Taxing Tax-Immune Income

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The exemption from taxation of the compensation of governmental officers and employees and interest upon governmental obligations is a source of much just resentment to taxpayers, editorial writers and others.

The prohibition against taxation by state and nation, each by the other, of state and national agencies and obligations, arises not by virtue of any express constitutional provision, but is based upon the theory that the power to tax is the power to destroy, and that hence, by necessary implication, the means and instrumentalities which either government employs to carry out its powers shall be free from taxation by the other government.¹

This article, on methods of meeting the situation under existing constitutional limitations, does not assume to add another voice or view to the already abounding discussion as to whether or not the Supreme Court should or would restate the doctrine in a new case adequately raising and arguing the issue. Suffice it to mention that Brush v. Commissioner² has renewed the hopes of the advocates of restatement or abrogation of the doctrine, while Helvering v. Gerhardt,³ decided by the United States Supreme Court on May 23, 1938, has greatly raised these hopes.

In the Brush case, Justices Stone and Cardozo voted with the majority, holding that the taxpayer’s salary as Chief Engineer of the Bureau of Water Supply of the City of New York was immune from federal taxation, but did so on the ground that the taxpayer had brought himself within the terms of the exemption prescribed by the Treasury Department in article 643 of Regulation 74,⁴ and that the validity of that article had not been challenged by the Government. They said: “In the

² (1937) 300 U. S. 352.
³ U. S. LAW WEEK 1175. A stay of mandate has been granted pending action by the Supreme Court upon a petition for rehearing. 5 U. S. LAW WEEK 1281.
⁴ “Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, . . . is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. . . .” Corresponding provisions of regulations under later acts are substantially the same in the pertinent respects. See articles 116-2, Regulations 94 and 86 and article 643, Regulations 77.
absence of such a challenge no opinion is expressed as to the need for revision of the doctrine of implied immunities declared in earlier decisions. We leave that subject open.\footnote{Brush v. Commissioner, supra note 2, at 374. While these Justices were technically correct in that the government did not raise the question of a restatement of the doctrine, but tacitly conceded the taxpayer's case if the Court found that what he was engaged in was a governmental function, in accordance with the regulations, nevertheless they might have taken a broader view of the case and have stated their views on the constitutional question which they mentioned, without raising possibly false hopes on the part of the government. Various holdings on the effect of regulations follow and indicate that they are no impediments: "An interpretation of the Act by the Treasury Department would not estop the Government from asserting the tax, even though the taxpayer may have been misled by such interpretation." Langstaff v. Lucas (W.D. Ky. 1925) 9 F. (2d) 691, aff'd (C.C.A. 6th, 1926) 13 F. (2d) 1022 cert. den. (1926) 273 U. S. 721, 47 Sup. Ct. 111. In the construction of a statute, the regulations and practices of the Treasury Department are entitled to weight and serious consideration, but it is for the courts to construe a statute and not the executive departments of the Government. Edwards v. Douglas (1925) 269 U. S. 204. The continuous construction given to a statute by the Treasury Department since the passage of an act is binding upon the courts, except where the text of the statute furnishes cogent reasons to depart from it. Bowring v. Bowers (C.C.A.2d, 1928) 24 F. (2d) 918, cert. den. (1928) 277 U. S. 608. In Hadley Falls Trust Co. v. U. S. (D. C. Mass., Feb. 14, 1938) 384 C. C. H. par. 9115, the court held that notwithstanding article 193, Regulations 74 to the contrary the taxpayer is not entitled to a deduction from its income of the sum by which the purchase price at a foreclosure sale, or the amount of the mortgage debt, exceeded the fair market value of the property. The writer listened to the argument in the case of Helvering v. Gerhardt, October term 1937, No. 789. Mr. Justice Stone's questions are interesting. He first mentioned to counsel that the Treasury Department had changed the regulations since the Brush case and that they no longer were an impediment to the restatement of the doctrine, if the court saw fit to restate. Counsel stated that the government was not asking for a restatement in the pending case. Another question is also interesting. He asked counsel if there was any case which could be found holding an employee, as distinguished from an officer, immune from taxation. Counsel stated that they knew of none.\footnote{Treasury Decision 4787, Internal Revenue Bulletin 1938-3, p. 6, amending articles 116-2 of Regulations 94 and 86, articles 643 of Regulations 77 and 74 and article 88 of Regulations 69. Thus, all regulations possibly operative and dealing with the subject now read as follows (only pertinent part quoted): "Compensation of State Officers and Employees.—Compensation received for services rendered to a State is to be included in gross income unless the person receives such compensation from the State as an officer or employee thereof and such compensation is immune from taxation under the Constitution of the United States. . . . As used in this article, the term 'State' includes a political subdivision of a State."} Following this decision, the Treasury Department amended this and other regulations dealing with the subject,\footnote{It is to be observed that under the presently operative revenue act (Revenue Act of 1936) 49 Stat. 1648, there is no provision exempting from taxation the compensation of State officers or employees. However, section 22(b)(4) of that act provides that interest upon the obligations of a State, Territory, or any subdivision
would not abrogate its earlier decisions, it might go so far as to adopt a theory along the lines enunciated by Justices Roberts and Brandeis in their dissenting opinion, (i.e., looking to the practical effects of the tax), extending immunity only if the tax is discriminatory, or if to do otherwise would impose a substantial burden upon the state. Premising such a theory, future litigation would then be confined to the question of whether or not a tax was in fact discriminatory or imposed such a burden.⁸

The Gerhardt case involved the constitutionality of a federal income tax upon the salaries of certain employees (a construction engineer and two assistant general managers) of the Port of New York Authority, a bi-state corporation created by compact between New York and New Jersey approved by Congress. The corporation operated bridges, tunnels, an interstate bus line and a freight terminal. These employees took oaths of office, although neither the compact nor the related statutes appear to have created any office to which they were appointed. After reviewing and analyzing the authorities, the Court held that the imposition of the federal income tax on such salaries was valid. The grounds stated in the opinion of Mr. Justice Stone, concurred in by three other justices, were:

