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STATE TAXATION OF INTERSTATE COMMERCE, AND FEDERAL AND STATE TAXATION IN INTERGOVERN- MENTAL RELATIONS—1930-1932

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It is elementary in American constitutional law that the states may not, by taxation or otherwise, unduly burden interstate commerce. The only direct reference to this subject in the Constitution is the clause giving the federal government power to regulate such commerce.¹ But the federal Supreme Court has held that it has the power and duty to invalidate any state regulation of such commerce which is in purpose or effect hostile or burdensome to it. In taking such action, the Court is undoubtedly justified, not so much by the express language of the Constitution, as by the consideration that one of the chief purposes for the formation of the federal government was to insure the possibility of carrying on such commerce free from improper interference by the states. Such interference is therefore in fundamental conflict with one of the important functions of the national government, and one which that government, acting through its judicial branch, is bound to prevent. And an obvious, and in fact very common, method by which such interference is consciously or unconsciously attempted, is through the exercise by the states of their power of taxation.

Just as elementary and even more stringent in application is the rule that neither the states nor the federal government may interfere with the functions of the other. For this rule there is not even the vague and general provision in the language of the Constitution which was relied on by the

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¹ Art. I, § 8.

Court in preventing state interferences with interstate commerce; the Constitution has, in fact, no provision whatever with respect to this matter. Yet this rule is also justified, since the Constitution itself and the whole governmental system which has been built up under it is predicated upon the continued existence and active functioning of the states as well as of the federal government. To permit such interference by either government with the other would lead eventually to the practical destruction of the states by the national government or of the nation by the states, and thus to putting an end to our whole governmental system. And here too, taxation is one of the methods by which the forbidden result is most often attempted to be reached.

The result is that the Supreme Court will invalidate state taxation which is considered to unduly burden interstate commerce, or to interfere with the functions and operation of the federal government. Likewise, it will invalidate federal taxation which is considered to improperly interfere with the states. So far as taxation in intergovernmental relations is concerned, the powers and duties are reciprocal and the test is much the same. It may be, as suggested by Chief Justice Marshall in *McCulloch v. Maryland*,² that the powers of the federal government are to be somewhat more liberally construed, because of the fact that it is acting upon its own constituents; but the fact remains that an interference by the federal government with the states is just as dangerous to our constitutional system as an interference by the states with the federal government, and should be as severely dealt with.

But to justify these rules is not to solve the problem of their application; and this problem is one of great difficulty. It needs no argument to show that an alleged government—local or general—without any power of taxation has only the name of sovereignty, and exists, if at all, only on sufferance. The federal government can just as effectively destroy the states by prohibiting any taxation by the latter, as it can through the use of its own taxing power. And this is exactly what will happen if the states are prevented from imposing all taxation which in any degree affects interstate commerce; for any possible state taxation may conceivably have some slight effect upon such commerce. The same is true with respect to taxation in intergovernmental relations. It is impossible to conceive of any possible form of federal taxation which does not have some trifling effect upon state functions; and the same is true of state taxation as affecting federal functions. A rule that all such taxation is prohibited, instead of saving either the states, or the nation, would rather result in their destroying each other, like the proverbial Kilkenny cats.

The problem is therefore one of reasonable adjustment, and one which has never been and perhaps never will be fully solved. The tendency of the

² 4 Wheat. 316 at 435-6 (U. S. 1819).

Court has been (though its theory has been far from consistent) to uphold all state taxation, so far as interstate commerce is concerned, unless it discriminates against, or very distinctly burdens, such commerce. As to taxation in intergovernmental relations, the test has been, and perhaps properly so, somewhat stricter; for here we have a direct interference with the other government rather than a possible effect upon a non-governmental activity which the government is merely to regulate and protect, which is the relation of the national government to interstate commerce.³ But, for the reasons already stated, some adjustment is necessary here also, and the Supreme Court has recognized this, even with respect to the protection of that other financial power of governments—the borrowing power.⁴

As has been said, these problems of adjustment are still far from settled. But progress has been made, and the progress has been especially rapid in the last two or three years. It is the purpose of this article to review the cases decided by the Supreme Court during this period, and to consider the problems which they solve—and also those which they raise.⁵

The Interstate Commerce Cases

The cases involving the validity of state taxation attacked as involving a burden upon interstate commerce may properly be divided into several classes, according to the nature of the tax. The first of these is a state tax upon fuel—usually gasoline—used for transportation.

In *Helson v. Kentucky*⁶ a state tax upon the use of gasoline was held unconstitutional when applied to use in an interstate ferry. This is clearly a use in interstate commerce.⁷ The gasoline in question was bought outside the state but was used in part in the state. There would seem to be no objection to the levying of an excise tax upon the use of the gasoline within the state, even though it was used in interstate commerce. And it is submitted that the fact that the fuel was purchased outside the state is immaterial, since the tax in question was upon the use, not the purchase, and the use was within the state. But the result seems correct, since the tax was measured by all the gasoline purchased by the taxpayer whether or not used within the state.⁸ The effect of the tax was therefore extraterritorial, and whatever other objections there might have been to it, it certainly imposed an improper burden upon interstate commerce.

³ See *Gillespie v. Oklahoma*, 257 U. S. 501 at 505, 42 Sup. Ct. 171 at 172 (1922).

⁴ See *e. g.* *Home Insurance Co. v. New York*, 134 U. S. 594, 10 Sup. Ct. 593 (1890).

⁵ See *Brown, Restrictions on State Taxation Because of Interference with Federal Functions* (1931) 17 VA. L. REV. 325, for a discussion of the earlier authorities on the topic of this article.

⁶ 279 U. S. 245, 49 Sup. Ct. 279 (1929).

⁷ *Gloucester Ferry Co. v. Pennsylvania*, 114 U. S. 196, 5 Sup. Ct. 826 (1885).

⁸ *Cf.* *Case of the State Freight Tax*, 15 Wall. 232 (U. S. 1872).

On the other hand, it was held in *Eastern Air Transp. Co. v. South Carolina Tax Commission*⁹ that a state may levy a tax on the sale of gasoline within its borders, although the gasoline was used solely in interstate commerce. As the burden of the tax was upon the purchaser, there is obviously an indirect burden on the interstate commerce in which he used it. The Court recognized this, but said:

"The mere purchase of supplies or equipment for use in conducting a business which constitutes interstate commerce is not so identified with that commerce as to make the sale immune from a non-discriminatory tax imposed by the State upon intrastate dealers."¹⁰

This class of cases, then, supports the view that the states may by taxation burden interstate commerce, so long as the burden is not heavy or discriminatory.

