Catholic University Law Review

Volume 8 | Issue 1 Article 2

1959

The Recent Supreme Court Tax Cases from a Federal Viewpoint

Meritt H. Steger

THE RECENT SUPREME COURT TAX CASES FROM A FEDERAL VIEWPOINT*

by

MERITT H. STEGER**

During the 1957 term the Supreme Court of the United States upheld in four decisions the right of the states to tax real and personal property belonging to the United States government in the possession of defense contractors (Borg-Warner,[1] Continental Motors,[2] Murray Corporation,[3] and American Motors[4]). Regardless of his interest in the complex issues, it benefits everyone to analyze these four decisions closely and to avoid, if he can, looking at them narrowly through glasses tinted with his own peculiar prejudices. The four cases may be conveniently classified in two ways: *Borg-Warner* and *Continental Motors* as involving taxation of the use of Government-owned real property under a special privilege statute; and *Murray* and *American Motors* as involving the taxation under an ordinary *ad valorem* tax statute of the privilege of using personal property owned by the Government.

First, I will deal briefly with the real estate tax cases.

Borg-Warner and Continental Motors: At the outset, it is most important to note that in *Borg-Warner* and *Continental Motors* the State of Michigan levied these taxes under a special privilege tax statute, Public Act 189 of 1953.[5] This statute subjects to taxation any exempt real property that is leased and used by a private individual or corporation "in connection with a business conducted for profit." However, the statute exempts from taxation three classes of exempt property:

1. Property "where the use is by way of a concession in or relative to the use of a public airport, park, market, fair

* The substance of this paper was the subject of a speech on June 9, 1958 to the National Association of Tax Administrators at Coronado, California.

** Deputy General Counsel for the Department of the Navy and member of the Texas Bar. The views expressed are not necessarily those of the Department of the Navy.

[1] United States and Borg-Warner Corp. v. City of Detroit, 355 U.S. 466 (1958).

[2] United States and Continental Motors Corp. v. Township of Muskegon, 355 U.S. 484 (1958).

[3] City of Detroit v. Murray Corporation of America, 355 U.S. 489 (1958).

[4] American Motors Corporation and the United States of America v. City of Kenosha, 80 N.W. 2d 363, aff'd *per curiam*, 356 U.S. 21 (1958).

[5] 6 MICH. STAT. ANN. 1950 (Supp. 1957): §§7.7(5)(6).

ground, or similar property which is available to the use of the general public, . . .";

2. Federal property "for which payments are made in lieu of taxes in amounts equivalent to taxes which might otherwise be lawfully assessed . . ."; and
3. Property "of any state-supported educational institution."

The Court in both *Borg-Warner* and *Continental Motors* by a seven to two vote [6] held that because both Borg-Warner and Continental Motors were using the plants to make a commercial profit, each could be taxed by Michigan to the extent of the use. For one year's use the annual real estate tax was said to be a proper measure even though it happened to coincide in amount with the tax on the assessed value a fee-simple owner would pay.[7]

In upholding the tax levied upon Borg-Warner and Continental Motors, the Court emphasized that "the tax applies to every private party who uses exempt property in Michigan in connection with a business conducted for private gain." Also, it said there was no "showing that the tax is in fact administered to discriminate against those using federal property." Frankly, it is difficult to accept these conclusions of the Court that the statute is in fact so nondiscriminatory. Is it in fact nondiscriminatory for the state or a municipality to lease lucrative concessions at airports, parks, markets and fair grounds to private concerns, conducting businesses for profit, free from such real estate tax, where leased property of the federal government is subject to such tax? In any event, these exceptions, although not discussed by the Court, are inconsistent with the Court's statement that the Michigan tax statute "applies to every private party who uses exempt property in Michigan in connection with a business conducted for private gain."

[6] Only Justices Whittaker and Burton dissented; in *Murray* and *American Motors* Justices Harlan and Frankfurter joined Justices Whittaker and Burton in dissent.

