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Taxation -- Constitutional Law -- Exemption of Governmental Instrumentalities

James D. Carr

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the principle on which one state will give effect to the law of another, not because it is obligated to do so, but because it is more courteous and convenient.²⁶ As no state is bound to give effect to the law of another, many states extend this courtesy only to states which grant them similar privileges. This has been called the theory of reciprocity, and, although it is frequently applied,²⁷ it has been condemned by courts holding that comity is not a mere courtesy, but a legal right which should not be denied for any reason so flimsy as that of reciprocity.²⁸ Another approach to the problem, advocated by scholars and gaining ground with the courts, is that, in an accurate sense, the forum does not apply any theory such as that of comity, but rather its own set of rules applicable in cases involving a foreign element, or in other words, its own law of conflict of laws.²⁹

ELIZABETH SHEWMAKE.

Taxation—Constitutional Law—Exemption of Governmental Instrumentalities.

The Port of New York Authority is a municipal corporate instrumentality organized under a compact between the states of New York and New Jersey for the purpose of improving the port of New York and facilitating its use by the construction and operation of bridges, tunnels, terminals and other facilities. In pursuance of its purpose it has constructed the Outerbridge Crossing, the Bayonne, Goethals, and George Washington bridges, the Holland and Lincoln tunnels, and the Port Authority Commerce Building of New York City, and operates an interstate bus line over one of the bridges. The Authority has been financed by funds advanced by the two states, revenue from the sale of its own bonds, and income from bridge and tunnel tolls and from bus fares. This action was brought by the United States Commissioner of Internal Revenue to collect federal income taxes assessed against a construction engineer and two assistant general managers employed by the Port Authority. *Held*, employees of the Authority are not exempt from the federal income tax because no burden is imposed there-

²⁶ See *Franklin Sugar Refining Co. v. William D. Mullen Co.*, 7 F. (2d) 470, 473 (D. Del. 1925); *Herron v. Passailaigue*, 92 Fla. 818, 823, 110 So. 539, 542 (1926).

²⁷ *Mosko v. Matthews*, 87 Colo. 55, 284 Pac. 1021 (1930); *Farmers' and Merchants' State Bank v. Sutherlin*, 93 Neb. 707, 141 N. W. 827 (1913); *Hart v. Oliver Farm Equipment Sales Co.*, 37 N. M. 267, 21 P. (2d) 96 (1933).

²⁸ *Fuller v. Webster*, 5 Boyce 539, 95 Atl. 335 (Super. Ct. Del. 1915), *aff'd*, 6 Boyce 297, 99 Atl. 1069 (Sup. Ct. Del. 1916); *Hughes v. Winkleman*, 243 Mo. 81, 247 S. W. 994 (1912); *RESTATEMENT, CONFLICT OF LAWS* (1934) §6, comment *a*.

²⁹ *Cook, The Logical and Legal Bases of the Conflict of Laws* (1924) 33 YALE L. J. 457.

by upon a state instrumentality performing an essential governmental function.¹

In *M'Culloch v. Maryland*² Chief Justice John Marshall laid down the principle that a state may not levy special taxes upon instrumentalities of the Federal Government, for to allow such discriminatory taxation would be to deny the *supremacy* of that Government and subject its operations to possible interference and control by the respective states, in contravention of the implications of the United States Constitution. Marshall's doctrine of the supremacy of the Federal Government over the state governments was religiously adhered to while he occupied the position of Chief Justice, and for some years thereafter, and was made the basis for declaring state taxes levied upon federal securities as such³ and upon salaries of federal officials⁴ unconstitutional.

The first serious extension⁵ of the principle enunciated in *M'Culloch v. Maryland* came during the Civil War when the Supreme Court ruled that United States securities were exempt from a non-discriminatory state tax levied upon all bank property.⁶ But, although Marshall's prohibition against discriminatory taxation was thus extended to include non-discriminatory taxation, his principle of the supremacy of the Federal Government was upheld and applied.⁷ Seven years later the Court was confronted for the first time⁸ with the question whether the Federal Government might tax a state instrumentality and, for the last time in the field of taxation,⁹ the theory of the superiority of the national sovereignty was made the basis for the decision.¹⁰ In this case a federal tax on banks measured by the amount of state notes paid out by them was upheld.¹¹

¹ *Helvering v. Gerhardt*, — U. S. —, 58 Sup. Ct. 969, 82 L. ed. Adv. Ops. 962 (1938).