The next class of cases relates to taxes on sales which involve interstate commerce but where the thing sold is not to be used by the purchaser in carrying on such commerce. Obviously the effect on interstate commerce of such a tax is less direct than in the cases just considered, but it still exists.

*Superior Oil Co. v. Mississippi*¹¹ is a rather easy case, because it did not really involve interstate commerce, though the taxpayers attempted to argue that it did. Here there was a tax on the sale of gasoline within the state to dealers who ordinarily took it outside the state for resale to fishermen, who were the ultimate consumers. The papers were drawn so as to make it appear to be an interstate transaction, though it appeared that the dealers received full title within the state and were under no obligation to take it into any other jurisdiction.

Even considered as an interstate transaction, the tax seems sustainable under the doctrine of *Eastern Air Transp. Co. v. South Carolina Tax Commission*, which however was decided later. The Court sustained the tax on the simpler ground that interstate commerce was not involved. The attempt of the parties to make it appear that it was, could not avail, for as the Court said in *Browning v. Waycross*:¹²

"It was not within the power of the parties by the form of their contract to convert what was exclusively a local business, subject to state control, into an interstate commerce business protected by the commerce clause."¹³

*East Ohio Gas Co. v. Tax Commission*¹⁴ was also held not to involve interstate commerce, though the case is much closer. Here a state gross receipts tax was imposed upon all corporations supplying natural gas to con-

⁹ 285 U. S. 147, 52 Sup. Ct. 340 (1932).

¹⁰ *Id.* at 153, 52 Sup. Ct. at 341.

¹¹ 280 U. S. 390, 50 Sup. Ct. 169 (1930).

¹² 233 U. S. 16, 34 Sup. Ct. 578 (1914).

¹³ *Id.* at 23, 34 Sup. Ct. at 580.

¹⁴ 283 U. S. 465, 51 Sup. Ct. 499 (1931).

sumers within the state. It was held that this tax should be applied to the receipts from the sale of gas brought from other states at high pressure, and reduced within the state to the lower pressure necessary for consumers' use. This reduction of pressure was held to be equivalent to the breaking of the "original package", and the case was thus brought within that well-settled though wholly judicially-invented theory.¹⁵ There was already considerable authority in the decisions of the Court that such reduction of the pressure of gas¹⁶ or of the voltage of electricity¹⁷ was a breaking of the original package so that the interstate commerce is at an end. But it seems clear that this whole original package doctrine is rather fictional; the truth is that interstate commerce exists, and the tax burdens it, but not unduly.

In rather curious contrast with the last case is *State Tax Commission v. Interstate Natural Gas Co.*,¹⁸ where a similar transaction and a similar state tax were involved. But here the pressure of the gas was reduced in order to permit its measurement, and not for the use of consumers. The plaintiff corporation did not deliver gas to consumers but rather to retailers. There was held to be no breaking of the original package, since the reduction was merely incidental to transportation.¹⁹ The plaintiff was accordingly engaged solely in interstate commerce, and the tax being a direct burden upon such commerce, was invalid as applied to the plaintiff.

Another case, important as showing the rather close formal distinctions which the Court makes, is *Utah Power Co. v. Pfof*.²⁰ Here the problem was as to the validity of a state tax upon the production of electrical energy. This particular taxpayer sent practically all the power which it produced into an adjoining state, where it was used. The taxpayer's contention was therefore that the tax was a burden upon interstate commerce.

The Court sustained the tax, upon the ground that it was levied upon the manufacturing in the taxing state rather than upon the delivery of the power in the other state. It is settled that a state may tax manufacturing or other productive processes carried on within its borders, even though all the products are to be carried into another state for use there.²¹ This is true

¹⁵ *Brown v. Maryland*, 12 Wheat. 419 (U. S. 1827), is the leading case on the original package theory.

¹⁶ *Public Utilities Commission v. Landon*, 249 U. S. 236, 39 Sup. Ct. 268 (1919); *Missouri v. Kansas Gas Co.*, 265 U. S. 208, 44 Sup. Ct. 544 (1924). In *Pennsylvania Gas Co. v. Public Service Commission*, 252 U. S. 23, 40 Sup. Ct. 279 (1920), it was held that such distribution was within the regulatory power of the state where the gas was consumed; but that the entire transaction constituted interstate commerce. The principal case disapproves the doctrine of this case on the last point, holding, as stated in the text, that such a transaction does not constitute interstate commerce.

¹⁷ *Public Utilities Commission v. Attleboro Co.*, 273 U. S. 83, 47 Sup. Ct. 294 (1927).

¹⁸ 284 U. S. 41, 52 Sup. Ct. 62 (1931).

¹⁹ *Cf. Ozark Pipe Line Corp. v. Monier*, 266 U. S. 555, 45 Sup. Ct. 184 (1925).

²⁰ 286 U. S. 165, 52 Sup. Ct. 548 (1932).

²¹ *American Mfg. Co. v. St. Louis*, 250 U. S. 459, 39 Sup. Ct. 522 (1919); *Oliver Iron Co. v. Lord*, 262 U. S. 172, 43 Sup. Ct. 526 (1923); *Hope Gas Co. v. Hall*, 274 U. S. 284, 47 Sup. Ct. 639 (1927). *Cf. Cornell v. Coyne*, 192 U. S. 418, 24 Sup. Ct. 383 (1904), holding that a federal tax on the manufacture of cheese is not a tax on exports (which the federal government is forbidden to impose) merely because the cheese was manufactured for export.

even though the tax is measured by the sales, none of which take place in the taxing state.²² The Court held that this principle was applicable here, even though generation and transmission of electricity are substantially simultaneous²³ and despite the further fact that it was necessary to measure the current at the point of use in order to allow for transmission losses, which could be deducted in computing the tax.

It is believed that the Court is right in its contention that the rather unusual circumstances mentioned above do not prevent the application of the theoretical distinction between generation, which is wholly within the state, and transmission, which is interstate commerce. Yet the proverbial "man of the street" would find this distinction a bit beyond his comprehension. It seems hard to escape from the proposition that all taxes on the production of goods which are to be taken into another state affect to some degree interstate commerce. But such taxes should be sustained, as the effect on interstate commerce is trifling, and what is even more important, to forbid them would unreasonably cripple, and indeed almost wholly destroy, the taxing power of the states.