That the tax was laid on net income derived from employment in common occupations not shown to be different in their methods or duties from those of similar employees in private industry, and thus was a nondiscriminatory tax laid on the net incomes of such employees in common with that of all other members of the community; that as such, the tax could by no reasonable probability be considered to preclude the performance of the functions which New York and New Jersey have undertaken, or to obstruct them more than like private enterprises are obstructed by our taxing system; that the tax does not curtail any of those functions which have hitherto been thought to be essential to the continued existence of New York and New Jersey as states; and that the burden of thereof, or the District of Columbia shall not be included in gross income and shall be exempt from taxation. Accordingly, no express statutory provision bars the inclusion of such compensation in gross income. The opportunity for another test will come when, as and if the Treasury proceeds to include such compensation in a taxpayer's gross income and asserts a deficiency with relation thereto which the taxpayer will contest. It may be argued, however, that this may not be done (as a matter of statutory construction) without an amendment of the law, in view of the long standing interpretation of the revenue laws and the continued reenactment of similar provisions by Congress, always given a similar interpretation by the department, that such compensation was not subject to taxation thereunder.

⁸ James v. Dravo Contracting Company (1937) 302 U. S. 134, presages the diversity of opinion which would ensue as to what is a burden. It also casts some doubt upon the possibility of procuring a restatement of the doctrine of implied immunities, as applied to governmental officers and employees, insofar as it seems to accept the theory that officers' salaries cannot be taxed regardless of burden. The "burden theory" was enunciated in Willcuts v. Bunn (1931) 282 U. S. 216.
the tax affecting the states, as it does, only to the extent, if any, to which
the employees pass it on to the states, does not give rise to an immunity
from taxation because the actual burden on the state is so speculative and
uncertain that immunity if granted would restrict the federal taxing
power without affording any corresponding tangible protection to the
state governments. Mr. Justice Black concurred separately, basing his
opinion on a restatement and abrogation of the immunity doctrine, and
also on the proposition that the Sixteenth Amendment in authorizing
the taxation of income "from whatever source derived," justified the tax.
Justices Butler and McReynolds dissented on the ground that the taxa-
tion was constitutionally prohibited and said that the majority opinion
had overruled a century of precedents.

The opinion of Mr. Justice Stone, after stating these grounds for its
decision, undermined their value as positive guides for the future by
stating, in further support of the decision, that employees of the Port
Authority are not employees of a state or a political subdivision thereof
within the meaning of the original applicable Treasury regulation.

While the holding in this case may be restricted to the point that the
taxpayers involved were not considered to be officers or employees of a
state, nevertheless the language of the decision may be taken to indicate
that a contrary result would be reached in the event the *Brush* case were
to be litigated again. The decision is negative in effect, in that it indicates
that no exemption exists with respect to the compensation of an officer
or employee of a state if such officer or employee is not engaged in a
function which has hitherto been thought to be essential to the continued
existence of the state. Query as to those officers or employees who are so
engaged? *Collector v. Day,* while not overruled by the decision, is not
specifically recognized as authority. The Court said, however, that since
that case involved a state judicial officer, it was narrowly limited to a
function which pertained to state governments at the time the Constitu-
tion was adopted, without which no state could long preserve its existence.
Regardless of opinions as to the actual effect of the decision on previous
doctrines, it would seem to presage a holding, in a case adequately raising
and arguing the issue, that officers of states and their political subdivi-
sions not performing legislative, executive or judicial functions and hav-
ing counterparts in private employment are not immune from federal
taxation; and the possibility that officers performing such functions may
be held to be taxable. On all points the opinion leaves the matter open for
whatever action the court may subsequently decide to take.

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9 *Supra* note 1.
It furnishes no reason, however, to believe that *McCulloch v. Maryland* will be abrogated, although this point too is left open, for the Court definitely recognized a distinction between the immunity of the states and the immunity of the nation, and illustrated the distinction by use of the original language of Marshall in *McCulloch v. Maryland*. So also, the Court is silent as to what it may do with respect to the taxation of interest from state and local obligations.

The opinion is of immediate concern to officers and employees of states and their political subdivisions and instrumentalities. Except insofar as prior decisions are *res adjudicata* in a technical sense, or as the statute of limitations may be applicable, tax deficiencies would seem to exist with respect to compensation received in past years by persons in governmental employments who were not engaged in performing functions essential to the continued existence of states, as states. Even the statute of limitations would provide no bar as to those who have not filed returns. While it would now be close to ruinous in many instances to open up past years during which these persons were lulled into a sense of security by virtue of what they then properly assumed to be the law, nevertheless it would seem to be the duty of the Treasury to effect collection of these deficiencies. It is thus incumbent upon the Congress to define the policy which the Treasury Department should apply with respect to this subject, and it is submitted that it should enact legislation which would eliminate the retroactive effect of this decision.

It is thus apparent that more than ever before consideration should be given to what may be done in the field of legislation. Especially is this true as concerns the states, since there is no indication in the *Gerhardt* case that *McCulloch v. Maryland* will be overruled.

In the absence of restatement, and short of a constitutional amendment, what may be done at this time in the field of legislation? The

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10 *Supra* note 1.

11 An interesting discourse to the effect that it should be restated is to be found in Powell, *National Taxation of State Instrumentalities* (1936) 34 ILL. L. BULL. 118. *Cf.* Note (1937) 37 COX. L. REV. 1019, 1020, to the effect that the doctrine of implied immunities, "although frequently criticized is one that appears to be so well established as to be unsusceptible of change save by amending the Constitution."

It is submitted that the Supreme Court could very well have decided, since the enactment of the Sixteenth Amendment, and notwithstanding decisions before that time, that such compensation and interest are subject to taxation, on the ground that the amendment gives the power to lay and collect taxes on incomes, "from whatever source derived." However, this clause has not been so interpreted, and future assistance therefrom appears remote. Brushaber v. Union Pacific R. R. Co. (1915) 240 U. S. 1; Evans v. Gore (1920) 253 U. S. 245. Furthermore, the Court, with propriety, could have determined that although federal instrumentalities are immune from taxation by the states, the converse is not true. It may be interesting to note that Chief Justice Hughes, when Governor of New York, at the time when the amendment was being debated prior to ratification, objected to the measure on the
writer intends that no inference be drawn from this paper with respect to the constitutionality of a federal statute providing for taxation of state-paid interest and compensation in the absence of waivers of immunity by the states. This paper submits the following possibilities for consideration:

ground that it included income from state sources. (Special message to New York Legislature of January 25, 1910).