² 4 Wheat. 415, 4 L. ed. 389 (U. S. 1819).

³ *Weston v. Charleston*, 2 Pet. 448, 7 L. ed. 481 (U. S. 1829) (Marshall, writing the opinion, stated that ". . . we have considered it as a necessary consequence, from the *supremacy of the government of the whole*, that its action, in the exercise of its legitimate powers, should be free and unembarrassed by any conflicting powers in the possession of its parts. . . ." Italics inserted.)

⁴ *Dobbins v. The Commissioners of Erie County*, 16 Pet. 435, 10 L. ed. 1022 (U. S. 1842) (The line of reasoning here was that Congress fixes the amount to be earned by the officer; a tax levied on such officer diminishes the amount so fixed by Congress; hence the tax conflicts with the law of Congress, which is the *supreme* law of the land because made in pursuance of the United States Constitution, and the tax is therefore invalid.)

⁵ Boudin, *The Taxation of Governmental Instrumentalities* (1933) 22 GEO. L. J. 1, 254.

⁶ *People v. Tax Commissioners*, 2 Black 620, 17 L. ed. 451 (U. S. 1863).

⁷ Boudin, *supra* note 5, at 25. ⁸ *Id.* at 29.

⁹ Phillipsborn and Cantrill, *Immunity from Taxation of Governmental Instrumentalities* (1938) 26 GEO. L. J. 543, 551.

¹⁰ "It was the first time that the claim of exemption on behalf of state instrumentalities had come before the Supreme Court—in itself a weighty piece of evidence against the existence of such exemption or the claim of parity and state sovereignty on which it is based." Boudin, *supra* note 5, at 29.

¹¹ *Veazie Bank v. Fenno*, 8 Wall. 533, 19 L. ed. 482 (U. S. 1869).

The reasoning in *M'Culloch v. Maryland* remained effective only three more years. In 1870 the momentous decision of *Collector v. Day*¹² repudiated Marshall's principle that the Federal Government is supreme. This opinion held a state judge exempt from a general, non-discriminatory federal income tax on the ground that the sovereignty of the state governments is *equal* to that of the Federal Government and, hence, that instrumentalities of either government are reciprocally immune from taxation by the other.

As neither government may tax the instrumentalities of the other, the question has repeatedly arisen as to what constitutes a governmental instrumentality.¹³ The Supreme Court has held that a bond required by a state of a licensed liquor dealer,¹⁴ a lease of Indian lands,¹⁵ a lessee of Indian lands,¹⁶ a lease of state lands,¹⁷ a mortgage executed to a federal corporation,¹⁸ patents issued by the Federal Government,¹⁹ corporations whose stock is owned by a government,²⁰ corporate franchises granted by the Federal Government,²¹ government bonds,²² and municipal waterworks²³ are all governmental instrumentalities. On the other hand, it has held that the following are not: a bank in which state funds were deposited;²⁴ land purchased from the United States subject to the contingency that the purchaser build a dry

¹² 11 Wall. 113, 20 L. ed. 122 (U. S. 1870).

¹³ *Philipsborn and Cantrill*, *supra* note 9.

¹⁴ *Ambrosini v. United States*, 178 U. S. 1, 23 Sup. Ct. 1, 47 L. ed. 49 (1902).

¹⁵ *Indian Territory Illuminating Oil Co. v. Oklahoma*, 240 U. S. 522, 36 Sup. Ct. 453, 60 L. ed. 779 (1916); *Gillespie v. Oklahoma*, 257 U. S. 501, 42 Sup. Ct. 171, 66 L. ed. 338 (1922), *overruled* by *Helvering v. Mountain Producers Corp.*, — U. S. —, 58 Sup. Ct. 623, 82 L. ed. Adv. Ops. 607 (1938).

¹⁶ *Choctaw, O. & G. R. R. v. Harrison*, 235 U. S. 292, 35 Sup. Ct. 27, 59 L. ed. 234 (1914); *Jaybird Mining Co. v. Weir*, 271 U. S. 609, 46 Sup. Ct. 592, 70 L. ed. 1112 (1926).

