THE TAXING POWER OF THE FEDERAL AND STATE GOVERNMENTS

(1936–1937 SUPPLEMENT)

REPORT

TO THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

BY ITS STAFF

PURSUANT TO

SECTION 1203, REVENUE ACT OF 1926

Printed for the examination and use of the members of the committee

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NOTE—This report has been ordered printed for purposes of information and discussion, but it has not yet been considered or approved by the committee or any member thereof.

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LETTER OF TRANSMITTAL

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, September 27, 1938.

To Members of the Joint Committee on Internal Revenue Taxation:

There is transmitted herewith a supplemental report to the report on the taxing power of the Federal and State Governments, which was transmitted to you by letter of November 24, 1936, as prepared by the staff of the committee.

This supplementary report brings up to date the material contained in the original report by the inclusion of an analysis of the cases, dealing with the powers of the Federal and State Governments to levy and impose taxes, decided by the Supreme Court during the 1936 and 1937 terms. It deals with the law as applied by the Court in actual cases and makes no attempt to set out individual opinions or beliefs.

A number of important cases in this field have been decided by the Court during this period, and it is believed that this report will prove of value to the members of the committee, especially as a ready reference to the cases decided.

Very truly yours,

PAT HARRISON,
Chairman, Joint Committee on Internal Revenue Taxation.

LETTER OF SUBMITTAL

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, September 27, 1938.

Hon. PAT HARRISON,
Chairman, Joint Committee on Internal Revenue Taxation,
Washington, D. C.

MY DEAR MR. CHAIRMAN: There is submitted herewith a report containing a discussion of the cases dealing with the taxing powers of the Federal and State Governments, decided by the Supreme Court during the October terms 1936 and 1937. This report is supplemental to a report entitled "The Taxing Power of the Federal and State Governments," which was submitted to you by letter, dated October 8, 1936, and, in turn, transmitted by you to the members of the Joint Committee on Internal Revenue Taxation by letter, dated November 24, 1936.

This supplementary report follows the form and general outline of the original report, so that the later cases dealing with any given point are readily comparable with those contained in the original report.

In the Federal field, questions involving the differences between direct and indirect taxes, the interpretation of the general welfare clause, the restrictions under the due-process clause of the fifth amendment, the infringement of State powers under the tenth amendment, and the taxability of income from State securities, have been passed upon by the Court during this 2-year period. And, of particular importance, the question of the Federal power to tax State employees was thoroughly discussed in the recent *Brush* and *Gerhardt cases*.

With respect to the taxing power of the States, many important questions have been passed upon during this period. Questions concerning the impairment of obligations of a contract, the restraint of the "due process" and "equal protection of the law" provisions of the fourteenth amendment, the interference with interstate and foreign commerce, the interference with Federal functions, and the increasingly important question of a State's taxing jurisdiction with respect to Federal property located within its borders, have been discussed and decided.

As in the original report, no attempt has been made to express individual opinions, but merely to set forth the law as interpreted and construed by the court. It is hoped that this supplementary report, as used and referred to in conjunction with the original report, will prove of value to the committee, to the Members of Congress, and to the public as to the powers of the Federal and State Governments to tax. It is the intention of the staff to keep this material current by the publication from time to time of additional supplemental and revised reports on this subject.

Respectfully submitted.

WEAVER MYERS, *Attorney.*

Approved:

COLIN F. STAM, *Chief of Staff.*

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THE TAXING POWER OF THE FEDERAL AND STATE GOVERNMENTS, 1936–37 SUPPLEMENT

INTRODUCTION

Since the publication, in 1936, of the report The Taxing Power of the Federal and State Governments, by the staff of the Joint Committee on Internal Revenue Taxation, a number of decisions have been handed down by the Supreme Court that are of particular interest with respect to the powers of the Federal and State Governments to levy taxes. It is the purpose of this supplement to bring that report up-to-date by the analysis of such cases decided during the October terms of 1936 and 1937. It is intended to keep this material current by the publication of additional supplements from time to time.

By reference to the original report, it will be noted that the supplement follows the same general outline and classification, making the material included in the supplement readily comparable with that contained in the report.

PART I. POWERS OF THE FEDERAL GOVERNMENT

A. SCOPE OF POWERS

3. Delegation of Legislative Powers

The power granted by the Congress to the Commissioner of Internal Revenue to determine whether or not under the facts in each case section 104 of the Revenue Act of 1928, imposing an additional income tax on companies accumulating an unreasonable surplus for the purpose of avoiding the imposition of surtax on the individual stockholders, was applicable, was upheld in *Helvering* v. *National Grocery Co.*[1] as not being an unlawful delegation of legislative power.

4. Power to Levy Taxes, Duties, Imposts, and Excises

(a) in general

In upholding the excise tax with respect to employment under the Social Security Act, Mr. Justice Cardozo in *Steward Machine Co.* v. *Davis* [2] laid down the following general rules concerning the Federal taxing power:

> The subject matter of taxation open to the power of the Congress is as comprehensive as that open to the power of the States, though the method of apportionment may at times be different. "The Congress shall have power to lay and collect taxes, duties, imposts, and excises" (art. 1, sec. 8). If the tax is a direct one, it shall be apportioned according to the census or enumeration. If it is a duty, impost, or excise, it shall be uniform throughout the United States. Together, these classes include every form of tax appropriate to sovereignty.

[1] 304 U. S. 282.
[2] 301 U. S. 548.

(d) DIRECT AND INDIRECT TAXES DISTINGUISHED

Taxes on income from real or personal property were held to be direct taxes (for purposes of the constitutional requirement for apportionment) in *Pollock* v. *Farmer's Loan & Trust Co.*,[3] and taxes upon incomes from professions, trades, employments, and vocations have always been regarded as excises, or indirect taxes. This position was arrived at upon the theory that, for the purposes of determining the applicability of the constitutional apportionment rule, a tax upon the income from property was a tax upon the property itself.

In this connection the recent State-income-tax cases of *New York ex rel. Cohn* v. *Graves* [4] and *Hale* v. *Iowa State Board* [5] are of interest.

In the former case the question of the validity of the New York income tax upon the revenue accruing to Cohn, a resident of New York, from rents from lands situated in another State and from interest on bonds secured by mortgages on real estate situated in another State, was at issue. In upholding the tax, the Court ruled that the income tax upon the rents and interest was not a tax upon the property from which such income arose.

The same conclusion was reached in *Hale* v. *Iowa State Board* [6] with respect to personal property. Here the tax was upon the interest from Iowa State securities, which, when they were issued prior to the adoption of the State income tax, were exempted by statute from taxation. The Court, in holding that presently to tax the interest from these securities did not impair the obligations of the contract between the State and its bondholders, ruled that the tax upon this income was not a tax upon the bonds themselves.

However, in both of these cases the Court pointed out that they were decided upon different bases. In the *Cohn case*,[7] the Court said:

> Nothing which was said or decided in *Pollock* v. *Farmer's Loan & Trust Co.*[8] calls for a different conclusion. There the question for decision was whether a Federal tax on income derived from rents of land is a direct tax requiring apportionment under article 1, section 2, clause 3, of the Constitution. In holding that the tax was "direct" the Court did not rest its decision upon the ground that the tax was a tax on the land, or that it was subject to every limitation which the Constitution imposes on property taxes. It determined only that for the purposes of apportionment there were similarities in the operation of the two kinds of tax which made it appropriate to classify both as direct, and within the constitutional command.
>
> It is by a parity of reasoning that the immunity of income-producing instrumentalities of one government, State or National, from taxation by the other, has been extended to the income. It was thought that the tax, whether on the instrumentality or on the income produced by it, would equally burden the operations of government. But as we have seen, it does not follow that a tax on land and a tax on income derived from it are identical in their incidence or rest upon the same basis of taxing power, which are controlling factors in determining whether either tax infringes due process.

In *Hale* v. *Iowa State Board*,[9] in distinguishing the *Pollock case*, the Court said:

> There was no holding (in the *Pollock case*) that the tax is a property one for every purpose or in every context. We look to all the facts.

[3] 157 U. S. 429.
[4] 300 U. S. 308.
[5] 302 U. S. 95.
[6] 302 U. S. 95.
[7] 300 U. S. 308.
[8] 157 U. S. 429.
[9] 302 U. S. 95.

In line with that conception of the *Pollock case* is *Brushaber* v. *Union Pacific Railroad Co.*,[10] where the Court pointed out that "the conclusion reached in the *Pollock case* did not in any degree involve holding that income taxes generically and necessarily came within the class of direct taxes on property" but that to the contrary such taxes were enforcible as excises except to the extent that violence might thus be done to the spirit and intent of the rule governing apportionment.