There are pending before this session of Congress about thirty House and Senate Joint Resolutions proposing amendments to the Constitution, which would permit taxation of compensation paid to government officers and employees or interest upon government obligations, or both. In a Treasury letter made public under date of June 12, 1937, Under Secretary Magill, writing for the Treasury Department, stated that: “The Treasury Department has on numerous occasions, during the present and former administrations, gone on record unequivocally as favoring the adoption of a constitutional amendment which would permit the taxation by the United States of the interest on future issues of state and municipal securities; and by the states on future issues of federal securities. The Department continues to adhere to its previous position upon this question.” Efforts along this line during previous sessions of Congress have proved abortive.

In addition to the method here suggested, it seems possible, in the case of corporations, to circumvent the decisions by substituting an excise tax for the present income tax. As before noted, this method was held valid in Flint v. Stone Tracy Co. (1911) 220 U. S. 107.

While Macallen Co. v. Massachusetts (1929) 279 U. S. 620, Traynor, National Bank Taxation in California (1929) 17 CALIF. L. REV. 456, standing by itself may be said to overrule the Stone Tracy case (see T. R. Powell, The Macallen Case (1930) 8 NAT. INC. TAX MAG. 47, 91), and Miller v. Milwaukee (1927) 272 U. S. 713, to be an impediment because of the fact that the purpose would unquestionably be to reach tax-exempt income, nevertheless, in the light of Educational Films Corporation v. Ward (1931) 282 U. S. 379 (holding that a franchise tax measured by net income, including royalties from the use of copyrights, was valid), it would seem that the authority of the Stone Tracy case is once again established and the Macallen case, in effect, overruled. See (1931) 44 HARV. L. REV. 889. This position was confirmed in Pacific Co. v. Johnson (1932) 285 U. S. 480.

Other interesting examples are: Cohn v. Graves (1937) 300 U. S. 308 (upholding taxation by New York of net income, consisting in part of rent from lands situate in New Jersey and interest on bonds secured by mortgage on lands situate outside of state); Greiner v. Lewellyn (1922) 258 U. S. 384 (securities of a state or political subdivision not exempt from national succession taxes); Thompson v. Commissioner (1929) 17 B.T.A. 987 (rent received by lessor from City of Baltimore for use of land for school purposes held not within the exemption accorded “interest” by Revenue Act of 1924); Willcuts v. Bunn, supra note 8, (profits from sale of tax-exempt bonds held taxable since the tax imposed no burden on the state); Denman v. Slayton (1931) 282 U. S. 514 (interest on money borrowed to buy and carry bonds of a Municipality held taxable); United States Trust Company of New York v. Anderson (C. C. A. 2d, 1933) 65 F. (2d) 575, cert. den. 290 U. S. 683 (interest paid on a condemnation award held taxable).

This method would seem to be usable either independently of, or as supplementary to, the proposal made in the latter half of this manuscript. It is apparent that in the case of a corporation, the inclusion of exempt income for the purpose of ascertaining the tax rate is of little utility, since there is very little change from one bracket to another of the progressive rates of tax imposed with respect to corporations.
1. The enactment of some form of reciprocal legislation, whereby Congress would waive federal immunity from state taxation of its officers' and employees' compensation and interest upon its obligations, in any case in which a state legislature would do likewise with respect to its officers and employees and obligations.

2. The addition of tax-immune income to surtax net income for the purpose of ascertaining the surtax, or surtax rates, applicable to taxable income, by one of two distinct methods hereinafter more specifically outlined, such addition to include interest on all government obligations whatever may be their issue date.

I. RECIPROCAL WAIVER OF IMMUNITY

In this connection, it must first be determined who possesses the tax immunity; the government or the officer thereof receiving the compensation or the owner of the obligation receiving the interest. The basis of the theory giving rise to the principle would indicate that the immunity is that of the respective governments. This principle has arisen out of what the Court says is necessity—the necessity of preserving such governments' separate and sovereign existences. The exemption of the individual is due to a purpose not to interfere with or impair the operations of the government or its power to borrow money, or to impose a burden upon any part of the public debt. The effect of such taxation on the individual has not been the activating cause of the decisions.

In National Bank v. Commonwealth the Court said: "The most important agents of the federal government are its officers, but no one will contend that when a man becomes an officer of the government he ceases to be subject to the laws of the state." Having once arrived at the view that the immunity is the government's and not the individual's, the one to waive it, if it is waivable, is the government. May this immunity be waived? A long line of cases has held that although otherwise immune, the shares of a national bank may be taxed by a state, if Congress has consented thereto. In Baltimore National Bank v. State Tax Commission an unanimous Supreme Court said: "Even on that assumption taxation by state or municipality may overpass the usual limits if consent of the United States has removed the barriers or lowered them."

The following statement from the majority opinion in Home Savings Bank v. Des Moines is troublesome, but passed over as unconsidered

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13 Supra note 1.
14 Supra note 1, at 361.
15 Lionberger v. Rouse (1869) 76 U. S. (9 Wall.) 468.
16 (1936) 297 U. S. 209, 211.
17 (1907) 205 U. S. 503, 513.
dictum: "From that time no one has questioned the immunity of national securities from state taxation. It may well be doubted whether Congress has the power to confer upon the States the right to tax obligations of the United States. However this may be, Congress has never yet attempted to confer such a right."

At the expense of being prolix, a portion of the majority opinion in *Van Allen v. The Assessors* is quoted:

"It is said that Congress possesses no power to confer upon a State authority to be exercised which has been exclusively delegated to that body by the Constitution, and, consequently, that it cannot confer upon a State the sovereign right of taxation; nor is a State competent to receive a grant of any such power from Congress. We agree to this. But as it respects a subject-matter over which Congress and the States may exercise a concurrent power, but from the exercise of which Congress, by reason of a paramount authority, may exclude the States, there is no doubt Congress may withhold the exercise of that authority and leave the States free to act... The power of taxation under the Constitution as a general rule, and as has been repeatedly recognized in adjudged cases in this court, is a concurrent power. The qualifications of the rule are the exclusion of the States from the taxation of the means and instruments employed in the exercise of the functions of the Federal Government."