One other case belongs in this category. This is *Gregg Dyeing Co. v. Query*,²⁴ which sustains a state tax on the storage of gasoline brought into the state and stored there for use over twenty-four hours "after the same shall have lost its interstate character". There can be no doubt that there was no direct burden on interstate commerce, under the original package doctrine previously referred to.²⁵ Either the sale or use of products removed from the original package is then subject to state taxation.²⁶

The chief argument of the taxpayer was that the tax discriminated against interstate commerce in that it was imposed only with respect to gasoline brought from another state. This argument is *prima facie* sound, as it is clear that a tax which discriminates against interstate commerce cannot be sustained even though otherwise reasonable.²⁷ The fact that the original package is broken does not subject the goods or any use of them to a discriminatory tax.²⁸ But the answer is that the state subjected all gasoline not subject to the particular tax in issue, whether produced within or outside the state, to a tax at a similar rate based upon its sale or use. There was thus no substantial discrimination against gasoline brought from outside the state;

²² *American Mfg. Co. v. St. Louis*, *supra* note 21.

²³ The length of time which it would take the electrical current to traverse this distance is so short as to be practically unmeasurable.

²⁴ 286 U. S. 472, 52 Sup. Ct. 631 (1932).

²⁵ See *Brown v. Maryland*, *supra* note 15.

²⁶ *Bowman v. Continental Oil Co.*, 256 U. S. 642, 41 Sup. Ct. 606 (1921); *Texas Co. v. Brown*, 258 U. S. 466, 42 Sup. Ct. 375 (1922); *Sonneborn Bros. v. Cureton*, 262 U. S. 506, 43 Sup. Ct. 643 (1923); *Hart Refineries v. Harmon*, 278 U. S. 499, 49 Sup. Ct. 188 (1929).

²⁷ *Welton v. Missouri*, 91 U. S. 275 (1875).

²⁸ See *New York Trust Co. v. Eisner*, 256 U. S. 345, 41 Sup. Ct. 506, 507 (1921).

and the problem of discrimination was properly regarded as one of substance rather than of form.²⁹

The next class of cases relate to taxes exacted for the use of highways. Here the burden upon interstate commerce is, or may be, quite direct. Nevertheless such taxation may under certain circumstances be sustained.

But in the first case of this nature in the period under consideration, *New Jersey Bell Telephone Co. v. State Board*,³⁰ the state tax was upset as a burden upon interstate commerce. The tax was upon the gross receipts of a telephone company carrying on business in the state, the total gross receipts being proportioned upon a mileage basis. The tangible property was taxed locally, and the tax was so high that it amounted to \$3200 a mile for the lines in the highways.

The majority of the Court held that the tax could not be sustained. This cannot be merely because it was a gross receipts tax, as that kind of tax has been sustained even with respect to corporations engaged in interstate commerce.³¹ Besides, there was the important circumstance that the taxpayer was using the state highways.³² The opinion of the Court, written by Mr. Justice McReynolds, is not entirely lucid, but seems to rest upon the theory that the tax is too high. Justices Holmes and Brandeis dissented.

Whether or not the decision is sound is a question as to which there may well be a difference of opinion. It is submitted, however, that the legal position of the majority is justified. The states should have the right to exact reasonable compensation for the use of their highways, and the fact that the highways are used by the particular taxpayer partly or wholly in interstate commerce makes no difference. But such a tax does in fact burden interstate commerce, and the burden should be restricted to what is reasonable. And reasonableness may, of course, depend upon the rate of the tax.

The next case, *Interstate Transit, Inc. v. Lindsey*,³³ also upset a state tax which was attempted to be sustained as compensation for the use of state highways. The Court admitted, as both on principle and by its former decisions³⁴ it was bound to admit, that a reasonable tax for the use of state highways may be exacted from those engaged in interstate commerce, either exclusively or only in part.³⁵ But since the tax can only be sustained as com-

²⁹ *General American Tank Car Corp. v. Day*, 270 U. S. 367, 46 Sup. Ct. 234 (1926).

³⁰ 280 U. S. 338, 50 Sup. Ct. 111 (1930).

³¹ *Cudahy Packing Co. v. Minnesota*, 246 U. S. 450, 38 Sup. Ct. 373 (1918). But *cf.* *Galveston Ry. Co. v. Texas*, 210 U. S. 217, 28 Sup. Ct. 638 (1908).

³² See *Sprout v. South Bend*, 277 U. S. 163, 48 Sup. Ct. 502 (1928).

³³ 283 U. S. 183, 51 Sup. Ct. 380 (1931).

³⁴ *Hendrick v. Maryland*, 235 U. S. 610, 35 Sup. Ct. 140 (1915); *Kane v. New Jersey*, 242 U. S. 160, 37 Sup. Ct. 30 (1916); *Clark v. Poor*, 274 U. S. 554, 47 Sup. Ct. 702 (1927); *Interstate Busses Corp. v. Blodgett*, 276 U. S. 245, 48 Sup. Ct. 230 (1928).

³⁵ *Interstate Busses Corp. v. Holyoke Street Ry. Co.*, 273 U. S. 45, 47 Sup. Ct. 298 (1927).

compensation for the use of the state roads, it must be reasonably proportionate to such use. The state tax under consideration in the *Interstate* case was held not to comply with this last requirement. It was a tax upon passenger motor vehicles varying according to their seating capacity but without any regard to the distance traversed. Obviously it would be proper to vary the tax on the basis of the weight of the vehicles, and the seating capacity would seem to be a sufficiently accurate measure of such weight. But the Court concluded that to tax all vehicles of equal seating capacity alike, regardless of how much or how little they traveled the roads, could not be sustained on the theory that it was compensation for the use of the roads. Of course such use cannot be accurately measured, but a reasonable attempt must be made to estimate it. As this was not done here, the tax was held to be a direct burden upon interstate commerce, and so invalid.