(G) EXCISE DEFINED

To the list of excises imposed by the Federal Government has been added the excise tax upon employment imposed by the Social Security Act. In upholding this tax, in *Steward Machine Co.* v. *Davis*,[11] over the contention that employment is a "natural," "inherent," or "inalienable" right and not a "privilege" and as such is not subject to an excise, the Court said:

> But natural rights, so called, are as much subject to taxation as rights of less importance. An excise is not limited to vocations or activities that may be prohibited altogether. It is not limited to those that are the outcome of a franchise. It extends to vocations or activities pursued as of a common right. What the individual does in the operation of a business is amenable to taxation just as much as what he owns, at all events if the classification is not tyrannical or arbitrary. Business is as legitimate an object of the taxing power as property. Indeed, ownership itself * * * is only a bundle of rights and privileges invested with a single name. A State is at liberty, if it pleases, to tax them all collectively, or to separate the faggots and lay the charge distributively. * * * The power to tax the activities and relations that constitute a calling considered as a unit is the power to tax any of them. The whole includes the parts.

5. Specific Limitations Upon Federal Taxing Power

(B) TO PAY THE DEBTS AND PROVIDE FOR THE COMMON DEFENSE AND GENERAL WELFARE

(1) Debts Defined

In *Cincinnati Soap Co.* v. *United States*,[12] in passing upon the validity of a processing tax upon coconut oil where the proceeds from the tax on that originating in the Philippine Islands were earmarked to be paid to the Philippine treasury, the Supreme Court held that the moral obligation which the United States owed to the Philippines by reason of their dependency was such that it was honor bound to protect, defend, and provide for the general welfare of the inhabitants—

> and such an obligation well may require the appropriation of money from the national purse—in which case the obligation fairly comes within the term "debts" as used in the taxing clause.

(2) General Welfare Defined

The exact interpretation of the general welfare clause remains in doubt in spite of the decisions upon the Social Security Act. Theretofore, the Hamiltonian theory, as espoused by Justice Story, had the support of the Supreme Court, and it is still favored but with such modification as to leave considerable doubt as to whether the Story interpretation—that the Federal Government could not regulate but could only appropriate in aid of powers not expressly granted to it—was still adhered to.

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[10] 240 U. S. 1.
[11] 301 U. S. 548.
[12] 301 U. S. 308.

In both *Steward Machine Co.* v. *Davis* [13] and *Helvering* v. *Davis*,[14] the Court concluded that the relief of unemployment and the provision for old-age pensions were matters clearly covered by the general welfare clause, and as such the Congress could tax and appropriate in their support. In holding the old-age pension program valid, the Court said in *Helvering* v. *Davis*, supra:

> "Congress may spend money in aid of the general welfare" * * *. The conception of the spending power advocated by Hamilton and strongly reinforced by Story has prevailed over that of Madison, which has not been lacking in adherents. Yet difficulties are left when the power is conceded. The line must still be drawn between one welfare and another, between particular and general. Where this shall be placed cannot be known through a formula in advance of the event. There is a middle ground or certainly a penumbra in which discretion is at large. The discretion, however, is not confided to the courts. The discretion belongs to Congress, unless the choice is clearly wrong, a display of arbitrary power, not an exercise of judgment. * * * Nor is the concept of the general welfare static. Needs that were narrow or parochial a century ago may be interwoven in our day with the well-being of the Nation. What is critical or urgent changes with the times.

While it thus seems definitely enough settled that Congress may spend to promote the general welfare, the open question, and the part of this decision that leaves confusion, relates to what may be done along with this spending or through or by reason of it. With respect to unemployment insurance, this question is not so vital, as there the appropriation is made to the States, and the actual administration is carried on by the States. The old-age pension, however, is administered directly by the Federal Government, and there is more involved than simply spending money.

In upholding these provisions, it should be pointed out that the Court not only approved the grants-in-aid but inferentially said these matters could be regulated directly by the Federal Government. The Court going on to say in *Steward Machine Co.* v. *Davis*, supra:

> In ruling as we do, we leave many questions open. We do not say that a tax is valid, when imposed by act of Congress, if it is laid upon the condition that a State may escape its operation through the adoption of a statute unrelated in subject matter to activities fairly within the scope of national policy and power. No such question is before us. In the tender of this credit Congress does not intrude upon fields foreign to its function.

Thus, it is strongly inferred that the Federal Government could have administered the unemployment portion of the Social Security Act directly without going through the process of giving grants-in-aid to States.

(F) DUE PROCESS—FIFTH AMENDMENT

In *Cincinnati Soap Co.* v. *United States* [15] it was held that a tax upon the first domestic processing of coconut oil, the revenue from that originating in the Philippine Islands to be earmarked and paid to the Philippine treasury, did not violate the due-process clause of the fifth amendment.

With respect to title IX of the Social Security Act, it was contended that the exemptions from the tax on employees of eight or more were so many and so arbitrary as to invalidate the tax under the fifth amendment. The Court held these exemptions to be fully supported

[13] 301 U. S. 548.
[14] 301 U. S. 619.
[15] 301 U. S. 308.

by considerations of policy and practical convenience in the case of *Steward Machine Co.* v. *Davis*.[16]

In *Helvering* v. *National Grocery Co.*,[17] section 104 of the Revenue Act of 1928, imposing an additional income tax for the unreasonable accumulation of surplus to avoid the payment of individual surtax, was upheld over objections that it was so lacking in definite standards as to be arbitrary, capricious, and unreasonable.

(5) Denial of Refunds Where Tax Passed On

Relative to the refund of processing and floor stock taxes under the Agricultural Adjustment Administration, title VII of the Revenue Act of 1936, sections 901–917, provided an administrative procedure in which the application of a formula for the determination of the margin of profits during the tax period and just before and just after this period made out a prima facie case either for or against the claimant. The law provided that either the taxpayer or the Commissioner may rebut these presumptions "by proof of the actual extent to which the claimant shifted to others the burden of the tax."

In *Anniston Mfg. Co.* v. *Davis*,[18] the Court upheld these provisions, saying:

> In the light of the context, and of the entire scheme of the administrative proceeding, we are of the opinion that the provision was intended to afford, and does afford, full opportunity to the claimant to present any evidence which may be pertinent to the question to be determined by the Board.

(6) (B) Irrevocable Trusts

In *Helvering* v. *Bullard*,[19] the inclusion of the corpus, with the reservation of a life estate to the grantor, of an irrevocable trust in the gross estate of a decedent for estate-tax purposes, was upheld. It was contended that to lay an estate tax upon such inter vivos transfers was a denial of due process. In answering this objection, the Court said:

> Since Congress may lay an excise upon gifts, it is of no significance that the exaction is denominated an estate tax or is found in a statute purporting to levy an estate tax. Moreover, Congress, having the right to classify gifts of different sorts might impose an excise at one rate upon a gift without reservation of a life estate and at another rate upon a gift with such reservation. Such a classification would not be arbitrary or unreasonable.

(7) Retroactive Taxes

The Silver Purchase Act (June 19, 1934) was made retroactively effective from May 15, 1934, or 35 days prior to its approval. The Court held in *United States* v. *Hudson*[20] that the retroactivity of the tax to include the period while the law was in the course of enactment was consistent with due process and in line with former decisions of the Court. The tax was held to be a special income tax and not an excise. This is of particular interest, because the only retroactive excise taxes that have thus far received the sanction of the Court are those imposed upon an incident or object that is already subject to a similar tax at the time the transaction subject to the disputed tax was entered into.

[16] 301 U. S. 548.
[17] 304 U. S. 282.
[18] 301 U. S. 337.
[19] 58 S. Ct. 565.
[20] 299 U. S. 498.

(8) Denial of Court Review

Sections 901–917, title VII, of the Revenue Act of 1936 provided a new administrative procedure for the recovery of the Agricultural Adjustment Administration taxes. A remedy directly against the Government was substituted for the existing method of proceeding against the collector. In addition, a formula was provided, the application of which made out a prima facie case either for or against the taxpayer.

In *Anniston Mfg. Co.* v. *Davis*,[21] the Court held that the provisions of title VII were not in conflict with the due process clause as—

> this plan of procedure provides for the judicial determination of every question of law which the claimant is entitled to raise.

And further—

> the substitution of an exclusive remedy directly against the Government is not an invasion of constitutional right. Nor does the requirement of recourse to administrative procedure establish invalidity if legal rights are still suitably protected.

(G) THE TENTH AMENDMENT

(7) National Firearms Case

The National Firearms Act imposes an annual special tax of $200 on dealers in sawed-off shotguns and rifles or machine guns. In *Sonzinsky* v. *United States*,[22] the Supreme Court upheld the validity of the tax over the objection that the act was a regulatory measure and was not designed to raise revenue.

(8) Processing Tax on Coconut Oil

In *Cincinnati Soap Co.* v. *United States*,[23] the Court held that this tax was not a regulatory measure but a proper excise.

(9) Social Security Act

In *Steward Machine Co.* v. *Davis*,[24] the objection that the Social Security Act was an unlawful invasion of the reserved powers of the States was answered by the Court as follows:

> (*b*) The unemployment compensation law which is a condition of the credit has had the approval of the State and could not be a law without it.
> (*c*) The condition is not linked to an irrevocable agreement, for the State at its pleasure may repeal its unemployment law, terminate the credit, and place itself where it was before the credit was accepted.
> (*d*) The condition is not directed to the attainment of an unlawful end but to an end, the relief of unemployment, for which Nation and State may lawfully cooperate.