This case indicates that if the condition placed upon the federal consent to the taxation in question had been complied with, the act of the state in so taxing would have been upheld.

In addition to the national bank cases, Acts of Congress have removed federal immunity in various fields. In *State v. Central Pac. R. Co.*, the Court held that Congress, having full control over the public domain, may make it subject to state taxation upon such conditions as are deemed proper, and then, if so taxed, it must be done subject to those conditions. *Central Pacific Railroad v. Nevada* is to the effect that if Congress gives express authority to tax lands of the United States, a state may so do.

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18 (1865) 70 U. S. (3 Wall.) 573, 585.

19 2 Cooley, TAXATION (4th ed., 1924), sec. 606, states, *inter alia*: "but the sovereignty in whose interest the exemption exists is fully protected if it controls in respect to taxation; and it may, in its discretion, permit its own agencies or its own property to be taxed by the other, under limitations prescribed by itself, as the federal government has permitted the states to tax the national banks as they tax other monevied corporations within their jurisdiction.

"On the general principle above stated, the states are precluded from taxing, without federal permission, the salaries or emoluments of national officers, or the bonds of the United States issued under their constitutional power to borrow money for governmental purposes, etc." (Italics added).

20 For other examples of legislation with relation to taxation by the states, see CODE OF LAWS OF THE UNITED STATES, 1934 EDITION, Title XII, section 932 (shares of joint stock land bank); Title XII, section 1261 (shares in National Agricultural Credit Corporations); Title XII, section 1722 (National mortgage associations); Note (1938) 38 Col. L. Rev. 128, 139.

21 (1892) 21 Nev. 247, 30 Pac. 686.

22 (1896) 162 U. S. 512.
The Act of August 13, 1894, subjected to state taxation national bank notes and United States Treasury notes. In the absence of this statute, the state could not tax. In *Howard Savings Institution v. Mayor*, the New Jersey Court of Errors and Appeals, the highest state court, said:

"The act of Congress undoubtedly gave permission to the state to impose its taxes on the securities named therein, and to that extent removed the quality of nontaxability otherwise inherent therein. The state might, therefore, tax such securities, or it might decline to do so."

The theory behind state taxation of national banks is admirably discussed by Roger J. Traynor in his article entitled "National Bank Taxation in California," As he pointed out, "it is difficult to see how any kind or degree of subjection of such instruments to state taxation could be unconstitutional per se .... In other words, it seems clear that no kind or degree of consent to taxation of a federal instrument could be anything more than a limitation of the powers of the instrument. It could never be a delegation of federal powers. A grant of power to tax and therefore interfere with an instrument created to subserve a federal power is not power to interfere with the power subserved and could not possibly be considered a grant of it."

So also, a waiver of immunity with respect to compensation paid to the government's officers and employees and interest paid on its obligations is not a grant of power to interfere with the power subserved and could not be considered a grant of it.

There would seem to be nothing in the nature of the instruments, powers, immunities or privileges of the states, as distinguished from the national government, to make the foregoing nonapplicable to consent by them, or to lead to a contrary result in a reciprocal situation.

The theory upon which was predicated the immunity of the federal government from taxation by the states of its agencies and instrumentalities, was that upon which was based the immunity of the states from taxation by the federal government of their agencies and instrumentalities. In principle, as in result, this theory was stated to be coextensively and correlatively applicable. Hence, if the results as to one may be abrogated by waiver, a like consequence as to the other should follow.

As a matter of fact, the validity of waiver, per se, by the states might well follow a fortiori. It has been argued, and the writer believes with considerable force, that there was no necessity for the result of *McCulloch v. Maryland* to have been made reciprocal, for, *inter alia*, not only is

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24 *Supra* note 11, at 108 et seq.
there the requirement of uniformity of operation of federal legislation, which would prevent the federal government from destroying any particular state, but all states are represented in Congress, while the federal government is not represented in the legislature of any state. If, therefore, we accept the Court's statement that the rule of immunity is one of reciprocal necessity, implied in order to protect the respective governments, it should not be guarded as zealously by the court when it concerns a state as when it concerns the federal government.

It is submitted further that Professor Traynor's analysis of national bank taxation, which strongly supports the argument here made for validity of waiver by the federal government, is applicable, reciprocally, to waiver by the states.

Prior to the decision by the Supreme Court in *United States v. Bekins* on April 25, 1938, the broad language of the Court in *Ashton v. Cameron County Water Improvement District* presented a difficult hurdle. The Court was there concerned with the constitutionality of federal municipal bankruptcy legislation. The Act in question provided for the readjustment of indebtedness of municipalities, etc., upon compliance with certain conditions. By section 80(k) thereof, it was provided that the Act should not impair or limit the control of the state over any municipality, etc., including the power to require the approval of the state of any petition filed thereunder, and other limitations not here necessary to be indicated. The Texas legislature enacted a statute providing that municipalities, etc., might proceed under this Act.

The majority opinion stated that the fiscal affairs of a state are not subject to control or interference by the national government, that the Act might materially restrict state control over fiscal affairs, that the power to establish uniform laws on the subject of bankruptcy is of no higher rank or importance in our government than the power to lay and collect taxes and that the Constitution provides that no state shall pass any law impairing the obligations of a contract. The Court further went on to say that such impairment may not be accomplished under the form of a bankruptcy act or otherwise; nor can a state "accomplish the same end by granting any permission necessary to enable Congress to do so."