¹⁷ *Burnet v. Coronado Oil & Gas Co.*, 285 U. S. 393, 52 Sup. Ct. 443, 76 L. ed. 815 (1932), (1932) 21 CALIF. L. REV. 172, (1933) 27 ILL. L. REV. 172, (1932) 11 TEX. L. REV. 120. This case was overruled by *Helvering v. Mountain Producers Corp.*, — U. S. —, 58 Sup. Ct. 623, 82 L. ed. 607 (1938).

¹⁸ *Federal Land Bank v. Crosland*, 261 U. S. 374, 43 Sup. Ct. 385, 67 L. ed. 703 (1923).

¹⁹ *Long v. Rockwood*, 277 U. S. 142, 48 Sup. Ct. 463, 72 L. ed. 824 (1928), (1928) 27 MICH. L. REV. 225.

²⁰ *Clallam County v. United States*, 263 U. S. 341, 44 Sup. Ct. 121, 68 L. ed. 328 (1923); *New Brunswick v. United States*, 276 U. S. 547, 48 Sup. Ct. 371, 72 L. ed. 693 (1928); *New York ex rel. Rogers v. Graves*, 299 U. S. 401, 57 Sup. Ct. 269, 81 L. ed. 306 (1937), (1937) 21 MINN. L. REV. 867, (1937) 2 Mo. L. REV. 372, (1937) 11 U. OF CIN. L. REV. 540.

²¹ *California v. Central Pac. R. R.*, 127 U. S. 1, 8 Sup. Ct. 1013, 32 L. ed. 150 (1888).

²² *Home Ins. Co. v. New York*, 134 U. S. 594, 10 Sup. Ct. 593, 33 L. ed. 1025 (1889); *Home Sav. Bank v. Des Moines*, 205 U. S. 503, 27 Sup. Ct. 571, 51 L. ed. 901 (1907); *Northwestern Mut. Ins. Co. v. Wisconsin*, 275 U. S. 136, 48 Sup. Ct. 55, 72 L. ed. 202 (1927).

²³ *Brush v. Commissioner of Internal Revenue*, 300 U. S. 352, 57 Sup. Ct. 495, 81 L. ed. 691 (1937), (1937) 12 IND. L. J. 421, (1937) 21 MINN. L. REV. 866, (1937) 14 N. Y. U. L. Q. REV. 550.

²⁴ *Manhattan Co. v. Blake*, 148 U. S. 412, 13 Sup. Ct. 64, 37 L. ed. 504 (1893).

dock thereon and allow United States vessels to use it free of charge;²⁵ a surety on bonds given by United States officers;²⁶ personal property used in the performance of a contract with the Federal Government;²⁷ independent contractors carrying on work for the Government;²⁸ corporations licensed by the Federal Government.²⁹ A glance at these cases will convince the reader that, whatever the reasoning in each case may be, the results are neither logical nor consistent.

If the first question is answered in the affirmative, it next becomes necessary to determine a second question: Is the tax from which exemption is sought actually a tax *on* the instrumentality? Or, as it has been phrased by the courts, is the burden imposed by the tax direct, or is it too remote to interfere with any governmental function?³⁰ Here, again, the decisions are highly inconsistent, for the so-called "burden test"³¹ is necessarily indefinite and confusing, since the terms "direct" and "remote" are in themselves intangible, and the degrees of each are infinite. Intergovernmental tax immunity has been allowed as to taxes ranging all the way from an income tax on dividends paid by a corporation out of a surplus which was built up in part with interest received on United States bonds³² to an excise tax levied upon gasoline distributors from whom purchases were made by federal agencies.³³ But the Court has held the burden imposed to be too remote to warrant exemption of a state university from payment of duties levied upon scientific equipment imported for use in its laboratories,³⁴ or of an independent contractor from payment of an income tax upon compensa-

²⁵ *Baltimore Shipbuilding Co. v. Baltimore*, 195 U. S. 375, 25 Sup. Ct. 50, 49 L. ed. 242 (1904).

²⁶ *Fidelity & Deposit Co. v. Pennsylvania*, 240 U. S. 319, 36 Sup. Ct. 298, 60 L. ed. 664 (1916).

²⁷ *Gromer v. Standard Dredging Co.*, 224 U. S. 362, 32 Sup. Ct. 499, 56 L. ed. 801 (1912).

