att'y Gen. 2. This is simply a statutory enactment of the policy pursued by the war-time United States Housing Corporation. Van Dorn, *Government Owned Corporations* (1926) 348-349.

41. Sec. 18 of Federal Credit Union Act. (1934) 48 Stat. 1216, (1936) 12 U. S. C. A. sec. 1751. The National Mortgage Associations, chartered by the Federal Housing Administrator under the National Housing Act (1934) 48 Stat. 1246, (1936) 12 U. S. C. A. sec. 1702, were subject to all state taxation until Feb. 3, 1938, when sec. 307 of the Act was amended and the tax-exempt privilege extended. Pub. No. 424, 75th Cong., 3d Sess. (1938).

41a. Nelson, J., in Collector v. Day (1871) 11 Wallace 113.

tice—John Marshall[41b]—who is to be credited with or blamed for "discovering" the doctrine. It was he who in his short treatise on general political theories[42] found "a principle which so entirely pervades the Constitution, is so intermixed with the materials which compose it, so interwoven with its web, so blended with its texture, as to be incapable of being separated from it, without rending it into shreds."

In 1791 the first Congress passed an act incorporating the Bank of the United States,[43] calling for a private stock corporation with power to establish branches and to engage in a general banking business. The federal government was to purchase two million of the ten million dollars capital. In 1811, before the legality of the measure was adjudicated, the bank's charter automatically expired and owing to political reasons was not renewed. In 1816, Congress incorporated the Second Bank of the United States,[44] the government to purchase seven million of the thirty-five million dollars capital. The bank was constituted a depository of the government, and given the power to engage in a general banking business and establish branches. Branches were established in many states, including Maryland, which in 1818 passed "An Act to impose a tax on all banks or branches thereof in the State of Maryland not chartered by the state legislature." The bank refusing to pay the tax, the state brought suit against McCulloch, treasurer of the bank.

The able counsels' arguments were directed to the issue of whether a state could completely frustrate an activity of the federal government within its territory. The issue was crucial; eight states had already enacted laws designed to expel the bank or seriously hamper its operations.[45] Under the circumstances, then, the Chief Justice, after sustaining the federal government's

41b. "He [Marshall] gave to the Constitution of the United States the impress of his own mind; and the form of our constitutional law is what it is, because he moulded it while it was still plastic and malleable in the fire of his own intense convictions." Cardozo, *Nature of the Judicial Process* (1921) 151.

42. McCulloch v. Maryland (1819) 4 Wheaton 316.

43. (1791) 1 Stat. 191.

44. (1816) 3 Stat. 266, sec. 7 read: "That the subscribers to the said bank of the United States of America, their successors, and assigns, shall be and are hereby, created a corporation and body politic, by the name and style of 'The President, directors, and company, of the Bank of the United States.' * * * "

45. 1 Warren, *The Supreme Court* (1935) 505-6.

power to create a corporation,[46] was faced with the necessity of shaping an opinion which would effectively protect an important federal policy from annihilation at the hands of the dissident states. Holding the tax invalid was only half the task; starting the Constitution working was the more important phase of his job.[47] Embarking upon an excursion of words, the Chief Justice announced that the states have no power to retard, impede, burden, or in any manner control the operations of the national government. That taxation was or at least could be a weapon to so interfere, he thought undeniable.[48] Clearly Chief Justice Marshall regarded the doctrine as applicable irrespective of the type of activity which the instrumentality pursued, or of the possibly divergent purpose of the state tax.[49] He regarded the very attempt of a state to tax the means employed by the federal government as "itself an abuse"[50] because the usurpation of a power which the people of a single state could not give. The Chief Justice was ever-conscious of that "great principle" that "the Constitution and the laws made in pursuance thereof are supreme; that they control the Constitution and laws of the respective states, and cannot be controlled by them."[51]

Five years later, in *Osborn v. United States Bank*,[52] Chief Justice Marshall reinforced his earlier expression. The case arose under an Ohio law, enacted "for the avowed purpose of expelling the Bank from the State" and imposing an annual tax of $50,000 for the privilege of doing business in the state. The act authorized the state official to distrain in the event the tax was not paid. The bank sued to enjoin the state official from proceeding under the act, and the appropriate injunction was issued. Despite this decree the state official ordered his deputy to collect the tax. The deputy in turn proceeded to the office of the bank and took therefrom $100,000 in specie and bank notes.

46. (1819) 4 Wheaton 316, 407, 408, 411.
47. Holmes, *Collected Legal Papers* (1920) 268.
48. For " * * * the power to tax involves the power to destroy." 4 Wheat. at 327, 427, 431. Therefore " * * * that the power to destroy may defeat and render useless the power to create; that there is a plain repugnance, in conferring on one government a power to control the constitutional measures of another, which other, with respect to those very measures, is declared to be the supreme over that which exerts the control, are propositions not to be denied." Id. at 431.
49. 4 Wheaton at 432.
50. Id. at 430.
51. Id at 429. Cf. U. S. Const. Art. VI, Cl. 2.
52. (1824) 9 Wheaton 738.

The bank sued to recover this money and to enjoin the state officials from further proceeding under the act. The opinion, in substance reaffirming the *McCulloch* decision in holding the tax unlawful, is further important as an *ex post facto* explanation of the basis for the *McCulloch* decision. Here we find the Chief Justice speaking as though the immunity rested upon the will of Congress rather than upon constitutional compulsion.[53]

In both cases the court was confronted with a discriminatory tax.[54] Marshall, though, addressing himself to a problem larger than that in fact presented, used language applicable to non-discriminatory as well as discriminatory taxes. Throughout the opinions we find him speaking of "supremacy," a concept reiterated by his later statements.[55]

Marshall's "total failure" stage has for the most part been limited to that early period in our history when the nation and the states were potentially, if not actually, hostile sovereigns. When, however, we entered a period of assumed friendly relations and common purposes;[56] when the Court agreed that where the exercise of the right is lawful, the courts may not prevent its exercise because of the fear that it may, if indiscriminately extended, lead to disastrous results;[57] when an eminent authority pointed to the fallaciousness of the "power to tax is the power to destroy" argument;[58] the court dismissed this mechanical application for a more rational principle which gave full recognition to actualities.[59]

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53. Id. at 865, 868.

54. Even the most vitriolic opponents of the immunity agree that a discriminatory tax is invalid. For cases declaring a discriminatory tax invalid see Pelton v. Commercial Bank of Cleveland (1830) 101 U. S. 143; Boyer v. Boyer (1885) 113 U. S. 689; Schuylkill Trust Co. v. Pennsylvania (1936) 296 U. S. 113.

55. Weston v. Charleston (1829) 2 Peters 449, 466.

56. Dowling, Cheatham, and Hale, Mr. Justice Stone and the Constitution (1936) 36 Col. L. Rev. 351, 357.

57. Knowlton v. Moore (1900) 178 U. S. 41; Flint v. Stone Tracy Co. (1911) 220 U. S. 107, 169.

58. Powell, Indirect Encroachment on Federal Authority by the Taxing Powers of the States (1918) 31 Harv. L. Rev. 321. Cf. the statement of Mr. Justice Holmes, dissenting in Panhandle Oil Co. v. Knox (1928) 277 U. S. 218, 223: "The power to tax is not the power to destroy while this Court sits."

59. Educational Film Corp. v. Ward (1931) 282 U. S. 379; Fox Film Corp. v. Doyal (1932) 286 U. S. 123. Cf. Peckham, J., in Nicol v. Ames (1898) 173 U. S. 509, 516: "Taxation is eminently practical, and is in fact brought to every man's door, and for the purpose of deciding upon its validity a tax should be regarded in its actual, practical results, rather

Since the Court now views a tax in light of its "consequence to the operations of government," this must necessarily include a consideration of the support of the taxing state.[60] For the power to tax is the right to "keep alive."[61] Various criteria have been advanced: the tax may not be direct;[62] may not interfere with the efficient performance of governmental functions;[63] may not affect governmental efficiency.[64] Moreover, it has been said that the immunity extends only to functions which are strictly,[65] essentially,[66] usually,[67] or traditionally[68] governmental. The difficulty with these norms is that they permit the mind to wander afield[69] and consider matters having no relation to the problem of whether a governmental activity of the taxed sovereign is being subjected to "undue harm,"[70] which comes close to being a test of quantum.[71] The decisions defy any symmetrical plan; the boundaries of the doctrine are shaped by no ineluctable logic.

In another respect the doctrine has changed from that announced by Chief Justice Marshall. There is nothing in *McCulloch v. Maryland* to indicate that Marshall believed that the states enjoyed rights corresponding to the federal immunity from state taxation. In fact, he addressed himself to the argument that any principle that would sustain their subsumed right of the federal government to tax state banks would at the same

than with reference to those theoretical or abstract ideas whose correctness is the subject of dispute and contradiction among those who are experts in the science of political economy."

60. Cf. James v. Dravo Construction Co. (1937) 58 S. Ct. 208; South Carolina v. United States (1905) 199 U. S. 437; Chase, C. J., in Thomson v. Union Pacific R. R. (1869) 9 Wallace 579, 591; Hughes, C. J., in Helvering v. Mountain Products Corp. (1938) 58 S. Ct. 623.

61. Mr. Justice Peckham in Nicol v. Ames (1899) 173 U. S. 509, 515.

62. Metcalf & Eddy v. Mitchell (1926) 269 U. S. 514, 524.

63. National Bank v. Commonwealth (1869) 9 Wallace 353, 362.

64. Helvering v. Powers (1935) 293 U. S. 214, 255.

65. South Carolina v. United States (1905) 199 U. S. 437, 461.

66. Flint v. Stone Tracy Co. (1911) 220 U. S. 107, 172.

67. Helvering v. Powers (1934) 293 U. S. 214, 225.

68. United States v. California (1936) 297 U. S. 175, 184.

69. Watkins, The Power of the State and Federal Governments to Tax One Another (1938) 24 Va. L. Rev. 475, 501.

70. Dowling, Cheatham, and Hale, supra, note 56, at 353-357; Note (1937) 12 St. John's L. Rev. 81.

71. Cf. James v. Dravo Construction Co. (1937) 58 S. Ct. 208. Contra: Indian Motorcycle Co. v. United States (1931) 283 U. S. 570, 575: "Where the principle [of intergovernmental tax immunity] applies it is not affected by the amount of the particular tax or the extent of the resulting interference, but is absolute." Trinity Farm Construction Co. v. Grosjean (1933) 291 U. S. 466, 471.

time sustain the right of the states to tax national banks, and expressly rejected the parallel.[72] Then in 1869 Chief Justice Chase, in *Texas v. White*,[73] casually mentioned that we were "an indestructible Union composed of indestructible states." When this utterance was made, it is probably fair to say that the Chief Justice had no idea it would be relied upon to furnish an "indestructible" principle of taxation, making every rule of tax immunity applicable to the federal government applicable also to the states. From 1871, when Mr. Justice Nelson referred in *Collector v. Day*[74] to the principle of "equality," until May, 1938, such judicial utterances as there were seemed to support the proposition that the doctrine of the immunity of federal instrumentalities from state taxation extended to the states a corresponding immunity of their instrumentalities from federal taxation.[75]

III

Occasionally the federal government, unlike state governments, has waived its immunity and permitted the states to impose non-discriminatory taxes upon federal instrumentalities.[76] Its right to do so is unmistakably clear.[77] The most notable ex-

72. "But the two cases are not on the same reason. The people of all the States have created the general government. The people of all the States, and the States themselves, are represented in Congress, and, by their representatives, exercise this power. When they tax the chartered institutions of the States, they tax their constituents; and these taxes must be uniform." (1819) 4 Wheaton at 435.

But he continued: "When a State taxes the operations of the government of the United States, it acts upon institutions created, not by their constituents, but by people over whom they claim no control. It acts upon measures of a government created by others as well as themselves, for the benefit of others in common with themselves. The difference is that which always exists, and always must exist, between the action of the whole on a part, and the action of a part on the whole—between the laws of a government declared to be supreme, and those of a government which, when in opposition to those laws is not supreme." Id. at 436. Cf. Bradley, J., dissenting in Railroad Co. v. Penniston (1875) 85 U. S. 5, 48.