From all this, it would seem to follow that a tax which is a reasonable compensation for the use of the highways, because fairly proportioned to the actual use of such highways by such taxpayer, would be sustained even though imposed with respect to activities in interstate commerce. Such is the ruling of the Court in *Continental Baking Co. v. Woodring*,³⁶ a case arising out of attempted regulation by a state of the use of trucks on the highways. It is clear that the states may make reasonable regulations in the interests of public safety and the preservation of the roads, and that the regulations must apply to trucks engaged in interstate commerce as well as to others, or they will be wholly ineffective. Such regulations are therefore valid.³⁷

In the *Woodring* case a tax was imposed as a part of an elaborate system of regulations of this sort. All carriers by highway were taxed on the basis of gross ton mileage, the tax thus being proportioned both to the weight of the loads carried and to the distance traversed. The tax was sustained as applied to interstate carriers, on the ground that it was so computed as to constitute a fair compensation for the use of the highways. The fact that the entire tax was paid into the state highway funds also made this conclusion easier.

One other class of cases must be considered in the category of interstate commerce decisions. These are corporation tax cases. While the states have rather full power to tax both domestic and foreign corporations—this being merely an application of the almost complete control which they have over corporate enterprise in general—yet it is evident that the imposition of a burdensome tax upon corporations engaged in interstate commerce is an

³⁶ 286 U. S. 352, 52 Sup. Ct. 595 (1932).

³⁷ *Sproles v. Binford*, 286 U. S. 374, 52 Sup. Ct. 581 (1932), a case decided the same day as *Continental Baking Co. v. Woodring*, *supra* note 36. See also, *Broadway Express v. Murray*, 60 F. (2d) 293 (W. D. Okla. 1932), and *Grolbert v. Board of R. R. Comm'rs*, 60 F. (2d) 321 (S. D. Iowa 1932).

indirect but very real tax upon that commerce itself. It follows that this power of taxation must also be limited.³⁸ Indeed, *New Jersey Bell Telephone Co. v. State Board*³⁹ may be cited on this proposition, for the tax there considered, while primarily based upon the use of the highways and so considered in this article under that category, may also be regarded as a corporation tax. So considered, it must be regarded as having been invalidated because unduly burdensome.

The only case in this period which involves a pure corporation tax as affecting interstate commerce is *Western Cartridge Co. v. Emmerson*.⁴⁰ This involved the validity of an Illinois tax as applied to a corporation having its factory in that state, but shipping most of its product to other states. No doubt the state could have imposed an excise tax upon the manufacturing alone,⁴¹ but the tax was not thus computed. It was 5 cents on each \$100 of the proportion of issued capital stock represented by property owned and business done in Illinois. But the state treated all the plaintiff's business as done in Illinois, and so exacted a tax at the above rate upon the whole issued stock.

The tax was sustained; but the Court was not obliged to consider carefully the theory of the matter, as it relied upon one of its earlier decisions, *Hump Hairpin Co. v. Emmerson*,⁴² which is certainly a controlling authority, being almost precisely parallel. The doctrine of these cases cannot be rested upon the theory that this was merely a corporation tax or that it was measured by the capital stock of the corporation; for such taxes have been invalidated as improper burdens on interstate commerce.⁴³ Nor can it be said that the Illinois tax does not at all burden interstate commerce when it is applied, as here, to corporations engaged in such commerce.⁴⁴ The real explanation is the one which in various forms of statement is implicit in practically all cases where state taxation attacked under the commerce clause is sustained; namely, that while the burden exists, it is not heavy, and is therefore not an unfair or improper exercise of the taxing power of the state.

Merely for completeness, two other cases should be cited. They are *Matthews v. Rodgers*,⁴⁵ and *Stratton v. St. Louis Ry. Co.*⁴⁶ In both of these cases state taxing statutes were attacked as burdening interstate commerce; but the Court decided the cases on procedural points, without passing on the substantive validity of the taxes.

³⁸ *Cudahy Packing Co. v. Hinkle*, 278 U. S. 460, 49 Sup. Ct. 204 (1929).

³⁹ *Supra* note 30.

⁴⁰ 281 U. S. 511, 50 Sup. Ct. 383 (1930).

⁴¹ See the cases cited in note 21, *supra*.

⁴² 258 U. S. 290, 42 Sup. Ct. 305 (1922).

⁴³ *Gloucester Ferry Co. v. Pennsylvania*, *supra* note 7.

⁴⁴ *Ozark Pipe Line Corp. v. Monier*, *supra* note 19.

⁴⁵ 284 U. S. 521, 52 Sup. Ct. 217 (1932).

⁴⁶ 284 U. S. 530, 52 Sup. Ct. 222 (1932).

Intergovernmental Cases

While, as already stated, the test as to the validity of state taxes which are claimed to interfere with federal functions, or of federal taxes which are claimed to interfere with state functions, is more severe than in the interstate commerce cases, yet here too some leeway must be given. Otherwise both the nation and the states would be in danger of destroying each other. This was in general the position of the Court during most of its history.

But a distinct change of view seemed to be evidenced by its decision in *Macallen Co. v. Massachusetts*,⁴⁷ decided just before the period here under consideration. This case held that a state which imposed an income tax upon domestic corporations could not include in the taxable income of such a corporation interest from federal securities held by it. The theory was that this would be a direct burden upon the federal borrowing power. The majority of the Court refused to give any heed to the arguments which the minority adduced, and which would seem to be true in fact, that the burden upon the federal securities was unsubstantial and of trifling consequence.

It is true that the state tax here involved violated the doctrinal immunity of the federal securities, since the taxable income, and therefore the tax, was somewhat higher because of the ownership by the taxpayer of such securities. But it is no less true that the burden upon the federal borrowing power was inconsequential, and the benefit to the nation from the invalidation of the tax was likewise trifling. The Court therefore deliberately rejected the test of practical adjustment (which it still adhered to in the interstate commerce cases⁴⁸) and insisted on the maintenance of the doctrinal immunity at all costs.

The *Macallen* decision made a difficult situation for the states, and also for the federal government if, as seemed only fair, it should be compelled in its taxation to give effect to the doctrinal immunity of state securities and perhaps other functions, which they had been compelled to do with respect to the federal immunity. But it seemed reasonable to suppose that the Court, having made its choice deliberately, would adhere to it.

