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Intergovernmental Taxation - Recent Problems

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WHEREVER several governmental authorities function within substantially the same area, a problem inevitably arises as to the scope and manner in which the official behavior of one is subject to the legal control and regulation of others occupying the same or overlapping areas. This problem has continuously become more acute with the expansion of governmental activities, especially where the shifting relationships in the balance of power have steadily progressed in one particular direction, as in the case of the recent activities of the Federal government in fields commonly believed to be reserved to activities of other levels of government or of private enterprise.

In confining himself to the taxing aspects of these interrelationships, the writer seeks to show how competing

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1 Metropolitan areas in the United States have given the most striking examples of this “chaos of area and rates [taxes].” In the Chicago area, for example, there are at the present time 1621 units of government, including 204 cities, 15 counties, 165 townships, 978 school districts, 49 park districts, 4 forest preserve districts, 11 sanitary districts, 190 drainage districts, 4 mosquito abatement districts, and 1 health district. This enumeration is adapted from Merriam, Parratt and Lepawsky, The Government of the Metropolitan Region of Chicago (University of Chicago Press, 1933).

theories of constitutional law have led to far-flung exemp-
tions of private interests and behavior under the guise of con-
stitutional compulsion, hidden the costs of govern-
ment, and called for the intervention of remedial legis-
lation. Such legislation has been piecemeal in character, and has been designed to meet the demands of special pressure-groups. No attempt has been made to meet the situation in a comprehensive manner.

Before undertaking to sketch the confusing maze of cases, we may consider a few typical illustrations of the way in which this age-old problem has re-emerged on the national scene within the past few years.

When the Reconstruction Finance Corporation, as the duly constituted arm of the Federal government, acquires vast holdings in bank stock, must it pay state and local taxes thereon as a private owner would under like circumstances or may it claim governmental immunity? When the Public Works Administration constructs a housing project and undertakes to sell plots to private persons by long-term contracts reserving title until the purchase price has been paid, will the local taxing authorities lose the revenue that they would have received but for the fact of Federal ownership? When the Tennessee Valley Authority acquires major portions of land within particular counties for inundation by its navigation-power dams, are such lands permanently withdrawn from the local tax

3 For illustrations of this type of legislation see table, footnote 56. In some cases these special bills have been reported disapproved by the administration on the very ground of their piecemeal character, pending an over-all determination of policy.

4 Classification of what is actually confused achieves little other than unreality. If the cases that are discussed in following sections do not fall neatly into convenient patterns and categories, it may be the fault of the data as well as of the analyst.

5 In Baltimore National Bank v. State Tax Commission, 297 U. S. 209, 80 L. Ed. 586 (1936), the Supreme Court construed the statutory intention that it should so pay, but under the urgings of the administration Congress promptly amended the R. F. C. act to expressly deny that it had so intended. 74th Congress, Public No. 482.

6 It is frankly admitted by the T. V. A. that its power program as such, without subordinate reference to navigation, has no constitutional leg upon which to stand.
rolls? When the Home Owners' Loan Corporation and the Farm Credit Administration acquire vast tracts of land formerly in private ownership, what shall be done for the local units that are thereby deprived of considerable sources of revenue? Or when the land-purchase program of the Resettlement Administration\(^7\) contemplates the acquisition of almost ten million acres, what remedies are afforded the local communities that may legally be called upon to render additional social services—as school and highway maintenance—to "relocated families," or that have accumulated vast bonded debts demanding annual interest payments and eventual liquidation?\(^1\)

Juristically the *modus vivendi* of the Federal government with respect to the state and local governments in the field of taxation has been that of reciprocal immunity. This principle has emerged in typical common-law fashion, initially wavering between alternative theories of governmental relations, and then eventually crystalizing in its broadest form, with little conscious regard for the far-flung economic implications which have only in modern times been forced upon public attention.\(^8\) Scattered statutes have recognized the problem and provided for various and conflicting types of ameliorating payments,\(^9\)

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\(^7\) Although the Resettlement Administration was created and exists by mere executive order, which may be rescinded or altered quite easily, its land retirement program will probably be made permanent shortly.

\(^8\) See the dissenting opinion of Justice Brandeis in Burnet v. Coronado Oil & Gas Co., 285 U. S. 393, 76 L. Ed. 815 (1932), where he advocated the frank overruling of previous precedents that were encloaking "vast private incomes" from Federal and state taxation. At p. 405.

\(^9\) Weeks Forest Purchase Act of 1911 (Sec. 13); Taylor Grazing Act (Sec. 11); TVA Act (Sec. 13; relates only to power production in two states), among the federal laws have been noted. Many state laws include provisions equalizing with local districts the problem of state land, as in New York, Laws (1932) Ch. 61, sec. 4, at p. 2277 (forests); Massachusetts, General Laws (1921) Ch. 58, § 13, 17; Pennsylvania, Statutes with supplement (1928), p. 451; Wisconsin, Sec. 77.04-5; Minnesota, Session Laws of 1933, Ch. 318, Secs. 1-2; Michigan, General Laws, Secs. 3739-40, 3756, 5731, 5760; Texas, Revd. Civil Statutes, II, § 7150, at p. 2970; Oklahoma, Comp. Statutes (1921) at p. 2227. Doubtless many other provisions exist. Most of these provisions relate to forests or wastelands, and simply permit some in lieu payment by the state to the appropriate local subdivision. Generally, see Claude W. Stimson, "Exemption of Publicly Owned Property from Taxation," 8 U. Cin. L. Rev. 32 (1934).
but the vast bulk of the litigated cases remain within the sphere of judicial precedents.