73. (1869) 7 Wallace 700.

74. (1871) 11 Wallace 113. The conclusion was not wholly unexpected. It had been hinted by Clifford, J., in Provident Savings Institution v. Massachusetts (1868) 6 Wallace 594, 638-9.

75. Metcalf and Eddy v. Mitchell (1926) 269 U. S. 514, 523-4; Willcuts v. Bunn (1931) 282 U. S. 216; Indian Motorcycle Co. v. United States (1932) 283 U. S. 570; Helvering v. Powers (1935) 293 U. S. 214; United States v. California (1936) 297 U. S. 175, 185; Brush v. Commissioner (1937) 300 U. S. 352; James v. Dravo Contracting Co. (1937) 58 S. Ct. 208, 231; Cohen and Dayton, Federal Taxation of State Activities and State Taxation of Federal Activities (1925) 34 Yale L. J. 807.

76. (1918) 40 Stat. 458, (1928) 43 U. S. C. A. secs. 337-8 (consenting to state taxation of railroads during government operation).

77. Van Allen v. The Assessors (1865) 3 Wallace 573, 583, 585.

ample has been in authorizing the states to tax national banks.[78] Since 1864,[79] the states have been permitted to impose a general tax on the shares of stock in national banks.

When, in 1933,[80] the Reconstruction Finance Corporation was authorized to lend money to banks on preferred stock of the borrowing institution, the problem was presented whether these shares were taxable in the hands of the Reconstruction Finance Corporation. One statute provided that "all" shares of a national bank were taxable. Another statute extended to the Reconstruction Finance Corporation general tax-emption privileges. A lower federal court and the Maine Supreme Court regarded the latter statute as controlling and held the tax improper as a tax on a federal instrumentality.[81] The Maryland Supreme Court held the tax valid on the basis that the Reconstruction Finance Corporation was not entitled to the benefit of the government's tax immunity because not engaged in an essential governmental function.[82] On appeal the Supreme Court upheld the judgment in the Maryland case[83] without, however, affirming the reasoning. The Supreme Court found the Reconstruction Finance Corporation to be acting in furtherance of a governmental activity[84] but sustained the state tax on the ground that Congress had removed the barrier against state taxation.[85] The Reconstruction Finance Corporation, therefore, was to be regarded as any other stockholder.[86] Subsequently a bill to make the stock of national banks

78. Owensboro National Bank v. Owensboro (1899) 173 U. S. 564; Iowa-Des Moines National Bank v. Bennett (1931) 284 U. S. 239; Note (1931) 17 ST. LOUIS LAW REVIEW 38.

79. (1864) 13 Stat. 99, 112.

80. (1933) 48 Stat. 5, 6, (1936) 12 U. S. C. A. sec. 51a-d, as amended (1933) 48 Stat. 20, 21, (1936) 12 U. S. C. A. sec. 51d.

81. United States v. Lewis (W. D. Ky. 1935) 10 F. Supp. 471; Opinion of the Justices (Me. 1935) 177 Atl. 897.

82. State Tax Commission v. Baltimore National Bank (1935) 169 Md. 65, 180 Atl. 260, cert. granted (1935) 296 U. S. 538.

83. Baltimore National Bank v. Tax Commission (1936) 297 U. S. 209.

84. Id. at 211.

85. It is a well settled rule of statutory construction that an act whose terms are specific is to be construed as an exception to one more general in terms. Kepner v. United States (1904) 195 U. S. 100, 125; Townsend v. Little (1883) 109 U. S. 504, 512. It seems, then, that the Court's view that the act creating the R. F. C. and granting to it immunity from taxation was not intended to preclude the operation of the earlier act withdrawing the immunity from national bank shares is correct. See Comment (1936) 84 U. Pa. L. Rev. 793.

86. Shares of stock of a national bank held by another national bank are taxable. Bank v. Boston (1888) 125 U. S. 60, 69-70; Bank of California

acquired by the Reconstruction Finance Corporation exempt from state taxation was passed.[87] In the light of the Supreme Court's holding in *Smith v. Kansas City Title & Trust Co.*[88] the right of Congress to exempt these shares from state taxation seems indisputable.

In many states, statutes provide that no mortgage may be filed or received in evidence in any proceeding, on which a mortgage registration fee has not been paid. The general counsel of the Home Owners' Loan Corporation ruled, shortly after the corporation was organized, that mortgages taken over by the corporation are exempt from state mortgage recording taxes.[89] The Supreme Court had earlier declared this to be the law where the federal act expressly made the mortgages federal instrumentalities.[90] Some states passed laws expressly exempting the federal lending agencies from the operation of this requirement,[91] while in other states the result was reached by holding that the statute could not constitutionally apply because it would amount to a tax on a federal instrumentality.[92]

IV

State incorporation of federal-owned corporations has given rise to legal as well as political questions. From the taxation

v. Richardson (1919) 248 U. S. 476, 483; Des Moines National Bank v. Fairweather (1923) 263 U. S. 103.

87. The bill was originally introduced in Congress immediately following the decision upholding the state tax. The measure passed the Senate but was defeated in the House by a narrow margin. N. Y. Times, Feb. 26, 1936, p. 1: 4. The measure was reintroduced and was subjected to vigorous debate. See 80 Cong. Rec. 4041 et seq. (March 19, 1936). Representative Patman denounced the act as a "banker's bonus bill" (at p. 4062). Representative Hancock was of the opinion that the towns gained more by the Reconstruction Finance Corporation saving their banks than from taxes (at p. 4045). The bill passed on March 20, 1936. 49 Stat. 1185, (1936) 12 U. S. C. A. sec. 51d.

88. (1921) 255 U. S. 180, 211: "Deciding, as we do, that these institutions have been created by Congress within the exercise of its legitimate authority, we think the power to make the securities here involvd tax exempt necessarily follows."

89. (1933) 1 U. S. Law Week 116.

90. Federal Land Bank of New Orleans v. Crosland (1923) 261 U. S. 374, rev'g (1922) 207 Ala. 456. The court reached this conclusion even though the land bank could compel the borrower to reimburse it for the tax.

91. See, for example, N. Y. Laws of 1933 (Ex. Sess.) c. 785. Held constitutional in Home Owners' Loan Corporation v. Barbone (Sup. Ct. 1937) 164 Misc. 187, 298 N. Y. S. 531.

92. Home Owners' Loan Corporation v. Anderson (1937) 145 Kansas 209, 64 P. (2d) 14; Ops. Att'y Gen. of Pa. (1935-1936) No. 176, p. 55 (reversing an earlier ruling).

angle it is clear that the incorporating state may exact such general incorporation fees as it levies against all other corporations.[93] May such a corporation do business in other states unqualifiedly? In only one instance has a state attempted to restrict this right. Maryland sought to collect its usual foreign corporation qualifying tax from the Electric Home and Farm Authority, incorporated in Delaware and later under the laws of the District of Columbia.[94] The Comptroller General, however, ruled such an exaction unauthorized because the Authority was "an instrumentality of the United States."[95] If that is so, certainly a corporation created by statute should not be required to pay an entrance fee in order to do business within a state. Such authority as there is on this problem so holds.[96] While the Supreme Court has sustained a federal tax on a corporate franchise granted by a state,[97] it has denied the states the right to levy a tax on a franchise granted by Congress.[98] Recently, a state tax on the equivalent of a federal franchise was sustained[99] where there was no exemption expressly provided. Where, as in the case of the government corporations, Congress has expressly provided against state taxation of a federally-granted "franchise," it is doubtful that the Court would sustain such a tax. A patent and a copyright are held for private gain; government corporations are not profit-making agencies; they are instrumentalities through which the government performs its functions.

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93. Delaware, where most of the state-chartered federal-owned corporations were chartered, waived payment of the usual incorporation taxes; charged only nominal fees for services actually rendered, such as the filing of the application and the issuing of certificates; waived the annual franchise taxes; and charged only a nominal fee for the filing of the annual report. Schnell, Federally Owned Corporations and their Legal Problems (1936) 14 N. C. L. Rev. 337, 349. See also letter of Comptroller General McCarl reprinted in 78 Cong. Rec. 1053 (Jan. 22, 1934).

94. (1935) 95 Baltimore Daily Record 1.

95. (1936) Compt. Gen. Dec. No. A-71363.

96. Federal Land Bank of Spokane v. Statelen (Wash. 1937) 70 P. (2d) 1053.

97. Flint v. Stone Tracy Co. (1911) 220 U. S. 107.

98. California v. Central Pacific R. R. Co. (1888) 127 U. S. 1. But a few years later the Court, over the dissents of Justices Field and Harlan, permitted the state to tax the value of the state franchise of the railroad. The dissenters thought that the two franchises, under which the railroad operated, were so blended together as to defy separate evaluation. Central Pacific R. R. v. California (1896) 162 U. S. 91.

99. Education Film Corp. v. Ward (1931) 282 U. S. 379; Fox Film Corp. v. Doyal (1932) 286 U. S. 123.

V

With the government-owned corporations holding vast amounts of property and with the Attorney General advising the corporations to resist all taxes[100] except those which they are expressly authorized to pay, it becomes important to consider the law relating to state taxation of property owned by federal-owned corporations.[100a]

The first official opinion that there rests no power in a state to tax the property of the United States situated within its borders was in 1806.[101] In 1819, Chief Justice Marshall, in *McCulloch v. Maryland*,[102] casually announced the *dictum*,[103] which he repeated in *Osborn v. United States*,[104] that the local property of the United States Bank could be taxed by the state of Maryland. It remained for a later opinion of Marshall's to clarify this statement. In *Weston v. Charleston*[105] he said that property "acquired by the corporation" would be taxable by the state. The original property of the instrumentality was not then subject to state taxation, but only the property which it acquired in the course of its dealings. Save for two unreported cases,[106] the Court has consistently held that no state can tax property of the

100. (1934) 38 Ops. Att'y Gen. 2.

100a. There is no need to discuss this problem from the viewpoint of state-owned corporations since the federal government is, owing to the requirement of the apportionment of direct taxes, unable effectively to levy a property tax.

101. (1806) 1 Ops. Att'y Gen. 157.

102. (1819) 4 Wheaton 316.

103. Id. at 436-437.

104. (1824) 9 Wheaton 738, 867.

105. Weston v. Charleston (1829) 2 Peters 449, 468.

106. United States v. Portland (1847), involving tax on land owned by United States and used for custom house; evenly divided court on a certification from Circuit Court remanded the case, but Maine repealed the law and so case never came up again; Roach v. Philadelphia County, where tax on building of United States Mint was sustained by the Pennsylvania courts, and affirmed by an equal division of opinion in the Supreme Court. These two cases are mentioned in Van Brocklin v. Tennessee (1886) 117 U. S. 151, 175, 176.

Originally the Court held invalid the attempts of a state to assess an *ad valorem* tax to the lessee of Indian land on ores extracted from the land but before sale and before the equitable interests of the Indians had been paid. Jaybird Mining Co. v. Weir (1926) 271 U. S. 609. But where the lessee of Indian land had extracted oil and stored it in his own tanks, the Court held that a state might lawfully levy an *ad valorem* tax. Indian Territory Illuminating Oil Co. v. Board of Equalization (1933) 288 U. S. 325; Taber v. Indian Territory Illuminating Oil Co. (1937) 300 U. S. 1 (*ad valorem* tax on equipment employed in drilling for oil and gas). Cf. British American Oil Producing Co. v. Montana (1936) 299 U. S. 159.

United States without consent,[107] nor property which the United States has sold until the government has parted with legal and equitable title.[108]

Does this same immunity apply when title to the property is in the name of a corporation? The Supreme Court, with deference to the state's need for revenue, early held that a state might lawfully tax property of a private corporation engaged in performing duties imposed on it by Congress where Congress had not expressly provided that it be tax-exempt.[109] There is, as Chief Justice Chase said, "a clear distinction between the means employed by the government and the property of agents employed by the government."[110] His recognition that a different conclusion would apply to federal instrumentalities created for constitutional ends[111] foreshadowed the later rebuffs by the courts of every attempt on the part of states to tax property of

107. Van Brocklin v. Tennessee (1886) 117 U. S. 151; Wisconsin, etc., R. R. v. Price County (1890) 133 U. S. 496; Lee v. Osceola Improvement District (1925) 268 U. S. 643; United States v. Hoboken (D. C. D. N. J. 1928) 29 F. (2d) 932; (1911) 28 Ops. Att'y Gen. 604; De La Vergne Machine Co. v. Commission (1925) 211 App. Div. 227, 207 N. Y. S. 680, aff'd (1925) 241 N. Y. 517, 150 N. E. 536.