But the attempt of the Supreme Court to defy the necessity of practical adjustments in taxation matters was doomed to failure; and it soon found that a retreat was necessary. It is true that its next move was apparently in the same direction as the *Macallen* case, by invalidating a state tax on insurance companies, measured by the value of their assets in excess of reserves and unpaid claims, but requiring that such reserves and unpaid claims be reduced by the proportion that the value of United States bonds held by the

⁴⁷ 279 U. S. 620, 49 Sup. Ct. 432 (1929). For a more detailed discussion of this case see Brown, *supra* note 5, at 340 *et seq.*

⁴⁸ See especially *Galveston Ry. Co. v. Texas*, *supra* note 31.

various companies bore to their respective total assets.⁴⁹ The tax was held to be an indirect burden on the federal borrowing power. This seems sound, as it would probably substantially discourage the investment by these companies in such bonds.

But in *Denman v. Slayton*,⁵⁰ the doctrinal immunity of state securities was definitely repudiated. This case upheld the provision of the federal income tax law permitting the deduction in computing taxable income of all interest on indebtedness, except on indebtedness incurred to purchase or hold securities whose interest was not subject to federal income tax. That means that because the interest on state and municipal bonds is not subject to federal income tax, interest on indebtedness incurred to purchase or carry such bonds cannot be deducted in computing taxable income, though all other interest paid on indebtedness is deductible. This may be, and probably is, entirely reasonable; but it is a departure from the doctrinal immunity which the Court insisted on in the *Macallen* case.

This doctrinal immunity from taxation in intergovernmental relations received an even more direct blow in *Wilcutts v. Bunn*.⁵¹ Here it was held that profits realized on the sale of state and municipal securities by one not a dealer in such securities is subject to federal income tax. The Court intimated that in this matter the rule works both ways, and that the states could impose a similar tax upon profits realized from the sale of federal bonds.

It is true that such profits as were permitted to be taxed in the principal case do not come from the state. It had also been held that amounts actually paid by states to independent contractors are not exempt from federal taxation, the burden on the state functions being regarded as too trifling and remote.⁵² But there is certainly a theoretical burden on the state bonds, since they are not quite so attractive as investments as if this exemption were accorded—though it must be confessed that if this were done, it would be quite reasonable to impose a like burden by denying the right to deduct losses realized by the sale of such securities. All this, plus the additional fact that such income is non-recurrent and thus unlike income from interest, shows that there is no substantial burden on the states, and that the decision is sound and wholly desirable. But it proves again that this is really a problem of practical adjustment, and that attempts to solve it on any other basis are merely conducive to confusion and error.

⁴⁹ *Missouri v. Gehner*, 281 U. S. 313, 50 Sup. Ct. 326 (1930). For a fuller discussion of this problem see Brown, *Reduction of Tax Exemptions by Reason of Receipt of Tax-Exempt Income* (1932) 80 U. OF PA. L. REV. 534.

⁵⁰ 282 U. S. 514, 51 Sup. Ct. 269 (1931). See Brown, *supra* note 49. The rule of this case was applied to a situation where a national bank had joint stock land banks as subsidiaries, in *First National Bank v. United States*, 283 U. S. 142, 51 Sup. Ct. 378 (1931). Interest paid on the joint stock bonds was not permitted to be deducted in the consolidated return of the banks.

⁵¹ 282 U. S. 216, 51 Sup. Ct. 125 (1931).

⁵² *Manhattan Co. v. Blake*, 148 U. S. 412, 13 Sup. Ct. 640 (1893); *Metcalf v. Mitchell*, 269 U. S. 514, 46 Sup. Ct. 172 (1926).

The last and the most important case involving this question of taxation of securities is *Pacific Co. v. Johnson*.⁵³ This is not strictly a case of taxation in intergovernmental relations, but involves the same problem. Here the state constitution provided that bonds issued by its political subdivisions should be tax-exempt. The Court assumes that this is a promise binding on the state,⁵⁴ so that such bonds are as fully exempt from state taxation as bonds issued by the federal government.

The majority of the Court, speaking by Mr. Justice Stone, sustained a state tax measured by corporate income including interest from such tax-exempt bonds. He cited many decisions prior to *Macallen Co. v. Massachusetts*, to the effect that a non-taxable subject may be used in the measure of a tax so long as the burden thereby imposed is not substantial, and there is no discrimination against such non-taxable subject. This seems entirely sensible, but it is avowedly turning away from the doctrinal immunity test, and going back to the test of practical effect—a test differing possibly in degree but certainly not in kind from that applied in the interstate commerce cases.

But the problem of distinguishing the *Macallen* case remained, and was made the more acute by the direct contention in the dissenting opinion that such distinction was impossible. This dissenting opinion was written by Mr. Justice Sutherland, who had written the opinion of the Court in the *Macallen* case. It would certainly seem, so far as we have gone, that the cases are in direct conflict.

To clarify this matter, one further explanation must be made concerning the *Macallen* case. The Court, in deciding that case, took much comfort from the fact that the state in question (Massachusetts) had originally not included interest from federal securities in the corporate income which constituted the basis of the tax. Such inclusion had been provided for by a later amendment passed for that express purpose. The Court expressed the opinion that this deliberate inclusion of the income from federal securities in the measure of the tax evidenced a deliberate and rather dishonest intent to burden them.

It is rather difficult to understand how a mere intention to violate a constitutional immunity from taxation will insure that such violation is actually accomplished. Furthermore, it was entirely clear that the state legislature considered that it had a right to withdraw such exemption.⁵⁵

⁵³ 285 U. S. 480, 52 Sup. Ct. 424 (1932).

⁵⁴ Under the so-called "contracts clause" of the Constitution, Art. I, § 10. The same problem is presented with respect to state bonds in *Macallen Co. v. Massachusetts*, *supra* note 47.

⁵⁵ The inclusion of such interest in the income which constituted the measure of the tax was probably correctly thought to be justified by previous decisions of the Supreme Court. Furthermore, it was considered that the withdrawal of the previous exemption was required in order to avoid a discrimination against national banks, forbidden by federal statutes.

But the most conclusive objection to this theory is that it makes the power of the state depend upon the method it used in passing its tax legislation—whether indeed it swallowed the cherry in one gulp, which was apparently all right, or whether it attempted to take two bites, which would not be permitted. Apart from the absurdity of this theory, the result would be that the powers of the different states in regard to this matter would vary—an obviously impossible situation. Most commentators on the *Macallen* case, quite naturally therefore, regarded this particular theory as mere window-dressing.