It is significant to note how the present American doctrine has arisen and persisted in direct opposition to English and continental practice. In England the quasi-governmental proprietary corporations, like the Port of London Authority, are subject to the national income tax. Germany has a series of comprehensive statutes permitting local and state (or Länder) taxation of the proprietary functions of the Reich.

Under the persuasive influence of American constitutional precedents, such as *McCulloch v. Maryland*¹² and *Collector v. Day*,¹³ Australia initially followed the doctrine of reciprocal immunity, but its High Court has recently¹⁴ disavowed the weight of its earlier decisions and sanctioned local taxation of the income of federal officers. This is also the law of Canada.¹⁵

How then the American case? The answer is partly historical, partly evolved from the theory of dual sovereignty, and partly practical. Like most problems of American government, the attempts to solve the difficulty were made primarily by the judiciary, although the problem itself was clearly not pre-eminently a justiciable one.

During the period from 1923 to 1927, the average annual contribution of the Federal government to the twenty-eight states in which national forests were located amounted to $10,250,000, which exceeded the actual cost of local government in the same area ($9,750,000). See "A National Plan for American Forestry," 73rd Congress, 1st Sess., Sen. Doc. No. 121, pp. 1106-09 (1933).

¹⁰ See Port of London Authority v. Commissioners of Inland Revenue, [1920] 2 K. B. 612.
¹¹ See Hatschek, *Die rechtliche Stellung des Fiscus*. Note how the German concept of "Fiscus" is much broader than our somewhat corresponding "proprietary functions" developed in the field of municipal corporation law. The Nazi Revolution has apparently not greatly affected this problem although some of the regional reforms contemplated may radically alter these relationships. See Lepawsky, "The Nazis Reform the Reich," American Political Science Review, April, 1936, pp. 324-50.
¹² 4 Wheat. 316, 4 L. Ed. 579 (1819).
¹³ 11 Wall. 113, 20 L. Ed. 122 (1871).
It called for legislative and administrative action which could weigh the factors of fiscal and functional relations. The doctrine arose first in a very practical case. The Second United States Bank, never popular with the masses, found itself the object of several discriminatory state laws, which confronted it with the Hobson's choice of surrendering the activities of its local branches to state control or being taxed out of existence. The refusal of the Baltimore branch to comply with such a statute raised the issue before Chief Justice John Marshall, who first, in that remarkably written opinion on the scope of the power of the national government to do what was "necessary and proper" to effect the nation's business, sustained the congressional employment of a banking corporation, and then passed on to condemn state interference by tax or otherwise. His language was:

It is obvious that it [the power to tax] is an incident of sovereignty, and is co-extensive with that to which it is an incident. All subjects over which the sovereign power of a state extends, are objects of taxation; but those over which it does not extend, are, upon the soundest principles, exempt from taxation.

The result is a conviction that the states have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government. This is, we think, the unavoidable consequence of that supremacy which the Constitution has declared. . . . On the other hand Marshall was careful to point out expressly that his opinion did not deprive the states of any resources which they originally possessed. It does not extend to a tax paid by the real property of the bank, in common with the other real property within the state, nor to a tax imposed on the interest which the citizens of Maryland may hold in this institution, in common with other property of the same description throughout the state.

16 See Harlan F. Stone, "The Common Law in the United States," 50 Harv. L. Rev. 4 (1936) at p. 12, for general characterization of the relative roles of the judiciary, the legislature, and the administration in handling the growing social needs.

17 McCulloch v. Maryland, 4 Wheat. 316, 4 L. Ed. 579 (1819).
What Marshall feared, and meant to condemn through the constitutional processes, was the destructive interference of state and local units with the activities of a budding national republic.

To him, "the power to tax involves the power to destroy." Self-preservation of national authority, for which none was a better champion in word and deed than the venerable Chief Justice, implied a constitutional immunity from state and local taxation. At the time it did not involve a general immunity, nor can the language be so construed. It was simply an immunity from discriminatory taxation. Even as it was, *McCulloch v. Maryland* met with a fiery reception from the public, and the national bank had to weather many cases and wrathful revolt of local officialdom before it died so painfully under the veto of President Jackson.

More than half a century passed before the states were to present their claim of reciprocal immunity and to achieve it. But in 1871, only shortly after the Civil war, the Supreme Court enunciated a hitherto ignored parity between the Federal and state governments, as far as intergovernmental taxation was concerned. Constitutional federalism implied that *McCulloch v. Maryland* had a natural corollary for the states: If the national authority was exempt from state and local taxation, then, in all

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18 Holmes pithily modified this to "not . . . while this court sits." Panhandle Oil Co. v. Mississippi, 277 U. S. 218, 12 L. Ed. 857 (1928), at p. 223.
19 See McLaughlin, Constitutional History of the United States (1935), pp. 388-94; and Warren, History of the United States Supreme Court, Ch. 6.
20 *Veazie Bank v. Fenno*, 8 Wall. 533, 19 L. Ed. 482 (1869), which sustained a national tax designed to drive state banks out of existence. As it could be plausibly argued that such banks were as much state instrumentalities as the national bank was a Federal instrumentality, why, if Collector v. Day were sound, was not the national tax, which was admittedly discriminatory, invalid on the same ground?