108. New Brunswick v. United States (1928) 276 U. S. 547; Railroad Co. v. Prescott (1872) 16 Wall. 603; R. R. v. McShane (1874) 22 Wall. 444; Railroad Co. v. Traill County (1885) 115 U. S. 600; Tucker v. Ferguson (1875) 22 Wall. 527; United States v. Rickert (1903) 188 U. S. 432; Irwin v. Wright (1922) 258 U. S. 219; Lincoln County v. Pacific Spruce Corp. (C. C. A. 9, 1928) 26 F. (2d) 435, aff'g (D. C. D. Ore. 1927) 21 F. (2d) 586; Port Angeles Western R. R. v. Clallam County (D. C. W. D. Wash. 1927) 20 F. (2d) 202; United States v. Milwaukee (D. C. E. D. Wis. 1893) 100 Fed. 828; Philadelphia v. Meyers (1931) 102 Pa. Super. 424, 157 Atl. 13; Mint Realty Co. v. Philadelphia (1907) 218 Pa. 104, 66 Atl. 1130; Copp v. State (1911) 69 W. Va. 444, 71 S. E. 580. But the state may tax the purchaser's interest in the land. Port Angeles Western R. R. v. Clallam County (D. C. W. D. Wash. 1930) 36 F. (2d) 956, aff'd (C. C. A. 9, 1931) 44 F. (2d) 28, cert. denied (1931) 283 U. S. 848; New Brunswick v. United States (1928) 276 U. S. 547, 556, modifying (C. C. A. 3, 1926) 11 F. (2d) 476.

109. Thomson v. Pacific R. R. (1869) 9 Wall. 579 (1869) Railroad Co. v. Peniston (1873) 18 Wall. 5; Baltimore Shipbuilding & Dry Dock Co. v. Baltimore (1904) 195 U. S. 375 (1904); Alward v. Johnson (1931) 282 U. S. 509; Susquehanna Power Co. v. State Tax Commission of Maryland (1931) 283 U. S. 291; Choctaw, etc., R. R. v. Mackey (1921) 256 U. S. 531; Thomas v. Gay (1898) 169 U. S. 264. The same rule applies to privately owned property under the control of the United States through the exercise of war power, see St. Louis, etc., Ry. v. Middlekamp (1920) 256 U. S. 226, and to property under the control of officers of the United States courts by virtue of receivership or bankruptcy proceedings. Stevens v. New York & O. M. R. Co. (C. C. S. D. N. Y. 1875) 23 Fed. Cas. No. 13,405; Swartz v. Hammer (1904) 194 U. S. 441.

110. In Thomson v. Pacific R. R. (1869) 9 Wall. 579, 591.

111. Id. at 590.

wholly government-owned but state-incorporated corporations.[112] The reasoning of all the last-cited cases was essentially the same: first, taxation of the property is not necessarily taxation of the means, except where property is itself the only means and instrumentality by which the federal purpose can be performed; second, property does not lose its public character merely because the government chooses for its own convenience to have legal title taken in the name of a corporation, which it brings into existence and completely controls.

These decisions, all on war-time corporations, rest heavily on the fact that the corporations were utilized to facilitate prosecution of the war. Only one case has arisen from the attempt of a state to tax the property of a peace-time government corporation.[113] A similar result obtained, but it is not clear whether the decision rests chiefly on the implied immunity which prompted the conclusions in the cases concerned with the war-time corporations, or whether the court was merely giving effect to the statute declaring the corporation exempt from state excise taxes.

VI

Insofar as the doctrine of inter-governmental tax immunity grants an exemption to state or federal employees from taxation of their salaries by the other government, it is the least satisfactory segment of the anachronistic tenet.

Since 1842, when the Court in *Dobbins v. Commissioner*[114] held it unlawful for a state to tax the office of a captain in the United States revenue-cutter service, it has been generally accepted that a state may not tax the salary of an employee of the federal government.

112. United States Spruce Production Corporation: Clallam County v. United States Spruce Production Corporation (1923) 263 U. S. 341; United State Spruce Production Corporation v. Lincoln County (D. C. D. Ore. 1922) 285 Fed. 388; Lincoln County v. Pacific Spruce Corp. (C. C. A. 9, 1928) 26 F. (2d) 435. Emergency Fleet Corporation: United States v. Coughlin (D. C. D. Md. 1919) 261 Fed. 425; King County v. U. S. Shipping Board Emergency Fleet Corp. (C. C. A. 9, 1922) 282 Fed. 950; U. S. Shipping Board Emergency Fleet Corporation v. Delaware County (C. C. A. 3, 1928) 17 F. (2d) 40, aff'd on rehearing (C. C. A. 3, 1928) 25 F. (2d) 722, appeal dismissed (1927) 275 U. S. 483, cert. denied (1928) 278 U. S. 607. United States Housing Corporation: Brunswick v. United States (1928) 276 U. S. 547; U. S. Housing Corp. v. Watertown (Sup. Ct. 1920) 113 Misc. 679, 186 N. Y. S. 309.

113. Federal Land Bank of Columbia v. Highway Dept. of South Carolina (1933) 172 S. C. 174, 173 S. E. 284.

114. (1842) 16 Peters 435.

Suppose the taxpayer is employed by a wholly government-owned corporation? The general counsel of the Home Owners' Loan Corporation has ruled that the salaries of employees of the corporation are not subject to state taxation.[115] The Montana Supreme Court, however, has sustained state taxation of the salary of an employee of the Reconstruction Finance Corporation.[116] The salary of an official of a federal land bank has been held subject to taxation by the Supreme Court of Mississippi.[117] The Kansas Supreme Court held the salary of a clerk employed by corporations comprising the Wichita farm credit district[118] subject to state income tax, not relying on any one ground but announcing three bases: (1) the corporations are not engaged in essential governmental functions; (2) the tax would not unduly interfere with the operations of the government, and (3) Congress by failing to expressly exempt the salary of the employees of a corporation, while at the same time enumerating other exemptions, indicated that it did not intend that the employees' salaries should be immune from state taxation.[119]

The Supreme Court has not as yet been called upon to determine whether the immunity extends to employees of the recently-organized federal-owned corporations. While it is always hazardous to predict the view which the court will follow, it does not seem unreasonable to suggest that the Court will probably dismiss as unreal a distinction based upon the fact that the employees are technically employees of the corporations rather than

115. Ruling of June 10, 1936. The ruling is premised upon the unconvincing reasoning that if a state were permitted to tax the employee's salary, it would be necessary for the corporation to raise wages, and this would burden and impede the corporation in the performance of governmental functions.

116. Pomeroy v. State Board of Equalization (1935) 99 Mont. 534, 45 P. (2d) 316. The wholesome result is buttressed by unsound reasoning. Matthews, J., speaking for the court was of the opinion that employees of government-owned corporations were not entitled to the immunity enjoyed by those government workers employed by government departments or agencies. But the government regards the employees of both the corporations and the agencies similarly in most respects. See (1936) 49 Stat. 1161, (1938 Supp.) 5 U. S. C. A. secs. 29a, 31a, 30b, 30c, 30d (vacations and sick leave); (1937) 50 Stat. 528, (1938 Supp.) 7 U. S. C. A. sec. 1015 (compensation benefits); Exec. Order No. 6746, June 21, 1934; (1935) 49 Stat. 620, 639, 643, (1938 Supp.) 42 U. S. C. A. secs. 301-2, 1011, 1101-2, 1108-9 (both excluded from old-age benefits and unemployment insurance).

117. Parker v. State Tax Commission (Miss. 1937) 174 So. 567.

118. Federal Land Bank, Federal Intermediate Credit Bank, Production Credit Corporation, and Bank for Cooperatives.

119. Clinton v. State Tax Commission (Kan. 1937) 71 P. (2d) 857.

of the government. This prediction is not based upon surmise alone. The Court has held immune from state taxation the salary of an employee of the government-owned Panama Canal Railroad, which in addition to its railroad across the Isthmus of Panama operates a steamship line, a commissary, a dairy, and two hotels.[120]

In *Collector v. Day* the Court ruled, over the dissent of Mr. Justice Bradley, that the salary of a state judge was exempt from federal taxation.[121] The decision is one of the unhappy aftermaths of the Civil War.[121a] Insofar as the opinion proceeds upon the premise of parity between the state and federal sovereigns, it is diametrically opposed to Marshall's concept of federal supremacy announced in the vanguard case of *McCulloch v. Maryland.* In 1871 the Court had not yet fully determined to what extent the Civil War Amendments had enlarged the federal power at the expense of the states.[122] Having witnessed the exercise of the federal taxing power to destroy a state function,[123] the Court was undoubtedly tacitly solicitous of the continued existence of the states as governmental units. It may well be that the Court looked askance at any endeavor to extend the federal taxing power[124] to reach the salaries of officials engaged in the performance of a function which pertained to state governments at the time the Constitution was adopted and without which no state could long preserve its orderly existence.

120. People ex rel. Rogers v. Graves (1936) 299 U. S. 401, rev'g (1936) 271 N. Y. 543, 2 N. E. (2d) 686; Comment (1937) 23 Va. L. Rev. 922. It is noteworthy that in 1905 the Attorney General ruled that employees of the Panama Railroad Company were not "employees of the United States." (1905) 25 Ops. Att'y Gen. 465. The Court in the instant case reasoned thus: The acquisition, construction, and maintenance of the Canal was a proper exercise by Congress of its power to provide for the national defense and regulation of commerce; the railroad is a cooperating auxiliary of the Canal; therefore, the railroad company is a government instrumentality. So: " * * * the Railroad company being immune from state taxation, it necessarily results that fixed salaries and compensation paid to its officers and employees in their capacity as such are likewise immune." 299 U. S. at 408. Mr. Justice Sutherland, speaking for the Court, went on to say: "The primary purpose of the enterprise being legitimately governmental, its incidental use for private purposes affords no ground for objection."

121. (1871) 11 Wall. 113.

121a. The Supreme Court has recently acknowledged this fact. See Stone, J., in Helvering v. Gerhardt (1938) 58 S. Ct. 969.

122. Cf. Slaughterhouse Cases (1872) 16 Wall. 36.

123. Veazie Bank v. Fenno (1869) 8 Wall. 533.

124. Cf. Lane County v. Oregon (1869) 7 Wall. 71, 76, 77; Slaughterhouse Cases (1873) 16 Wall. 36, 82.

The doctrine of *Collector v. Day* has been more strictly applied than that of *Dobbins v. Commissioner*. Often the Court would say that the *Day* case was limited to instances where the employee was engaged in a function "usually" or "traditionally" performed by the state. In two important cases the Court upheld application of the federal income tax to the salaries of an adviser to the state on water supply and sewage disposal[125] and of employees of a state-owned corporation, the Boston Elevated Railway.[126] In the spring of 1937 the Court seemed to make an about-face. Over the vigorous protest of two dissenting and two concurring justices, the majority held the salary of the chief engineer of the Bureau of Water Supply of New York City not subject to federal income tax,[127] pointing to the important relation between the conservation and distribution of water supply and the maintenance of health, disposal of sewage, fire protection, *et cetera,* in reaching the conclusion that the petitioner was employed in connection with a purely governmental function. If the *ratio decidendi* of the case was at all valid, it meant that where a state or its political subdivision performed a service of vital importance to the public, that service would be regarded as an essential governmental function although the activity could be and often was performed under the auspices of private capital. Surely the case rejected the argument that the immunity extends only to employees performing functions traditionally governmental.

