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Excise Tax--Immunity of Governmental Instrumentalities (Macallen v. Massachusetts, 279 U.S. 620 (1929))

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any portion of such dividend income similarly treats the income as dividends and becomes entitled to the credit against net income allowed an individual in determining the amount to be subject to normal tax rates. Similarly exempt interest income received by the trust would also be exempt when distributed to a beneficiary.[31]

In this brief survey of the law with respect to the taxation of estates and trusts under the Revenue Act of 1928, no attempt has been made to go into the finer points that arise in connection with each individual estate. The general principles of the law as applicable to all estates and trusts have been indicated. Numerous provisions in the law attempt to safeguard the payment of taxes and the responsibility for such payment is fixed both upon the fiduciary and the beneficiaries.[32]

BENJAMIN HARROW.

EXCISE TAX—IMMUNITY OF GOVERNMENTAL INSTRUMENTALITIES.—Plaintiff, a business corporation organized under the laws of Massachusetts, owned a large number of United States Liberty Bonds and Federal Farm Loan Bonds together with bonds of Massachusetts counties and municipalities. The Commonwealth, in determining plaintiff's excise tax for the year 1926, included as a measure of determination, the interest earned from the federal, county and municipal bonds. After making payment of the tax under protest, plaintiff sought an abatement which was denied. Subsequently the constitutionality of the statute was upheld by the Supreme Judicial Court. On appeal, *held,* that the statute is unconstitutional in that the tax on the federal bonds is in derogation of the constitutional power of Congress to borrow money on the credit of the United States, as well as in violation of the Acts of Congress declaring such bonds and securities to be non-taxable and, as to the county and municipal bonds, it impairs the obligation of the statutory contract of the state by which such bonds were made exempt from state taxation. Macallen v. Massachusetts, 279 U. S. 620, 49 Sup. Ct. Rep. 432 (1929).

Of particular importance is this decision, not alone because of its tremendous effect in many jurisdictions, but also because of the trend of decisions prior to it. No one denies the validity of the statement that the Federal Government may not tax the income arising from the obligations of a state or any of its governmental subdivisions,[1] or that the states are without right to tax the instrumentalities of the

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[31] Rev. Act of 1928, Sec. 163 (a), (b); Reg. 74, Art. 821.

[32] *Ibid.* Sec. 161 (b), 311, 312 (a), (b); Reg. 74, Art. 862; U. S. C. A. 31, Secs. 191, 192.

[1] Collector v. Day, 78 U. S. 113, 124–5 (1870); Pollock v. Farmers Loan and Trust Co., 157 U. S. 429, 583, 588, 15 Sup. Ct. Rep. 673 (1895).

Federal Government.[2] It would seem to follow, logically, that any attempt to tax the exempt instrumentality whether it be by a direct tax such as one levied directly on property or an indirect tax such as an excise or privilege tax, should be condemned at its inception. Indeed the decision in the instant case is an illustration of just such a situation.

But in this connection it appears that the court had previously countenanced such action, for, while it had zealously upheld the immunity of federal and state instrumentalities from taxation, where a direct tax was concerned,[3] it nevertheless permitted income and interest from the same instrumentalities to be employed as a measure in determining excise and franchise taxes.[4] What may have been the ultimate effect of such continued sanction, had it been permitted to continue, we need not now attempt to predict. Some twenty years after the decision in Home Insurance Co. v. New York,[5] in which property not subject to a direct tax, was nevertheless included as a measure in determining a franchise tax, the pendulum began to swing in the opposite direction.[6] Its movement was retarded by the decision in Flint v. Stone Tracy Co., where a federal excise on doing business in corporate form measured by all income, including that received from state and municipal bonds was upheld.[7] The instant

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[2] McCulloch v. Maryland, 4 Wheat. 316 (U. S. 1819); Osborn v. Bank of the United States, 9 Wheat. 734 (U. S. 1824); Johnson v. Maryland, 254 U. S. 51, 53, 41 Sup. Ct. Rep. 16, 17 (1920).

[3] *Supra* Notes 1 and 2.

[4] Societe for Savings v. Coite, 6 Wall. 594 (U. S. 1867) (a franchise tax assessed on the total deposits of savings banks was declared constitutional even though the deposits were invested in federal instrumentalities); Provident Institution for Savings v. Massachusetts, 6 Wall. 611 (U. S. 1867); Home Insurance Co. v. New York, 134 U. S. 594, 10 Sup. Ct. Rep. 593 (1890); Flint v. Stone Tracy Co., 220 U. S. 107, 31 Sup. Ct. Rep. 343 (1911).

[5] *Supra* Note 4 at 601, 10 Sup. Ct. Rep. at 595, the Court stated: "The tax in the present case would not be affected if the nature of the property in which the whole capital stock is invested were changed and put into real property or bonds of New York, or of other states. From the very nature of the tax being laid upon a franchise given by the state and revocable at its pleasure, it cannot be affected in any way by the character of the property in which its capital stock is invested."

[6] Galveston, H. & S. A. Ry. Co. v. Texas, 210 U. S. 217, 28 Sup. Ct. Rep. 638 (1908); Western Union Telegraph Co. v. Kansas, 216 U. S. 1, 30 Sup. Ct. Rep. 190 (1910). While these two cases involve attempts to place a tax on a basis of gross receipts of a corporation and a tax on the entire capital stock where the property of the corporation for a large part was located outside the taxing state, it seemed as if the Court had decided on a new avenue of approach in determining the validity of all taxes in which instrumentalities of the governments, federal and state, were concerned.