²⁸ *Metcalf v. Mitchell*, 269 U. S. 514, 46 Sup. Ct. 172, 70 L. ed. 384 (1926), (1926) 39 HARV. L. REV. 768, (1926) 21 ILL. L. REV. 38; *Trinity-farm Construction Co. v. Grosjean*, 291 U. S. 466, 54 Sup. Ct. 469, 78 L. ed. 918 (1935); *James v. Dravo Contracting Co.*, 302 U. S. 134, 58 Sup. Ct. 208, 82 L. ed. Adv. Ops. 125 (1937), (1938) 86 U. OF PA. L. REV. 308, (1938) 24 VA. L. REV. 455; *Silas Mason Co. v. Tax Comm.*, 302 U. S. 190, 58 Sup. Ct. 233, 82 L. ed. Adv. Ops. 154 (1938); *Atkinson v. State Tax Comm.*, 302 U. S. 641, 58 Sup. Ct. 419, 82 L. ed. Adv. Ops. 440 (1938).

²⁹ *Susquehanna Power Co. v. Tax Comm.*, 283 U. S. 291, 51 Sup. Ct. 434, 75 L. ed. 1042 (1931); *Broad River Power Co. v. Query*, 288 U. S. 178, 53 Sup. Ct. 326, 77 L. ed. 685 (1933); *Federal Compress & Warehouse Co. v. McLean*, 291 U. S. 17, 54 Sup. Ct. 267, 78 L. ed. 622 (1933).

³⁰ The *amount* of the tax is immaterial. *Metcalf v. Mitchell*, 269 U. S. 514, 46 Sup. Ct. 172, 70 L. ed. 384 (1926).

³¹ Note (1931) 79 U. OF PA. L. REV. 948; (1937) 25 GEO. L. J. 766.

³² *Miller v. Milwaukee*, 273 U. S. 713, 47 Sup. Ct. 280, 71 L. ed. 487 (1926).

³³ *Panhandle Oil Co. v. Knox*, 277 U. S. 218, 48 Sup. Ct. 451, 72 L. ed. 857 (1928), (1928) 42 HARV. L. REV. 128, (1928) 27 MICH. L. REV. 225, (1928) 14 ST. LOUIS L. REV. 86.

³⁴ *Board of Trustees of U. of Ill. v. United States*, 289 U. S. 48, 53 Sup. Ct. 509, 77 L. ed. 1025 (1933).

tion received for construction work done for the United States.⁸⁵ These examples are typical of the inconsistent results the Supreme Court has reached in applying the "burden test", and nearly all of the cases in which the test is applied are similarly confusing.⁸⁶

⁸⁵ *James v. Dravo Contracting Co.*, 302 U. S. 134, 58 Sup. Ct. 208, 82 L. ed. Adv. Ops. 125 (1937).