With the change in personnel of the Court[128] came a change in the judicial proclivity. Despite a favorable decision,[129] in

125. Metcalf and Eddy v. Mitchell (1926) 269 U. S. 514.

126. Helvering v. Powers (1934) 293 U. S. 214.

127. Brush v. Commissioner (1937) 300 U. S. 352. Mr. Justice Roberts and Mr. Justice Brandeis dissented upon the ground that where, as here, the tax falls equally upon all employed in a like occupation, and the burden of the tax on the state is uncertain, the constitutional principle of immunity is inapplicable. Mr. Justice Stone and Mr. Justice Cardozo concurred in the result only because they believed that the petitioner came within the terms of the exemption prescribed by Treasury Reg. No. 74, art. 643. See for an excellent comment (1937) 22 WASHINGTON U. LAW QUARTERLY 572. See also comments (1937) 37 Col. L. Rev. 1019; (1937) 21 Minn. L. R. 866; (1937) 14 N. Y. U. L. Q. Rev. 550.

128. Mr. Justice Black replaced Mr. Justice Van Devanter, and Mr. Justice Reed succeeded Mr. Justice Sutherland.

129. Helvering v. Therrell (1938) 303 U. S. 218, upholding the applicability of the federal income tax to the salary of a state-appointed bank liquidator, which salary was ultimately paid from the corporate assets of the solvent bank. Cf. Lucas v. Reed (1930) 281 U. S. 699.

which foreshadowing *dicta* went largely unnoticed,[130] few were prepared for the opinion which Mr. Justice Stone rendered in *Helvering v. Gerhardt* on May 23, 1938.[131] Philip L. Gerhardt was a salaried employee of the Port of New York Authority, a non-stock bi-state corporation existing by virtue of congressional authorization.[132] It engaged in the construction, operation, and maintenance of transportation facilities within the Port of New York district, which collects tolls, issues its own securities, and has been a rather profitable undertaking.[133] Relying upon earlier rulings of the Board of Tax Appeals,[134] Gerhardt resisted efforts to collect federal income tax on his salary, and the Board of Tax Appeals and the Second Circuit Court of Appeals sustained his position. Before the Supreme Court, the government admitted the validity of the doctrine of *Collector v. Day*[135] but sought to sustain the tax on other grounds.[136] With unconventional[137] suddenness, the Court "overruled a century of precedents"[138] and held that the immunity doctrine did not exempt the employee's salary from the federal income tax.[139] The decision rests on two bases: first, the activities of the Port of New York Authority are not considered essential to the state's continued

130. (1938) 303 U. S. at 223: "The United States may not tax instrumentalities which a state may employ in the discharge of her essential governmental duties—that is those duties which the framers intended each member of the union would assume in order adequately to function under the form of government guaranteed by the Constitution."

131. (1938) 330 U. S. 630.

132. Pub. Res. No. 66, 67th Cong., H. S. Res. No. 337 (1922) 42 Stat. 822.

133. *Seventeenth Annual Report* (1937) 42.

134. Moissieff v. Comm. (1930) 21 B. T. A. 515; Carey v. Comm. (1934) 31 B. T. A. 839.

135. *Transcript of Oral Argument*, pp. 7-8.

136. Namely, that (1) the activities of the Port Authority were proprietary in nature, (2) the Port Authority was an agency not created by the states alone, and (3) the Port Authority operates in interstate commerce, subject to the paramount power of Congress.

137. It is significant that in James v. Dravo Contracting Co. (1938) 302 U. S. 134 and Silas Mason Co. v. Tax Comm. (1938) 302 U. S. 186, where the Court entertained doubts upon the immunity of income derived by contractors from work for the United States, the cases were set down for reargument, on the issue, before the previously-existing doctrine was overruled.

138. Mr. Justice Butler and Mr. Justice McReynolds dissenting. (1938) 58 S. Ct. at 980.

139. Mr. Justice Black concurred separately. He suggested that, since the cases were irreconcilable, the entire subject of intergovernmental tax immunity should be reexamined and considered in light of the Sixteenth Amendment.

existence as a government entity; second, even if the function itself was immune, the burden on the state of a federal tax on state employees "was too speculative and uncertain" to justify the claimed immunity. After suggesting an unsatisfactory distinction of *Brush v. Commissioner,*[139a] the majority confessed that the latter was "limited" by what was now said. Actually, the *Brush* case was overruled. The decision attracted added attention because it followed closely upon President Roosevelt's plea[140] for a "simple statute" permitting federal taxation of state securities and the salaries of state employees, and permitting state taxation of federal securities and the salaries of federal employees.

The decision opens up a vast reservoir of revenue heretofore regarded as immune from the federal income tax.[141] It affords some ground for a forthcoming declaration that the immunity doctrine is not reciprocal.[142] It denotes a tendency narrowly to restrict the doctrine. It announces a new test of immunity, *viz.*, that the federal government may tax any state function which is "not one without which a state could not continue to exist as a governmental entity." It abandons the postulate that any economic burden that may be passed on to the state government and thus increase the state's expenses is an unconstitutional exaction.[143]

Judicial delimitation of the tax-exempt categories could best begin with the salaries of government employees. Even if the doctrine of immunity has some validity when applied to the taxation directly of government instrumentalities, the taxing of the salary of an employee cannot affect the activities which the state or federal-owned corporations are designed to pursue.[144] In the

139a. (1937) 300 U. S. 352. It is inaccurate to say that the Brush case was a decision on the applicability of the Treasury Regulation. Only Mr. Justice Stone and Mr. Justice Cardozo regarded it as such at the time. Five members of the Court rested the decision on the constitutional basis.

140. Message to Congress on April 25, 1938. N. Y. Times, April 26, 1938, p. 1: 3.

141. It is unlikely that Congress will permit the Treasury Department to assess back-taxes on the state employees affected by the Gerhardt decision. Cf. sec. 1211 of the Revenue Act of 1926, 44 Stat. 130; and cf. Cardozo, J., in Great Northern Ry. v. Sunburst Oil and Refining Co. (1932) 287 U. S. 358, 365.

142. (1938) 58 S. Ct. 969, 970-973.

143. Id. at 976.

144. Powell, Indirect Encroachment upon Federal Authority by the Taxing Power of the States (1919) 32 Harv. L. Rev. 902, 927-928; Magill, Tax Exemption of State Employees (1926) 35 Yale L. J. 956.

Gerhardt case Mr. Justice Stone announced that the fact that an activity might be immune was no assurance that the salary derived from such operation should be, because the effect of such tax was conjectural. The income from a source and the source itself are separate and distinct taxable subjects; a tax upon income is not equivalent to a tax upon the source.[145] When a salary is paid, it is divorced from its source.[146] There is no reason why the government employee should not contribute his proportionate share of the cost of the protection which the other sovereign gives him. A tax would be impalpable in influencing an employee to accept a position with the government rather than with a private employer. If a tax did in fact cause a government to raise salaries to mitigate the tax burden, this result would be simply a normal consequence of the existence within the same territory of two governments both possessing a taxing power.[147]

VII

In the field of state taxation of federal securities and federal taxation of state securities, the Court has disregarded economic realities and accepted a conceptualistic approach.

The federal corporations' power to issue bonds is expressly given.[148] They often are required to issue their security obligations through the Secretary of the Treasury,[149] whose approval is a prerequisite to issuance.[150] Some of the bonds are "fully and

145. N. Y. ex rel. Cohen v. Graves (1937) 300 U. S. 308, 313, 314; Hale v. State Board (1937) 302 U. S. 95; Adams Mfg. Co. v. Storen (1938) 304 U. S. 307, all overruling *sub silentio* Pollock v. Farmers' Loan and Trust Co. (1895) 157 U. S. 429; (1896) 158 U. S. 601.

146. Cf. Holmes, J., dissenting in Evans v. Gore (1920) 253 U. S. 245.

147. Cf. Stone, J., in Helvering v. Gerhardt (1938) 58 S. Ct. 969, 976.

148. In the field of private corporations the power to borrow money for purposes incidental to corporate existence is generally implied. 6 Fletcher, *Private Corporations* (Perm. Ed. 1931) sec. 2610. Of the federal-owned corporations, only two do not have the power to issue bonds. Farmers' Home Corp. (1937) 50 Stat. 527, (1938 Supp.) 7 U. S. C. A. sec. 1014, and Federal Crop Insurance Corp., Pub. No. 430, 75th Cong., 3d Sess. (1938). Both are bodies corporate "within" the Department of Agriculture.

149. See, for example, sec. 20(e) of United States Housing Act. (1937) 50 Stat. 888, (1938 Supp.) 42 U. S. C. A. secs. 1401-2. It is customary to provide that the Secretary prepare the forms of bonds, and that the engraved plates, dies, etc., executed in connection therewith shall remain in the custody of the Secretary of the Treasury. The issuing corporation is to reimburse the Secretary of the Treasury for any expense incurred in this connection. See sec. 11 of R. F. C. Act (1932) 47 Stat. 5; sec. 23 of Federal Home Loan Bank Act (1932) 47 Stat. 725.

150. The Secretary's approval is required before the following corporations may issue debentures: Reconstruction Finance Corporation, Home Owners' Loan Corporation, Federal Farm Mortgage Corporation, U. S. Housing Authority, and Commodity Credit Corporation.

unconditionally guaranteed both as to principal and interest" by the United States;[151] others must appeal to purchasers without this guarantee.[152] But with a few exceptions, all are tax-exempt.[153] That Congress can, if it sees fit, exempt such securities from state taxation seems to the Supreme Court "obvious upon the clearest principles."[154]

The doctrine denying to the states the right to levy an excise tax on federal securities, which immunity the government corporations are claiming,[155] was first announced by Chief Justice Marshall in *Weston v. Town of Charleston.*[156] The case is in one respect a narrow application of the rule of immunity, because here the tax was levied against the exercise of one of Congress' expressed powers, *viz.*, the power to borrow money; in another it extends the rule because the taxpayer was a private person and not the government. Since Marshall regarded the right to impose a tax, if it exists, as "acknowledging no limit,"[157] he disregarded the discriminatory nature of the tax involved.[158]

151. Reconstruction Finance Corporation, Home Owners' Loan Corporation, Commodity Credit Corporation, Federal Farm Mortgage Corporation, and U. S. Housing Authority. The acts generally provide that the government's guarantee shall be expressed on the face of the obligation. The right of the government to guarantee the obligations issued by its agencies is an aspect of the right to borrow on the credit of the United States. (1933) 37 Ops. Att'y Gen. 241, 247: "The power to borrow on the credit of the United States necessarily includes the power to make only a partial use of that credit for borrowing purposes." (1933) 38 Ops. Att'y Gen. 258, 272: "The power to expend necessarily includes the power to assume contractually obligations to pay money, and contingent obligations are as much within the power as are absolute promises. Furthermore, the power of the Congress to borrow on the credit of the United States—which must permit borrowings for all purposes for which the Congress is authorized to make expenditures—logically [legally?] authorize a guarantee by the United States of obligations incurred by its agencies in borrowing money." Originally the bonds of the Home Owners' Loan Corporation were guaranteed only as to interest; but now they are fully guaranteed as to both principal and interest. The bonds of the federal land banks were originally guaranteed as to interest but are now no longer guaranteed at all. (1934) 48 Stat. 346, (1936) 12 U. S. C. A. sec. 992a.

152. Federal Deposit Insurance Corporation, National Mortgage Associations (neither of these corporations having issued any bonds as yet), corporations under the supervision of the Federal Home Loan Bank Board, and Farm Credit Administration.

153. See discussion in text, supra, at notes 35-41.

154. Smith v. Kansas City Title & Trust Co. (1922) 255 U. S. 180, 212.

155. (1933) 37 Ops. Att'y Gen. 241, holding the immunity valid as to bonds issued by the H. O. L. C., and indicating that the rule of the Smith case, (1922) 255 U. S. 180, could sustain the immunity as to all other government corporations.

156. (1829) 2 Peters 449.

157. 2 Peters at 466.

