

# Intergovernmental Immunity from Taxation

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"In the law of taxation it is frequently reiterated that 'statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved most strongly against the Government and in favor of the citizen.'<sup>34</sup> Where the statute, however, contains no ambiguity it must be taken literally and given effect according to its language.<sup>35</sup> But the expounding of a statutory provision strictly according to the letter without regard to the other part of the act and legislative history, would often defeat the object intended to be accomplished."<sup>36</sup>

IRVING WEINSTEIN.

INTERGOVERNMENTAL IMMUNITY FROM TAXATION.—The problem of intergovernmental immunity from taxation is constantly assuming a more important place in the law of taxation.<sup>1</sup> With mounting deficits in national and state budgets due to tremendous relief expenditures, new sources of income must be found. To meet this need, governments have undertaken new fields of activity, such as liquor selling,<sup>2</sup> furnishing electric power<sup>3</sup> and the running of railroads.<sup>4</sup> With both Federal and State Governments engaging in these activities the question naturally arises, will each or either be immune from taxation by the other? The answer lies, if anywhere, in the decisions of the Supreme Court on the subject.

The roots of the problem are in the famous decision of Chief Justice Marshall in *McCulloch v. Maryland*<sup>5</sup> decided in 1819 on purely political grounds.<sup>6</sup> The rule established, there being no express provision in the Constitution,<sup>7</sup> was that a state could not tax the business and functions of the Bank of the United States, chartered by the Federal Government. The keynote of the decision was

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<sup>34</sup> *Gould v. Gould*, 245 U. S. 151, 153, 38 Sup. Ct. 53, 55 (1917); *United States v. Merriam*, 263 U. S. 179, 188, 44 Sup. Ct. 69, 71 (1923); *Reinecke v. Northern Trust Co.*, 278 U. S. 339, 348, 49 Sup. Ct. 123, 125 (1929); *Tyler v. United States*, 281 U. S. 497, 503, 50 Sup. Ct. 356 (1933); Note (1931) 6 St. JOHN'S L. REV. 172, and cases cited therein.

<sup>35</sup> *Bates Refrigerating Co. v. Sulzberger*, 157 U. S. 1, 37, 15 Sup. Ct. 508 (1895); *Commissioner of Immigration v. Gottleib*, 265 U. S. 310, 313, 44 Sup. Ct. 528 (1924).

<sup>36</sup> Note (1934) 9 St. JOHN'S L. REV. 222.

<sup>1</sup> Note (1934) 44 YALE L. J. 326.

<sup>2</sup> FOSDICK AND SCOTT, TOWARD LIQUOR CONTROL (1933).

<sup>3</sup> THOMPSON, PUBLIC OWNERSHIP (1925) 20, 204.

<sup>4</sup> *Supra* note 3.

<sup>5</sup> *Wheat*, 316 (U. S. 1819).

<sup>6</sup> BEVERIDGE, LIFE OF JOHN MARSHALL (1919) 302.

<sup>7</sup> *Supra* note 5.

the supremacy<sup>8</sup> of the Federal Government over the states. The federal supremacy theory<sup>9</sup> which was upheld in subsequent decisions<sup>10</sup> received a rude setback by a decision<sup>11</sup> a half a century later, which although not directly overruling the *McCulloch* case, had that practical effect, by holding that State and Federal Governments were on a par and that each being sovereign there was reciprocal immunity from taxation.<sup>12</sup>

The *Day* case<sup>13</sup> became a rallying ground for all types of exemptions<sup>14</sup> and in a great number of instances the exemption from a particular tax was claimed not by the state as such but by some private interest.<sup>15</sup> The rule of the *Day* case had been so often affirmed and so firmly entrenched in the law by judicial decision<sup>16</sup>

<sup>8</sup> In the language of Judge Marshall, "The difference is that which always exists, and always must exist between the action of a whole on a part, and the action of a part on the whole—between the laws of a government declared to be supreme, and those of a government which, when in opposition to those laws is not supreme."

<sup>9</sup> Boudin, *Taxation of Governmental Instrumentalities* (1933) 22 *Geo. L. J.* 6.; U. S. CONST. Art. VI, §2.

<sup>10</sup> *Brown v. Maryland*, 12 *Wheat.* 419 (U. S. 1827). This case held unconstitutional a Maryland statute taxing foreign imports (citing *McCulloch v. Maryland*, *supra* note 5, as authority); *Weston v. City of Charleston*, 2 *Pet.* 448 (U. S. 1829). Here a state tax on federal securities was held unconstitutional; *Veazie Bank v. Fenno*, 8 *Wall.* 533 (U. S. 1869). The power of federal government to tax a state bank was upheld but a strong dissent by Judge Nelson became the basis for the majority decision in the later case of *Collector v. Day*, *infra* note 11.

<sup>11</sup> *Collector v. Day*, 11 *Wall.* 113 (U. S. 1871). Here the salary of a state judge was held not subject to a federal income tax.

<sup>12</sup> Powell, *Indirect Encroachment on Federal Authority by Taxing Power of States* (1919) 32 *HARV. L. REV.* 902. Prof. Powell expressed the opinion that the doctrine of intergovernmental immunity is economically unsound.