⁸⁶ The Supreme Court has allowed exemptions in the following cases: *Forbes v. Gracey*, 94 U. S. 762, 24 L. ed. 313 (1877) (tax on proceeds from mines located on United States lands); *United States v. Baltimore & O. R. R.*, 17 Wall. 322, 21 L. ed. 597 (U. S. 1878) (tax upon interest on municipal bonds); *Pollock v. Farmers' Loan & Trust Co.*, 157 U. S. 429, 15 Sup. Ct. 673, 39 L. ed. 759 (1895) (tax on income derived from municipal bonds by private person or corporation); *Home Sav. Bank v. Des Moines*, 205 U. S. 503, 27 Sup. Ct. 571, 51 L. ed. 901 (1907) (tax on bank, measured by amount of surplus where surplus composed in part of government securities); *Farmers' & Mechanics' Sav. Bank v. Minnesota*, 232 U. S. 516, 34 Sup. Ct. 354, 58 L. ed. 706 (1914) (tax on surplus composed in part of bonds issued by municipality of a territory); *Choctaw, O. & G. R. R. v. Harrison*, 235 U. S. 292, 35 Sup. Ct. 27, 59 L. ed. 234 (1914) (tax on gross production of minerals by a lessee of Indian lands); *Indian Territory Illuminating Oil Co. v. Oklahoma*, 240 U. S. 522, 36 Sup. Ct. 453, 60 L. ed. 779 (1916) (tax on corporate stock, the only value of the stock being the value of a lease of Indian lands); *Gillespie v. Oklahoma*, 257 U. S. 501, 42 Sup. Ct. 171, 66 L. ed. 338 (1922) (tax on income derived from Indian lands); *Federal Land Bank v. Crosland*, 261 U. S. 374, 43 Sup. Ct. 385, 67 L. ed. 703 (1923) (tax on recordation of mortgage executed to federal agency); *Clallam County v. United States*, 263 U. S. 342, 44 Sup. Ct. 121, 68 L. ed. 328 (1923) (tax on real and personal property belonging to a federal corporation); *Jaybird Mining Co. v. Weir*, 271 U. S. 609, 46 Sup. Ct. 592, 70 L. ed. 1112 (1926) (*ad valorem* tax on ore produced and stored by lessee of Indian lands); *Northwestern Mutual Ins. Co. v. Wisconsin*, 275 U. S. 136, 48 Sup. Ct. 55, 72 L. ed. 202 (1927) (tax on corporate franchise measured by income derived in part from interest on government bonds); *New Brunswick v. United States*, 276 U. S. 547, 48 Sup. Ct. 371, 72 L. ed. 693 (1928) (tax on land mortgaged to a federal agency); *Long v. Rockwood*, 277 U. S. 142, 48 Sup. Ct. 463, 72 L. ed. 824 (1928) (tax on income in the form of patent royalties); *Macallen Co. v. Massachusetts*, 279 U. S. 620, 49 Sup. Ct. 432, 73 L. ed. 874 (1929) (tax on corporate franchise measured by income derived in part from interest on government bonds); *Missouri v. Gehner*, 281 U. S. 313, 50 Sup. Ct. 326, 74 L. ed. 870 (1930) (tax on net worth where ownership of federal securities was taken into account in determining the net worth); *Indian Motorcycle Co. v. United States*, 283 U. S. 393, 51 Sup. Ct. 601, 75 L. ed. 1277 (1931) (tax on sale of police equipment to a municipality); *Burnet v. Coronado Oil & Gas Co.*, 285 U. S. 393, 52 Sup. Ct. 443, 76 L. ed. 815 (1932) (tax on income derived from state lands by the lessee thereof); *New York ex rel. Rogers v. Graves*, 299 U. S. 401, 57 Sup. Ct. 269, 81 L. ed. 306 (1937) (tax on income of general counsel for federal corporation); *Brush v. Commissioner of Internal Revenue*, 300 U. S. 352, 57 Sup. Ct. 495, 81 L. ed. 691 (1937) (tax on income of chief engineer of municipal waterworks). But the Court has refused to grant immunity, on the ground that the burden imposed upon a governmental function is too remote, in the following cases: *Shaw v. Gibson-Zahniser Oil Corp.*, 276 U. S. 575, 48 Sup. Ct. 333, 72 L. ed. 709 (1928) (tax on property belonging to lessee of Indian lands); *Wheeler Lumber Bridge & Supply Co. v. United States*, 281 U. S. 572, 50 Sup. Ct. 419, 74 L. ed. 1047 (1930) (tax on transportation of goods delivered to a county f.o.b. point of delivery); *Willcuts v. Bunn*, 282 U. S. 216, 51 Sup. Ct. 125, 75 L. ed. 804 (1931) (tax on income derived from resale of county and municipal bonds); *Educational Films Corp. v. Ward*, 282 U. S. 379, 51 Sup. Ct. 170, 75 L. ed. 400 (1931) (franchise tax measured by income derived in part from royalties on copyrights granted by Federal Government); *Alward v. Johnson*, 282 U. S. 509, 51 Sup. Ct. 273, 75 L. ed. 496 (1931) (tax on gross receipts of automotive stage line, including compensation from Federal

The Court applied, in the instant case, a limitation on the doctrine of immunity of governmental instrumentalities which tends to confound the law to an even greater extent. This is the requirement that, in order to be exempt from taxation, the instrumentality must perform an "essential governmental" function. It was first applied³⁷ in *South Carolina v. United States*,³⁸ in which it was held that persons conducting a liquor business on behalf of the state, in the form of a state dispensing system, were not immune from a federal license tax because the function performed was not essentially governmental in nature. Because of the vast extension of governmental activities into new and varied fields in modern times,³⁹ this limitation is being applied more and more often and with increasing strictness.⁴⁰ Hence, yet another question is becoming vital in the determination of intergovernmental tax immunity: Does the particular instrumentality perform an "essential governmental" function? In deciding that corporations organized pursuant to a state law and conducting private businesses thereunder are not exempt from a federal franchise tax, the Court, in *Flint v. Stone Tracy Co.*,⁴¹ defined functions which are essentially governmental as