158. Only five items were taxed under the act in question. Because, however, it was a hostile discrimination, Mr. Justice Johnson thought that the

The national government's inability to tax the income from state securities dates from *Pollock v. Farmers' Loan and Trust Co.*[159] The entire Court, divided on other issues, agreed that the tax upon income from state and municipal bonds was unconstitutional,[160] failing to recognize the important distinction between a tax upon the income from the bonds and a tax directly upon the bonds. Viewing the tax as one of the obligations,[161] the Court had only to rely on precedent to hold the tax unconstitutional.[162] Had the distinction been appreciated, the Court would have not been driven to its unfortunate conclusion. This is clear from the opinion rendered upon rehearing.[163] After explaining that the first opinion ruled that income from municipal bonds could not be taxed because of "want of power to tax the source,"[164] the Chief Justice went on to announce that "income is taxable irrespective of the source from whence it is derived."[165] But the damage was done. Subsequent courts accepted the doctrine that the federal government had no power to tax the income from state securities without challenge.

The immunity, where it exists, is not confined to securities issued directly by the government; it extends to the securities issued by federal instrumentalities[166] or by state instrumentalities[167] except where the federal tax is supported by other expressed powers.[168] Attempts to escape the rule of the *Weston*

tax should have been sustained. Id. at 472-473. Mr. Justice Thompson, dissenting, accused the majority decision of "establishing a privileged class of public creditors, who, though living under the protection of the government, are exempted from bearing any of its burdens." Id. at 478.

159. In which the income tax provisions of the 1894 Revenue Act were declared unconstitutional. (1895) 157 U. S. 429; (1896) 158 U. S. 601. The case was the first in which a stockholder's suit was used to contest the validity of a federal law. See Frankfurter and Fisher, The Business of the Supreme Court at the October Terms, 1935 and 1936 (1938) 51 Harv. L. Rev. 577,629.

160. Fuller, C. J., for the majority, 157 U. S. at 429; Field, J., id. at 601-604; White, J., id. at 652; Harlan, J., id. at 652-654.

161. Id. at 429, 586, 601-3, 652, 653-4.

162. United States v. B. & O. R. R. (1872) 17 Wall. 322, holding unconstitutional a federal income tax on private bonds owned by a municipality.

163. (1896) 158 U. S. 601.

164. 158 U. S. at 618.

165. 158 U. S. at 629.

166. Bank of Louisville v. Kentucky (1869) 9 Wall. 353 (national banks); Farmers and Mechanics Savings Bank v. Minnesota (1914) 232 U. S. 516 (territorial municipalities).

167. Pollock v. Farmers' Loan and Trust Co. (1896) 158 U. S. 601. But cf. Flint v. Stone Tracy Co. (1911) 220 U. S. 107.

168. Veazie Bank v. Fenno (1869) 8 Wall. 533; Trustees of Illinois University v. United States (1933) 289 U. S. 48.

case by levying taxes on the stock held by a state corporation;[169] on the valuation of a corporation equal to the amount of its capital stock, some of which was invested in government securities;[170] by a license tax measured by the income from tax-exempt securities;[171] or by permitting only an illusory deduction,[172] have failed. Moreover, the rule cannot be evaded by taxes which in any manner discriminate against the securities.[173] A state's power[174] to tax corporate franchises is, however, unaffected by the fact that the corporation has its capital invested in tax-exempt federal securities,[175] although the difference—economically speaking—between a tax on the capital of a corporation and a tax on its franchise measured by its capital is the difference between "tweedledum and tweedledee."[176]

Concerning the immunity expressly extended to stock in the federal government-corporation,[177] we are forced to look to the

169. Bank of Commerce v. Tax Commissioners (1863) 2 Black 620.

170. Bank Tax Cases (1865) 2 Wall. 200.

171. Northwestern Mutual Life Ins. Co. v. Wisconsin (1927) 275 U. S. 136.

172. National Life Insurance Co. v. United States (1928) 277 U. S. 508; Missouri Insurance Co. v. Gehner (1930) 281 U. S. 313. In each of these cases Justices Stone, Brandeis, and Holmes dissented on the ground that the construction adopted by the majority of the Court did more than protect the ownership of government securities and conferred upon that ownership an affirmative benefit at the expense of the taxing power of the state.

173. Miller v. Milwaukee (1927) 272 U. S. 713; Macallen Co. v. Massachusetts (1929) 279 U. S. 620, reh'g denied (1929) 280 U. S. 513, as explained in Pacific Co. v. Johnson (1932) 285 U. S. 480, 494; Schuylkill Trust Co. v. Philadelphia (1936) 296 U. S. 113. For a criticism of the Macallen case, written before the Court "explained" the decision, see Powell, An Imaginary Judicial Opinion (1931) 44 Harv. L. Rev. 889.

174. A state may lawfully impose its inheritance tax on a bequest of federal securities. Plummer v. Coler (1900) 178 U. S. 115. Cf. Snyder v. Bettman (1903) 190 U. S. 249 (federal inheritance tax applied to legacy to a municipal corporation); Greiner v. Lewellyn (1922) 258 U. S. 384. It has been long settled that one state may tax the securities of another state. Bonaparte v. Tax Court (1881) 104 U. S. 592.

175. Society for Savings v. Colite (1868) 6 Wallace 594; Provident Savings Institution v. Massachusetts (1868) 6 Wall. 611; Hamilton Mfg. Co. v. Massachusetts (1868) 6 Wall. 632; Home Insurance Co. v. New York (1889) 134 U. S. 594. And the reverse is also true. Flint v. Stone Tracy Co. (1910) 220 U. S. 107.

176. Powell, Indirect Encroachment on Federal Authority by the Taxing Power of the States (1919) 32 Harv. L. Rev. 909, 915.

177. The exemptions have been upheld. Ops. Att'y Gen. of Pa. (1935-36) p. 59; Ops. Att'y Gen. of Utah, June 5, 1935; C. C. H. Bank Law Serv., Par. No. 13,508. The lone exception is the shares of stock in the Federal credit unions. They are expressly made subject to state taxes in the hands of the owner. Federal Credit Union Act, sec. 18 (1934) 48 Stat. 1216, (1936) 12 U. S. C. A. sec. 1751. In Missouri the tax exemption of the shares of stock in a Federal Land Bank was not placed upon the federal

analogous situation in the case of the taxation of shares of stock in national banks. Shares in national banks would not be taxable to the owner except for the statutory permission which Congress has given.[178] A tax on a stockholder, however, may be assessed without regard to the fact that the assets of the corporation include government securities.[179] Where the tax, while nominally on the shares of the corporate stock, is actually on the corporation, federal securities may not be included in assessing the value of the shares for taxation.[180]

It seems that in this matter the Court has engaged in a little mental gymnastics. If there is any economic truth to the *Weston* case, then the *Van Allen* case was incorrectly decided, for if the real owners of corporate property are the stockholders, the real incident of the tax falls upon them whether the tax is on the bank or on them. In the *Weston* line of decisions the Court has yielded to the commands of legalistic ritual subversive of the basis on which the doctrine of immunity rests. In the *Van Allen* line of cases the Court has accepted as an economic truism that a tax which does not discriminate against governmental securities is not a burden upon the government issuing the securities.

What the lawyer may call intergovernmental immunity, the economist may justly label intergovernmental subsidy.[181] Trea-

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statute but on the ground that the bank's business was confined to farm loans and therefore was not a "banking business" within the meaning of the Missouri statute subjecting shares of stock in banks doing a banking business to state taxation. State ex rel. Compton v. Buder (1925) 308 Mo. 253, 271 S. W. 772.

178. (1923) 42 Stat. 1499; (1926) 44 Stat. 223, (1936) 12 U. S. C. A. sec. 548; People v. Weaver (1879) 100 U. S. 539, 543; Owensboro National Bank v. Owensboro (1899) 173 U. S. 664, 669; Des Moines National Bank v. Fairweather (1923) 263 U. S. 103, 106; First National Bank v. Anderson (1926) 269 U. S. 341.

179. Van Allen v. Assessors (1866) 3 Wall. 573; Cleveland Trust Co. v. Lander (1902) 184 U. S. 111; Des Moines National Bank v. Fairweather (1926) 269 U. S. 341.

180. Home Savings Bank v. Des Moines (1907) 205 U. S. 503. There is some reason to believe that the cited case has been recently overruled *sub silentio*. In Schuylkill Trust Co. v. Pennsylvania (1938) 302 U. S. 506 the Court held that the State of Pennsylvania, in taxing shares of trust companies on the basis of value as reflected from the companies' paid-in capital, surplus, and undivided profits, was not obliged to exclude from the measure obligations of the federal government owned by the companies.

181. Brabson, Income Tax Exemptions and the Loss of Federal Revenue (1937) 15 Tax Mag. 8; Withers, The Menace of Tax-Exempt Bonds (1935) 141 Nation 241; Rowe, The Burden of Tax Exemption of Government Bonds (1926) 16 Amer. Econ. Rev. 653; Martin, The Social Aspects of Tax Exemption (1936) 183 Annals 48.

sury operations indicate that the credit of the federal government does not need the stimulation of the tax-exemption device; the strength of the federal credit and the easy state of the money market makes this a propitious moment for the removal of this imponderable obstacle to a just distribution of the tax load.[182]

It is more important that the national government be permitted to tax the income from state securities than that the states be allowed to tax the income derived from the securities of the federal government or its instrumentalities. The states can, and generally do, reach federal securities by a general property tax; but the federal government is denied the right to tax the property of state corporations effectively because of the constitutional requirement of apportionment. The burden of an income tax is insignificant in contrast to the burden of a general property tax.

And what of the *Pollock* case? Altogether aside from the effect of the Sixteenth Amendment, the "want of the power to tax the source" basis should no longer prevent the application of a federal income tax to the income from state securities. Thrice within the past two years the Court has expressly recognized the distinction between the "source" and the "income," and in each case the appreciation of this difference prompted the sustaining of a state tax on income from a "source" which for constitutional or statutory reasons would have been exempt.[183] The Court need now only accept the words of Chief Justice Fuller in the *Pollock* case.[183a]

There is a need to remove the entire doctrine insofar as it

182. Martin, op. cit. supra, note 181.

183. New York ex rel. Cohen v. Graves (1936) 300 U. S. 308, sustaining a New York income tax on rents derived from property in New Jersey because "income is not necessarily clothed with the immunity enjoyed by its source"; Hale v. State Board (1937) 302 U. S. 95, upholding state income tax upon bonds issued tax-exempt; Adams Mfg. Co. v. Storen (1938) 304 U. S. 307, deciding that the Indiana gross income tax might lawfully be assessed against the income from tax-exempt municipal bonds. There is nothing in Evans v. Gore (1930) 253 U. S. 245 to the contrary. The exemption which it extends to federal judicial salaries is not premised upon the "source" of the salary but upon the recipient. U. S. Const. Art. III.

183a. "But if * * * the interest when received has become merely money in the recipient's pocket and taxable as such without reference to the source from which it came, the question is immaterial whether it could have been originally taxed at all or not * * *." 229 (1898) 158 U. S. 601, 630. See Department of Justice, *Taxation of Government Bondholders and Employees* (1938) 105-119.

impedes the just administration of our taxing system.[184] There seems to be no special reason to remove this subsidy from the securities of government corporations, state or federal, unless a corresponding privilege is denied the tax-exempt securities now issued by conventional government sources, with which the securities of government corporations compete in the open market.[185]

VIII

The attorney of the Home Owners' Loan Corporation has ruled that the corporation is not subject to state sales taxes, and the California Supreme Court has decided that the state's sales tax may not be imposed on purchases of federal land banks and other corporations comprising a farm credit district, although paid to the state by the vendor.[186] This conclusion is probably correct. In 1928 the Supreme Court, in a five-to-four decision, held that a state could not lawfully tax the sale of gasoline to the United States Coast Guard Fleet and Veteran's Hospital, because "the necessary operation * * * is directly to retard, impede, and burden the exertion by the United States of its constitutional powers to operate the fleet and hospital."[187] After granting a reciprocal immunity to the vendor of motorcycles to a state against a federal excise tax,[188] the Court extended the immunity by declaring unlawful the attempt of Alabama to apply a tax, exclusively upon the *privilege* of sale, to gasoline sold to the federal government.[189] In 1937, however, the Court held that the federal government could lawfully impose an excise tax on the manufacture of to-

184. As of June 30, 1937, there was $50,522,000,000 of wholly or partially tax-exempt securities held by non-governmental owners. This amount exempts from taxation an income of $1,554,000. N. Y. Times, Sept. 19, 1938, p. 25: 1.