In the *Bekins* case, however, the Court upheld the Municipal Bankruptcy Act of 1937, providing for the composition of the debts of certain municipalities upon their voluntary application, as a constitutional exercise of the federal bankruptcy power as applied to the Lindsey-Strath-

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29 (April 25, 1938) 58 Sup. Ct. 811.
30 (1936) 298 U. S. 513.
31 Chap. IX of Bankruptcy Laws, 30 Stats. (1898) 544, as amended May 24, 1934, by 48 Stats. 798.
more Irrigation District. The Court did not overrule the Ashton case, but distinguished it on the ground that "... the statute is carefully drawn so as not to impinge upon the sovereignty of the state. The state retains control of its fiscal affairs. The bankruptcy power is exercised in relation to a matter normally within its province and only in a case where the action of the taxing agency in carrying out a plan of composition approved by the bankruptcy court is authorized by the state law. It is of the essence of sovereignty to be able to make contracts and give consents bearing upon the exertion of governmental power ... 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."\textsuperscript{32}

While the Court did not expressly overrule the Ashton case, it seems to have done so in the respects here pertinent for all practical purposes. Notwithstanding this fact, the instant problem may have been distinguishable therefrom.\textsuperscript{33}

A sophisticated examination of the Ashton and Bekins cases should demonstrate once again the utilitarian philosophy motivating the Court. The end sought is the motive, and in the almost unpredictable field of constitutional law, to attempt to reason syllogistically is to abandon all hope of becoming a prognosticator. One approaching the answer to a point heretofore unpassed on must, in addition to reasoning by analogy, look to the practical effects of any given result. How does the result fit in with the prevailing economic, social, political, and moral tenets? It is thus reasonable to assume that the Court will, in connection with the problem at hand, be influenced by the current view that the principle of tax-immunity is an evil the elimination of which is desirable, and thus, in fact, abrogate it or hedge it about with limitations, if not required explicitly to emasculate the bald statement of the principle.

\textsuperscript{32} Supra note 29, at 815-816.

\textsuperscript{33} Where the power of Congress to legislate depends upon consent, such consent must be legally given. In the bankruptcy matter the power of Congress to legislate depended upon the state's consent, and since the state had no power so to legislate for itself, by virtue of the constitutional prohibition against impairing the obligations of contracts, it could not grant the power. A delegated power cannot exceed that possessed by the delegating authority. 1 Cooley, \textit{op. cit. supra} note 19 at 199.

Moreover, the Ashton case may be said to turn on the question of the delegation of legislative authority by the states. It may be argued that the state, by the mere act of waiving an immunity could not make valid such federal legislation. The bankruptcy of a municipality is quite different from that of a private corporation. While a municipal corporation may partake of the nature of a private corporation, nevertheless it is an arm of the state itself. Any action or legislation which
At any rate, to make a more na"ıve statement, the determination of the constitutionality of reciprocal legislation, generally, seems to be dependent upon the degree to which sovereignty shall have been surrendered. The surrender of the sovereignty of the national government by legislation of the proposed character would seem to involve little, if any, greater degree of derogation than in the national bank share cases. It is submitted that as concerns the states, nothing more is involved than in the case of the national government and certainly less than in the case of voluntary municipal bankruptcy.

It may be argued that the constitutional grant of power to the federal government to tax does not include the power to tax the salary of a state officer or interest on state obligations, even when consented to, on the ground that the power so to tax was never conferred; and notwithstanding the fact that the federal government may consent to the taxing of its means and instrumentalities. The Court should not come to such an uninformed result, however, for the constitutional grant is plenary. 34

"The power of taxation is an essential and inherent attribute of sovereignty, belonging as a matter of right to every independent government . . . . Constitutional provisions relating to the power of taxation do not operate as grants of the power of taxation to the government but affects its status is the exercise of the powers of the state. A state legislature, with few limitations, may legislate with relation to a municipality and affect or change its status, but when a state gives its consent to Congress so to legislate, the consent may be considered to be a delegation of the state's legislative powers. Consent of this nature, which amounts to a delegation of legislative authority, is quite different from consent which operates merely as a waiver of the protective shield of immunity.

"It is a general rule of constitutional law that a sovereign power conferred by the people upon any one branch or department of the government is not to be delegated by that branch or department to any other. This is a principle which pervades our whole political system, and, when properly understood, admits of no exception." 1 Cooley, ibid. at 184. Thus, the powers of a State legislature to legislate with relation to its municipalities would not seem to be delegable to the federal government, except possibly to the extent to which the State constitution might be construed to permit the same, subject to the caveat that (aside from the question of delegation) the federal government might be restricted by a lack of constitutional grant to exercise such power. See in this connection, Note (1938) 38 Col. L. Rev. 142.

The Ashton case went on the broad ground that neither consent nor submission by the states can enlarge the powers of Congress; none can exist except those which are granted and the sovereign entity of a state essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation. The Court also said that the same basic reasoning which leads to the conclusion that the taxing power of Congress does not extend to the states or their political subdivisions requires the conclusion that like limitation exists upon the power which springs from the bankruptcy clause.

instead merely constitute limitations upon a power which would otherwise be practically without limit." 35

As a matter of fact, immunity from taxation has not been granted as extensively to the states as it has to the federal government. In South Carolina v. United States, 36 the Court held that only purely governmental functions of a state are entitled to immunity from federal taxation and that the proprietary agencies are taxable. No enterprise of the federal government, however, has ever been held to be subject to a state’s taxing powers. The conclusion is that although the rule as to immunity of state agencies from federal taxation has been narrowed, the converse is not true as to federal agencies. 37 We have also seen that the immunity may be suspended when it conflicts with the commerce power of Congress. 38 It would be as reasonable to hold that the commerce power of Congress should be suspended when it conflicts with the immunity from national interference which the Constitution tacitly extends to state agencies. 39

In other connections, it has been held that certain rights guaranteed by the Constitution may be waived by the individual to whom they are accorded. 40

It is contemplated that legislation effecting the proposed suggestion would waive the immunity, subject to the statutory condition that the laws of the other government do likewise.