Compare some of the state cases arising under the attempt, in 1864, to impose a national stamp duty on writs issuing out of state courts—almost resurrected shades of royal tyranny. The duty was ordered set aside in the following cases on the argument based on the reciprocal nature of governmental immunity from taxation: *Warren v. Paul*, 22 Ind. 276 (1864); *Jones v. Keep*, 19 Wis. 390 (1865); and *Fifield v. Close*, 15 Mich. 504 (1867). No Federal decision has been found; and in 1867 the national duty was repealed.
INTERGOVERNMENTAL TAXATION

fairness, the state government, with its instrumentali-
ties and subdivisions, must likewise enjoy immunity from
Federal taxation. This was announced in the case of
Collector v. Day,\(^2\) where salaries of state officials were
held exempt from the current wartime income tax.\(^2\) Instead of reasserting Marshall's doctrine of national su-
premacy, the court stated that "the two governments are
upon an equality."\(^2\)

These are the two leading cases from which have de-
veloped the tangled webs of constitutional exemption
from taxation. The earlier case was predicated upon a
national theory of government, the later upon a states' right theory. The result was far-flung exemptions from
the taxing processes of vast amounts of economic wealth,
public and private.\(^4\)

**FEDERAL LAND EXEMPTED FROM STATE TAXATION**

It is not without significance that when the United
States Supreme Court had the first occasion, as late as
1886,\(^5\) to examine the problem of the immunity from
state taxation of federally owned land, it apparently con-
sidered the issue debatable. The result was inevitable,
however, and the immunity was eventually declared. With
the multiplication of Federal agencies, stretching into

\(^{21}\) 11 Wall. 113, 20 L. Ed. 122 (1871). Bradley dissented, "I cannot but regard it as founded on a fallacy, and that it will lead to mischievous con-
sequences." Students of the subject of tax-exempt securities have lamented it particularly. The writer believes that a tolerable economic case for the present practice of tax-exempt securities may be made, depending in part upon
whether ownership of such securities is concentrated or widespread. If the latter, the controversy may be largely an accounting matter, for the exemp-
tion is clearly related to the amount of interest payable.

\(^{22}\) In Dobbins v. Commissioners, 16 Pet. 435, 10 L. Ed. 1022 (1842),
salaries of Federal officeholders were held immune.

\(^{23}\) For a view that this "equality" but furnishes a loophole for tax-dodgers whereby the Federal government is deprived of large portions of its legitimate revenue, see Louis B. Boudin, "Taxation of Governmental Instrumentali-

\(^{24}\) Thomas Reed Powell, "Indirect Encroachment on Federal Authority by

\(^{25}\) See Van Brocklin v. Tennessee, 117 U. S. 151, 29 L. Ed. 845 (1886).
In Wisconsin Central R. Co. v. Price County, 133 U. S. 496, 33 L. Ed. 687
(1890), the same rule was held applicable to any of the administrative sub-
divisions of the state.
corporate forms like the Emergency Fleet Corporation or the Tennessee Valley Authority, the doctrine has been correspondingly extended. But this process has not gone on without noteworthy judicial complaint: "The immunity of the sovereign from taxation would seem to belong to the legal philosophy of the Middle Ages ... and to be as unsuited to modern conditions as the immunity from suit. . . ." Although the case might be one of hardship, as another court candidly admitted, the relief therefrom does not lie with the courts, but with the legislative branch of government.

In the recent case of Mullen Benevolent Corporation v. United States, an interesting argument was presented to get back of the simple syllogism leading from sovereignty to immunity. An Idaho statute providing for the assessment of lands for local improvements and thus giving any holder of bonds issued to advance such work an enforceable lien on the land, directed the special governmental unit, to reassess as many times as necessary, in the event that one assessment proved insufficient to retire the bonds. The local unit was not directly liable on the bonds, nor were the landowners under any personal obligation. Over a period of years the Federal government has been acquiring title to all the lands within the district of the American Falls reservoir, by condemnation and deed. Before the last land strips had been purchased it became apparent that the previous assessments would not suffice to retire the outstanding bonds. Action was

27 For cases dealing with the extent of this immunity in cases of transfer by the Federal government to private hands, see Irwin v. Wright, 258 U. S. 219, 66 L. Ed. 573 (1922), holding land taxable although subject to government lien for unpaid balance of purchase price; Lincoln County v. Pacific Spruce Corp., 26 F. (2d) 435 (1928), holding land taxable where equitable title had not been completely divested from the United States; New Brunswick v. United States, 276 U. S. 547, 72 L. Ed. 693 (1928), involving land sold by the Emergency Housing Corporation.
28 290 U. S. 89, 78 L. Ed. 192 (1933), noted in 47 Harv. L. Rev. 706. Cf. Lee v. Osceola & Little River Road Imp. Dist., 268 U. S. 643, 69 L. Ed. 1133 (1925), invalidating a state special tax imposed on land then owned by private persons for benefits resulting from improvements made when the title was in the Federal government.
then instituted by a bondholder against the United States, and it was contended that by these extensive land acquisitions the government had been taking his property (that is, the bonds), and impliedly promised to pay for it. The Supreme Court dismissed his suit with the statement (derived from some war cases\(^2\)) that the program of purchase and condemnation by the Federal government amounted at most to a frustration of the power to reassess, from which no promise on the part of the United States could be implied.

**Federal Agency-Instrumentality**

The first type of Federal agency-instrumentality to claim immunity was the national bank, whose claim was upheld, under the specific ruling of *McCulloch v. Maryland*, except where Congress had specifically waived it, which was quickly done in response to the demands of local constituents.\(^3\) But suppose the agency in question, although performing Federal functions, owes its legal authority through incorporation to the laws of the state which seeks to impose the tax. At first impression, the case for the affirmative power of the state would seem clear, on ordinary principles of corporation law, for the new entity comes into being only at the will of the power of the state.