Government for mail transportation); *Group No. 1 Oil Co. v. Bass*, 283 U. S. 279, 51 Sup. Ct. 432, 75 L. ed. 1032 (1931) (tax on income derived from lands leased from a state); *Fox Film Corp. v. Doyal*, 286 U. S. 123, 52 Sup. Ct. 546, 76 L. ed. 1010 (1932) (tax on gross receipts of copyright royalties); *Broad River Power Co. v. Query*, 288 U. S. 178, 53 Sup. Ct. 326, 77 L. ed. 685 (1933) (tax on production and sale of electric power under federal license); *Indian Territory Illuminating Oil Co. v. Board of Equalization*, 288 U. S. 325, 53 Sup. Ct. 388, 77 L. ed. 812 (1933) (*ad valorem* tax on oil produced by lessee from Indian lands); *Burnet v. A. T. Jergins Trust*, 288 U. S. 508, 53 Sup. Ct. 439, 77 L. ed. 925 (1933) (tax on income derived from land leased from a municipality); *Trinityfarm Construction Co. v. Grosjean*, 291 U. S. 466, 54 Sup. Ct. 469, 78 L. ed. 918 (1934) (tax on gasoline used by independent contractor in execution of government construction contract); *Liggett & Myers Tobacco Co. v. United States*, 299 U. S. 388, 57 Sup. Ct. 239, 81 L. ed. 294 (1937) (stamp tax on tobacco sold to a state hospital); *Taber v. Indian Territory Illuminating Oil Co.*, 300 U. S. 1, 57 Sup. Ct. 334, 81 L. ed. 463 (1937) (*ad valorem* tax on property belonging to lessee of Indian lands); *Helvering v. Bankline Oil Co.*, — U. S. —, 58 Sup. Ct. 616, 82 L. ed. Adv. Ops. 618 (1938) (tax on income received from lands leased from state); *Helvering v. Mountain Producers Corp.*, — U. S. —, 58 Sup. Ct. 623, 82 L. ed. Adv. Ops. 607 (1938) (tax on income derived from lands leased from state).

³⁷ *Johnson, Federal Taxation Affecting State Instrumentalities* (1934) 68 U. S. L. REV. 248; notes (1935) 24 CALIF. L. REV. 110, (1935) 33 MICH. L. REV. 1283, (1937) 14 N. Y. U. L. Q. REV. 550, (1932) 81 U. OF PA. L. REV. 194, (1937) 3 U. OF PITTSBURGH L. REV. 259.

³⁸ 199 U. S. 437, 26 Sup. Ct. 110, 50 L. ed. 261 (1905) (This problem has again arisen since the repeal of the Eighteenth Amendment. The decision in the *South Carolina* case was upheld in *Ohio v. Helvering*, 292 U. S. 360, 54 Sup. Ct. 725, 78 L. ed. 1307 (1934) on a similar set of facts.)

³⁹ See Culp, *Creation of Government Corporations by the National Government* (1935) 33 MICH. L. REV. 473; Philipsborn and Cantrill, *Immunity from Taxation of Governmental Instrumentalities* (1938) 26 GEO. L. J. 543; notes (1936) 49 HARV. L. REV. 1323, (1938) 15 N. Y. U. L. Q. REV. 426.

⁴⁰ (1936) 20 MINN. L. REV. 442, (1934) 21 VA. L. REV. 120.

⁴¹ 220 U. S. 107, 31 Sup. Ct. 342, 55 L. ed. 389 (1911).