(10) Municipal Bankruptcy Act

The question of Federal and State cooperation toward accomplishing betterments which the States cannot effectively bring about alone and which, if attempted by the Federal Government directly would raise doubts of constitutional power, has received considerable attention recently. By compacts or by State consent to Federal action, some of the most obvious dangers of running afoul of the provisions of the tenth amendment seem to be avoided.

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[21] 301 U. S. 337.
[22] 300 U. S. 506.
[23] 301 U. S. 308.
[24] 301 U. S. 548.

In *United States* v. *Bekins*,[25] in upholding the Municipal Bankruptcy Act which provided for voluntary compositions of debts in the case of insolvent governmental subdivisions, the Court said:

> In the instant case we have cooperation to provide a remedy for a serious condition in which the States alone were unable to afford relief. Improvement districts, such as the petitioner, were in distress. Economic disaster had made it impossible for them to meet their obligations. As the owners of property within the boundaries of the district could not pay adequate assessments, the power of taxation was useless. The creditors of the district were helpless. The natural and reasonable remedy through composition of the debts of the district was not available under State law by reason of the restriction imposed by the Federal Constitution upon the impairment of contracts by State legislation. The bankruptcy power is competent to give relief to debtors in such a plight and, if there is any obstacle to its exercise in the case of the districts organized under State law it lies in the right of the State to oppose Federal interference. The State steps in to remove the obstacle. The State acts in aid, and not in derogation, of its sovereign powers. It invites the intervention of the bankruptcy power to save its agency which the State itself is powerless to rescue. Through its cooperation with the National Government the needed relief is given. We see no ground for the conclusion that the Federal Constitution, in the interest of State sovereignty, has reduced both sovereigns to helplessness in such a case.

This excerpt from the *Bekins case* is included here for the reason that, while it deals with bankruptcy instead of taxation, the similarity between the Federal power in these fields is marked. (See the discussion on State securities, p. 8.)

(11)

In *Helvering* v. *National Grocery Co.*,[26] section 104 of the Revenue Act of 1928, which levied an additional income tax upon the unreasonable accumulation of corporate surplus for the purpose of avoiding surtax liability upon the individual shareholders, was upheld over the contention that this section interfered with the power to withhold earnings or to declare dividends—a power reserved to the States.

(H) INCOME UNDER THE SIXTEENTH AMENDMENT

(6) Dividends

(*e*) *Sale of stock dividends.*

In *Helvering* v. *Gowran*,[27] the question of the taxability of a preferred-stock dividend to common-stock holders was before the Court. In line with the *Koshland case*,[28] the Court held the dividend to be taxable income, as by it the stockholder acquired an essentially different interest in the corporation from that which he formerly held. However, by section 115 (f) of the Revenue Act of 1928, it was provided that "a stock dividend shall not be subject to tax."

The question for decision, then, revolved around the adoption of a proper basis for determining the gain realized by the taxpayer upon the sale of the preferred-stock dividends. The method of computing the income from the sale of stock dividends constitutionally taxable was not specifically provided for. In the absence of such a provision, the Court concluded that the general sections controlled and that the gain should be computed by the "excess of the amount realized" over "the cost of such property." The cost of preferred stock to Gowran being zero, the whole of the proceeds was held taxable.

[25] 58 S. Ct. 811.
[26] 304 U. S. 282.
[27] 302 U. S. 238.
[28] 298 U. S. 441.

(J) STATE SECURITIES

(2) Present Status

With regard to the possibility of effecting a mutual waiver of constitutional limitations upon their respective taxing powers by compacts between the States and the Federal Government, the case of *United States* v. *Bekins* [29] is of interest. In that case, the question of the validity of the Municipal Bankruptcy Act was before the Court. This act provided for the composition of indebtedness of certain governmental units and was limited to voluntary proceedings. The State of California had, by statute, signified its consent for its subdivisions to take advantage of the Federal act.

The Court held that this act did not violate the tenth amendment, as—

> The reservation to the States by the tenth amendment protected, and did not destroy, their right to make contracts and give consents where the action would not contravene the provisions of the Federal Constitution. * * * Nor did the formation of an indestructible union of indestructible States make impossible cooperation between the Nation and the States through the exercise of the powers of each to the advantage of the people who are citizens of both.

And, of extreme importance to this study—

> While the instrumentalities of the National Government are immune from taxation by a State, the State may tax them if the National Government consents and by a parity of reasoning the consent of the State could remove the obstacle to the taxation by the Federal Government of State agencies to which the consent applied.

While this is dicta, as no question of taxation was pertinent to the central question, it is of particular interest in view of the fact that the Court has long considered the Federal taxing power upon pretty much the same footing as the power with regard to bankruptcies, saying in *Ashton* v. *Cameron County Water Improvement District:* [30]

> The power "to establish * * * uniform laws on the subject of bankruptcies" can have no higher rank or importance in our scheme of government than the power "to lay and collect taxes." Both are granted by the same section of the Constitution, and we find no reason for saying that one is impliedly limited by the necessity of preserving independence of the States, while the other is not.

(K) STATE FUNCTIONS

(3) Governmental and Nongovernmental Functions Defined

In *Brush* v. *Commissioner*,[31] the question of the power of the Federal Government to tax the salaries of local governmental employees was fully discussed. Brush was an engineer employed by the New York City Bureau of Water Supply. He resisted the Federal levy upon the grounds that he was engaged in an essential governmental function. The Court apparently assumed, because of the Government's contentions and the Treasury Regulations, that it need go no further than to pass upon whether or not the water system of New York was created and operated in the exercise of the city's essential governmental functions. It held that the operation of the water system was the exercise of an essential governmental function and then went on to say:

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[29] 58 S. Ct. 811.
[30] 56 S. Ct. 892.
[31] 300 U. S. 352.

If so, its operations are immune from Federal taxation and, as a necessary corollary, "fixed salaries and compensation paid to its officers and employees in their capacity as such are likewise immune." *New York ex rel. Rogers* v. *Graves* (299 U. S. 401).

However, in *Helvering* v. *Gerhardt*,[32] it would appear that in an almost identical case a contrary ruling was laid down. In this case, Gerhardt was an employee of the New York Port Authority, a bi-State corporation, created by compact between New York and New Jersey, whose function it was to construct and operate bridges and tunnels connecting New York and New Jersey and to operate a bus line across one of these bridges.

The Port Authority's income came from tolls and revenue from its bus line. It was financed largely by funds advanced by the two States and by the sale of its own bonds which were exempt from State taxation by statute. It had no stock or stockholders, and no part of its income went to any private persons.

The Court, in holding that the Federal income tax upon Gerhardt's salary placed no unconstitutional burden upon the States of New York and New Jersey, modified its ruling in the *Brush case*. No necessity was seen for determining whether or not the activity of the Port Authority was an essential governmental function. The Court simply said that the tax upon Gerhardt's salary—

neither precludes nor threatens unreasonably to obstruct any function necessary to the continued existence of the State government. So much of the burden of the tax laid upon respondents' income as may reach the State is but a necessary incident to the coexistence within the same organized government of the two taxing sovereigns and, hence, is a burden the existence of which the Constitution presupposes. The immunity, if allowed, would impose to an inadmissible extent a restriction upon the taxing power which the Constitution granted to the Federal Government.

It is not made clear whether the tax on Gerhardt's salary was upheld because he was not engaged in an essential governmental function or because that, even though he were engaged in such a function, the tax on his salary did not sufficiently burden or obstruct this function to be stricken down.

It is apparent that the Court is getting away from the essential governmental test which it has applied heretofore in similar cases. In place of this yardstick, the present test seems to be whether the function exercised is of such nature that it could be done by private persons. The Court traced the history of the decisions upon this point and then drew attention to the fact that—

In each of these cases, it was pointed out that the State function affected was one which could be carried on by private enterprise, and that, therefore, it was not one without which a State could not continue to exist as a governmental entity.

And—

The challenged taxes * * * are upon the net income of respondents, derived from their employment in common occupations not shown to be different in their methods or duties from those of similar employees in private industry. The taxpayers enjoy the benefits and protection of the laws of the United States. They are under a duty to support its Government and are not beyond the reach of its taxing power. A nondiscriminatory tax laid on their net income, in common with that of all other members of the community, could by no reasonable probability be considered to preclude the performance of the function which New York and New Jersey have undertaken, or to obstruct it more than like private

[32] 304 U. S. —.

enterprises are obstructed by our taxing system. * * * When immunity is claimed from a tax laid on private persons, it must clearly appear that the burden upon the State function is actual and substantial, not conjectural.