\(^3\) See *Queensboro National Bank v. Queensboro*, 173 U. S. 664, 43 L. Ed. 850 (1899), for a discussion of the legal effects of such waiver. A distinction has sometimes been taken between *legal incidence* and *economic incidence* of the tax in question: If the former is involved, the tax is void; if the latter is involved, the validity of the tax turns on the degree of interference with the governmental agency. Willoughby, *Constitutional Law of the United States*, II, p. 150, citing as a type case of economic incidence *Union Pacific Ry. Co. v. Peniston*, 18 Wall. 5, 21 L. Ed. 787 (1873), where in sustaining a state property tax upon a railroad incorporated by the Congress, the court said, "... exemption of Federal agencies from state taxation is dependent ... upon the question whether the tax does in truth deprive them of power to serve the government as they were intended to serve it, or does hinder the efficient exercise of their power. A tax upon their property has no such necessary effect." Cf. *Burnet v. Jergins Trust*, 288 U. S. 508, 77 L. Ed. 925 (1933). It appears that types of the latter class are not very important, and merge in fact with the type situations considered in subsequent sections of this paper.
imposing the tax. In a war-time case,\(^3\) however, where the question first arose, Holmes pithily dismissed the problem with the statement that "the incorporation and formal erection of a new personality was for the convenience of the United States to carry out its ends." However, the present applicability of this case has not been considered very strong by public administrators. The Comptroller General of the United States, for example, has interposed fiscal objections, on this very ground, to the employment by the "New Deal" (specifically the Public Works Administration's Division of Housing) of corporate authorities created under state law, regardless of the broader powers which the state is able to bestow, as compared with Congress.

The primary factor in determining the validity of a state tax imposed upon a private person or agency under contract with the Federal government is the extent to which the imposition of such a tax will interfere with and unduly burden the performance of the service in question.\(^3\)\(^2\) Obviously the scope and meaning of this doctrine must be pricked out by the individual cases. Considerable ingenuity is frequently needed by the courts to see differences in cases apparently presenting substantially identical factual relations, yet meeting with markedly different judicial fate. For example, in Gillespie v. Oklahoma,\(^3\)\(^8\) the court (speaking through Holmes) held the lessee of restricted Indian mineral lands, title to which was in the United States, exempt from the general state income tax, on the ground that in taxing the income derived by the lessee from his share of oil and gas received from the leased lands, the state was in effect taxing a

\(^3\) See Clallam County v. United States, 263 U. S. 341, 68 L. Ed. 328 (1923), involving the U. S. Spruce Production Corporation, incorporated under the state laws of Washington, with ownership of all the stock in the United States. This was distinctly a war-time case, for the purpose of the corporation was to provide materials for the construction of airplanes.\(^3\)\(^2\) See Gromer v. Standard Dredging Co., 224 U. S. 362, 56 L. Ed. 801 (1912), sustaining a tax upon machinery and tools used in the performance of a contract with the United States.\(^3\)\(^3\) 257 U. S. 501, 66 L. Ed. 338 (1922). Brandeis vigorously dissented.
Federal instrumentality. When, almost a decade later, the converse political relations obtained, that is, the Federal government sought to tax a lessee of land, title to which was in the state, the tax was sustained in *Group Number One Oil Corporation v. Boss.* It seemed as if the broad exemptions allowed in the Gillespie case were narrowing. Then, in the following year, the wide-immunity doctrine flowered again in *Burnet v. Coronado Oil & Gas Company,* where the Federal tax was held inapplicable to income derived from the lease of state lands dedicated to the support of schools, by which lease part of the proceeds from the oil and gas production was reserved to the state for its public school fund. Vigorous dissent was voiced by Brandeis, concurred in by Stone, Cardozo, and Roberts:

Under the rule of *Gillespie v. Oklahoma* vast private incomes are being given immunity from state and federal taxation . . . that case was wrongly decided and should now be frankly overruled. Merely to construe strictly its doctrine will not adequately protect the public revenues.

In the recent case of *Susquehanna Power Co. v. State Tax Commission of Maryland,* the ingenious argument was advanced by a power company that, inasmuch as it was operating under license issued by the Federal Power Commission, it was *ipso facto* a Federal instrumentality

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34 283 U. S. 279, 75 L. Ed. 1032 (1931).
35 285 U. S. 393, 76 L. Ed. 815 (1932).
36 It was in this dissent that Brandeis developed his famous rationale of overruling unfortunate legal decisions, supplemented by his exhaustive listing of previously overruled opinions.

Cf. *Metcalf v. Mitchell,* 269 U. S. 514, 70 L. Ed. 384 (1926), where a consulting engineer for the state was held subject to the federal income tax; in *Alward v. Johnson,* 282 U. S. 509, 75 L. Ed. 496 (1931) a person having a contract to carry the mails was held subject to state tax; in *Indian Motorcycle Co. v. United States,* 283 U. S. 570, 75 L. Ed. 1277 (1931), the sale of a motorcycle to the city for police functions was held exempt from the Federal excise tax; in *Trinityfarm Construction Co. v. Grosjean,* 291 U. S. 466, 78 L. Ed. 918 (1934), an exemption from the state gas tax on products used in connection with a construction contract made with the United States was disallowed. Cf. *Standard Oil Co. v. California,* 291 U. S. 242, 78 L. Ed. 775 (1934).
37 283 U. S. 291, 75 L. Ed. 1042 (1931). This same argument had been made, to be rejected, in several of the early cases upholding the constitutionality of state liquor laws.
and consequently immune from state taxation. But the Supreme Court, speaking through Mr. Justice Stone rejected the claim by insisting that the exemption rule "must be given such a practical construction as will not unduly impair the taxing power of the one [government] or the appropriate exercise of its function by the other." The cases had long made a distinction between a privilege or franchise granted by the government to a private corporation in order to effect some governmental purpose, and the property employed by the grantee of the privilege solely for private business advantage. No necessitous policy could operate to deprive the state of jurisdiction to tax in this latter category, which was obviously the case under consideration.