[7] *Supra* Note 4. Mr. Justice Day in the prevailing opinion stated: "* * * it is therefore well settled by the decisions of this court that when the sovereign authority has exercised the right to tax a legitimate subject of taxation as an exercise of a franchise or privilege, it is no objection that the measure of taxation is found in income produced in part from property which of itself considered is non-taxable."

case is *contra* to the holding in Flint v. Stone Tracy Co.,[8] and represents the present attitude of the Court, which is that no distinction shall be made between direct and excise taxes when levied on governmental instrumentalities.

The conclusion adopted by the Court in its decision is well stated in the words of an extract from the opinion in Fairbank v. United States,[9] as follows:

> "* * * what cannot be done directly because of constitutional restriction cannot be accomplished indirectly by legislation which accomplishes the same result. * * * constitutional provisions, whether operating by way of grant or limitation, are to be enforced according to their letter and spirit, and cannot be evaded by any legislation which, though not in terms trespassing on the letter, yet in substance destroy the grant or limitation." [10]

Encroachment on federal and state instrumentalities by the respective taxing powers has been received unfavorably by the Supreme Court.[11] In Pollock v. Farmers Loan and Trust Company [12] a tax on income derived from interest on municipal bonds was declared unconstitutional in that it imposed a burden upon the right of the state to borrow money. In Miller v. Milwaukee [13] an income tax on corporate dividends paid directly from interest on United States bonds was held invalid. It appears reasonable that any attempt to tax income or interest received from federal or state bonds should be frowned upon and so it is not difficult to agree with the decisions in the Pollock and Miller cases. But the result of the Court's attitude, to guard zealously against encroachment, has led to decisions not easily reconcilable with the fundamental principle and concept of "immunity." In Gillespie v. Oklahoma [14] income received from the sale of oil and gas produced under a lease of Indian lands was held to be immune from a state income tax. In Long v. Rockwood,[15] the Supreme Court denied the state of Massachusetts the right to tax income received by one of her residents as royalties for the use of patents issued to him by the United States. Where, as in these cases,

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[8] *Ibid.*

[9] 181 U. S. 283, 21 Sup. Ct. Rep. 648 (1901).

[10] *Ibid.* at 294, 300, 21 Sup. Ct. Rep. at 653, 655.

[11] Subject, however, to instances referred to wherein the courts allowed income from governmental instrumentalities to be employed in determining excise, franchise and privilege taxes and other instances wherein a state tax was in a measure levied on interstate commerce.

[12] *Supra* Note 1.

[13] 272 U. S. 713, 47 Sup. Ct. Rep. 280 (1927).

[14] 257 U. S. 501, 42 Sup. Ct. Rep. 171 (1922).

[15] 277 U. S. 142, 48 Sup. Ct. Rep. 463 (1928).

the tax is not levied directly on the instrumentality and does not affect the proper functioning of the government, it is more difficult to fit the case to the principle. In a recent decision by the Circuit Court of Appeals a federal tax on profits derived from the *resale* of municipal bonds was declared unconstitutional.[16] The protective cloak is thus thrust about that which is without need of protection.

What ultimate effect the Macallen decision will have, no one can prophesy with any degree of accuracy. This may be due in part to the lack of judicial candor on the part of the Court on its decision and to its departure from the course established heretofore. Certainly the decision has instilled "fear" into the taxing bodies of states possessing statutes similar to that in question.[17]

A. K. B.

FEDERAL TAX—GIFTS INTER VIVOS—CONSTITUTIONALITY.—Bromley, a resident of the United States, brought suit to recover a tax alleged to have been illegally exacted under the Revenue Acts of 1924 and 1926, since repealed, which imposed a tax upon a transfer of property by gift, *inter vivos,* not made in contemplation of death. The plaintiff contended that the tax thus imposed was a direct unapportioned tax and therefore unconstitutional because it violated the third clause of Section 2 and the fourth clause of Section 9 of Article 1 of the Constitution. *Held,* that the provisions of the Revenue Acts of 1924 and 1926 relating to taxation by the Federal Government of gifts *inter vivos,* levied an excise tax and did not impose such a direct tax as is prohibited by the Constitution. Bromley v. McCaughn, 280 U. S. —, 50 Sup. Ct. Rep.—Decided Nov. 25, 1929.

Taxes are of two kinds, direct and indirect. A direct tax is a tax levied upon the owner of property merely because he happens to be the owner and not because of any use or disposition he might make of it; a tax on the property itself.[1] An indirect tax is one which is assessed upon commodities before they reach the consumer and are paid by those upon whom they ultimately fall, not as taxes, but as part of the market price of the commodity. Among indirect taxes fall duties, imposts and excises.[2]

A direct unapportioned tax being forbidden by Section 2 of Article 1 of the Constitution which requires "direct taxes to be ap-

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[16] Willcuts, etc. v. Bunn, 35 F.(2nd) 29 (C. C. A. 8th, 1929). See (1929) 4 St. John's L. Rev. 138.

[17] Graves, The Macallen Decision, N. Y. State Bar Assn. Bull., Dec. 1929.

[1] Billings v. United States, 232 U. S. 261, 34 Sup. Ct. Rep. 421 (1913); Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 15 Sup. Ct. Rep. 673 (1894); *rehearing* 158 U. S. 601, 15 Sup. Ct. Rep. 912 (1895).

[2] Bouvier, Law Dictionary, 3rd Revision (Ed. 8) N-Z: "A tax upon certain kinds of property having reference to their origin and their intended use is not a tax on the property but is an excise." Patton v. Brady, 184 U. S. 608, 619, 22 Sup. Ct. Rep. 493 (1902).