And further—

The basis upon which constitutional tax immunity of a State has been supported is the protection which it affords to the continued existence of the State. To attain that end, it is not ordinarily necessary to confer on the State a competitive advantage over private persons in carrying on the operations of its government. There is no such necessity here, and the resulting impairment of the Federal power to tax argues against the advantage. * * * The mere fact that the economic burden of such taxes may be passed on to a State government and thus increase to some extent, here wholly conjectural, the expense of its operation, infringes no constitutional immunity

With regard to *Collector* v. *Day*,[33] the Court said:

* * * there may be State agencies of such a character and so intimately associated with the performance of an indispensable function of State government that any taxation of it would threaten such interference with the functions of government itself as to be considered beyond the reach of the Federal taxing power. If the tax considered in *Collector* v. *Day*, *supra*, upon the salary of an officer engaged in the performance of an indispensable function of the State which cannot be delegated to private individuals, may be regarded as such an instance, that is not the case presented here.

Whatever reconciliation the Court considered necessary to be made relative to the *Brush case* is contained in the following:

In *Brush* v. *Commissioner*, *supra*, the applicable Treasury regulation, upon which the Government relied, exempted from income tax the compensation of "State officers and employees" for "services rendered in connection with the exercise of an essential governmental function of the State." The sole contention of the Government was that the maintenance of the New York City water-supply system was not an essential governmental function of the State. The Government did not attack the regulation. No contention was made by it or considered or decided by the Court that the burden of the tax on the State was so indirect or conjectural as to be but an incident of the coexistence of the two Governments, and therefore not within the constitutional immunity. If determination of that point was implicit in the decision, it must be limited by what is now decided.

The Court then pointed out—

that the allowance of a tax immunity for the protection of State sovereignty is at the expense of the sovereign power of the Nation to tax. Enlargement of the one involves diminution of the other. When enlargement proceeds beyond the necessity of protecting the State, the burden of the immunity is thrown upon the National Government with benefit only to a privileged class of taxpayers.

It was strongly inferred that the only State functions beyond the Federal taxing power are those "essential operations of government which have existed from the beginning" and which are necessary to the continued exercise of "the high and responsible duties assigned to them (the States) in the Constitution."

In *Helvering* v. *Therrell*,[34] the taxpayers involved were attorneys and liquidators appointed by State comptrollers or like officers for work in the liquidation of closed financial institutions. In each case their compensation was paid from the assets of the closed institution being liquidated. The process of liquidation was carried on by statutory authority under a department of the State government and was under the direction and control of State officers.

[33] 11 Wall. 113.
[34] 58 S. Ct. 539.

The question for decision was whether the Federal income tax upon these attorneys and liquidators with respect to their compensation as such, burdens the State to a degree forbidden by constitutional implication.

The Court ruled that the business in which the taxpayers were engaged was not one utilized by the State in the discharge of essential duties. The Court saying:

> The fact that the State has power to undertake such enterprises and that they are undertaken for what the State conceives to be a public purpose, does not establish immunity.

(NOTE.—This case was decided prior to the *Gerhardt case.*)

Wyoming leased to the Midwest Oil Co. a section of State "school land" with a retained royalty of 65 percent of the oil and gas produced. The Midwest Co. entered into a trust agreement to the effect that it held an undivided 50-percent interest in the lease for the benefit of Wyoming Associated. In 1925 the State received the royalty agreed upon, and the remainder was divided between Midwest and Wyoming Associated according to the trust agreement.

The question of whether the Federal income tax can be properly applied to the profit accruing to Wyoming Associated under the trust agreement from these leased oil lands, was answered in the affirmative by the Court in *Helvering* v. *Mountain Producer's Corp.*[35] In reaching this conclusion it was necessary for the Court to overrule *Gillespie* v. *Oklahoma* (257 U. S. 501) and *Burnet* v. *Coronado Oil & Gas Co.* (285 U. S. 393), the Court going on to say:

> That immunity from nondiscriminatory taxation sought by a private person for his property or gains because he is engaged in operations under a Government contract or lease cannot be supported by merely theoretical conceptions of interference with the functions of Government. Regard must be had to substance and direct effects. And 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 remote and indirect.

B. FEDERAL TAXES HELD CONSTITUTIONAL

13. A tax upon transfers of property by gift inter vivos not made in contemplation of death was upheld in *Bromley* v. *McCaughn.*[36]

14. A tax upon the first domestic processing of coconut oil was upheld in *Cincinnati Soap Co.* v. *United States.*[37]

15. An excise tax upon employers of eight or more with respect to having persons in their employment was upheld in *Steward Machine Co.* v. *Davis.*[38]

16. A gross income tax upon employees was upheld in *Helvering* v. *Davis.*[39]

17. A special income tax on profits arising from sales and transfers of silver was upheld in *United States* v. *Hudson.*[40]

18. A special tax on dealers in firearms was upheld in *Sonzinsky* v. United States.[41]

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[35] 58 S. Ct. 623.
[36] 280 U. S. 124.
[37] 301 U. S. 308.
[38] 301 U. S. 548.
[39] 301 U. S. 619.
[40] 299 U. S. 498.
[41] 300 U. S. 506.

PART II. POWERS OF THE STATE GOVERNMENTS

B. LIMITATIONS UNDER THE FEDERAL CONSTITUTION

4. Impairment of Obligations of a Contract

(a) effect on state contracts

Iowa issued State securities providing by statute that such bonds "shall be exempt from taxation," "are not to be taxed," and the like. Later, the State enacted an income tax and under it sought to levy upon the interest from these securities.

In holding that such a tax did not violate the constitutional provision against the impairment of contractual obligations, the Court, in *Hale* v. *Iowa State Board*, [42] ruled that, as there was no tax on income at the time the contract arose and none was contemplated, the exemption then pertaining to ad valorem and other taxes could not now be spread to include the income from the bonds. This conclusion was arrived at after reference was made to the rule by which tax exemptions are construed strictly against the taxpayer, and the Court ruled that a tax upon income was not a tax upon the property from which the income arose. (See discussion on "direct and indirect taxes distinguished," p. 2.)

The New York Rapid Transit Co. operated under a contract with New York City by which it furnished transportation for a 5-cent fare. The city laid a 3-percent tax upon the gross income of all utility companies doing business in the city. The levy was resisted upon the ground that it impaired the obligations of the contract between the transit company and the city. The Court found there was no provision regarding taxes in the contract and upheld the levy in *New York Rapid Transit Co.* v. *City of New York*.[43]

(b) effect on private contracts

In *Barwise* v. *Sheppard*,[44] the question before the Court was whether an excise tax on the production of oil which applied to the royalty interest of the lessor as well as to the interest of the lessee and was apportioned between the parties in ratio to their respective interests, impairs the obligation of their contract where the lease stipulated that the lessor was to have delivered to him "free of costs," in a pipe line, the equal one-eighth part of the oil produced. The lease contained no mention of taxes or of their payment. The Court held that the lease was made in subordination of the State's right to tax the production of oil and to apportion the tax between the lessor and lessee.

7. Denial of Due Process

(a) arbitrary state action

To subject the lessor, as holder of a beneficial interest in a lease to oil lands (he retained a royalty right to one-eighth of all oil produced), to a proportionate part of an occupational tax based on gross income from the production of oil, along with the lessee, was upheld in *Barwise*

[42] 302 U. S. 95.
[43] 58 S. Ct. 721.
[44] 299 U. S. 33.

v. *Sheppard* [45] on the basis that such apportionment according to their interests was neither arbitrary nor unreasonable.

In *Binney* v. *Long*,[46] a Massachusetts succession tax on transfers made to take effect in possession and enjoyment after the donor's death, as applied upon the death, intestate, of a life tenant, to remainders then vesting but theretofore contingent, under a trust inter vivos antedating the taxing legislation, was upheld as not infringing the due-process clause.

In *Great Northern Railway Co.* v. *Washington*,[47] with regard to a State inspection fee, the Court held that States may levy such fees to cover the expense of local inspection and supervision within the State's police power; but the exaction violates the fourteenth amendment, if, in addition to these legitimate purposes, it is used to defray the cost of other State activities. For the State to sustain the exaction in the case of an interstate utility, the burden rests upon the State to show that the fees collected from such utility do not exceed what is reasonably needed for inspection and supervision service in its particular case.

In *Carmichael* v. *Southern Coal Co.*[48] it was decided that the due-process clause was not violated by the State Unemployment Compensation Act, which singles out for taxation employers of eight or more and exempts certain types, such as those engaged in agriculture, educational pursuits, etc., as a State is not bound by rigid rules, but may tax one class and exempt another; and, even within a class, it may make distinctions in degrees that have a rational basis. Lines must be drawn somewhere; and, as long as the line is reasonable and not arbitrary and capricious, it is a matter for the judgment of the legislators and not for the courts.