[7] Editor's Note: The 80th Congress passed the Military Leasing Act of 1947, Public Law 364. The first sentence of Section 6 of that Act provides: "The lessee's interest, made or created pursuant to the provisions of this Act, shall be made subject to state or local taxation." Secretary Royall of the Army drafted this sentence at the Committee hearing (Senate Hearing on S-1198 at page 32). The Borg-Warner Company occupied under a lease authorized by Public Law 364, but Continental Motors occupied under a temporary permit. However, the Solicitor-General agreed that whatever interest Continental held under its permit was taxable. His point was that the lease-hold interests, if any, of both Borg-Warner and Continental Motors could not be measured by the assessed value of a fee-simple owner. In other words, except for their "Lessee's interest", taxable under Public Law 364, *supra*, the real property owned by the Government but occupied by the two contractors was immune from taxation under McCulloch v. Maryland [4 Wheat. 316, 4 L. ed. 579 (1819)]. As a matter of interest, the plant at Muskegon had belonged to the R.F.C. who made payments in lieu of taxes. The R.F.C. transferred it to the Defense Department, but it was not authorized to continue the R.F.C. payments until 1955 when Public Law 388 (84th Cong.) was passed. Thus for the year in suit (1954) Defense did not make any payments in lieu of taxes.

Significantly, after these Supreme Court decisions, the legislature of the State of New York passed a bill similar to the Michigan statute but it did not adopt the Michigan exemptions. As passed by the New York state legislature, the bill subjected all lessees of state and federal property to taxation. I do not know whether the legislature felt that in order for the law to be sustained, lessees of state and federal property, leasing in connection with a business conducted for private gain, should be treated alike. In any event, as soon as the New York bill was passed, state officials complained loudly to the Governor for relief. They commented that the statute, if enacted, would seriously jeopardize the leasing operations of the Port of New York Authority, jointly operated by the states of New York and New Jersey, and the many park and turnpike Authorities. Apparently Governor Harriman felt that these strong oppositions to the bill were valid because he promptly vetoed it.

Other states like New York will be faced with a real problem in enacting legislation with which they can live and which, at the same time, can be upheld as being in fact nondiscriminatory both in its language and its application. Undoubtedly, the precise question as to what classes of property can be excepted and still leave the tax nondiscriminatory will be the subject of future litigation.[8]

Taxation of Possessory Interest in Personal Property Under Ad Valorem Taxes: This brings me to the decisions in *Murray* and *American Motors,* where the cities of Detroit, Michigan and Kenosha, Wisconsin were permitted under an *ad valorem* statute to tax government-owned personal property in the possession of the Murray Corporation as a subcontractor under a defense contract, and American Motors under a prime defense contract.[9] At the request of the Department of Defense, the

[8] The discrimination point has been considered and rejected in Texas. Phillips Chemical Company v. Dumas Independent School District, 1 *Texas Supreme Court Law Journal* 497, June 18, 1958 and rehearing denied without opinion, October 22, 1958, 2 *Texas Supreme Court Law Journal* 28. On March 17, 1950, Texas passed a statute (5248) permitting school districts to tax a "lessee's interest" in government property. In this case the school district sought to tax both before and after the passage of the statute. In the Court of Civil Appeals it was held that the school district could tax under the statute on and after March 17, 1950 but not before that (307 S.W. 2d 605) and measure the tax by the assessed value of the property. While the Supreme Court of Texas affirmed, four of its nine Judges dissented, two specifically on the ground that the statute was discriminatory. Judge Robert W. Calvert in an opinion that Mr. Justice Walker joined said lessees of state property are not similarly taxed. Moreover, under Texas law no lessees of leases of a term less than three years are taxed. Since the government lease to Phillips could be terminated at any time in the event of a national emergency, Judge Calvert said it was not a lease for more than a three year term. As such, it was on a parity with leases less than three years. Presumably, a petition for certiorari to the Supreme Court of the United States will be filed in this case.

[9] Both were fixed price contracts. Murray was a sub-contractor, American a prime contractor.