185. See p. 86 of Reply Brief of Respondent written by Mr. (now Chief Justice) Hughes in Smith v. Kansas City Title & Trust Co. (1922) 255 U. S. 180.

186. M. G. West Co. v. Johnson (Cal. 1937) 66 P. (2d) 1211. But the Treasury Department has ruled that persons selling articles to government corporations are not exempt from the federal manufacturer's excise tax. S. T. No. 731, April 2, 1934. There being no federal sales tax, the treatment of the relation of sales taxes to the doctrine of intergovernmental tax immunity may be confined to the effect of local and state taxes on purchases of federal-owned government corporations.

187. Panhandle Oil Co. v. Mississippi (1928) 277 U. S. 218, 222. In accord, Texas Co. v. Carmichael (D. C. M. D. Ala. 1935) 13 F. Supp. 242, with Hutcheson, J., dissenting.

188. Indian Motorcycle Co. v. United States (1931) 283 U. S. 570.

189. Graves v. Texas Co. (1936) 298 U. S. 393. Mr. Justice Cardozo and Mr. Justice Brandeis dissented. Mr. Justice Stone did not sit.

bacco subsequently sold to a state for free distribution in a state hospital.[190]

The cases involving taxation of independent contractors working under contracts with the federal government look in a different direction. It has been held that the state may lawfully apply its excise tax on gasoline used by such a contractor.[191] Originally the Court declared a state tax on the net income on profits derived by the lessee of Indian lands unconstitutional.[192] With this rule the court played hide-and-seek[193] until March 7, 1938, when it was discarded because, in the words of the Chief Justice,

> * * * where it merely appears that one operating under a government contract or lease is subjected to a tax with respect to his profits on the same basis as others who are engaged in similar businesses, there is no sufficient ground for holding that the effect upon the Government is other than indirect and remote.[194]

Unlike state taxation of revenue derived from interstate commerce, in the field of intergovernmental taxation there is no distinction made between taxes upon gross and net income. In the first case to sustain a state tax on the gross income derived from furnishing a service—here direct—to the federal government

190. Liggett and Myers Tobacco Co. v. United States (1937) 299 U. S. 383.

191. Trinityfarm Co. v. Grosjean (1934) 291 U. S. 466. But a state may not include government messages in taxing telegraph companies. Western Union Telegraph Co. v. Texas (1881) 105 U. S. 460; Williams v. Talladega (1912) 226 U. S. 404.

192. Gillespie v. Oklahoma (1922) 257 U. S. 501.

193. In 1931, the Court held that the rule of the Gillespie case did not apply where the taxable income was derived by the lessee from lands which the Court found had really been sold. Group No. 1 Oil Corp. v. Bass (1931) 283 U. S. 279. But the rule of the Gillespie case was revived long enough to declare invalid the levying of the federal income tax on the profits derived from a lease of school lands. Burnet v. Coronado Oil and Gas Co. (1932) 285 U. S. 393. In a dissenting opinion, Mr. Justice Stone, speaking also for Justices Roberts, Brandeis, and Cardozo, said he thought the Gillespie case ought to be overruled. In the next case a unanimous Court "distinguished" the Burnet case and approved a federal income tax on lessee of municipally owned oil lands. Burnet v. A. T. Jergins Trust (1933) 288 U. S. 508. This was followed in Atkinson v. State Tax Commission of Oregon (1938) 58 S. Ct. 419 and Bankline Oil Co. v. Commissioner (1938) 303 U. S. 363. Finally in Helvering v. Mountain Producers Corporation (1938) 303 U. S. 376, the Court, speaking through Mr. Chief Justice Hughes, expressly overruled the Burnet v. Coronado Oil Co. and Gillespie v. Oklahoma cases. For a revealing discussion of the Chief Justices' "about-face" see Dilliard, The Chief Justice on Tax Immunity (1938) 27 Survey Graphic 338.

194. Helvering v. Mountain Producers Corp. (1938) 303 U. S. 376, 386-7.

there was congressional consent to state taxation.[195] Recently in *James v. Dravo Contracting Co.* the Court sustained, by a vote of five-to-four, a non-discriminatory state gross receipts tax upon income derived by a contractor with the federal government.[196] A combination of three factors seems to have controlled the majority opinion: (1) the tax was not discriminatory, (2) it was levied against an independent contractor, and (3) the tax was not on the contract with the federal government.[197] Mr. Chief Justice Hughes thought the question of the taxability of a contractor "upon the fruits of his service" was the same as a tax on his property used in performing the services since "his earnings flow from his work; his property is employed in securing them."[198] Mr. Justice Roberts in a lucid dissent pointed out that "to use the value and amount of the goods and services furnished to the United States as a measure of the tax is in substance and effect to tax the transaction itself."[199]

From an economic standpoint, the *Dravo* case is difficult to justify. The federal power to contract for supplies or services is as necessary as the power to borrow money and to employ officers. A tax on the gross receipts of one who supplies the government with goods or services is in effect a sales tax, and will prove a greater burden to the government than a tax on the income of its employee or on its bonds. The only justification for the *Dravo* case then is that the only party who was entitled to the benefit of the immunity, if any, was the federal government—and it disclaimed the immunity.

IX

Not all activities pursued under the state auspices are immune from federal taxation. In *South Carolina v. United States*[200] the Supreme Court, three justices dissenting,[201] declared that the

195. Fidelity & Deposit Co. v. Pennsylvania (1916) 240 U. S. 319 (tax on gross income from bonds furnished by the taxpayer to federal officials).

196. (1937) 302 U. S. 134, rev'g (D. C. S. D. W. Va. 1936) 16 F. Supp. 527. Accord, Silas Mason Co. v. Tax Commission (1938) 58 Sup. Ct. 233 and Ryan v. Washington (1937) 302 U. S. 186. See Note (1938) 51 Harv. L. Rev. 707, 713.

197. Note (1938) 51 Harv. L. Rev. 707, 713: " * * * it is difficult to discover on what theory the opinion proceeds."

198. (1937) 302 U. S. 134, 153.

199. Id. at 170.

200. (1905) 199 U. S. 437. In accord, see Ohio v. Helvering (1934) 292 U. S. 360; cf. Salt Lake City v. Hollister (1886) 118 U. S. 256.

201. Mr. Justice White, with whom Justices Peckham and McKenna concurred, said: " * * * the decision [of the majority] overrules many cases,

federal excise tax on liquor could lawfully be imposed upon a liquor dispensing system operated by the state. There were two bases for the decision: (1) the rule of immunity is limited to functions "ordinarily" performed by the state and of a "strictly" governmental character, and does not extend to those activities generally performed by private enterprises, because (2) a state may not withdraw sources of revenue from the federal government by entering into essentially "proprietary" activities, to which the federal taxing power would normally extend. Since then the Court has indicated that application of the decision depends upon whether the activity is one "usually,"[202] "essentially,"[203] and finally "traditionally"[204] governmental. Recently the Court ruled that the federal excise tax may be collected on the price of admission to football games conducted by state universities.[205] In the words of Mr. Justice Roberts, the immunity is inapplicable where the state "has embarked in a business having the incidents of similar enterprises usually prosecuted for private gain."[206]

The disturbing part of the cases is the failure to announce any formula by which to determine whether or not an activity is strictly governmental in character. In *South Carolina v. United States,* Mr. Justice Brewer indicated some possible considerations. His suggestion that determination of what is a governmental function for purposes of tax immunity should be decided in the light of conditions existing at the time of the adoption of the Constitution[207] would deny to the states the right

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departs from a principle which has been recognized from the beginning. * * * the ancient landmarks are obliterated and the distinct powers belonging to both the National and State Governments are reciprocally placed the one at the mercy of the other, so as to give to each the potency of destroying the other." (1905) 199 U. S. 437, 464.

202. Helvering v. Powers (1934) 293 U. S. 214.

203. Brush v. Commissioner (1937) 300 U. S. 352.

204. United States v. California (1936) 297 U. S. 175, 184. This case involved regulation and not taxation.

205. Allen v. Regents of University System of Georgia (1938) 58 S. Ct. 980. Justices Reed, Stone, and Black concurred but on the ground that the action should have been dismissed because the Act of Mar. 2, 1867, c. 169, sec. 10, 14 Stat. 475, (1935) 26 U. S. C. A. sec. 1543, proscribed the plaintiff's right to sue to enjoin the collection of the tax. Cf. Note (1937) 23 Va. L. Rev. 570.

206. (1938) 58 S. Ct. at 986. Justices Butler and McReynolds voted to declare the tax unconstitutional because they were of the opinion that the conduct of football games was an integral part of the program of public education and that it did not cease to be such because it produces gain.

207. (1905) 199 U. S. 437, 456-457.

to perform functions made necessary by an increasingly complex society.[208] The same criticism may be made of his suggestion to use the common law activities of the state as the norm.[209] His analogy to the governmental and proprietary capacities of municipalities in the field of tort liability is inadequate, because that distinction is premised upon a misconception[210] and persists by reason of antiquity alone.[211] What the Court did was to introduce into the law of federal taxation a concept of "private business" which, in indefiniteness, parallels that of the "police power,"[212] and which has led lower courts[213] and itself[214] along a zig-zag path. There is no formula by which *a priori* a line of demarcation between "private" and "governmental" activities may be drawn. All that is certain is that the exemption from federal taxation does not extend to *every* instrumentality which a state may see fit to employ.

The difficulty of "drawing the line" is not the greatest objection, for "drawing the line" is the question in pretty much every thing worth arguing about in the law.[214a] Objection may be directed to the very attempt of the Court to set a standard which would be synonymous with tax-exemption or tax-liability. Actu-

208. Id. at 472.

209. Id. at 458-459.

210. Borchard, Government Liability in Tort (1929) 34 Yale L. J. 1, 129, 229.

211. Freedman, Tort Liability of Municipal Corporations in Missouri (1938) 3 Mo. L. Rev. 275, 296.

212. Note (1932) 81 U. Pa. L. Rev. 194, 195.

213. Government functions: Regents of University of Georgia v. Page (D. C. D. Ga. 1937) 18 F. Supp. 62, aff'd (C. C. A. 5, 1937) 93 F. (2d) 887 (football games), rev'd (1938) 58 S. Ct. 980; Hopkins v. Commissioner (C. C. A. 5, 1936) 84 F. (2d) 627 (school cafeteria); Therrell v. Commissioner (C. C. A. 5, 1937) 88 F. (2d) 869, and Tunnicliffe v. Commissioner (C. C. A. 5, 1937) 88 F. (2d) 873 (state bank liquidator), both rev'd (1938) 58 S. Ct. 539; Commissioner v. Ten Eyck (C. C. A. 2, 1935) 76 F. (2d) 515 (Albany Port Authority).

Proprietary functions: North Dakota v. Olson (C. C. A. 8, 1930) 33 F. (2d) 848, dismissed for want of jurisdiction (1929) 280 U. S. 528; Saxe v. Anderson (D. C. S. D. N. Y. 1937) 19 F. Supp. 21 (court-appointed guardian); Galveston v. United States (Ct. Cl. 1935) 10 F. Supp. 810 (operation of a wharf); Garden Homes v. Commissioner (C. C. A. 7, 1933) 64 F. (2d) 593 (housing).

214. The salary of an attorney of the Panama Railroad Company is exempt from state taxation, see People ex rel. Rogers v. Graves (1936) 299 U. S. 401; but the salary of a special attorney of Pennsylvania is not exempt from federal taxation. Lucas v. Reed (1930) 281 U. S. 699. The operation of a waterworks is a governmental function. Brush v. Commissioner (1937) 300 U. S. 352, but the operation of a transit system is not. Helvering v. Powers (1934) 293 U. S. 214.