First National Bank in St. Louis et al. v. Buder may throw some light upon the conditional grant of authority so proposed. It was there said that: 41

"... no power exists in the states to tax national banks at all, except and until Congress shall so permit, and that such permission, when granted, may be hedged about with conditions, which conditions must be met by the states before they may tax these banks. ... Congress, having the right to forbid taxation, even by its failure to pass any law at all on the subject, had the right to confer this power on such conditions as it saw fit." 42

The theory behind the decision in People ex rel. Dunn v. Bunker 43 that an officer who has acted under and received money under an act cannot contest its constitutionality, may, and should, also be invoked in the case of the proposal here made. Accordingly, any statute of a state or the

35 1 Cooley, op. cit. supra note 19, at 149.
37 Note (1932) 81 U. of Pa. L. Rev. 194. Cf. Note (1936) 49 Harv. L. Rev. 1323. Note that the latter note seems to recognize that the federal government may consent to state taxation, p. 1327. See Note (1937) 22 Iowa L. Rev. 430.
38 United States v. California (1936) 297 U. S. 175; Board of Trustees, etc. v. United States (1933) 289 U. S. 48.
39 Powell, op. cit. supra note 11, at 145.
41 (E. D. Mo. 1925) 8 F. (2d) 883, 887.
42 (1886) 70 Cal. 212, 11 Pac. 703.
federal government, carrying out the instant suggestion, should contain adequate phraseology whereby its provisions would be made a condition of holding office or employment under such government, and a term of the obligation or of the act authorizing its issue. No cause for complaint would, accordingly, seem to accrue to a person who has been employed thereunder or who has purchased such an obligation. This phase of the suggestion, of course, contemplates prospective application of the waiver. Obligations theretofore issued would not be affected. The argument would then be primarily concerned with the validity of the condition. Is the condition imposed invalid as contrary to public policy? The answer to this would seem to be resolved by the foregoing discussion wherein the writer suggested that the present view is that such taxation is desirable.

As to waiving the immunity with respect to obligations issued before the enactment of such legislation, no general discussion will be undertaken, since the answer thereto may depend upon the terms of the obligations themselves or of the Act under which they were issued. For example, many United States bonds provide that they "shall be exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State or any of the possessions of the United States; or by any local taxing authority, except [certain taxes] imposed by the United States ...". While the Constitution of the United States has no provision concerning the impairment of the obligations of contracts which is applicable to the federal government, would not such a waiver be held to be invalid?

In *Choate v. Trapp* the Court said that the provision, in a patent of lands (within what was subsequently to become the State of Okla-
homa) to certain Indian tribes, that the land should be nontaxable, was a property right, and the patentee acquired as good a title to the exemption as it did to the land itself. "Under the provisions of the Fifth Amendment there was no more power to deprive him of the exemption than of any other right in the property." Accordingly, it was held that the land so patented could not be taxed by the State of Oklahoma (admitted into the Union with a constitution providing that property exempt from taxation by federal laws should so remain during the force and effect of such laws) notwithstanding the fact that, prior to such attempt to tax, Congress had passed an act providing that such lands should be subject to taxation.

The case against such waiver by the states, with respect to their obligations containing similar clauses, would seem to be even stronger. The Constitution expressly forbids states to pass any laws impairing the obligation of contracts.46

In addition, in the opinion of the writer, ethical reasons would forbid the subjection of such previously issued obligations to taxation. They were all undoubtedly sold with the express or implied understanding, although oftentimes, perhaps, not an understanding ripening into a legally binding agreement, that they would be exempt from taxation. While in those cases in which the obligations contain no such clause it may be possible, legally, to waive immunity with respect to them, no such proposal is here made, and it is submitted that no such proposal should be made.

In the light of the foregoing, assuming that legislation of the suggested character is otherwise valid, would it result in taxes lacking in uniformity? The Brushaber case46 held that the income tax was subject to the constitutional requirement of uniformity,47 although the Pollock48 case had held an income tax to be a direct tax.

An examination of the cases indicates that "the constitutional requirement for uniformity is not intrinsic, but geographic. . . . And differences of state law, which may bring a person within or without the category designated by Congress as taxable, may not be read into the Revenue Act to spell out a lack of uniformity."49 In the instant connection, complaint on this score would be to "the want of uniform existence

46 U. S. CONST., Art I, sec. 10.
46 Brushaber v. Union Pacific R. R. Co., supra note 11.
47 Art. I, sec. 8, cl. 1 of the Constitution of the United States provides, inter alia: "... all duties, imposts and excises shall be uniform throughout the United States; ..." 48 Pollock v. Farmers' Loan & Trust Co., supra note 1.
of things to which the act applies and not to an absence of uniformity in
the act itself." 50

Steward Machine Co. v. Davis, 51 a very late case, reiterated that ac-

50 Clark Distilling Co. v. Western Maryland Railway Co. (1917) 242 U.S. 311,
327; Continental Illinois Bank & Trust Co. v. United States (C.C.A. 7th, 1933)
65 F. (2d) 506; Gottlieb v. White (C.C.A. 1st, 1934) 69 F. (2d) 792.

51 (1937) 301 U.S. 548, particularly at 583.

52 49 STAT. 639.

53 Treasury, Annual Reports, 1919, Finance, pp. 24-25.
respect to his other income. It is intolerable that taxpayers should be allowed, by purchase of exempt securities, not only to obtain exemption with respect to the income derived therefrom, but to reduce the supertaxes upon their other income, and to have the supertaxes upon their other income determined upon the assumption, contrary to fact, that they are not in possession of income derived from State and municipal bonds."

“A question has been raised,” he said, “concerning the right of the Federal Government under the Constitution to tax the income from State and municipal bonds, but there can be no doubt of the constitutionality of such an administrative provision. The proposal is not to tax the income derived from State and municipal securities, but to prevent evasion of the tax in respect to other income. The principles involved are abundantly established in the decisions of the Supreme Court sustaining taxes upon corporations, bank stock, etc., computed after taking into account income derived from Government, State, and municipal bonds.”

Carter Glass’ suggestion in this regard was not carried out. Thus, his optimistic statement that “there can be no doubt of the constitutionality of such an administrative provision” has never been put to the test.

Tax immunity results in surtax being eliminated at the highest rates, when considered with respect to a taxpayer’s total income, both taxable and otherwise. What of legislation doing the converse, namely, giving effect to the tax-exempt character of any income by applying to it the lowest surtax rates, rather than the highest as at present? The tax would be imposed upon the taxable income, but would be computed in the first instance upon the entire income, taxable or otherwise, immunity being accorded to the tax-exempt income by subtracting from the tax so computed an amount of tax which would be imposed with respect to the tax-exempt income computed as if that were the taxable income.