Solicitor-General took the step, which is an extraordinary one for him, of asking the Supreme Court of the United States to rehear both the *Murray* and *American Motors* cases. It has been nine years since the Solicitor-General asked the Supreme Court to rehear a case which the Court decided against the government on the merits after the rendition of a formal opinion. I thought that it was significant that the Court directed the cities of Detroit and Kenosha to file answers. But you cannot safely predict action of the Supreme Court. On June 9, 1958, much to my surprise, the Supreme Court of the United States denied rehearing in both cases.[10]

The Solicitor-General in his petition for rehearing accepted as sound the broad principle asserted by the majority of the Court in *Borg-Warner, Continental Motors, Murray Corporation* and *American Motors,* that a state may "tax private parties on the privilege of using government property in connection with a private business conducted for profit." I would add that the tax must also be in fact nondiscriminatory. His petition for rehearing was closely confined to attacking the Court's assumption and holding that *ad valorem* personal property tax statutes "are the equivalent of privilege taxes on the use of Government-owned property."

No matter how favorably or unfavorably one views the *Murray* and *American Motors* decisions, he must at least admit that the Court converted what is clearly an *ad valorem* property tax into a privilege tax in sustaining the levies made by Detroit and Kenosha. In my opinion, the Court erred in assuming that there is no substantial difference between a privilege tax and a property tax and that the two should be equated.[11] I believe there are basic differences between *ad valorem* property taxes and privilege taxes and that these differences cannot be so easily brushed aside. Yet, under the reach of these decisions, and despite the refusal of the Michigan legislature to extend its Public Act 189 to personal property, the Supreme Court has done this for Michigan! It is interesting to note that the Supreme Court recognized that the Michigan *ad valorem* statute does not exactly state that the person in possession is taxed "for the privilege of using or possessing" personal property. The Court considered that the form of the tax did not alter its substance, and that to strike down the

[10] 357 U.S. 913 (1958).

[11] Editor's Note: The Senate Armed Services Committee had the same problem in drafting the first sentence of Section 6 in Public Law 364. When Senator Baldwin proposed a sentence that would tax property of the Government in the possession of the contractor, Senator Tydings objected, saying: "To get down to constitutional law, you would be taxing a man on property he did not own, and I am afraid it would not hold water." (p. 30, Senate Hearing of July 19, 1947 on S-1198 and H.R. 3471).

tax "because of such verbal omission would only prove a victory for empty formalisms." The words the Supreme Court added to cure this verbal omission were indeed few, but they are most significant!

In his dissent to the action of the Court in denying the petitions for rehearing, Justice Frankfurter forcibly points out that the Court erred in equating *ad valorem* and privilege taxes:

> "The petitions for rehearing in these cases should be granted. Petitioners direct attention to the statement in the Court's opinion of March 3, 355 U.S. 489, 492 (Prelim. Print), that 'There is no contention that these taxes were levied directly against the United States or its property.' The contentions made by the parties throughout this litigation and the characteristics of the taxes sustained make evident that the case was decided under a misapprehension of what was in issue. Simply to delete from the quoted sentence reference to what the parties contended, as has now been done, cannot delete the significance of its original inclusion in the opinion as a manifestation of the direction of the Court's thoughts. In reaching the conclusion that the tax here involved is indistinguishable from a tax on the privilege of possessing or using government property, the Court proceeded on mistaken notions about Michigan tax law and its administration.
>
> "The petitions for rehearing make more vivid than did the original briefs the distinction between the ad valorem property tax that was in fact imposed and a privilege tax with which the former was identified. The distinction is deeply embedded in Michigan statutory and constitutional law, and guides taxing authorities in their administration of the local statutes. The tax that Mchigan levied and this Court sustained is imposed on the property of the United States. Property is the subject of the tax and is the ultimate reliance for its satisfaction. . . . It is persuasively shown that, had the state authorities been satisfied that full ownership in the particular property was in the United States—an issue for controlling determination by this Court—the tax would not have been imposed. Indeed, as to tools concededly owned by the United States, no attempt was made to collect a tax. Such administrative practice by the taxing authorities would be inexplicable if the tax were conceived as an excise, a privilege tax, that is, on possession of property.
>
> "The petitions for rehearing have thrown into sharp relief the fact that the tax here imposed is simply an ordinary ad valorem tax imposed on the property, a tax indistinguishable from that in United States v. County of Allegheny, 322 U.S. 174. Therefore this tax is sustainable, unless Michigan law is to be construed in a way wholly at variance with the actual provisions of the state statutes and demonstrated administrative practice thereunder, only by disregarding Allegheny or overruling it. The Court does not purport to overrule Allegheny. The erroneous hypothesis about Michigan law underlying the Court's opinion could hardly have failed to obscure the full implications of the decision the Court was called upon to make. . . ."[12]