Virginia levied an entrance fee upon foreign corporations for the privilege of doing business in the State which was graduated from $30, for companies whose maximum authorized capital stock was $50,000, to $5,000 for those with authorized capital of more than $90,000,000. In upholding the tax over the contention that it was arbitrary, in view of the fact that the fee was based on the authorized capital stock, regardless of whether such stock was actually issued and that only a portion of such stock is related to the amount of intrastate business that is contemplated being done in Virginia, the Court, in *Atlantic Refining Co.* v. *Virginia*,[49] pointed out that it was a matter of State policy as to whether any company should be admitted at all and that certain kinds of business might be admitted while others were excluded; that small companies might be allowed to enter and large ones denied the privilege; and that the entrance fee was not a tax, but compensation for a privilege, and the State is free to charge any sum it sees fit.

In *New York Rapid Transit Co.* v. *City of New York*,[50] the Court upheld a 3-percent gross-income tax on utility companies as applied to the transit company. The company contended the tax was unreasonable and arbitrary, as the city's contract forbade the company from raising its rates (it was obliged by law to furnish transportation for a

[45] 299 U. S. 33.
[46] 299 U. S. 280.
[47] 300 U. S. 154.
[48] 301 U. S. 495.
[49] 302 U. S. 22.
[50] 58 S. Ct. 721.

5-cent fare) and thus denied it the means of passing the tax on. The Court in answering this objection said:

> The legislature is not required to make meticulous adjustments in an effort to avoid incidental hardships.

(c) Jurisdictional Limitations

(1) Real Property Taxes

In *New York ex rel. Cohn* v. *Graves*,[51] the question before the Court was whether New York could assess a tax upon income accruing to a resident from rents from land situated in another State. The Court held that income derived from real estate may be taxed to the recipient at the place of his domicile, irrespective of the location of the land.

> It would be pressing the protection which the due-process clause throws around the taxpayer too far to say that because a State is prohibited from taxing land which it neither protects nor controls, it is likewise prohibited from taxing the receipt and command of income from the land by its resident, who is subject to its control and enjoys the benefit of its laws.

(2) Personal Property Taxes

(b) Intangible personal property.

In *First Bank Corporation* v. *Minnesota*,[53] the power of Minnesota to lay a property tax upon the shares of Montana and North Dakota State banks held by the First Bank Corporation, a Delaware corporation, which had its place of business in Minnesota and transacted its corporate and fiscal affairs there, was before the Court. These stock certificates were kept in Minnesota where appellant received dividends thereon and where it declared and paid dividends upon its own stock. The Court declared these shares had acquired a business situs in Minnesota and were subject to its property tax.

Pennsylvania imposed a tax upon the shares of trust companies charted in Pennsylvania. The company was responsible for the tax and must pay it from its own funds or collect it from the stockholder and pay it over. In *Schuylkill Trust Company* v. *Pennsylvania*,[54] the Court decided that such a tax as applied to the shares owned by nonresidents of Pennsylvania was not invalid under the due-process and equal-protection clauses of the fourteenth amendment.

(3) Death Taxes

(b) Intangible personal property.

The tax authorities of both California and Massachusetts claimed the decedent "X" was domiciled in their respective States and that his intangibles were, therefore, subject to their death duties. The executor, under the Federal Interpleader Act, sought to have these rival claims adjudicated on the basis that it was impossible for a person to be domiciled in two States at once.

In *Worcester County Trust Co.* v. *Riley*,[52] the Court held this to be such a suit, by a citizen of one State against another State, as to come under the provisions of the eleventh amendment. In its decision, however, the Court made the following interesting statement with

[51] 300 U. S. 308.
[52] 302 U. S. 292.
[53] 301 U. S. 234.
[54] 302 U. S. 506.

regard to the possibility of two States laying death duties upon the intangibles of the same decedent, saying that—

> Differences in proof and the latitude necessarily allowed to the trier of fact in each case to weigh and draw inferences from evidence and to pass upon the credibility of witnesses, might lead an appellate court to conclude that in none is the judgment erroneous. In any case, the Constitution of the United States does not guarantee that the decisions of State courts shall be free from error, or require that pronouncements shall be consistent. Neither the fourteenth amendment nor the full faith and credit clause require uniformity in the decisions of the courts of different States as to the place of domicile, where the exertion of State power is dependent upon domicile within its boundaries.

(5) Income Tax

(*a*) *Income earned within State.*

In *N. Y. ex rel. Whitney* v. *Graves*,[55] the Court upheld the right of New York to lay an income tax upon the profit accruing to Whitney, a resident of Massachusetts, from the sale of a membership right in the New York Stock Exchange. Whitney argued that his membership in the exchange is intangible personal property and as such the profit resulting from the sale of a right appurtenant to that membership is taxable only at the domicile of the owner and that, unless the membership has a "business situs" in New York, it is not taxable there. Whitney resided and transacted all of his business in Massachusetts and used his membership only by sending the orders of his customers to fellow members who bought or sold on the floor for him. For this reason, it was contended that the right to the stock exchange seat had not a business situs in New York. In answering this, the Court found that the dominant attribute of the membership so links it to the situs of the exchange as to localize it at that place and, hence, to bring it within the taxing power of New York.

(*b*) *Income earned without State.*

In *New York ex rel. Cohn* v. *Graves*,[56] the Court held that income derived from real estate may be taxed to the recipient at the place of his domicile, irrespective of the location of the land. The Court, in upholding the validity of a New York income tax upon Cohn, a resident, with respect to rents from lands lying in New Jersey, said:

> Neither analysis of the two types of taxes (property and income) nor consideration of the bases upon which the power to impose them rests, supports the contention that a tax on income is a tax on the land that produces it. The incidence of a tax on income differs from that of a tax on property. Neither tax is dependent upon the possession by the taxpayer of the subject of the other. His land may be taxed although it produces no income. * * *
>
> It would be pressing the protection which the due-process clause throws around the taxpayer too far to say that because a State is prohibited from taxing land which it neither protects nor controls, it is likewise prohibited from taxing the receipt and command of income from the land by its resident, who is subject to its control and enjoys the benefit of its laws.

The X company had its principal plant and office in Pennsylvania. It had been admitted to do business in West Virginia and was engaged in constructing dams there. A large part of its work was done at its Pittsburgh plant. In *James* v. *Dravo Contracting Co.*,[57] the Court

[55] 299 U. S. 366.
[56] 300 U. S. 308.
[57] 302 U. S. 134.

declared West Virginia had no authority to lay a gross-receipts tax upon the company with respect to the portion of its work done without the State.

(*e*) *Franchise taxes*

Louisiana levied a privilege tax upon chain stores graduated by the number of stores under the same management irrespective of whether such stores were within or without Louisiana. The operation of this tax was such as to subject the A. & P. Co. stores in Louisiana (106) to $550 each and to levy on the Hill Stores, Inc., a Louisiana corporation with no stores outside the State, a tax of only $30 each on its 92 stores.

In *Atlantic and Pacific Tea Company* v. *Grosjean*,[58] the Court held that the tax did not violate the due-process clause and was not upon subjects beyond the jurisdiction of the State. It pointed out that the incident of the tax was a legitimate one, that is, the operation of a retail store in Louisiana; that the measure was a valid one, that is, the number of such stores in the State; and that the rate of tax for each unit was also valid, as in legal contemplation the State is not taxing property beyond its borders but is merely fixing the rate on that within the State in the light of each unit's setting as an integral part of a much larger organization. The Court then went on to say that—

> Our decisions need not rest on conceptions of subject, measure, and rate of tax. Much broader considerations touching the State's internal policy of police sustain the exaction. * * * In the exercise of its power the State may forbid, as inimical to the public welfare, the prosecution of a particular type of business, or regulate a business in such a manner as to abate evils deemed to arise from its pursuit.

In *Atlantic Refining Co.* v. *Virginia*,[59] a corporation entrance fee was upheld which was graduated according to the authorized capital stock of the company, irrespective of whether such stock had been issued or of its relation to the amount of business expected to be done in the State. The Court declared that it was a matter of State policy as to whether any company should be admitted at all and that certain kinds of business might be admitted while others were excluded, that small companies might be allowed to enter and large ones denied the privilege. The entrance fee was not a tax, but compensation for a privilege, and the State is free to charge any sum it sees fit.

California levied a franchise tax upon insurance companies "upon the gross premiums received upon business done in this State, less return premiums and reinsurance in companies authorized to do business in this State." The X company, a Connecticut corporation, privileged to do business in California, conducted a general insurance business in California and in addition reinsured other companies doing business in the State against loss through policies issued to residents of California. These reinsurance contracts were entered into in Connecticut where the premiums were paid and where the losses, if any, were payable.

The California Supreme Court upheld the tax on the theory that, as deductions were allowed in the first instance for reinsurance, the inclusion of the reinsurance premiums paid to a company authorized to do business in the State was a means of equalizing the tax and an

[58] 301 U. S. 412.
[59] 302 U. S. 22.

offset against the benefit of the deduction which was made in the first instance and passed on (presumably) to the reinsurer.

In striking down this tax as applied to the reinsurance premiums, the Supreme Court, in *Connecticut General Life Insurance Co.* v. *Johnson*,[60] declared:

> The tax cannot be sustained either as laid on property, business done, or transactions carried on within the State, or as a tax on a privilege granted by the State.