<sup>13</sup> *Supra* note 11.

<sup>14</sup> *United States v. B. & O. R. R. Co.*, 17 *Wall.* 322 (U. S. 1873); *Mercantile National Bank v. Major*, 121 U. S. 138, 7 *Sup. Ct.* 826 (1887); *Gillespie v. Oklahoma*, 257 U. S. 501, 42 *Sup. Ct.* 171 (1922), held unconstitutional an income tax on a lessee of Indian lands owned by the United States; *Metcalf v. Mitchell*, 269 U. S. 514, 46 *Sup. Ct.* 172 (1926), in which an engineer claimed exemption as an independent contractor with the state, the income being derived as a result of the contract; *Panhandle Oil v. Mississippi*, 277 U. S. 218, 48 *Sup. Ct.* 451 (1928); *Burnett v. Coronado Oil and Gas Co.*, 285 U. S. 393, 52 *Sup. Ct.* 443 (1932).

<sup>15</sup> *United States v. B. & O. R. R. Co.*, *supra* note 14; *Manhattan v. Blake*, 148 U. S. 412, 13 *Sup. Ct.* 640 (1893); *Indian Motorcycle v. United States*, 283 U. S. 570, 51 *Sup. Ct.* 601 (1931); *Willcutts v. Bunn*, 282 U. S. 216, 51 *Sup. Ct.* 125 (1931). In the *Indian Motorcycle* case, at 580, Justice Stone, in his dissenting opinion, said: "The implied immunity of one government either national or state from taxation by the other should not be enlarged. Immunity of the one necessarily involves curtailment of the other's sovereign power to tax. The practical effect of enlargement is commonly to relieve individuals from a tax at the expense of the government imposing it without substantial benefits to the government for whose theoretical advantage the immunity is invoked."

<sup>16</sup> *Supra* notes 14 and 15.

that possibilities of overruling it became remote, if not impossible.<sup>17</sup> Despite this fact there has been a marked tendency on the part of the courts<sup>18</sup> and in contemplated legislation<sup>19</sup> toward limiting its application.

In a recent decision, *Powers v. Commissioner of Internal Revenue*,<sup>20</sup> the Supreme Court held taxable under the Federal Income Tax Law, the salary of a trustee of a municipally owned railroad, the trustee having been appointed by the legislature of the state of Massachusetts and receiving the salary as an officer of the state. To support its decision the Court relied on the case of *South Carolina v. United States*,<sup>21</sup> in which officers of a state liquor dispensary were held liable to a general license tax of the Federal Government. This was the ruling despite a holding three years earlier by the Supreme Court in *Ambrosini v. U. S.*,<sup>22</sup> that a federal stamp tax on a bond furnished by a liquor dealer to the state was unconstitutional. These two latter cases, though factually different, should be governed by the same principle.<sup>23</sup> The *South Carolina* case however, for the first time<sup>24</sup> placed a direct limitation on the *Day* case,<sup>25</sup> by setting up a proprietary governmental test to the activity, and confining the state to the latter; and since a state engaged in the liquor business is not exercising a strict governmental function<sup>26</sup> it is not entitled to immunity. In applying this test to the *Powers* case, Chief Justice Hughes in the course of his opinion, pointed out that the running of a railroad is not the exercise of a governmental function<sup>27</sup> and since the railroad itself is not exempt from federal taxation<sup>28</sup> it would be illogical to hold that its employees, though

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<sup>17</sup> S. J. RES. 251, 72d Cong., 2d Sess. A proposed constitutional amendment was introduced into the Senate in 1933 for the purpose of amending the Constitution in order to do away with tax-exempt government bonds.

<sup>18</sup> *South Carolina v. United States*, 199 U. S. 437, 26 Sup. Ct. 110 (1905); *Flint v. Stone Tracy*, 220 U. S. 107, 31 Sup. Ct. 342 (1911); *State of North Dakota v. Olson*, 33 F. (2d) 848 (C. C. A. 8th, 1929); *Ohio v. Helvering*, 292 U. S. 360, 54 Sup. Ct. 725 (1934); *Metcalf v. Mitchell*, 269 U. S. 514, 46 Sup. Ct. 172 (1926); *Willcutts v. Bunn*, 282 U. S. 216, 51 Sup. Ct. 125 (1931); *Susquehanna Power Co. v. Tax Commission*, 283 U. S. 291, 51 Sup. Ct. 434 (1931).

<sup>19</sup> *Supra* note 17.

<sup>20</sup> 293 U. S. —, 55 Sup. Ct. 171 (1934).

<sup>21</sup> *Supra* note 18.

<sup>22</sup> *Ambrosini v. United States*, 187 U. S. 1, 23 Sup. Ct. 1 (1902).

<sup>23</sup> *Boudin, Taxation of Governmental Instrumentalities, supra* note 9, at 276.

<sup>24</sup> The term "governmental" had previously been used as a limitation, but had never fully been applied until the *South Carolina* case. See *United States v. Baltimore, supra* note 14; *Ambrosini v. United States, supra* note 22.

<sup>25</sup> *Supra* note 11.