"those operations of the States essential to the execution of its governmental functions, and *which the State alone can do itself*. . ."⁴² The case of *Indian Motorcycle Co. v. United States*,⁴³ decided in 1931, invalidating a federal sales tax levied upon the sale to a municipality of a motorcycle for use by its police force, seems to fit into this definition, as does a decision to the effect that the operation of a street railway by a state is not such a usual⁴⁴ governmental function as to allow exemption of the members of the board of trustees of such railway from a federal income tax.⁴⁵ But several recent cases are not so clear. In *New York ex rel. Rogers v. Graves*⁴⁶ the relator was allowed to escape payment of a state income tax because of his position as general counsel for the Panama Railroad Company, a federal corporation operating a dairy, two hotels, a railroad and a commissary establishment in the Panama Canal Zone, and a steamship line. Shortly afterward it was held that a municipal waterworks performs an essential governmental function, and hence that an engineer employed to supervise its operation does not have to pay a federal income tax.⁴⁷ But the liquidation of banks,⁴⁸ operations under a lease of state lands,⁴⁹ and the conducting of football games by a state university⁵⁰ have since been held to be non-essential governmental functions and therefore not immune from federal taxation.

These recent applications of the "essential governmental function" test seemingly reveal a trend back to the results of, if not the reasoning behind, the doctrine of federal supremacy as laid down by Marshall in *M'Culloch v. Maryland*.⁵¹ The Supreme Court has applied this test only to allow taxation of state instrumentalities by the Federal Government,⁵² and immunity has been granted federal instrumentalities engaged in activities far less essentially governmental than many en-

⁴² *Id.* at 172, 31 Sup. Ct. at 357, 55 L. ed. at 422. (Italics inserted.)

⁴³ 283 U. S. 570, 51 Sup. Ct. 601, 75 L. ed. 1277 (1931).

⁴⁴ The Supreme Court has granted immunity where the activities engaged in were: "usual" governmental functions, "traditional" governmental functions, and "essential" governmental functions. (1937) 14 N. Y. U. L. Q. Rev. 550. But there seems to be little real distinction between these terms.

⁴⁵ *Helvering v. Powers*, 293 U. S. 214, 55 Sup. Ct. 171, 79 L. ed. 291 (1934), note (1935) 24 CALIF. L. REV. 110, (1935) 33 MICH. L. REV. 1283.

⁴⁶ 299 U. S. 401, 57 Sup. Ct. 269, 81 L. ed. 306 (1937).

⁴⁷ *Brush v. Commissioner of Internal Revenue*, 300 U. S. 352, 57 Sup. Ct. 495, 81 L. ed. 691 (1937).

⁴⁸ *Helvering v. Therrell*, — U. S. —, 58 Sup. Ct. 539, 82 L. ed. Adv. Ops. 537 (1938).

⁴⁹ *Helvering v. Bankline Oil Co.*, — U. S. —, 58 Sup. Ct. 616, 82 L. ed. Adv. Ops. 618 (1938).

⁵⁰ *Allen v. Regents of The Univ. System of Ga.*, — U. S. —, 58 Sup. Ct. 980, 82 L. ed. Adv. Ops. 975 (1938). Circuit court decision discussed in note (1938) 16 N. C. L. REV. 292.

⁵¹ Note (1937) 22 IOWA L. REV. 430.

⁵² *Johnson*, *supra* note 37; note (1936) 49 HARV. L. REV. 1323.

gaged in by state agencies to which exemption has been refused.⁵³ In the *Graves* case, the Court intimated, for the first time,⁵⁴ that the test applies to federal agencies, but it allowed exemption of an instrumentality performing a function no more essentially governmental than that performed by the state agency in the principal case. The *Graves* case, then, when compared with other recent decisions, raises the question of whether the "essential governmental function" test *actually* does apply to federal instrumentalities. An argument against such application is that the Federal Government is a government of delegated powers, and hence every federal activity undertaken in pursuance of those powers is of necessity essentially governmental.⁵⁵ But this question must remain open to conjecture for the present, although the *Graves* case furnishes some indication that the Court may eventually nullify the "essential governmental" test insofar as federal agencies are concerned.

The attitude of the Treasury Department,⁵⁶ resulting from an opinion rendered to it by the Department of Justice,⁵⁷ has caused widespread fear that the effect of *Helvering v. Gerhardt* will be to destroy all immunity now enjoyed by state employees from the federal income tax. Such an interpretation of the decision would probably result in increased cost of state government, thereby adding to the burden of the state taxpayer without correspondingly lightening the burden of the federal taxpayer, for it does not necessarily follow that an increase in federal revenue will decrease federal taxes. This interpretation would seriously impair states' rights as set forth in *Collector v. Day*. But do those rights rest on valid grounds? As pointed out by Marshall in *M'Culloch v. Maryland*,⁵⁸ the people of all the states, including the ones affected, have a voice, through their representatives in Congress, in the levying of federal taxes upon state agencies, while only a small

⁵³ Brown, *State Taxation of Interstate Commerce, and Federal and State Taxation in Intergovernmental Relations, 1932-35* (1936) 24 GEO. L. J. 584; (1935) 20 ST. LOUIS L. REV. 290.