The Court looked to the State's power to control the objects of the tax as marking the boundaries of the power to lay it. No act in the formation, performance, or discharge of the reinsurance contracts took place in California; nor were they dependent upon any privilege or authority granted by the State, and California laws gave them no protection.

8. Equal Protection of the Laws

(b) decisions holding clause violated

The Iowa chain-store tax, based on gross receipts from sales according to an accumulative graduated scale, was declared invalid under the equal protection clause of the fourteenth amendment in *Valentine* v. *Great A. & P. Company*.[61]

X died intestate in 1931 leaving four children as her sole heirs. In 1862 X's father purchased an insurance contract that agreed to pay a certain income to X for life and, upon her death, to distribute the principal and any unpaid income to such person as she might, by will, appoint and, in default of appointment, to her surviving children.

X's mother, who died in 1891, bequeathed property in trust to pay the income to each of her six children, two of whom still survive, and to the issue, per stirpes, of any deceased child so long as any of her children lived. For 20 years after the death of her last-surviving child, the income was to be paid to her grandchildren and their issue, per stirpes, and at the expiration of that period, the principal was to be divided between the grandchildren per capita. Each child of X's mother was empowered to appoint the proportions in which the income and principal were to be divided between his or her children. X failed to exercise this power, and her four children succeeded to equal life estates in her share. She also failed to exercise the power of appointment provided for in the 1862 trust and the corpus of that trust passed to her four children also.

When these trusts were created, Massachusetts imposed no inheritance or succession tax. In 1907, a law was passed taxing testamentary lineal devolutions of property, but it was prospective in nature and specifically exempted estates of those dying prior to its effective date. In 1909, a new law was adopted which provided for a tax upon the occasion of the exercise or nonexercise of powers of appointment, but only where such power was derived from a disposition of property made prior to 1907. The law, therefore, created two classes: The one composed of beneficiaries who take at the death of the donee of a power of appointment created by an instrument antedating 1907, who are taxed, and the other of beneficiaries who take in succession to a donee of a power conferred by a deed executed subsequent to 1907, who are not taxed. In addition, the 1909 act imposed a graduated rate, while the 1907 law provided a flat rate.

[60] 303 U. S. 77.
[61] 299 U. S. 32.

With regard to the 1862 trust, the Court, in *Binney* v. *Long*,[62] declared the 1909 act denied equal protection of the laws in that it taxed the succession of property through the exercise or nonexercise of a power of appointment only where the instrument, creating the power was executed prior to 1907. It thus discriminated against a class of remaindermen arbitrarily singled out for taxation from all of those similarly situated.

As to the 1891 trust, the Court came to the same conclusion. In addition, the discrimination goes further in that the statute in the case of the 1891 trust had the effect of subjecting it to a higher rate of tax, by aggregating it with the other property passing to the same heirs (under the graduated rates of the 1909 act), than is applicable to others who are similarly situated except for the artificial and arbitrary distinctions set out in the act. The Court considered it an unreasonable discrimination that the beneficiary of a power must aggregate the interest derived therefrom with that enjoyed by inheritance of property owned in fee by the donee of the power, if the creation of the power antedates 1907, but need not so aggregate the interests for the purpose of taxation if the creation of the power be subsequent to 1907.

In *Great Northern Railway Co.* v. *Washington*, [63] the Court struck down an inspection fee as violating the equal-protection clause where the fee was in excess of that required to cover the costs of local inspection and supervision and was used to defray the expense of other State activities.

(c) DECISIONS HOLDING CLAUSE NOT VIOLATED

In *A. & P. Co.* v. *Grosjean*,[64] the Court upheld a Louisiana chain-store tax as not infringing the equal-protection clause, where the tax was graduated according to the total number of stores under the same mangement irrespective of whether the stores were within or without the State. The rate was fixed by the total number of stores but applied only with respect to those within the State.

The Alabama State Unemployment Compensation Act was upheld in *Carmichael* v. *Southern Coal Co.*[65] The Court said the equal-protection clause was not violated by a tax which singles out employees of eight or more and exempts certain types such as agricultural employees, etc. It found also that the restriction of the benefits of the act to certain classes of employees did not infringe the provision.

That a State entrance fee required of foreign corporations does not violate the equal-protection clause where it is graduated according to the total authorized capital stock, irrespective of the amount issued or the portion related to the amount of business expected to be done in the State, was decided in *Atlantic Refining Co.* v. *Virginia*.[66]

A California law imposed a tax of $500 annually upon the privilege of importing beer into the State. The fee for a wholesaler of beer was separate and amounted to $50 a year. Thus, wholesalers selling domestic beer paid $50, while those selling imported beer were required to pay $550. The twenty-first amendment provides:

[62] 299 U. S. 280.
[63] 300 U. S. 154.
[64] 301 U. S. 412.
[65] 301 U. S. 495.
[66] 302 U. S. 22.

The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.

In *State Board* v. *Young's Market*,[67] the Court, in upholding this importer's license tax, declared that a classification recognized by the twenty-first amendment cannot be deemed forbidden by the fourteenth.

A poll tax on males between the ages of 21 and 60, with the specific exemption of females, males under and over the ages indicated, and blind persons, which must be paid before the taxpayer may vote, was upheld in *Breedlove* v. *Suttles*.[68]

Both Massachusetts and California sought to tax the intangible property of the same decedent, under their death-tax laws, each claiming decedent as a resident. The executor sought, by interpleader, to have the merits decided in Federal court. In *Worcester County Trust Co.* v. *Riley*,[69] the Court found this to be such a suit as was forbidden by the eleventh amendment and that the whole question was a matter for the State courts, and, unless a Federal matter was presented or the Constitution infringed, it could not consider it. The Court then went on to say:

In any case, the Constitution of the United States does not guarantee that the decisions of State courts shall be free from error, or require that pronouncements shall be consistent. Neither the fourteenth amendment nor the full faith and credit clause requires uniformity in the decisions of the courts of different States as to the place of domicile, where the exertion of State power is dependent upon domicile within its boundary.

In *New York Rapid Transit Co.* v. *City of New York*,[70] the Court upheld a gross-income tax upon utility companies as applied to a traction company which was under contract with the city to furnish transportation for a fixed fare. The proceeds from this tax were to be used for relief purposes. The Court declared that—

a tax is not an assessment of benefits—

and—

taxes are repeatedly imposed on a group or class without regard to responsibility for the creation or relief of the conditions to be remedied.

In *Schuylkill Trust Co.* v. *Pennsylvania*,[71] it was decided that a tax upon the shares of domestic trust companies held by nonresidents, where the company is responsible for the tax and must pay it, or collect it from the shareholders and pay it over, did not violate the equal protection clause.

9. Interference With Interstate and Foreign Commerce

In *State Board* v. *Young's Market*,[72] the Court upheld a California statute imposing an annual license fee of $500 upon persons importing beer into the State. It ruled that the twenty-first amendment, which "prohibited" the "transportation or importation" of intoxicating liquors into any State "in violation of the laws thereof," abrogated the right to import free, so far as concerns intoxicating liquors. It was

[67] 299 U. S. 59.
[68] 302 U. S. 277.
[69] 302 U. S. 292.
[70] 58 S. Ct. 721.
[71] 302 U. S. 506.
[72] 299 U. S. 59.

argued that, even if the State may prohibit the importation of liquors, it may do so only where it prohibits the manufacture and sale within the State. The Court answered this by saying that the State may adopt a lesser degree of regulation than total prohibition.

Washington imposed an inspection fee of one-tenth of 1 percent upon the gross operating revenue of public utility companies. It was contended by the Great Northern Railway Co. that this fee was greatly in excess of that necessary to defray the regulatory and inspection service expenses and that the fee was not based on actual expenses, but was used to defray the costs of other activities in connection with railroads, and also of other duties regarding unrelated public utilities, the expenses of which are not properly allocable to or connected with carriers by rail. It was further contended that this fee was in fact a revenue measure in view of the fact that there had accumulated $250,000 in the fund over the sums actually spent by the utilities department in the discharge of all of its duties.

The evidence did not disclose and the State was apparently unable to show the proper allocation of the sums paid in by various utilities to the separate phases of the department's activity. No separate accounts were kept, or required by law to be kept, and it was impossible to determine from the records and accounts of the department the expenses of inspecting and regulating railroads separate and apart from the expenses of inspecting and regulating various other utilities or in carrying on the other functions of the department.

In *Great Northern Railway Co.* v. *Washington*,[73] the Court ruled that, while a State may require an interstate utility company to pay a regulatory and inspection fee, in addition to its general taxation, to cover the expense of local inspection and supervision within the State's police power, the exaction violates the commerce clause if, in addition to these legitimate purposes, it is used to defray the cost of the other State activities.

The Court held further that for a State to sustain the exaction in the case of an interstate utility, the burden rests upon the State to show that the fees collected from such utility do not exceed what is reasonably needed for inspection and supervision service in its particular case.