But the theory gave a chance to devitalize the *Macallen* case without formally overruling it; and this chance was promptly seized upon by the Court. It was first used by Mr. Justice Stone himself in *Educational Films Corporation v. Ward*,⁵⁶ a case which will be discussed in another connection. And again here in *Pacific Co. v. Johnson*, the same Justice purported to distinguish the *Macallen* case by pointing out that that case rests upon the “artful and delusive” action of the state legislature in so amending the law as to provide for a tax burden upon the exempt securities.

The most serious difficulty in this attempt to distinguish the *Macallen* case is not the palpable absurdity of the distinction, but the fact that it will not even work in this case. Here, too, the state (California) had never imposed any tax on corporate incomes which would include the income from these exempt bonds, until 1929, when a law was passed which reached such income. Mr. Justice Sutherland points out in his dissenting opinion that the statute was avowedly passed to reach such income and thus, it was assumed, equalize the burden of taxation as between financial institutions, which were the largest holders of such securities, and other taxpayers. The Massachusetts legislature had avowed the same purpose in passing the amendment to their tax law which was invalidated in the *Macallen* case.

Mr. Justice Stone very sensibly observes:

“Since the mere intent of the Legislature to do that which the Constitution permits cannot deprive legislation of its constitutional validity, . . . the present act must be judged by its operation rather than by the motives which inspired it.”⁵⁷

But this was exactly the position which the Court explicitly rejected in the *Macallen* case, and especially in that part of the opinion which is now relied on for distinguishing that case. It follows that the case now under consideration does not merely limit the *Macallen* case, but really, though not avowedly, overrules it. The Court is now back to the position that non-discriminatory taxation which indirectly burdens securities not directly tax-

⁵⁶ 282 U. S. 379, 51 Sup. Ct. 170 (1931). See also the reference to this case in the text, page 261.

⁵⁷ 285 U. S. at 495, 52 Sup. Ct. at 428.

able because of restrictions resulting from our dual form of government, may nevertheless be upheld, provided the burden is not really substantial; in other words, that the test is to be practical rather than theoretical. One thing more may reasonably be asked of the Court: that it remove the uncertainties which the *Macallen* case has cast upon the subject of taxation in intergovernmental relations, by explicitly and completely overruling that unfortunate decision.

When other governmental powers, none of which certainly can be more vital than the borrowing power, are concerned, it would naturally be expected that the Court would be at least as liberal. An example of this is *Wheeler Lumber Co. v. United States*,⁵⁸ where it was held that a seller of highway materials to counties f. o. b. destination must pay the federal tax on transportation. It was argued by the Court that the transportation service was rendered to the seller rather than to the buyer counties, since the seller had contracted to deliver the materials. The case was thus brought within the doctrine that the federal government may tax an independent contractor with a state⁵⁹ (or *vice versa*). Even an agent of the other government may be taxed unless he is concerned as such agent with the very activity with respect to which the tax is levied.⁶⁰ While all this is entirely sound, yet there is a burden upon the county in the *Wheeler* case, since the seller will presumably attempt to add the federal tax to the price of the materials. The decision is to be justified, not on any doctrinal basis, but rather on the practical consideration that the burden of the tax upon the county is much less serious than would be that resulting to the federal government if exemption were enforced.

Similarly, in *Alward v. Johnson*,⁶¹ a state tax upon automotive transportation was upheld as to the plaintiff, a carrier who had a contract with the United States for the carriage of the mails. The tax was measured by gross receipts, and the bulk of the plaintiff's receipts came from this government contract. The Court seemed to think that the decision was justified by the previous approval of reasonable taxes for the use of highways in interstate commerce.⁶² But the plaintiff raised, as he was entitled to do, the claim of improper taxation in intergovernmental relations, where the test is more severe. It seems impossible to deny that there is, or at least might be, a slight indirect burden upon the federal government by this state tax; it might well obtain its mail contracts upon better terms if such a tax were forbidden. But again the tax is justified upon practical grounds.

⁵⁸ 281 U. S. 572, 50 Sup. Ct. 419 (1930).

⁵⁹ See the cases cited in note 52 *supra*.

⁶⁰ *Railroad Co. v. Peniston*, 18 Wall. 5 (U. S. 1873).

⁶¹ 282 U. S. 509, 51 Sup. Ct. 273 (1931).

⁶² See the cases cited in note 34, *supra*.

Far less liberal is the decision in *Indian Motorcycle Co. v. United States*,⁶³ where a federal excise tax on the sales of motor vehicles was held inapplicable to the sale of a motorcycle to a city for use by its police force. There can be no doubt that this is a strictly governmental function of the city; but the burden upon the city from the tax seems extremely slight and indirect.

The Court relied, however, upon *Panhandle Oil Co. v. Mississippi*,⁶⁴ which held invalid a state tax on the sale of gasoline so far as it applied to sales to the Coast Guard and to a United States Veterans Hospital. This authority certainly justifies the decision of the Court in the *Indian Motorcycle* case; in fact, Mr. Justice Holmes announced his concurrence in the decision of the latter case solely because he considered it to be governed by the *Panhandle* case. Mr. Justice Stone in his dissenting opinion, in which Mr. Justice Brandeis concurred, seems to admit that if the *Panhandle* case is a controlling precedent, it compels this result in the *Indian Motorcycle* case; but he insists that the *Panhandle* case is at least limited by *Wheeler Lumber Co. v. United States*.

In the *Indian Motorcycle* case, the Court also relied very heavily upon *Johnson v. Maryland*,⁶⁵ which holds that state requirements as to examination of drivers of motor vehicles cannot be enforced against drivers of United States mail trucks. It is submitted that this decision is unsound. The federal government should be subjected to such reasonable and non-discriminatory regulations as are made by the states in the interest of public safety. It is believed also that the taxes involved in the *Panhandle* and *Indian Motorcycle* cases are not sufficiently burdensome to justify their invalidation. Most of the members of the Court are disposed to strain against these precedents, and it is to be hoped that they will also be overruled.

Another rather distinct class of intergovernmental tax cases are those involving such governmental functions as are exercised primarily for the benefit of private individuals. Obvious examples are patents and copyrights. Here a very distinct trend toward liberality is apparent during the period under consideration.