The principle of reciprocal immunity from intergovernmental taxation has not been unqualifiedly accepted by the courts. In the language of the cases, the principle is usually stated without any equivocation, but one type of limitation must be noted in some detail.

By reason of the very nature of a constitutional system which undertakes to differentiate sharply the powers and functions of the state and Federal governments respectively, the cases presenting claims for state immunity have been far more variant and numerous than corollary assertions of Federal freedom from state and local taxation. The theory of American federalism vests in the states all the residual powers of government: they can do anything not forbidden by either the Federal Constitution or their own. On the other hand, the Federal government is required to isolate one or a series of "constitutional pegs" upon which to predicate its authority in any given case. Although the Federal government


39 The "general welfare" clause of the United States Constitution (Art. I, sec. 10) has not as yet been given an authoritative interpretation, although it was noted with respect in the AAA decision in United States v. Butler, 297 U. S. 1, 80 L. Ed. 477 (1936), to be passed by as "not necessary to
has continually advanced the scope of its activities, with but few reverses, the apparent magnitude of its operations is lessened by comparison with the activities of state and local governments. For example, in 1932 the latest date for which comparable financial statistics are available for the expenditures of all levels of government in the United States, the expenditures of the Federal government accounted for only slightly more than one-fourth of the aggregate. Conversely, the expenditures of the states, counties, cities, and other local governments accounted for 71 per cent of the total. It is thus apparent that the problem of immunity in inter-governmental taxation is much more serious for the Federal government than it is for the states and localities. And the courts have on occasion been keenly aware of the vital significance of this problem.

The typical judicial reaction in disposing of the more difficult cases is to develop "distinctions" which effectively annul or restrict the application of otherwise established principles to the specific situation, especially where, under the changed social and economic conditions of the time, a rigid application of principles might lead to impractical results unforeseeable when the principles were initially formulated.

The "distinction" so observed was one adapted and elaborated from the law of municipal corporations where...
it had similarly arisen to "escape difficulties, in order that injustice may not result from the recognition of technical defenses based on the governmental character of such [governmental] corporations." The items distinguished were "governmental" and "proprietary" functions. The established principle of tax immunity, like government immunity in tort, was restricted to the strictly "governmental" functions, that is, the older and securely recognized activities of government. But when the political authority undertakes to extend its sphere of official operation beyond the lines drawn by tradition into competition with private enterprise, utilities, trading, etc., then, the cloak of sovereignty no longer protects the state, which must then function as best it may in a world of competition and strife. But the passing of time—say a half a century or more—according to the Supreme Court of the United States in its latest expression on the subject in Brush v. Commissioner of Internal Revenue, may cause a municipal utility (such as waterworks, which is functionally the most important of all municipal utilities) to be classified as governmental, for the purpose of extending tax immunity. This decision, just announced, is thus clearly against the trend to restrict tax immunity and only serves again to cast doubt on the validity of the general American doctrine. The only comfort left is that Justices Cardozo and Stone indicated that the decision, because of the faulty pleadings of the government, left open "the need for revision of the doctrine of implied immunities."

The first indication of this tendency to restrict the

43 Trenton v. New Jersey, 262 U. S. 182, 67 L. Ed. 937 (1923) at p. 192. To gain "sovereignty" was the symbol causing all the difficulty. There is a distinctly recognized trend toward extending the scope of official liability. Theoretically the movement is "pluralistic." See Duguit, Law and the Modern State (translation and preface by Laski).

43a Decided March 15, 1937, and reported in United States Law Week, 823. The court, speaking through Mr. Justice Sutherland, said, "There probably is no topic of the law in respect of which the decisions of the state courts are in greater conflict and confusion than that which deals with the differentiation between governmental and corporate powers of municipal corporations."
scope of the immunity announced in *Collector v. Day*
came in the case of *South Carolina v. United States.*44
Having forsaken regulation as an effective means of
liquor control, South Carolina entered into the field of
the direct dispensing of liquor in state owned and oper-
ated stores. When the Federal commissioner of internal
revenue attempted to collect a Federal excise tax levied
on these state operations, the state claimed immunity.
In the face of the disastrous consequences for the national
revenue that might ensue, the United States Supreme
Court rejected the theory that *Collector v. Day* had no
limitations. If the contention of South Carolina were
. correct, an expanding sphere of economic activities might
readily be removed from the domain of Federal taxation
through the colorable device of state operation. The doc-
trine of state sovereignty could not be carried so far.
Later decisions refused to identify with "governmental"
—tax immune—such new state activities as banking46
and operation of utilities, such as transportation, power, and
light.46

The precise point of *South Carolina v. United States* was
presented anew for a less impassioned consideration
upon the return of legalized liquor and beer,47 but the
Federal tax was nevertheless sustained. If the state