As an alternative to this method, query as to the validity of a statute using tax-exempt income along with taxable income for the purpose of ascertaining the average surtax rate, but applying such rate only to taxable income? Thereunder, a tax would be determined with respect to the total amount of the taxpayer’s income (taxable or otherwise) and such proportion thereof would be paid as the amount of the taxable income would bear to such total income.

As to either or both of these methods, argument may only be made from analogy with cases such as Maxwell v. Bugbee,54 and Great Atlantic & Pacific Tea Co. v. Grosjean,55 to be contrasted with National Life In-
urance Co. v. United States; 56 Missouri v. Gehner; 57 Miller v. Milwau-

kee, 58 and Schuykill Trust Co. v. Pennsylvania. 59

In Maxwell v. Bugbee the Court upheld the validity of taxes imposed by the State of New Jersey upon the taxable estates of nonresident deces-
dents, computed under a statute providing that the tax should bear the same ratio to the entire tax to which the estate would have been subject had the nonresident decedent been a resident of the state and had all his property been located in the state, as the taxable property in the state bore to the entire estate wherever situated. The rate of tax was graduated in accordance with the amount of property transferred. The thing com-
plained of was that the apportionment formula fixed by the statute re-
sulted in a greater tax on the transfer of property of estates subject to the jurisdiction of New Jersey than would be assessed for the transfer of an equal amount, in a similar manner, of property of a decedent who died a resident of New Jersey.

In Great Atlantic & Pacific Tea Co. v. Grosjean, the Court was con-
cerned with a Louisiana statute which imposed a graduated scale of occupation or license taxes upon chain stores. The rates increased pro-
gressively so that for each store within the state which was part of a chain of more than five hundred stores wherever located, the tax was $550. In upholding the statute the Court said:

"The measure of the exaction is the number of units of the chain within the state—a measure sanctioned by our decisions. The rate of tax for each such unit is fixed by reference to the size of the entire chain. In legal con-
templation the state does not lay a tax upon property lying beyond her borders nor does she tax any privilege exercised and enjoyed by the tax-
payer in other states. We cannot hold that this privilege is unaffected by the status of the Louisiana stores as members of such a chain or that rec-
ognition of the advantages and capacities enjoyed by them as a result of that membership is forbidden in classifying them for progressive measure in rate."

The Bugbee and Grosjean cases open up new vistas in the field of taxation. While everything heretofore forbidden by reason of constitu-
tional provisions may possibly not be accomplished by utilizing the for-

mula and theory of these cases, nevertheless they recognize powers with

56 (1928) 277 U. S. 508.

57 (1930) 281 U. S. 313. See (1930) 19 Geo. L. J. 119.


which one must reckon. Their results are happy, since they give effect to a theory of taxation measured by ability to pay. Tax-immunity does violence to this theory.

Current opinion, generally, seems to be that the rule of tax immunity hurts and that the greatest good for the greater number calls for the abrogation of the doctrine. Is it not, therefore, reasonable to suppose that the Supreme Court also holds this opinion? Do not recent decisions show that the Court is attempting to keep abreast of the times? Is it not more than ever cognizant of changes demanded by a newly developing economic, social and political order? Accordingly, a method whereby the end sought would be accomplished without abrogating precedent would probably be sustained.

Cooley lists three so-called "inherent limitations on the power to tax."

(1) the want of power to tax for private purposes; (2) the want of power of a State to tax federal agencies and the want of power of the United States to tax State agencies; and (3) the want of power to tax property outside the territorial limits."

Immunity from taxation and lack of jurisdiction—is not the third mentioned limitation a greater restriction on the exercise of power than the second? The lack of jurisdiction over a subject matter has in all fields of law rendered action with relation thereto absolutely void. Yet are not these two analogous to a great extent? The one is to preserve the separate and sovereign nature of the government, the other is to preserve the individual from the repetition of taxation by many sovereigns, and both involve the power to destroy by taxation. Therefore, from a legalistic approach, Maxwell v. Bugbee provides a rather compelling analogy. This case is ably analyzed and discussed by Professor Lowndes, and there is little to add to his discussion thereof.

That at least one of the methods of taxation here suggested would fit into the formula of that case is evident. That the formula would be held to be applicable coextensively to tax immunity as it was to jurisdiction can be answered by referring again to the desirability of arriving at such a result. The philosophical considerations necessary to carry over the method there availed of to the field of tax immunity are present.

A serious question arises in connection with the formula. The tax in Maxwell v. Bugbee lends itself to the following analysis. The tax imposed equaled the tax computed with respect to all property of the decedent (entire estate) multiplied by a fraction of which the property in the jurisdiction was the numerator and the entire estate was the denominator.

60 Cooley, op. cit. supra note 19, §§86.

61 Lowndes, Rate and Measure in Jurisdiction to Tax—Aftermath of Maxwell v. Bugbee (1936) 49 Harv. L. Rev. 756.
Stated differently, the rate of tax was determined by dividing the tax computed with respect to the entire estate by the amount of such entire estate, producing an average rate.

In *Great Atlantic & Pacific Tea Co. v. Grosjean*, however, the statute under consideration provided for a graduated scale of taxes depending upon the number of stores owned by the taxpayer in all jurisdictions, the rate being applied with respect to the number of stores within the jurisdiction (Louisiana). The rate thus imposed was not an average rate, as in the *Maxwell v. Bugbee* situation, but was the top rate. The statute was held not to violate the due process clause, since only the rate of the tax, and not its subject or measure, included extraterritorial factors.

As to whether one of the two alternative methods suggested would be upheld and the other rejected, little more than a conditioned guess may be ventured. That the method patterned after the *Maxwell v. Bugbee* formula would, has already been asserted. That the other would not cannot be asserted. The *Maxwell v. Bugbee* method recommends itself as affording the opportunity for a stronger case. The legislative power to fix any desired rate with respect to taxable income has not been denied. Mathematically, the *Maxwell v. Bugbee* plan supplies a rate. *Frick v. Pennsylvania*,62 so analyzes it. The conclusion follows.