The first of these cases is *Educational Films Corporation v. Ward*, which upheld a state tax upon corporate income⁶⁶ as applied to a taxpayer which received practically all its income from copyrights granted by the federal government. The fact that such copyrights are granted for private benefit enabled the Court quite easily to distinguish the cases which have

⁶³ 283 U. S. 570, 51 Sup. Ct. 601 (1931).

⁶⁴ 277 U. S. 218, 48 Sup. Ct. 451 (1928).

⁶⁵ 254 U. S. 51, 41 Sup. Ct. 16 (1920).

⁶⁶ There was some disagreement among the members of the Court as to the nature of the tax. It was designated as a franchise tax, but since it was measured by corporate income, may be regarded as in effect an income tax.

just been considered, and also abundantly justifies the result as a matter of economics and common sense.

But *Macallen Co. v. Massachusetts* formed a very difficult intellectual hurdle for the Court to surmount. The highly ingenious but rather absurd scheme by which this case was distinguished has already been commented upon. The Court was also troubled by *Long v. Rockwood*,⁶⁷ which held that a state may not impose a tax upon income derived from patent royalties.⁶⁸ But the Court here took the position that a tax upon net income was a far less direct burden upon patents or copyrights than a tax imposed directly on gross receipts from such sources. On this theory, *Long v. Rockwood* and *Educational Films Corporation v. Ward* may well stand together.

*Group No. 1 Oil Corporation v. Bass*⁶⁹ is the next case in this category. Here it was held that the income of lessees of state oil lands was subject to federal taxation. It was conceded that under the doctrine of *Gillespie v. Oklahoma*,⁷⁰ such income cannot ordinarily be taxed, because even a net income tax is considered an improper burden upon the power of the state to lease its lands for its own profit or for the benefit of its wards. But here the lease was held (on interpretation of the state law) to constitute an actual sale of the oil in place. Obviously the fact that property may once have belonged to a state or the nation does not prevent the other government from taxing it, or the income derived from it, when the present owner is a private person or enterprise.⁷¹ The possible burden upon the government in disposing of its property, resulting from the tax, is obviously of no practical consequence.

But there was no escape from applying the doctrine of *Gillespie v. Oklahoma* in *Burnet v. Coronado Oil Co.*⁷² Here a federal tax upon the net income of lessees of state school lands was invalidated, the Court following the *Gillespie* case, but with very obvious reluctance.⁷³

In the *Burnet* case there were two different dissenting opinions. Mr. Justice Stone took the position that the *Gillespie* and the *Group No. 1* cases cannot be distinguished, and that the doctrine of the latter case is better. One may agree that the *Group No. 1* case enunciates the better doctrine, but to say that the cases are not distinguishable is clearly wrong, for under the state law (which is decisive in such matters) the so-called lease in the *Group No. 1* case was actually a sale of the oil.

⁶⁷ 277 U. S. 142, 48 Sup. Ct. 463 (1928).

⁶⁸ Cf. *Quicksafe Mfg. Corp. v. Graham*, 161 Tenn. 46, 29 S. W. (2d) 253 (1930).

⁶⁹ 283 U. S. 279, 51 Sup. Ct. 432 (1931).

⁷⁰ *Supra* note 3.

⁷¹ *Forbes v. Gracey*, 94 U. S. 762 (1873); *New Brunswick v. United States*, 276 U. S. 547, 48 Sup. Ct. 371 (1928).

⁷² 285 U. S. 393, 52 Sup. Ct. 443 (1932).

⁷³ Mr. Justice McReynolds, speaking for the majority, said in this case at 398, 52 Sup. Ct. at 444, "We are disposed to apply the doctrine of *Gillespie v. Oklahoma* strictly and only in circumstances closely analogous to those which it disclosed."

Mr. Justice Brandeis' dissenting opinion admits that *Gillespie v. Oklahoma* is a decisive authority, but contends that it should be overruled. He makes a combined philosophical and historical argument that decisions of questions of constitutional law, and especially of the "application" (as distinguished from the interpretation) of the Constitution ought to be, and in fact have been, more readily overruled than decisions of the Court in other branches of the law. He contends that the *Gillespie* case is concerned with the application of the Constitution, and as it is disapproved by practically all the members of the Court, it should now be overruled.

Whatever may be thought of this jurisprudential argument, it is certain that Mr. Justice Brandeis makes good his point that the Court has never considered itself bound to follow decisions that it has become convinced are erroneous. It seems, therefore, that it should overrule the *Gillespie* case, which is certainly very narrow. It is rather curious that the opinion in that case was written by Mr. Justice Holmes;⁷⁴ but this only emphasizes the correctness of the recent comment by Chief Justice Hughes that the attempt to classify judges as conservative or liberal is somewhat futile.

Even more definitely in this category of federal functions carried on primarily for private benefit is the problem presented in *Susquehanna Power Co. v. State Tax Commission*.⁷⁵ Here the plaintiff received a federal license to construct a power dam in a navigable river. To do this, it was necessary to buy lands which would be submerged as a result of the building of the dam. The plaintiff contended that such lands were not subject to state taxation, because acquired and used by it in the exercise of a federal franchise.

The Court denied this contention, on the ground that the franchise was granted to the plaintiff solely for its own benefit, so that the burden of the tax on the property used in operating under the franchise was very remote and unsubstantial, so far as the federal government is concerned. The position of the Court as to this matter is well shown in the following extract from the opinion:

"The distinction has long been taken 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 in the exercise of the privilege, but for private business advantage."⁷⁶

The Court further said:

"It would be difficult to suppose any case in which the adverse effect of a tax upon a governmental purpose would be more remote or

⁷⁴ He also wrote the opinion in *Johnson v. Maryland*, *supra* note 65.

⁷⁵ 283 U. S. 291, 51 Sup. Ct. 434 (1931).

⁷⁶ *Id.* at 294, 51 Sup. Ct. at 435.

attenuated, or in which the asserted immunity would more seriously impair the sovereign power of the State to tax, than in this one." ⁷⁷

The Court also denied the plaintiff's claim that, assuming the lands were taxable, yet they could not be taxed, as the state was doing, on the basis of a higher value of such lands because of their use under the federal franchise for overflowing. It would seem that such higher valuation is a proof of a definite burden upon the federal franchise. But the case stands for the proposition that a state tax whose burden upon a federal function is only "remote and attenuated" will stand, and that such remoteness of effect will generally be found to exist where the federal function is exercised primarily for private benefit.