214a. Holmes, J., in Irvin v. Gavit (1925) 268 U. S. 161, 168.

ally whether a function is essential to the attainment of a given end is a political question.[214b] The genius of our system of government lies largely in that phase which permits the citizenry acting through its elected legislative representative to determine what services are required in the public interest. When Mr. Justice Sutherland, speaking for the majority in the *Brush* case,[215] stressed the extent of the public interest in the activity assumed by the government as an aid in ascertaining whether it was an essential governmental function, it appeared as though the Court recognized that conceptions of essential governmental functions differ with individual philosophies. It is submitted that Mr. Justice Stone in the *Gerhardt* decision,[216] with due solicitude for the imperative need to preserve intact existing sources of revenue,[217] announced a test consistent with the thesis advanced. The decision clearly establishes that a federal tax may be applied to any state activity which is "not one without which a state could not continue to exist as a governmental entity." This was a subtle way of saying that the immunity extends to *no* activities of the states other than those performed by the three departments of government.[218]

That a state might divest itself of its sovereign character by entering into corporate activities essentially private (in the strict sense of the word) has long been accepted.[219] The activities of the federal-owned corporations with which we are concerned, generally speaking, are innovations in the field of governmental activity. As to them we get no help from tradition or *stare decisis*. To date the more considerable authority among such adjudications as there have been on the question of whether the activities of the corporations are governmental or proprietary regards them as governmental.[220]

214b. See Luther v. Borden (1849) 7 How. 1; Pacific States T. & T. Co. v. Oregon (1912) 223 U. S. 118.

215. (1936) 300 U. S. 352.

216. Helvering v. Gerhardt (1938) 58 S. Ct. 969.

217. It is of more than passing interest that in Helvering v. Mountain Products Co. (1938) 303 U. S. 376, Mr. Chief Justice Hughes undertook to reexamine the rule of Gillespie v. Oklahoma "in light of the expanding needs of State and Nation." Then he made reference to a "principle, buttressed by the most cogent considerations, that the power to tax should not be crippled."

218. Admittedly, on the facts, the case did not go so far. It is submitted, however, that the opinion presages the conclusion here drawn.

219. Bank of United States v. Planters' Bank of Georgia (1824) 9 Wheat. 904, 907; cf. Helvering v. Ohio (1934) 292 U. S. 360, 369.

220. Governmental: Smith v. Kansas City Title & Trust Co. (1922) 255

It may well be questioned whether a function which is either "governmental" or "proprietary" as the case may be when performed by a state need be the same when performed by the federal government. The traditional functions and expressed purposes of the two by no means coincide.[221]

The mere fact that a corporation operates under a federal franchise will not render it immune from state taxation if the corporation is "private."[222] Commentators have undertaken to suggest criteria,[223] all of the suggested formulae in some manner stressing the "profit" or "self-sustaining" feature. What they seem to overlook is that upon liquidation all assets become the property of the United States Treasury. And too, why must a governmental activity be operated at a loss?

It is necessary to consider whether the federal government can constitutionally engage in a "proprietary" function. If an activity may constitutionally be pursued, must it necessarily be a "governmental" activity? It is a truism that the federal government is one of enumerated powers, while the states enjoy residual powers. From this it has been argued[224] that the distinction

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U. S. 180; Federal Land Bank v. Gaines (1933) 290 U. S. 47; Federal Land Bank v. Priddy (1935) 295 U. S. 299, 231; Federal Land Bank v. Crossland (1923) 261 U. S. 374; People ex rel. Rogers v. Graves (1937) 299 U. S. 401; Baltimore National Bank v. State Tax Commission (1936) 297 U. S. 209; Hartford Production Credit Ass'n v. Clark (1934) 118 Conn. 341, 172 Atl. 266; Ellingson v. Iowa Joint Stock Land Bank (S. D. 1936) 264 N. W. 516; Langer v. United States (C. C. A. 8, 1935) 76 F. (2d) 817; United States v. Lewis (D. C. W. D. Ky. 1935) 10 F. Supp. 471; United States v. Doherty (D. C. D. Neb. 1937) 18 F. Supp. 793.

Proprietary: Clinton v. State Tax Commission (Kan. 1937) 71 P. (2d) 857; Pomeroy v. Board of Equalization (1935) 99 Mont. 534, 45 P. (2d) 316; Central Market, Inc. v. King (Neb. 1937) 272 N. W. 244; Gill v. Reese (1936) 53 Ohio App. 134, 4 N. E. (2d) 273; Pennell v. H. O. L. C. (D. C. D. Me. 1937) 21 F. Supp. 497.

221. For example, functions such as were exercised during the War by government corporations could not be considered "private," since they were serving the government in the carrying on of the War. See (1936) 49 Harv. L. Rev. 1323.

222. Susquehanna Power Co. v. State Tax Commission (1931) 283 U. S. 291, 294. The distinction has long been taken between a privilege of franchise granted by the government to a private corporation in order to effect some governmental purpose and the property employed by the grantee in the exercise of the privilege but for private business advantage.

223. Thurston, Government Proprietary Corporations (1935) 21 Va. L. Rev. 351; Note (1936) 49 Harv. L. Rev. 1323, 1329; Note (1933) 11 Temple L. Rev. 383; Cohen and Dayton, Federal Taxation of State Activities and State Taxation of Federal Activities (1925) 34 Yale L. J. 807.

224. Stokes, State Taxation and the New Federal Instrumentalities (1936) 22 Iowa L. Rev. 39; cf. Graham, J., in Alabama v. United States (1930) 69 Ct. Cl. 340, 38 F. (2d) 897, 902-3, rev'd (1931) 282 U. S. 502;

between governmental and proprietary functions of the states[225] is foreign to established views of the nature of the federal government. There is, however, more imposing authority to the contrary.[226] Legalistically, the former may be the better view, but if it is, it does violence to actualities. For our purposes we may base our determination not upon the source from which the function is derived but upon the function itself. The mere fact that the function is derived from the national government does not determine its nature.[227]

Suppose the corporations are performing functions which the courts will regard as proprietary.[228] Does it necessarily follow that the doctrine of the *South Carolina* case applies in reverse? It is perhaps of some significance that the Court has never sustained a state tax upon any federal instrumentality to which Congress has specifically granted exemption. What the cases reveal is this: A federal chartered bank is exempt from state taxation in the absence of express consent to be taxed,[229] but a state chartered bank is subject to federal taxation whether privately or state owned;[230] the salary of an attorney for a federal instru-

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Oliver P. Field, State versus Nation and the Supreme Court (1934) 28 Amer. Pol. Sci. Rev. 233, 243, and see Note (1934) 44 Yale L. J. 326, 337.

225. Cf. Ohio v. Helvering (1934) 292 U. S. 360, 369: "If a state chooses to go into the business of buying and selling commodities, its right to do so may be conceded so far as the Federal Constitution is concerned; but the exercise of the right is not the performance of a governmental function, and must find its support in some authority apart from the police power." It is to be noted that the same state functions which were held "proprietary" when federal taxation was involved were held "governmental" when the power of the state to levy a tax for their support was involved. Cf. Vance v. Vandercook Co. (1898) 170 U. S. 438, with South Carolina v. United States (1905) 199 U. S. 437; Green v. Frazier (1920) 253 U. S. 233, with South Dakota v. Olson (C. C. A. 8, 1929) 33 F. (2d) 848; Boston v. Jackson (1922) 260 U. S. 309, with Helvering v. Powers (1934) 293 U. S. 214; see Note (1936) 49 Harv. L. Rev. 1323, 1325n.

226. Twin Falls Canal Co. v. Foote (C. C. D. Idaho 1911) 192 Fed. 583; Clinton v. Commission (Kan. 1937) 71 P. (2d) 857; Pomeroy v. Board of Equalization (1935) 99 Mont. 534, 45 P. (2d) 316; Central Market, Inc. v. King (Neb. 1937) 272 N. W. 244; Gill v. Reese (1936) 53 Ohio App. 134, 4 N. E. (2d) 273; Tax Commission v. Baltimore Nat. Bank (1935) 169 Md. 65, 72, 180 Atl. 260, rev'd (1936) 297 U. S. 209.

227. See Thurston, *Government Proprietary Corporations* (1937) 85.

228. For this writer's opinion to the effect that most of the federal-owned corporations are not engaged in proprietary functions, see Freedman, Book Review (1938) 23 WASHINGTON U. LAW QUARTERLY 293, 295-296.

229. McCulloch v. Maryland (1819) 4 Wheat. 316; Owensboro National Bank v. Owensboro (1899) 173 U. S. 664.

230. Veazie Bank v. Fenno (1870) 8 Wall. 533; North Dakota v. Olson (C. C. A. 8, 1929) 33 F. (2d) 848, dismissed for lack of jurisdiction (1929) 280 U. S. 528.

mentality is exempt from state taxation,[231] but the salary of a state attorney[232] and that of an employee of a state agency[233] are not exempt from federal taxation; the principle of immunity does not prevent the federal government from levying import duties on supplies purchased by state instrumentalities,[234] and a state-owned and -operated railroad is subject to federal regulation;[235] a federal corporate excise tax may be measured by the income from tax-exempt securities,[236] although a state tax on a federal franchise is not allowed;[237] a federal tax measured by transportation costs was upheld when applied to materials sold to a state agency,[238] but a state may not tax the storage or withdrawal of gasoline sold to a federal instrumentality;[239] and finally it is proper to levy a federal tax on the manufacture of tobacco which was sold to a state hospital for free distribution to patients,[240] but a state tax on materials sold to the federal government is unconstitutional.[241]

Even to admit that many of the above decisions[242] can be explained or reconciled by saying that the immunity of state agencies is not enjoyed where the federal tax is imposed in the exercise of a granted power other than the taxing power would leave other decisions unexplained.[243] Unless the cases are taken to mean that the federal immunity is more extensive than the supposedly reciprocal state immunity,[244] how can the *Rogers* case[245] exist side-by-side with the *Brush* case?[246] How is Mr. Justice Stone's failure to cite the *Rogers* case in the *Gerhardt*[247] case to be accounted for?

231. People ex rel. Rogers v. Graves (1937) 299 U. S. 401.
232. Lucas v. Reed (1930) 281 U. S. 699.
233. Helvering v. Gerhardt (1938) 58 S. Ct. 969.
234. Trustees of Illinois University v. United States (1933) 289 U. S. 48.
235. United States v. California (1936) 297 U. S. 175.
236. Flint v. Stone Tracy Co. (1910) 220 U. S. 107.
237. California v. Central Pacific R. R. (1887) 127 U. S. 1.
238. Wheeler Lumber Co. v. United States (1930) 281 U. S. 572.
239. Graves v. Texas Co. (1936) 298 U. S. 393.
240. Liggett & Myers v. United States (1936) 299 U. S. 383.
241. Panhandle Oil Co. v. Mississippi (1928) 277 U. S. 218.
242. Particularly cases cited supra, notes 230, 234, and 235.
243. Cases cited supra, notes 236, 238, and 240.
244. Metcalf and Eddy v. Mitchell (1926) 269 U. S. 514, 523-4; United States v. California (1936) 297 U. S. 175, 184; Indian Motorcycle Co. v. United States (1930) 283 U. S. 570, 575.
245. (1937) 299 U. S. 401.
246. (1937) 300 U. S. 352.
247. (1938) 58 S. Ct. 969.

This explanation does not conclude our problem. Whether the rule of *South Carolina v. United States* should apply to federal agencies will depend largely upon a choice between two politico-constitutional theories: the supremacy of the federal government or reciprocity of federal and state instrumentalities. Mr. Justice Brewer who spoke for the majority in the *South Carolina* case indicated that he did not consider the rule of the case to apply in the reverse.[248]

There is good reason why the exemption of federal instrumentalities from state taxation should be more zealously guarded than state immunity from federal taxation.[249] The powers granted to the national government are few in comparison with those reserved to the states. A state tax on federal instrumentalities would have a greater effect on the federal sovereign than a federal tax on state instrumentalities would have on state sovereignty. Insofar, therefore, as the rule of the *South Carolina* case is premised upon the necessity for placing a practical limitation on the exemption of state agencies from federal taxation so that the federal sources of revenue will not be destroyed, it is unnecessary that the rule apply reciprocally. To carry over a principle which was used to sustain surreptitiously the federal supremacy and now to apply it to deny that supremacy would be anomalous.[250] States aggrieved by excessive federal immunity may seek relief through congressional consent, but the national government is powerless in the face of an excessive constitutional immunity of a state.[251] Moreover, it is important not to extend state immunity beyond the commands of the Constitution, for once an immunity is granted, restoration of that power is unlikely to be obtained through state action. States are without the

248. "Among those matters which are implied, though not expressed, is that the nation may not, in the exercise of its powers, prevent a state from discharging the *ordinary* functions of government, just as it follows from the second clause of Article IV of the Constitution that no state can interfere with the free and unembarrassed exercise by the National Government of *all* the powers conferred upon it." (Italics supplied.) (1905) 199 U. S. 437, 451-452.