Does the other method bring the exempt income into the measure of the tax? While *Great Atlantic & Pacific Tea Co. v. Grosjean* upheld taking the top rate, it cannot be analyzed as providing for an exemption with respect to a nontaxable at a different and lower average rate than that which is applied to the taxable property. The first of the above-mentioned methods would seem to provide for the entry of nontaxable income directly into the computation of the surtax. While it may well be upheld by the Court, out of a desire to adopt anything not specifically prohibited by precedent, it might be best to creep before attempting to walk, even though successful walking would lead to the destination more quickly.

Conceding that in both plans the exempt income goes into the measure of the tax to some degree, the plan patterned after the *Maxwell v. Bugbee* formula treats the nontaxable income in a manner uniform with the treatment accorded the taxable income. The other plan seems not to do so. Is not the latter thus akin to that which was struck down by the *National Life* case?63 It is submitted that if the treatment accorded tax-exempts by

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62 *Supra* note 54.

63 Since the decisions in the *National Life*, Gehner and Schuylkill Trust Co. cases, the members of the Court who were then in the minority seem to have exchanged positions with the then majority. It may thus be that what is now conceived to be the majority would not feel impelled to follow these cases. Accordingly, both plans may well be held to be valid. To so hold would not be inconsistent with
a proposed plan of taxation is uniform with the treatment accorded taxables, exemption being granted with relation to such tax-exempts in the same manner and upon the same basis as the taxables are taxed, the plan would probably be upheld.

In *National Life Insurance Co. v. United States*, the Court held that a provision of the Revenue Act of 1921, abating a 4% deduction from gross income therein allowed by the amount of interest received from tax-exempt securities, was invalid, since Congress may not tax such securities by denying to their owners deductions allowed to others.

If the income of the taxpayer in that case had been entirely taxable, the tax would have amounted to the exact sum which was imposed by the invalidated provisions. As stated in the opinion: "Thus it becomes apparent that petitioner was accorded no advantage by reason of ownership of tax-exempt securities." No more than this should have been said. Nevertheless, the language of the opinion is broad and presents a difficult hurdle. "One may not be subjected to greater burdens upon his taxable property solely because he owns some that is free. No device or form of words can deprive him of the exemption for which he has lawfully contracted..." said the Court.

In the light of subsequent cases, however, the most that should properly be ascribed to the *National Life* case is that in taxing income part of which is tax-exempt, the presence of exempt income can not be made the basis for denying to the taxpayer benefits enjoyed by taxable income, and that no discrimination may be practiced with relation to the exempt portion. In other words, deductions can not be limited by reason of the presence of exempt income. And so construed, the *National Life* case as well as *Missouri v. Gekner* is not authority against the suggestion here made. In the latter case, the state statute provided that in taxing an insurance company's assets, its legal reserves and unpaid policy claims should first be deducted from its total assets. The state supreme court construed the statute as requiring that the reserve and claims should be apportioned between the two classes of assets (taxable and nontaxable) and that the deduction should be in the proportion that the taxable assets bore to the total assets.

The Supreme Court reversed the judgment of the state court, holding that the statute as so construed was unconstitutioal. Justices Stone,

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what is taken to be the earlier minority views, although such a result would probably be incongruous when viewed from the aspect of the majority in those earlier cases.

64 *Supra* note 56.
67 *Supra* note 57.
Brandeis, and Holmes dissented. Analysis indicates that the tax-exempt property entered directly into the measure of the tax there invalidated, as it did in the National Life case. In neither case was the exempt income or property used solely for the purpose of determining the rate of tax. In both, a deduction was being denied or lessened because of the presence of tax-exempts. The curtailment of the exemption, in effect, increased the amount being taxed and discriminated against tax-exempts in favor of taxables, so far as concerned the allowance of deductions.

Again in Schuylkill Trust Co. v. Pennsylvania, the statute was construed to discriminate against tax-exempts. The state statute provided for the valuation of shares of a trust company by adding together the amount of the paid in capital, surplus and undivided profits that was not invested in the stocks of corporations liable to pay (or specifically exempted from the payment of) capital stock tax or a tax on shares, and by dividing this total amount by the number of outstanding shares of the company. The taxpayer in question possessed bonds of the federal government, which the state revenue department included in the measure of the tax. The tax was levied on the shares as so valued, and accordingly was held to be invalid. Justices Cardozo, Brandeis, and Stone dissented.

Here again the exempt property entered into the amount subjected to tax. It was not used merely to affect the rate of tax. The utility of the case as authority in the field of tax exemption would seem to be in connection with statutory attempts to use, through indirection, exempt property or income in determining the measure of a tax. As such it would fall into the same category of Macallen Co. v. Massachusetts, Miller v. Milwaukee, and others.

To attempt to develop a theory on the basis of a distinction between rate and measure is not entirely satisfactory, if we are taking an informed view of what is being attempted. An increase in rate, where the taxpayer has exempt income, just as effectively increases the tax payable, as if the measure of the tax were increased and the rate remained the same. If we are thinking in such concepts as "not doing by indirection what can not be done by direction," of course this proposal must fail. But many cases, without as well as within the field of taxation, indicate that this, like other maxims, is but a convenient handle to grasp after a result is once reached.

From an economic and sociological aspect, experimentation looking towards the taxation of tax-immune income seems to be justified, provided that there is a sound theory upon which attempts to reach the end

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68 Supra note 59.

69 See discussion supra note 12.
sought may be based. That there are such theories is illustrated by the foregoing discussion.

Effecting a solution of the problem of tax-exempts through constitutional amendment presents a maze of practical difficulties. If past experience is an indication, any such attempt is destined to fail. As a matter of fact, revision of the doctrine of immunity by the Court seems far less remote than possible accomplishment of the desired end through such efforts. As has recently been said by the President, something in this connection should and must be done to eradicate the evil. The instant suggestions go part of the way at least. Possibly some forward looking legislative body will take the first step and reap the benefits that should flow therefrom.

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