⁵⁴ Note (1937) 3 U. OF PITTSBURGH L. REV. 259; (1937) 11 U. OF CIN. L. REV. 540.

⁵⁵ Loundes, *The Supreme Court on Taxation, 1936 Term* (1937) 86 U. OF PA. L. REV. 1; Stoke, *State Taxation and the New Federal Instrumentalities*, (1936) 22 IOWA L. REV. 39; notes (1937) 22 IOWA L. REV. 430, (1937) 3 U. OF PITTSBURGH L. REV. 259. An argument which has been advanced against this is that the holding in *South Carolina v. United States*, 199 U. S. 437, 26 Sup. Ct. 110, 50 L. ed. 261 (1905) was that a "State cannot withdraw sources of revenue from the federal taxing power by engaging in businesses which constitute a departure from usual governmental functions", and that the rule thus stated would apply to federal as well as state instrumentalities. Note (1936) 49 HARV. L. REV. 1323, 1325.

⁵⁶ N. Y. Times, Aug. 10, 1938, p. 18, col. 1.

⁵⁷ N. Y. Times, July 22, 1938, p. 27, col. 1.

⁵⁸ 4 Wheat. 316, 435, 4 L. ed. 389, 608 (U. S. 1819).

part of the people of the United States control the laying of a tax upon a federal instrumentality by a particular state. Hence the opinion as construed by the Department of Justice would merely be a step back toward the doctrine of *M'Culloch v. Maryland*, the decision out of which all intergovernmental tax immunity developed. But the case does not seem to go so far, and apparently the rule that all federal instrumentalities are exempt from state taxation, while only those state instrumentalities which perform essential governmental functions are immune from federal taxes imposing a direct burden, remains unchanged. The decision does, however, further confound the shadowy concepts of what constitutes a "direct burden" and an "essential governmental function."

Helvering v. Gerhardt is a clear illustration of the present tendency on the part of the courts to limit intergovernmental tax exemptions. Such limitation is economically desirable for a number of reasons.⁵⁹ Tax exemptions seem to increase as governmental activities expand; but the cost of government likewise increases with such expansion, and exemptions paradoxically cut down governmental revenue. Many privately owned businesses must compete with similar governmentally owned enterprises which have no tax burden. Furthermore, persons employed by one government derive the same benefits from the other government as do private individuals, but they do not have to contribute to the costs of such benefits.⁶⁰ Why, then, should such a vast multiplicity of exemptions be allowed? The courts have lost sight of the reason for the rule of tax immunity—the prevention of reciprocal destruction of state and federal governments. The power to tax is *not* the power to destroy unless it is exercised with discrimination.⁶¹ The confusion in the law may be cleared up, the economic evils of exemptions may be eliminated, and the existence of governments safeguarded by restricting all immunity from intergovernmental taxation to those cases, and only those cases, where the tax complained of discriminates against a particular government.

JAMES D. CARR.

⁵⁹ See Brabson, *Income Tax Exemptions and the Loss of Federal Revenues* (1937) 15 TAX MAG. 8. One example given by Mr. Brabson is that only 1.39% of those receiving income are paying a federal income tax, a condition caused to a large extent by intergovernmental tax immunity.

⁶⁰ See concurring opinion of Black, J., in *Helvering v. Gerhardt*. Mr. Justice Black points out that the words of the Sixteenth Amendment, "collect taxes on incomes from whatever source derived", give Congress the power to collect taxes on the incomes of all state employees. He further maintains that the Court should "review and reexamine the rule based upon *Collector v. Day*", and that such vague doctrines as the "essential governmental function" test should be discarded.

⁶¹ "The power to tax is not the power to destroy while this Court sits." Holmes, dissenting, in *Panhandle Oil Co. v. Knox*, 277 U. S. 218, 223, 48 Sup. Ct. 451, 453, 72 L. ed. 857, 859 (1928).