Washington levied a 2 percent sales tax and, as a compensating measure, imposed a tax of 2 percent on the use of personal property which had been purchased at retail tax free, or at a rate of less than 2 percent (in the latter case the rate of the use tax is measured by the difference between the tax so paid and 2 percent).

The effect of this tax was to subject all property bought at retail, whether purchased in the State and subjected to the 2-percent sales tax (or tax-free by some quirk of the sales-tax law), or purchased without the State tax-free or taxed at less than 2 percent, and used in the State, to an equal burden of 2 percent.

The Silas Mason Co., a Delaware corporation, was engaged in the construction of the Grand Coulee Dam in Washington. In this work it was using machinery, materials, and tools bought outside Washington. It resisted the levy of the use tax upon the ground that it was an interference with interstate commerce. In *Henneford* v. *Silas Mason Co.*,[74] the Court in upholding the tax found that it was not

[73] 300 U. S. 154.
[74] 300 U. S. 577.

upon the operations of interstate commerce but upon the privilege of use after such commerce is at an end. And further—

> The tax upon the use after the property is at rest is not so measured or conditioned as to hamper the transactions of interstate commerce or discriminate against them.

In *Southern Gas Corporation* v. *Alabama*,[75] the Court decided that an annual franchise tax of $2 on each $1,000 of capital employed in the State by foreign corporations doing business there was not invalid where the company was engaged in both inter and intra-state commerce, regardless of whether such capital could be allocated to interstate or intrastate business, provided the tax was not so laid as to discriminate against interstate commerce or otherwise lay a direct burden upon it, the Court saying—

> A franchise tax imposed on a corporation, foreign or domestic, for the privilege of doing a local business, if apportioned to business done or property owned within the State, is not invalid under the commerce clause merely because a part of the property or capital included in computing the tax is used by it in interstate commerce.

Louisiana laid a franchise tax on chain stores graduated from $10 per store, in chains of from 2 to 10 stores, to $550 per store, in chains of more than 500 stores. The rate was based on the number of stores in the chain regardless of whether such stores were located within or without Louisiana, but the tax applied only to those in the State. The operation of this law was such as to subject the A. & P. Co. stores in Louisiana (106) to $550 each and to levy on the Hill Stores, Inc., a Louisiana corporation with no stores outside the State, a tax of only $30 each on its 92 stores. The evidence disclosed that Hill did a much greater volume of business per store and a greater total volume of business in the State than did the A. & P. Co.

The tax was resisted on the grounds that the method of ascertaining the rate offended the commerce clause.

In *Atlantic and Pacific Tea Co.* v. *Grosjean*,[76] the Court upheld the tax. It had found in the *Jackson case*[77] and the *Standard Oil case*[78] that a State may separately classify for taxation the conduct of a chain store and may vary the tax in proportion to the number of units operated within the State. In the present case, it found it difficult to see how the advantages of multiple units of a chain (the basis for the former decisions) ceased at a State boundary. It found that a tax on those stores in the State, measured by the total number of units both within and without the State, did not violate the commerce clause.

In *Atlantic Refining Co.* v. *Virginia*,[79] it was decided that a State entrance fee for foreign corporations did not infringe the commerce clause where the amount demanded was graduated in ratio to the total authorized capital stock of the company seeking admission, irrespective of the amount of such stock actually issued or of the amount commensurate with the business expected to be done in Virginia.

The X company was engaged in a general stevedoring business that included loading and unloading boats engaged in interstate and foreign

[75] 301 U. S. 148.
[76] 301 U. S. 412.
[77] 283 U. S. 527.
[78] 294 U. S. 87.
[79] 302 U. S. 22.

commerce. At times, it contracted to collect and supply the longshoremen and undertook no supervisory control of their activity, but simply paid off the men after the ship was loaded or unloaded and billed the shipping company for its costs plus a commission for its services. However, the greater part of the company's business was of the first type, that is, taking complete charge of the loading and unloading of these vessels. The State of Washington levied a gross-receipts tax upon this company based on the privilege of doing business in the State. The tax was resisted upon the grounds that it so burdened interstate and foreign commerce as to be repugnant to the Constitution.

In *Puget Sound Stevedoring Co.* v. *Washington*,[80] the Court ruled that the portion of the company's business attributable to the loading and discharge of cargoes by longshoremen, subject to its own direction and control, is interstate or foreign commerce and the State is not at liberty to tax the privilege of doing it by exacting in return therefore a percentage of the gross receipts therefrom. At the same time, it held that the portion of the company's business attributable to the supplying of longshoremen to shipowners without directing or controlling the work of loading or unloading is not interstate and foreign commerce, but rather a local business, and is subject, like such businesses generally, to taxation by the State.

In *Adams Manufacturing* v. *Storen*,[81] the Court struck down an Indiana gross receipts tax (not a franchise, or entrance tax, nor a tax in lieu of property taxes) as applied to receipts from interstate sales on the basis that such a tax violates the commerce clause if it includes in its measure, without apportionment, receipts derived from interstate commerce. It found that, as such, the tax directly burdens interstate commerce, and, if lawful, could be laid to the fullest extent by States in which the goods are sold as well as by those in which they are manufactured.

In distinguishing between *American Manufacturing Co.* v. *St. Louis* [82] and the present case, the Court said that the present tax was bad—

> because the tax, forbidden as to interstate commerce, reaches indiscriminately and without apportionment the gross compensation for both interstate commerce and intrastate activities.

and that for this reason it must fail in its entirety so far as applied to receipts from sales interstate.

Louisiana imposed a tax of $1 per horsepower capacity annually upon the privilege of operation power producing machinery, as an adjunct to the tax on the production of electrical energy in Louisiana. The Arkansas-Louisiana Pipe Line Co. was engaged in buying, producing, transporting, and selling natural gas in Louisiana and adjoining States. The gas is obtained in Louisiana and is carried by pipe line to adjoining States where 96 percent of it was sold. The gas could not be moved in proper quantities for the required distance without artificial pressure, and for this purpose the company maintained a compressing and pumping station in Louisiana which, under 10,500 horsepower, forces the gas through pipe lines into Arkansas and Texas.

[80] 302 U. S. 90.
[81] 58 S. Ct. 913.
[82] 250 U. S. 459.

The tax, as applied here, was upon the operation of power-producing machinery, which power, when generated, was used to propel natural gas in interstate commerce, and was resisted upon the grounds that it laid an unconstitutional burden upon such commerce.

The Court, in *Coverdale* v. *Arkansas-Louisiana Pipe Line Co.*,[83] upheld the tax after finding a distinction between the production of power and the use to which it was put. The Court said that, while this—

> production of power synchronizes with the transmission of that power to the compressor, production occurs prior to the transmission. It is just as much local as the generation of electrical power.

In addition, it was pointed out that the tax is laid so as to apply without discrimination as between inter- and intra-state commerce, and it cannot be imposed by more than one State. It bears generally on all production of power and is not discriminatory, and, while it adds to the cost of interstate commerce, increased cost alone is not sufficient to invalidate the tax as an interference with that commerce.

In *Western Live Stock* v. *Bingaman*,[84] the Court upheld a tax of 2 percent upon gross receipts from the sale of advertising space in publications, as applied to a magazine publisher whose publication circulated in interstate commerce and the advertisements in which were obtained by solicitation in a number of States. The tax was challenged on the grounds that it imposed an unconstitutional burden upon interstate commerce in that it taxed amounts arising from sales without the State to advertisers there of space in a journal which is published in New Mexico and circulated to subscribers both within and without the State.

The Court held that the test is not so much a question of whether the tax burdens interstate transactions (as "even interstate business must pay its own way"), but whether the tax and the incident upon which it is levied are of such a nature as to permit multiple and accumulative taxation of the same business by another State or States.

In the present case, the tax was deemed to be an excise conditioned on the carrying on of a local business, and, even though there were interstate aspects to the business, the burden on interstate commerce was too indirect and remote to invalidate the tax.

In *Ingels* v. *Morf*,[85] a California license or permit of $15, for the privilege of bringing into the State any motor vehicle on its own wheels for sale within the State, was stricken down where it was shown that the exaction was far in excess of that necessary to defray the cost of policing and supervising the traffic caused by "caravaning" (as the use of the highways for driving and towing these caravans of cars into the State for sale, was called).

In *Bourjois, Inc.*, v. *Chapman*,[86] a Maine statute requiring all cosmetics to be registered before being offered for sale within the State and a fee of 50 cents for each preparation so registered to be paid, was upheld over the contention of Bourjois, Inc., a New York company, having no place of business in Maine but selling there through direct solicitation, that the fee unconstitutionally burdened interstate commerce. The Court found that the statute is by its terms limited

[83] 58 S. Ct. 736.
[84] 58 S. Ct. 546.
[85] 300 U. S. 290.
[86] 301 U. S. 183.

to intrastate commerce; that is, it applies only to the sale or use of beauty preparations within the State, saying:

> There is no discrimination against interstate commerce, since the regulation applies equally to all preparations, whether manufactured within or without the State.