And, as if to lend point to the comment of Mr. Justice Brandeis in *Burnet v. Coronado Oil Co.* that the Court is, or should be, ready to overrule erroneous constitutional decisions, it has recently directly overruled *Long v. Rockwood*. This was in *Fox Film Corporation v. Doyal*.⁷⁸ The latter case, like *Educational Films Corporation v. Ward*, involved copyrights; but these are obviously no less federal instrumentalities than patents, though as the Court pointed out, both of these activities are of more private than governmental benefit. But the problem of *Long v. Rockwood* could not be avoided, since here the state tax was on gross receipts from the copyrights rather than merely from net income. The Court emphasized that after the copyright or patent is granted, the federal government has no longer any direct interest in the matter;⁷⁹ and a merely contingent interest is no bar to taxation in intergovernmental relations.⁸⁰ But the tax could not be sustained under the doctrine of the *Long* case, and that case was accordingly overruled. It is thus apparent that this group of cases also shows a very definite trend toward greater liberality in questions of intergovernmental taxation.

*Carpenter v. Shaw*⁸¹ is the only case decided in this period with respect to state taxation of Indians. In this class of cases the Court has insisted on rather liberal construction of the exemptions from state taxation, because of the necessity of giving the Indian wards of the federal government rather full protection against local regulations, which are apt to be somewhat hostile in purpose and effect.⁸² Here a state tax upon the lessors of Indian oil lands based upon gross receipts was involved, and was invalidated. The case is a much easier one than *Gillespie v. Oklahoma*, where a state tax upon the net income of such lessees was invalidated. While the *Gillespie* case is now

⁷⁷ *Id.* at 295, 51 Sup. Ct. at 435.

⁷⁸ 286 U. S. 123, 52 Sup. Ct. 546 (1932).

⁷⁹ *Bothwell v. Bingham County*, 237 U. S. 642, 35 Sup. Ct. 702 (1915).

⁸⁰ *Railroad Co. v. Peniston*, *supra* note 60; *Baltimore Shipbuilding Co. v. Baltimore*, 195 U. S. 375, 25 Sup. Ct. 50 (1904).

⁸¹ 280 U. S. 363, 50 Sup. Ct. 121 (1930).

⁸² See Brown, *The Taxation of Indian Property*, (1930) 15 MINN. L. REV. 182.

of somewhat dubious authority, yet it is not improbable that *Carpenter v. Shaw* will be adhered to. A tax upon gross receipts is so burdensome that it might well hamper the federal government in making advantageous terms with respect to the leasing of Indian lands.

It might perhaps be added that the Indians themselves are not exempt from federal income tax upon their receipts of rentals from oil lands.⁸³ This is not a problem in intergovernmental taxation, but there is little consistency or fairness in a denial to the states of the power to impose the same kind of tax which is permitted to the federal government, and which is unquestionably just as direct a burden upon the Indians themselves.

There are many cases which respect to the power of the states to tax national banks; but there is only one such decision during the period under consideration. This is *Iowa-Des Moines National Bank v. Bennet*,⁸⁴ where a tax upon a national bank was held improper because its competitors were taxed at a substantially lower rate. The case is thus a mere application of the well-settled rule that while a state may tax national banks doing business within its borders, yet these banks will be protected against any discrimination in favor of persons or institutions that are in competition with them.⁸⁵

Only one other case with respect to taxation in intergovernmental relations need be mentioned. This is *Alabama v. United States*.⁸⁶ Here the state of Alabama sued the federal government in the Court of Claims to recover an excise tax imposed upon the production and sale of hydro-electric power. The state contended that the federal government was liable for this tax on account of the production of such power at Muscle Shoals. The Supreme Court expressed grave doubt as to the validity of the tax, but held that at any rate the case was not within the jurisdiction of the Court of Claims, which has in general jurisdiction only of contractual claims. While the Court thus declined to pass on the merits, there would seem to be little doubt that this tax is invalid as a direct and heavy burden upon the federal government.⁸⁷

Conclusion

The past few years have, it would seem, shown a liberal tendency by the federal Supreme Court with respect to taxation problems arising out of our dual form of government. With respect to state taxation which affects interstate commerce, this is no real change of view, but merely strengthens the wise position which the Court had already usually taken—that such taxation

⁸³ *Choteau v. Burnet*, 283 U. S. 691, 51 Sup. Ct. 598 (1931).

⁸⁴ 284 U. S. 239, 52 Sup. Ct. 133 (1931).

⁸⁵ *Merchants' National Bank v. Richmond*, 256 U. S. 635, 41 Sup. Ct. 619 (1921). Cf. note 55 *supra*.

⁸⁶ 282 U. S. 502, 51 Sup. Ct. 225 (1931).

⁸⁷ The Court of Claims passed upon the merits, and so decided.

should be sustained unless it discriminates against interstate commerce or else substantially burdens it. We may reasonably hope that the Court will not hereafter substantially deviate from this view.

But as to taxation in intergovernmental relations, the recent decisions represent a real change of view from their immediate predecessors. While the Court has generally recognized the necessity of a practical adjustment with respect to this matter, yet the closing years of the 1920's had produced a recrudescence of insistence upon doctrinal immunity. This was especially evident with respect to taxation affecting governmental borrowing power, and also with respect to state taxation affecting patents and copyrights.

Both of these tendencies have been definitely checked in the period which we are considering. State taxation will not, it seems, be now overthrown because of its effect on federal securities unless either discriminatory or else seriously and practically, rather than merely theoretically, burdensome. And the same applies to federal taxation as relating to state securities.

As for state taxation which affects patents, copyrights, and other federal functions the exercise of which is primarily for private benefit, such effect would normally be almost infinitesimal, and certainly of no practical importance. It would seem, therefore, that the only state taxation in this category which would be invalidated is that which would substantially discriminate against such federal functions.

It is unfortunate that the Court ever deviated from this sensible and desirable position. And to get back to it, the Court has felt itself compelled to engage in some very puerile reasoning. But even this is worth while if the desired result is obtained. These problems cannot be solved by theorizing *in vacuo*; the only workable solution is practical adjustment. It is very encouraging to see a growing recognition and application by the Court of this principle; and if this tendency continues, the whole problem, difficult as it undoubtedly is, is a long way toward effective solution.