In the *American Motors* case, the city of Kenosha taxed on the theory that American Motors, rather than the federal government, owned the property and not on the basis of taxing a person possessing tax-exempt property. In its reply to the petition for rehearing the city of Kenosha stated "Wisconsin will not base any taxes upon the mere possession of

[12] 357 U.S. 913 (1958).

tax-exempt property *unless* and *until* the legislature adds an appropriate provision to the statutes." As stated by Justice Frankfurter, the question as to whether ownership of property is in the federal government is "an issue for controlling determination by this Court." The Supreme Court assumed in the *Murray* case that the United States had full title to the property. I fail to see how a final conclusion to the contrary, as to ownership, could be reached under the facts of the *American Motors* case. Therefore, even though we accept the proposition that a state may tax private parties on the privilege of using government property in connection with a private business conducted for profit, the problem remains as to whether a state may do so under its present laws as now administered without illegally discriminating against the federal government.

As pointed out by the Solicitor-General in his petition for rehearing, the state legislatures should rightfully have the power to decide whether or not to tax the use of exempt property. The Supreme Court should not legislate for them in this respect. Some states, to encourage the location of government-owned installations, or for other reasons, may not choose to tax those who use exempt property, and states may not, therefore, elect to add the "few words" to make their *ad valorem* taxes valid privilege taxes. To support this viewpoint, the Solicitor-General was able to tell the Supreme Court that two weeks after its decision in the *Murray* case the Supreme Court of Connecticut unanimously held that "a contractor is not subject to the state use tax with respect to property owned by the United States." To be "subject to the use tax," said the Court, "the use of property" must "be incident to ownership."[13]

Moreover, in a case almost identical on its facts to *Murray* and *American Motors* the Supreme Court of California has ruled[14] that the state cannot tax the possession of personal property under that state's ordinary straight *ad valorem* property tax statute. Since 1953 Los Angeles and San Diego Counties had been assessing a tax upon the many government contractors in California who possess government personal property.

From the federal point of view we must remember that the rulings in *Murray* and *American Motors* were made by a close five to four vote and that future cases may limit their effect. From the state point of view the decisions by the Supreme Courts of Connecticut and California clearly

[13] Avco Manufacturing Corp. v. Connelly, 145 Conn. 161, 140 A. 2d 479 (1958).

[14] General Dynamics Corp. and United States of America v. The County of Los Angeles, and Aerojet-General Corp. and the United States of America v. The County of Los Angeles, Superior Court, County of Los Angeles, (LA Nos. 24818 and 24819) decided March 22, 1957, 3 CCH Cal. State Tax Rep. para. 200-691. Unanimously affirmed by the Supreme Court of California in October, 1958, opinion by Traynor, J.

indicate that state courts are going to be reluctant to add the few words needed to convert a state property tax into a privilege tax. Perhaps, not even the Supreme Courts of Michigan and Wisconsin will do so in future cases. This leads me to observe that the denial by the Supreme Court of the petition of the Solicitor-General for a rehearing may not have finally resolved this problem of statutory construction.[15]

The Measurement Problem: I will now discuss briefly one other of such problems, namely the measurement problem. In *Borg-Warner* the Supreme Court said "In measuring such a use tax it seems neither irregular nor extravagant to resort to the value of the property used; . . . Other things being the same, it seems obvious enough that use of exempt property is worth as much as use of comparable taxed property during the same interval." In *Murray* the Court upheld the *ad valorem* tax "measured by the value of government property possessed." Do these decisions, however, finally resolve the measurement problems? For example, would the Court uphold a full value assessment (a) on a $10,000,000 government-owned bomber that was in a defense contractor's plant for one week around tax day for installation of new radar equipment and minor repair work, or (b) on a government-owned heavy drill press worth $750,000 that was leased for $2,000 to a defense contractor for one week around tax day, or (c) on government facilities worth $20,000,000 that are in a contractor's possession as a part of an industrial reserve for mobilization purposes and are used at only 5% or 10% of full capacity? The Supreme Court's words "during the same interval", I think, are significant in respect of the measurement problem. In my opinion, the many ramifications of this problem are far from being resolved by the present cases.