<sup>26</sup> Note (1933) 47 HARV. L. REV. 322. It was herein stated a state engaged in the liquor business is exercising a governmental function.

<sup>27</sup> *Flint v. Stone Tracy, supra* note 18.

<sup>28</sup> The fear that federal taxation might be undermined if the states could engage in various businesses is well expressed by Judge Brewer in *South Carolina v. United States, supra* note 18, at 455, "Obviously if the power of

state officers, were exempt. The lower court<sup>29</sup> on the strength of dicta in a prior case<sup>30</sup> had held, disregarding the rule in the *Carolina* case,<sup>31</sup> that no government officer's salary was subject to taxation.<sup>32</sup> The literal application of the *Day* case<sup>33</sup> justified the circuit court's interpretation. Yet even conceding the rule as laid down in the *South Carolina* case, it would still be possible and plausibly so, to distinguish the *Powers* case<sup>34</sup> on the ground that the trustees were regulating public utility rates and were to apportion deficits to be secured by taxation by the state.<sup>35</sup>

Since the *Carolina* case<sup>36</sup> was decided, however, the tendency has been to narrow the field of state exemption,<sup>37</sup> at least where the proprietary-governmental standard is applicable.<sup>38</sup> The *Powers* case<sup>39</sup> seems to emphasize this, and since it is the latest decision of the Supreme Court in interpreting the doctrine of intergovernmental immunity, it becomes important in determining the future attitude

the state is carried to the extent suggested and with it is relief from all federal taxation the national government would be largely crippled in its revenues. Indeed, if all the states should concur in exercising their powers to the full extent, it would be almost impossible for the nation to collect any revenues."

<sup>29</sup> 68 F. (2d) 634 (C. C. A. 1st, 1934).

<sup>30</sup> *Metcalf v. Mitchell*, *supra* note 18; see also *Frey v. Woodworth*, 2 F. (2d) 725 (E. D. Mich. 1924). Here salary of an employee of a municipally owned railroad was exempt from taxation.

<sup>31</sup> *Supra* note 18.

<sup>32</sup> *Metcalf v. Mitchell*, *supra* note 18, at 524, "Any taxation by one government of the salary of an officer of the other is prohibited." Also, *Commissioner v. Ogden*, 62 F. (2d) 334 (C. C. A. 1st, 1932), in which the same circuit court that decided the *Powers* case granted immunity to the fees paid an auditor appointed by a state court on the theory that he was a judicial officer. *Denman v. Com'r of Int. Rev.*, 73 F. (2d) 193 (C. C. A. 8th, 1934). The court in this case held taxable the income of a manager of a city-owned water works, expressly disproving the decision of the Circuit Court in the *Powers* case.

<sup>33</sup> *Supra* note 11.

<sup>34</sup> *Supra* note 20. See G. C. M. 13745 (1934) XIII, 41, 7064. Here it was held that a state engaged in the liquor business is ordinarily subject to a federal tax, but was immune in this case because the profits of the business were to be used for relief purposes, which is the exercise of a governmental function. In view of the *Powers* case the ruling is incorrect.

<sup>35</sup> Note (1934) 47 HARV. L. REV. 1212.

<sup>36</sup> *Supra* note 18.

<sup>37</sup> *Trinity Farm v. Grosjean*, 291 U. S. 466, 54 Sup. Ct. 469 (1934); *Metcalf & Eddy v. Mitchell*, *Willcutts v. Bunn*, both *supra* note 18.

<sup>38</sup> *Flint v. Stone Tracy*, *supra* note 18. The Supreme Court here refused to exempt public service corporations operating a railroad under state franchise from the operation of the internal revenue laws.

*Ohio v. Helvering*, *supra* note 18. State civil service employees of state liquor monopoly not exempt from federal income tax. Counsel opposed to the tax, without avail, attempted to distinguish the case from the *South Carolina* case on the ground that in the *Ohio* case state civil service employees were being taxed.

*State of North Dakota v. Olson*, 33 F. (2d) 848 (C. C. A. 8th, 1929), appeal dismissed, lack of jurisdiction, 280 U. S. 528, 50 Sup. Ct. 151 (1929), holding a state-owned banking corporation subject to federal capital stock tax.

<sup>39</sup> *Supra* note 20.

of the court. Will the court extend the doctrine of the *South Carolina* case<sup>40</sup> to apply to federal projects such as the T. V. A.<sup>41</sup> permitting the state to tax those that are not strictly governmental<sup>42</sup> or will it assert the admitted supremacy of the Federal Government?<sup>43</sup> Indications are that further limitations of the rule in the *Day* case<sup>44</sup> are not only possible but in view of the present attitude of the court as expressed in the *Powers* case, are likely.

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<sup>40</sup> *Supra* note 18.

<sup>41</sup> Tennessee Valley Authority Act, P. L. No. 17, 73d Cong., 1st Sess. (1933), 16 U. S. C. A. Supp. §831 (1933).

<sup>42</sup> Note (1934) 44 YALE L. J. 326. There is no justification in precedent for such an extension.

<sup>43</sup> *Supra* note 9.

<sup>44</sup> *Supra* note 11.