The statute provided that the fees collected should be set aside in a special account and should be used solely for the enforcement of the act. The Court found that the law had not been in effect long enough to determine whether the fee was insufficient or excessive to cover the costs of administration and decided that, in the meantime, it would not be presumed to be excessive in the absence of direct evidence to the contrary.

10. Interference With Federal Functions

(a) development of doctrine of federal immunity

Rogers was general counsel for the Panama Railroad Company, was on a yearly salary, and was not an independent contractor. The United States owns the entire capital stock of the company and operates it in conjunction with the Panama Canal as an auxiliary to the Canal itself. The State of New York levied an income tax upon Rogers' salary. In *N. Y. ex rel. Rogers* v. *Graves*,[87] the Court held that the Panama Railroad is a Federal instrumentality and is beyond the taxing power of the State and that the salaries of its employees are likewise exempt. It was brought out that the railroad was used also for private or proprietary functions, but it was decided that, even if this were true, the primary purpose of the enterprise being legitimately governmental, its incidental commercial use afforded no grounds for objection.

The Indian Territory Co. held an oil and gas lease covering lands of restricted Pawnee Indians. Oklahoma laid an ad valorem tax on property of this company, which was used in its operations of lessee, The tax was at the same rate applicable to other comparable property, and there were no allegations of discrimination. In *Taber* v. *Indian Territory Company*,[88] the Court held that the immunity of Federal instrumentalities cannot be held to extend to a nondiscriminatory ad valorem tax. Care was taken to distinguish between discriminatory and nondiscriminatory taxes, the Court saying:

> Such immunity as petitioner enjoyed as a governmental instrumentality inhered in its operation as such and being for the protection of the Government in its function extended no further than was necessary for that purpose.

Thus, where the influence of the tax upon the exercise of governmental functions is remote, if any, it is decided that, if it is a nondiscriminatory ad valorem tax, it is valid, although the property is used in the operations of a governmental agency.

"X", as guardian of an incompetent World War veteran, deposited the checks of the United States Government in payment of compensation and insurance due the veteran in a local bank in North Carolina. The State assessed property tax against these deposits. Section 22 of the World War Veterans' Act exempted from taxation payments made to, or on account of, a beneficiary under the act. The veteran's funds consisted of deposits in banks and real-estate loans. No question is

[87] 299 U. S. 401.
[88] 300 U. S. 1.

raised regarding the taxability of the investments in real-estate loans; it is only the bank deposits that are in issue. In *Trotter* v. *Tennessee* (290 U. S. 354), the veteran's money had been invested in real estate and merchandise. There the Court held that the funds had lost their identity and by this token the immunity conferred by the act was lost.

Lawrence v. *Shaw*,[89] the present case, was distinguished from the *Trotter case*, and in it the Court held that bank credits of a veteran, or his guardian, which do not flow from his investments, but result from the deposit of warrants received from the Government in payment of benefits under the act are exempted from local taxation by the act itself and that the funds in this case had not lost their identity by deposit in a bank.

In *James* v. *Dravo Contracting Co.*,[90] the Court upheld a West Virginia gross-receipts tax as applied to a company, building, under contract with the Federal Government, a series of locks and dams in West Virginia. It was decided that the tax was not upon an instrumentality of the Federal Government, nor was laid upon the contract. And, even though the tax on the gross receipts of the contractor may increase the cost of the job to the United States, that it still does not interfere in any substantial way with the performance of a Federal function and is a valid exaction.

Silas Mason Co. v. *Tax Commission of Washington*[91] related an almost identical set of facts as those in the *Dravo case* and was decided in the same manner and upon the same grounds.

13. Interference with Inherent Rights of Federal Citizenship

The State of Georgia imposed a poll tax upon all its inhabitants between the ages of 21 and 60 except females and blind persons. The State constitution provided that no person is entitled to register and vote until the poll tax payable by him has been paid. The amount of the tax was $1 a year. It was contended that the requirement offended the equal protection of the laws and the privileges and immunities provisions of the fourteenth amendment, the whole of the nineteenth amendment, and each citizen's inherent rights of Federal citizenship.

In upholding the tax and the requirement, the Court, in *Breedlove* v. *Suttles*,[92] held that to make the payment of the tax a prerequisite to voting, does not deny any privilege or immunity protected by the fourteenth amendment. Voting privileges are conferred by the State, and the State may condition them as it chooses, save as restrained by the fifteenth and nineteenth amendments and other constitutional provisions. The privileges guaranteed by the fourteenth amendment are only those that arise from the Constitution and laws of the United States and not those that come from other sources.

The Court went on to rule that the purpose of the nineteenth amendment is not to regulate the collection of taxes; that the payment of a poll tax as a prerequisite to voting is a reasonable measure, and the exaction of payment from males of from 21 to 60 years of

[89] 300 U. S. 245.
[90] 302 U. S. 134.
[91] 302 U. S. 186.
[92] 302 U. S. 277.

age before registration does not deny or abridge the right to vote on account of sex; and that imposition of the tax without enforcement would be futile, and this provision is simply a measure to enforce collection.

14. Jurisdiction With Respect to Federal Property Within the Various States

Article I, section 8, clause 17, of the Federal Constitution provides as follows:

> The Congress shall have power to exercise exclusive legislation in all cases whatsoever * * * over all places purchased by the consent of the legislature of the State in which the same shall be, for the erection of forts, magazines, and arsenals, dockyards, and other needful buildings.

The broadest construction has been placed upon the word "places," and it has been extended to include all structures and places necessary for the carrying on of the business of the National Government. The term is applicable even to a hotel located upon the Hot Springs reservation in Arkansas.

In the light of the ever-increasing spread of governmental functions and the acquisition of more and more property by governmental units for the erection of dams, irrigation and power units, resettlement and rehabilitation projects, the question of the jurisdiction of the States with respect to these places, particularly in the field of taxation, becomes increasingly important.

Recently, two decisions have been handed down by the Supreme Court that are of unusual interest in this regard. In the first case, *James* v. *Dravo Contracting Co.*,[93] the question before the Court was whether West Virginia had territorial jurisdiction to lay a gross-receipts tax upon a construction company, under contract with the Federal Government to construct a series of dams and locks for the United States in West Virginia, with respect to the portion of the work done (1) in the bed of a navigable river, (2) on property acquired by the Federal Government on the banks of the river, and (3) on property leased by the company and used for the accommodation of its equipment.

(1) As to work done in the bed of a navigable river, the Court held that, although the Federal Government may use the river beds for any structure which the interests of navigation may require, the State holds title to the lands under the river and has territorial jurisdiction over them.

(2) As to lands acquired by the United States (fee simple), the Court held that locks, dams, etc., are "needful buildings" and, like forts, magazines, etc., come within clause 17, section 8, article I, of the Constitution. But even as such, the ownership by the United States may be qualified by the terms of the cession granted by the State. In this instance, it was provided in the Cession Act of the West Virginia Legislature that the State should exercise concurrent jurisdiction with the Federal Government, and the right to serve process within such territory was specifically reserved. Thus, the Court ruled that these reservations by the State did not operate to deprive the United States

[93] 302 U. S. 134.

of the enjoyment of the property for the purpose for which it was acquired and that the quasi-State jurisdiction was compatible with the carrying out of the purposes which the Federal Government intended.

(3) As to the property leased by the company, the Court found no question as to the State's jurisdiction over this area.

Thus, the State has authority to lay the tax with respect to the company's activity in each of these three areas.

In the second case, *Silas Mason Co.* v. *Tax Commission of Washington*,[94] the facts were similar to those in the *Dravo case*, *supra*, but presented the additional problem of the difference that might arise between the State's jurisdiction, with regard to lands acquired by the Federal Government from the State, and that arising with respect to lands acquired from individuals.

As to lands acquired from the State, the Court ruled that the State had—

> legislative authority over all of this area consistent with Federal functions.

This conclusion was reached after reference was made to the State Cession Act which, in providing for the acquisition of title by the United States to these lands, specified that such title—

> shall vest in the United States to the extent necessary for the maintenance, operation, and control of such reservoir or other irrigation works.

As to lands acquired from individuals, the Court concluded that, while the Federal Government, under clause 17, section 8, of article I of the Constitution, has authority to take such lands and exercise exclusive jurisdiction over them, there is no reason why it is compelled to accept such absolute jurisdiction or the State to grant it. The Court pointed out—

> that our system of government is a practical adjustment by which the national authority may be maintained in its full scope without unnecessary loss of local efficiency. In acquiring property, the Federal function in view may be performed without disturbing the local administration in matters which may still appropriately pertain to State sovereignty.

and further—

> The mere fact that the Government needs title to property within the boundaries of a State, which may be acquired irrespective of the consent of the State, does not necessitate the assumption by the Government of the burdens incident to an exclusive jurisdiction.

Thus, the tax was upheld with respect to the company's activities in each of these areas.

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[94] 302 U. S. 186.

TABLE OF CASES

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