249. McCulloch v. Maryland (1819) 4 Wheaton 316, 435, 436; Bradley, J., dissenting in Railroad Co. v. Peniston (1873) 85 U. S. 5, 48; same in Collector v. Day (1871) 11 Wallace 113; Stone, J., in Helvering v. Gerhardt (1938) 58 S. Ct. 969, 973.

250. Note (1934) 44 Yale L. J. 326, 338.

251. McCulloch v. Maryland (1819) 4 Wheaton 316, 435-6; Helvering v. Gerhardt (1938) 58 S. Ct. 969, 973; Note (1936) 49 Harv. L. Rev. 1323.

inducements to act which have occasionally persuaded Congress to waive immunities thought to be excessive.[252]

Congress by expressly providing that these corporate agencies are to enjoy immunity from state taxation has indicated that it considered that any state tax would impede the performance of the corporation's governmental service. If the Court should hold that the doctrine of the *South Carolina* case applies reciprocally, in the absence of express exemption, it might conclude that Congress could not by express legislation exempt instrumentalities not exempt by constitutional implication.[253] On the other hand that the Court generally pays respect to a declaration of Congress was recently demonstrated.[254] It may be submitted, then, that the exemption from taxation is one of the rights and privileges which Congress can confer upon its legitimate instrumentalities because in its judgment the grant is necessary for the proper functioning of the agency.[255] Whether certain ends are constitutional is, of course, a judicial question, but the selection of the means for the accomplishment of ends which have been judged constitutional and the determination of their character and scope are matters of legislative policy.[256]

Commentators generally agree that there is no rational basis supporting the extension which the rule of tax immunity gives.[257] So long as the doctrine is retained there is no valid reason to refuse to apply it in the case of government corporations. If

252. Shaw v. Gibson-Zahniser Oil Corp. (1928) 276 U. S. 575, 581.

253. Note (1936) 49 Harv. L. Rev. 1323, 1331. Senator (later Mr. Justice) Sutherland has said: "Congress has not power to exempt from taxation anything which would not because of its nature be exempted under the provisions of the Constitution." 53 Cong. Rec. 6962 (April 28, 1916).

254. Lawrence v. Shaw (1937) 300 U. S. 245, where a tax on the payments received by a guardian of an incompetent veteran was held invalid because of the statutory immunity afforded by an act providing that payment of benefits shall "be exempt from taxation * * * before or after receipt by the beneficiary."

255. Cf. Chase, C. J., in New York ex rel. Bank of New York v. Supervisors (1869) 7 Wallace 26, 30, 31.

256. Stoke, State Taxation and The New Federal Instrumentalities (1936) 22 Iowa L. Rev. 39.

257. Cohen and Dayton, Federal Taxation of State Activities and State Taxation of Federal Activities (1925) 34 Yale L. J. 807; Powell, Indirect Encroachment on Federal Authority by the Taxing Powers of the States (1918) 31 Harv. L. Rev. 321, 572, 721, 932; (1919) 32 Harv. L. Rev. 243, 374, 634, 902; Watkins, The Power of the States and Federal Governments to Tax One Another (1938) 24 Va. L. Rev. 475; Note (1936) 49 Harv. L. Rev. 1323; Boudin, The Taxation of Governmental Instrumentalities (1933) 22 Geo. L. J. 1.

Congress, instead of creating corporations through which to perform the services which the corporations perform, had created an executive office and invested it with similar powers, would anyone question the proposition that, under the existing law, the property was tax-exempt and its employees agents of the United States? The government corporation and the executive tribunal should be similarly regarded, for in the words of Mr. Justice Holmes, "the incorporation and formal erection of a new personality was only for the convenience of the United States to carry out its ends."[258]

X

Because the Sixteenth Amendment may soon be the peg upon which the abolition of state immunity from federal taxation will be hung, it is desirable that a brief investigation into its fecund possibilities be made.

The Amendment was the aftermath of the unpopular decision in *Pollock v. Farmers' Loan and Trust Co.*[259] holding the income tax of 1894 unconstitutional. The public's displeasure with the decision crystallized finally in the advocacy of a Constitutional Amendment which would permit the federal government to put in effect a tax policy premised upon "ability to pay." The original draft of the proposal accepted the *Pollock* decision and sought only to remove the rule of apportionment insofar as a tax on the income from invested capital was a direct tax.[260] When the measure was reported out by the Senate Committee on Finance,[261] it contained significant changes. The word "direct" in the original draft was eliminated, and following the word "income" there was inserted the provocative phrase, "from whatever source derived." In the debate that followed much attention was directed to the effect of this expression.[262] It was the accepted conclusion in the Senate, and later in the House,[263] that the Amendment was putting an effective end to the immunity from federal taxation. After the proposal had passed both Houses of Congress, and

258. Clallam County v. United States (1923) 263 U. S. 341, 345; cf. Sutherland, J., in People ex rel. Rogers v. Graves (1936) 299 U. S. 401, 408.
259. (1895) 157 U. S. 429; (1895) 158 U. S. 601.
260. 44 Cong. Rec. 3377 (June 17, 1909). The proposal read: "The Congress shall have power to lay and collect direct taxes on income without apportionment among the several states according to population."
261. 44 Cong. Rec. 3900 (June 28, 1909).
262. 44 Cong. Rec. 4106-4120 (July 5, 1909).
263. 44 Cong. Rec. 4389-4440 (July 12, 1909).

while it was awaiting state ratification, the purport of the phrase "from whatever source derived" was brought to the public's attention. Governor (now Chief Justice) Hughes advised the New York Assembly to reject the Amendment because it would permit the taxation of income from state and municipal securities.[264] With other state governors and congressmen expressing approval or disagreement with Governor Hughes' expression,[265] Senator Borah introduced a resolution instructing the Senate Judiciary Committee to investigate and report on whether the New York governor was correct. Before a report was forthcoming, Senator Borah called up the resolution for discussion, and hastened to give his assurance that the disputed clause added nothing to the force or scope of the Amendment,[266] a conclusion approved by Senator Root.[267] Despite such telling expressions, there was ample belief that the phrase did have the effect of disposing of the immunity which state-derived income enjoyed from federal taxation.[268]

The Department of Justice has recently released a well documented report which makes it abundantly clear that the Amendment was ratified under the preponderant belief that Congress was being granted the power to tax income from sources heretofore considered immune.[269]

The judicial treatment of the Amendment, which developed without benefit of adequate presentation of the contemporaneous history,[270] has been premised upon a different supposition. The Supreme Court — rightly or wrongly,[271] but unquestionably thoughtfully — concluded that the Amendment did not render

264. N. Y. Sen. Doc. No. 3 (1910).
265. See N. Y. Times and N. Y. World for Jan. 7, 8, 9, 1910.
266. 45 Cong. Rec. 1694 (Feb. 10, 1910).
267. 45 Cong. Rec. 2539-2540 (March 1, 1910).
268. The then-authoritative New York Times editorally reported: "Indisputably they [the people] think and have a right to think that the proposition is that Congress may tax all incomes. The four words mean the same after the four thousand words of Senator Root's argument are digested as before, and can not be made to mean anything different, except by technicalities which can only prevail at the cost of defeating the people's will." March 2, 1910, p. 8: 2.
269. *Taxation of Government Bondholders and Employees: The Immunity Rule and the Sixteenth Amendment* (1938) 163-190.
270. Id. at 217.
271. Corwin, Constitutional Tax Exemptions (1924) 13 Nat. Mun. Rev. 51; Powell, The Sixteenth Amendment and Income from State Securities (1923) 2 Tax Mag. —; Hubbard, The Sixteenth Amendment (1920) 33 Harv. L. Rev. 794.

taxable that which was not taxable before its enactment but merely removed the source as a criterion of the necessity of apportioning the tax.[272] Antedating the recent statement of Mr. Justice Black in the *Gerhardt* case[273] there were only the passing protest of Mr. Justice Brandeis[274] and the more elaborate disapprobation of Mr. Justice Holmes.[275] They alone accepted the terms of the amendment as a "comprehensive grant of power" intended to do more than merely "obviate a single result."

Does the phrase "from whatever source derived" relate to the extent of the power, and is it independent of the words dealing with the subject of apportionment? Or was it merely introduced to make the exemption from the rule of apportionment comprehensive, and therefore merely an adjectival amendment to Sections 2 and 9 of Article One? It is noteworthy that similarly-worded clauses in other enactments have been considered as including income from state and municipal bonds.[276] If the words had not been thought to embody income from these sources, the issue would never have arisen in the *Pollock* case. The Amendment was sponsored with a view to removing the obstacles to federal taxation raised by the *Pollock* case. Of the three phases of the decision, two were that taxes on the income from realty and personalty were direct taxes and, since not apportioned, were void. The original draft of the Amendment—the draft without the clause "from whatever source derived"—would have successfully overcome these two holdings. The inclusion of the clause, then, must have indicated an intention to go further. The next step was the cancellation of the third phase of the case whereby interest from state and municipal securities was ruled immune from federal taxation.[277] This construction is not only in accord with the plain meaning of the words, but it is also supportable

272. Brushaber v. Union Pacific R. R. (1916) 240 U. S. 1; Stanton v. Baltic Mining Co. (1916) 240 U. S. 103; Peck v. Lowe (1918) 247 U. S. 165; Eisner v. Macomber (1920) 252 U. S. 189; Evans v. Gore (1920) 253 U. S. 245.

273. (1938) 58 S. Ct. 969, 975.

274. Eisner v. Macomber (1920) 252 U. S. 189, 237.

275. Evans v. Gore (1920) 253 U. S. 245, 267.

276. Corporate Excise Tax of 1909, 36 Stat. 11, 112-118; Flint v. Stone Tracy Co. (1911) 220 U. S. 107; cf. Collector v. Day (1871) 11 Wallace 113.

277. Magill, The Problem of Intergovernmental Tax Exemption (1937) 15 Tax Mag. 699; Hubbard, "From Whatever Source Derived" (1920) 6 A. B. A. J. 202; Hubbard, The Sixteenth Amendment (1920) 33 Harv. L. Rev. 794.

by the object which the aroused public had sought to attain. The Amendment arose from the well-considered conviction of its necessity, and a construction which would impair its efficacy is unwarranted[278]—especially when it can be achieved only by denying to all-embracing terms their accepted meaning.

XI

As this article is written a Special Senate Committee is, acting pursuant to a Resolution,[279] conducting a thorough study and investigation with regard to the entire doctrine of intergovernmental tax immunity. The results of this investigation may encourage the enactment of appropriate legislation. The revelations made by the Department of Justice study will be carefully weighed by an understanding Court. The same Court will know that unlike the rule of *res judicata, stare decisis* is not "a universal inexorable command"[280] and that at best it has but "a limited application in the field of constitutional law."[281]

These factors, buttressed by the fact that other federal governments have continued to function uninterruptedly although there the earlier rules of immunity have disappeared,[282] may induce the Court to depart from their jural pronouncements of past decades. Law school deans and professors, lawyers and laymen, and students and politicians are well prepared for the formal obituary of the time-worn dusty doctrine of intergovernmental tax immunity. It is the nomenclature of a disappearing age!

278. Marshall, C. J., in Brown v. Maryland (1827) 12 Wheaton 419, 446.

279. Sen. Res. No. 303, 75th Cong., 3d Sess. (1938), 83 Cong. Rec. 9549 (June 16, 1938).

280. Brandeis, J., in Burnet v. Coronado Oil and Gas Co. (1932) 285 U. S. 393, 405.

281. Stone and Cardozo, J.J., concurring in St. Joseph Stockyards v. United States (1936) 298 U. S. 38, 94.

282. Powell, McCulloch v. Maryland in Canada and Australia (1933) 31 Mich. L. Rev. 797.