44 199 U. S. 437, 50 L. Ed. 261 (1905).
45 North Dakota v. Olson, 33 F. (2d) 848, (1929), dismissed for want of
jurisdiction in 280 U. S. 528, 74 L. Ed. 594 (1929).
46 In Flint v. Stone Tracy Co., 220 U. S. 107, 55 L. Ed. 389 (1911), the
court said, at p. 172, "It is no part of the essential government functions of a
state to provide means of transportation, supply artificial light, power and
the like."
v. Powers, 293 U. S. 214, 79 L. Ed. 291 (1934), where members of the board
of trustees of the Boston Elevated Ry. Co., operated by the City, were held
subject to the Federal income tax. The court said, "... one of these limita-
tions [on immunity of state instrumentalities from Federal taxation] is that
the State cannot withdraw sources of revenue from the Federal taxing power
by engaging in businesses which constitute a departure from usual govern-
mental functions and to which, by reason of their nature, the Federal taxing
power would normally extend." Cf. Moiseiff v. Commissioner of Internal
Revenue, 21 B. T. A. 515 (1930), where a bridge engineer of the Port of
New York Authority was held exempt from the Federal income tax. Federal
Treasury Regulations, 77, Art. 643, exempts from the national income tax
only those state employees engaged in "essential governmental functions."
chooses to go into the business of buying and selling commodities, that is a matter for it to decide, and the Federal Constitution usually interposes no objection to its competency. By its entering "the market place, seeking customers," however, the state "divests itself of its quasi-sovereignty pro tanto, and takes on the character of the trader, so far, at least, as the taxing power of the Federal government is concerned."48 In other words, the state becomes depoliticalized, and assumes the legal status of a private entrepreneur under like circumstances.

With these precedents established, the states have more or less reconciled themselves to this type of limitation upon the scope of their tax exemptions.49 But the question of what the limitation may mean in any given case naturally remains open to administrative and judicial determination. Since the distinction is in origin frankly utilitarian or functional, its application must be determined in the light of the objective it attains. However, in a period of the rapid growth of national and state activities, political functions do not lend themselves to neat classifications. The result is the typical maze of conflicting decisions. In addition, trouble may be caused by the connotations with which these terms have already been identified in other fields of law, as in tort or condemnation procedure. The general purpose of the classifications of "governmental" or "public" and "proprietary" or "nonpublic" may be the same in all instances—the evasion of technical difficulties arising out of the concept of "sovereignty." But quite clearly the specific purpose may vary considerably. For example, the objective to be attained by determining what is a "public use" which will validate the exercise of the powers of condemnation is quite different from that to be attained by labeling given situations as "governmental" or "proprietary" for the purpose of ascertaining official tort liability. One

49 See notes 44-46.
involves the problem of determining whether or not the reason for condemnation is sufficiently important to require the use of an extraordinary legal remedy to force a sale of property. The other is concerned with the problem of the distribution of costs of accidents, whether it should fall on particular individuals or on the community as a whole.

In the field of inter-governmental taxation the problem is whether governmental functions or activities should be given preferential treatment by the fiscal systems in the same way as established functions of government are already or whether they should be placed on a parity with private activities of a similar character. For example, when the state undertakes to sell liquor through its statewide monopoly system, shall it enjoy the same immunity from Federal taxation as other units of government (as the highway department); or shall it pay the tax in the same way as the private liquor stores? The specific economic problem is thus different from that of the social distribution of cost in tort cases. But, in both, the general objective of the court is the same, namely to avoid unjust consequences from the application of the established legal categories by noting "distinctions." If this utilitarian purpose of these "distinctions" were frankly recognized to be functional in origin and design, then the role of the judiciary would appear actually as legislative and not judicial. In theory it is legislative only in a limited, remedial sense, that is, until legislation can adequately provide for the problem. In the meantime justice is done, or approximated.

In other words, these "distinctions" are employed, not for the purpose of explanation, as the legalist may too readily assume, but instead to accomplish just results determined on non-legal grounds. Without the observance of such "distinctions" traditional law easily may bar desirable results. Thus, a given practical result will occur where the factual phenomenon may be classified
under category A (for example, "governmental") and a different one under B ("proprietary"). But the content of these categories is not determined by the names they bear but by whether or not it is desirable to have the given result. If the court wants the result of traditional law, it labels the activity "governmental"; if it does not, it calls the case "proprietary." Thus, the "distinction" obviously is not an explanation, but a vicious circle for stating results of something already determined. But with the gradual accretion of precedents interpreting these "distinctions" the original objective may be lost sight of and the categories incorporated for all intents and purposes into the body of law.

This distinction between "governmental" and "proprietary" functions has been spoken of as a limitation on the doctrine of reciprocal immunity because a corresponding distinction has not been made with reference to the activities of the Federal government. Apparently all the activities and functions of the Federal government must fall into the category of "governmental."

At first glance, it might seem that such a distinction could not be constitutionally applied to the Federal government's activities, because by its nature the national government must always derive its powers from those expressly or impliedly granted, since it has no residuary source upon which to draw. And some credence might be lent to this point of view when examining the concrete instances cited in the opening paragraphs of this paper. For example, the Tennessee Valley Authority defends its constitutional status by references to Federal powers over navigation and conservation of natural resources, particularly when they can be used for war purposes. It is theoretically not in the business of manufacturing and

50 Compare dicta of Mr. Justice Stone in United States v. California, 297 U. S. 175, 80 L. Ed. 567 (1936), that the doctrine of the South Carolina case may be equally applicable to the Federal and state governments; Massachusetts Acts for 1936, Ch. 81, exemption of Federal property is limited to that used "for essential governmental functions."
distributing power, although as an incident to its regular activities (navigation and flood control by erecting dams), it may manufacture power. Thus, having the source of electric power quite incidentally, the Federal government may manifestly sell that power for what it will bring. But a closer analysis clearly indicates that in so doing the government is assuming the economic position of a trader disposing of property (electrical energy) just as much as South Carolina did in selling liquor. The only difference is that constitutional theory permits the state to engage directly in the business, whereas the Federal government can do so only incidentally to other functions.

If these distinctions of "governmental" and "proprietary" have any objective content, which after all they may not have, as already suggested, then they should be applicable to the Federal government. If they are, on the other hand, functional concepts through which the judiciary may actually determine policy before legislation has been formulated, the problem should clearly be approached as one of policy—the relative independence of the national authority from the state and local interference, fiscal or otherwise. It is not at all unreasonable to suppose that Marshall's own doctrine of national supremacy again determines the matter. After all, the court of ultimate resort is part and parcel of the agency determining the extent of its own authority, and has naturally favored its own growth.

The Supreme Court of the United States has been as impartial an umpire in national-state disputes as one of the members of two contending teams could be expected to be. . . . The states, as members of the Federal system, have had to play against the umpire as well as against the national government itself. The combination has long been too much for them. It is submitted that this is evident in the only case noted.

The state of Alabama attempted to apply its kilowatt tax on the generation of electricity to the operations of the United States at Muscle Shoals, where the dam and power plant constructed during the war was producing small and varying amounts of energy for sale to the Alabama Power Company. The contention of the state of Alabama was naturally put in terms of the distinction between governmental and proprietary acts, that is, that since the Federal government was actually in the business of producing power, its activities as such were "proprietary" and hence subject to state taxation. But the Federal District Court, upon the application of the Federal government, speedily enjoined the collection of the tax as an unconstitutional imposition upon a Federal instrumentality. The state of Alabama then applied to the Court of Claims in which it based its contention on an implied contract. After a hearing on demurrer, which raised the legal sufficiency of the claim, the Court of Claims dismissed the suit for lack of merit. The court, in its opinion, said:

... where Congress has taken the action... it was taken in the exercise of a public function, and the things to be done and the agencies erected in pursuance thereof were public acts and public agencies and cannot by any refinement or nice distinctions be treated as or converted into private agencies and thereby be subjected to state taxation. This being true, it follows that any sales made of property purchased or owned in connection with the creation of said agencies or the proceeds of the operation thereof were made in the performance of a public function, in the trans-action of public business, and cannot by any illogical twist or the use of a false face be made to appear as private business.53

The judgment was reversed, on appeal to the Supreme Court, on the ground that the case should have been dismissed for want of jurisdiction, since jurisdiction of the Court of Claims does not extend to cases of contracts implied in law.54 Thus, the opinion of the Federal district judge stands as the only direct pronouncement on the

subject matter. However, the states and localities have long accommodated themselves to its ruling as the law of the land.

As the case law presently stands, there is an implied constitutional prohibition of intergovernmental taxation. In language, cases generally treat this prohibition as reciprocal—that is, as the Federal government is immune from taxation by the states and localities, so the states and localities are immune from Federal taxation. But, as has been noted, this reciprocal immunity has not been allowed to develop without some modification. This modification typically took the form of a distinction between “governmental” and “proprietary” state activities, confining the doctrine of tax immunity to the former category. On the other hand, no such distinction has been taken with reference to the activities of the Federal government, all of which are treated as if they were classified as “governmental.”

Remedial adjustment by legislation is made difficult by the fact that this doctrine, insofar as the states and localities are concerned, has crystalized into a constitutional doctrine beyond the control of the Congress. Various types of “in lieu” payments to the states and localities have been authorized by the Congress, but clearly it can not legislate concerning the imposition of Federal taxes on states and localities. It cannot, for example, provide that state employees shall be subject to the Federal income tax in the same manner and to the same extent as others similarly situated except for the fact of official status. That is the doctrine of Collector v. Day, re-enforced by Pollock v. Farmer’s Loan and Trust Company. Unless a Brandeisian philosophy for circumvent-

55 157 U. S. 429, 39 L. Ed. 759 (1895). One of the reefs on which the national income tax went aground was the attempted taxation of income from state and municipal bonds. The Sixteenth Amendment failed to convince the courts that such income was not exempted by the general language, although elementary rules of statutory construction make exemption from legislative policy dependent upon specific phraseology. If the courts had wished to correct the damage wrought by the Collector case, they certainly passed up
ing past decisions may prevail upon the court, as is quite unlikely, the only recourse of adjustment lies through constitutional amendment.

Immediate legislative relief must thus be partial (affecting only state taxation of Federal activities, and not the converse) and inevitably at the expense of the national revenues. There may be a bare possibility of securing reciprocal action by the forty-eight legislatures by employing the following device: Enact a congressional act permitting states and localities to tax all Federal activities to their fullest capacity (aside from the problem of discrimination), provided that such states and localities enact similar permission for the Federal government to tax the state and its localities. This would be analogous to the Federal grants-in-aid made contingent upon corresponding state action. But since the taxes primarily affected are income taxes which are found only in a limited number of states, few practical results on a nation-wide basis may be expected to emerge out of this solution.

Piecemeal adjustment rather than the adoption of a definitive Federal policy has so far been the response of the "New Deal" administration. With the exception of the case of the Reconstruction Finance Corporation, all the legislation has been in the direction of limiting the traditional immunity of the Federal government and extending the claims of the states and localities. Aside from this general point of similarity, however, the legislation is most diverse. The two loan agencies providing for urban and rural debtors have claimed tax immunity from the states and localities in all respects except on the reality that they may acquire in the course of their operations.

The Public Works Administration secured authorization, upon request of a state or political subdivision af-

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fected by its program of low-cost housing and slum clearance,
to enter into an agreement . . . for the payment by the United
States of sums in lieu of taxes, . . . based upon the cost of the
public or municipal services to be supplied for the benefit of such
projects or the persons residing on or occupying such premises,
but taking into consideration the benefits to be derived by such
State or subdivision . . . from such project.56a
In no case are such in-lieu payments to exceed 5 per cent
of the gross rental income of the project or the actual
amount of real-property taxes paid on the property in
question for the year just previous to its acquisition by
the Federal government.

The act authorizing the Resettlement Administration57
to make tax adjustments with localities in which its re-
settlement projects (as distinguished from land retire-
ment projects) are situated is almost identical with the
PWA enactment, except that it contains no provision
limiting the total amount of such payments in terms of 5
per cent or the actual amount of past taxes. This pro-
vision was omitted at the express request of the adminis-
tration, which argued that discretionary authorization in

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56a U.S.C.A. Tit. 40, § 432.
57 H. R. 10551.
making adjusted payments in lieu of taxes was vastly preferable, if not actually indispensable, in the case of re-
settlement projects because of their diverse character,\textsuperscript{58} whereas all of the housing projects of PWA were in 
large urban centers. This diversity only made the prob-
lem of arriving at satisfactory fiscal adjustments with 
the local taxing authorities proportionately more com-
plicated. However, as was pointed out at the committee 
hearings, this discretion may readily give way under the 
inevitable pressure that local constituents and their rep-
resentatives will bring to bear.

The TVA situation remains as it was at the time of its 
creation in 1933. It was then empowered to pay 5 per 
cent of the gross proceeds from its sale of power to the 
states of Alabama and Tennessee (Section 13), in lieu of 
all other taxes. No mention was made of localities. Bills 
have been introduced into the Congress giving the Au-
thority power to make fiscal adjustments with localities 
particularly affected by its dam inundations, but so far 
nothing has been done.

In the case of the Reconstruction Finance Corporation 
specific legislation has been enacted by the Congress, at 
the behest of the administration, for the express purpose 
of correcting a Supreme Court decision which construed 
the RFC to be subject to local taxation on its bank bonds 
aquired and held by it in the course of its regular fiscal 
operations. This decision came as a considerable sur-
prise to the administration, but Congress quickly re-
ponded by declaring that, "notwithstanding any other 
provision or law," all personal property (specifically 
enumerated as shares of preferred stock, capital notes, 
and debentures) heretofore or hereafter acquired by the

\textsuperscript{58} The land retirement activities of the Resettlement Administration were 
not covered by these statutes, for sufficient studies had not been undertaken 
upon which to formulate legislative recommendations to the 74th Congress 
with the suggestion that perhaps some adjustment might be outlined to the 
forthcoming Congress. See Hearings before a Subcommittee of House Com-
mittee and Ways and Means of 74th Congress on H. R. 12876 (Bankhead 
Bill).
RFC shall not be subject to any taxation, "whether now, heretofore, or hereafter imposed," and "whether for a past, present, or future taxing period." It was authoritatively stated at the hearings of the congressional committee that the RFC might be subject to the payment of approximately five million dollars annually, without such assertion of tax immunity; and this would result in immediately higher costs of loans, etc.

So run the present statutes. Involved in all these situations may be at least two elements that must be considered in arriving at some feasible scheme of adjustment: (a) past costs of local government, and (b) current (and perhaps future) costs of local government. All of the present legislation has confined its attention to the second element—current costs. There can probably be no quarrel with the formula devised by PWA and modified by the Resettlement Administration: Contractual payments, in lieu of taxes, to the localities, for the support of such additional governmental services as a community may find itself obligated to undertake upon the advent of a Federal project, provided due allowance is made for benefits directly and incidentally conferred upon the community by virtue of its selection as a site for a Federal project (for example, the rise in land values). The precise problem of determining what in any given instance should be the amount of the adjusted payment is left, of necessity, to the administrative processes. However, so far, nothing has been attempted in adjusting the problem of accrued costs of government, or the existing debt structure whose reduction and eventual liquidation must be accomplished by the successive levying of taxes, primarily on realty. The acquisition by the Federal government of major portions of the land within a given community obviously operates to narrow the tax base and may easily nullify any real attempt at liquidation. There is little prospect for relief to these interests in view

59 See H. R. 7474 of the 73rd Congress, 2nd session.
of past court and legislative precedents. When added to this are the facts that many of these heavy debt structures represent watered or ill-advised obligations and that tax delinquency is rampant, the likelihood of legislative relief may be dark indeed.

With the passing of time and the consequent increase in Federal activities, a reversal in the judicial doctrine of intergovernmental taxation becomes constantly more difficult. That it can be done, Australia may bear witness. Whether it should be done may be another question. It has already been indicated that any congressional solution, without a constitutional amendment or a reversal of Collector v. Day and its ensuing decisions, can effect only a partial solution and one at the entire expense of the national revenues. Deplorable, too, is the fact that the discussion of tax immunity only serves to cloud clear thinking about the whole problem of taxation by hiding or shifting governmental costs. The early doctrine of Marshall for a national supremacy, assuring freedom of the national authority from discriminatory fiscal interference by the states and localities did not encounter these difficulties. But the ensuing constitutional tax decisions have digressed far from Marshall's simple formulation. Large in any future adjustment of the fiscal relations of the Federal government with the states and localities loom two elements now undergoing rapid changes: (1) the method and sources of taxation; (2) the larger problem of the general adjustment of state and Federal relations, in consonance with which any solution to the perplexing tax problem must be worked out.

60 See footnote 4.