What Will the Department of Defense and Congress Do to Remedy the Problems Raised by These Decisions? The simple answer to this question is that I do not know. I recognize that my further comments,

[15] Editor's Note: This is an understatement. In the wake of the four defense plant tax decisions in March of 1958, states and counties from coast to coast began to levy taxes upon real and personal property of the Government in the hands of its contractors. In California counties that had not heretofore levied the tax did so, but the decision declaring the possessory interest tax on personal property invalid as a matter of California state law ends the matter for the moment. One can only guess where and how it will break out in California again. These states are now levying the taxes: Florida, Indiana, Iowa, Maryland, Michigan, Minnesota, Missouri, New Jersey, Tennessee, Texas and Wisconsin. Other states such as Colorado, Connecticut, Massachusetts, New York and Ohio have proposed statutes under consideration. It was the estimate of the Solicitor-General that the defense plant tax cases would increase defense procurement costs by about "389 million per year". If the cost of the taxes upon the Atomic Energy Commission were added, "the tax would be some 658 million per year". In most states taxes can be levied retroactively for one or more years where no tax returns have been filed. "Assuming a three-year statute of limitations, a billion dollars would appear to be a minimum estimate of the potential retroactive tax liability." (See pp. 14-15, Petition for Rehearing.)

as to what may happen, are highly speculative. The Department of Defense has not yet formulated any new policies with respect to these taxes since the Supreme Court decisions other than to request that the petition for rehearing be filed. This is not to say that we do not seriously regard the grave consequences of these decisions on our appropriations, unless relief is provided by Congress or in some other way. In the petition for rehearing the Solicitor General set forth estimated figures showing the colossal financial burden that would fall on the Department of Defense, the Atomic Energy Commission, and their contractors if the states are permitted to levy the full property tax on persons in possession of government-owned property. The increased tax on defense property alone could run to several hundred millions of dollars per year. This is necessarily a serious matter to our contractors because in many situations and contracts they are not entitled to reimbursement by the government. This is especially true with respect to any taxes that might be retroactively assessed involving contracts that are either closed or as to which there is no provision for reimbursement by the government. Furthermore, contractors in states assessing such privilege taxes must be able to compete with contractors in other states that do not elect to levy such taxes for the reason of encouraging the location of government plants and government business or for other reasons. I should think that the states will seriously consider this factor in future legislation in this particular tax field.

It is the policy of the Department of Defense to avoid disagreements or litigation with its contractors and with state or local taxing authorities. However, where we consider that taxing authorities have levied unwarranted or illegal taxes that must be borne either directly or indirectly by defense appropriations, we have no alternative but to seek redress.

While I cannot tell you what policies the Department of Defense may adopt or what legislation it may propose to Congress, I will discuss briefly what, in my opinion, Congress could do to overcome the effects of these decisions. Under the holding of the Supreme Court in *Kern Limerick, Inc. v. Scurlock*[16] the Arkansas Gross Receipts tax could not be imposed on a defense prime contractor who, under the terms of its contract, was made the agent of the government for the purpose of acquiring material. The decision by the Court was reached, I might add, on the express assumption that the government used this device for the purpose of avoiding the imposition of state and local taxes. The Depart-

[16] Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1953).

ment of Defense, although it could as a matter of law, has not as a matter of policy, used this agency procedure for the past several years in contracts made in the United States. Senate Bill 6,[17] which passed the Senate in the 85th Congress, but not the House, provided that such agent of the United States would not be relieved of liability for taxes. Although the Senate passed this bill after the Supreme Court cases were decided, I do not believe that it considered fully or realized the serious consequences of the Supreme Court cases on the finances of the federal government. Congress will no doubt consider the agency procedure, among other remedies, in connection with future action it takes to overcome the effects of the Supreme Court cases.

In *James v. Dravo Contracting Company,*[18] and in *Alabama v. King & Boozer,*[19] the Supreme Court held independent contractors of the government subject to the state taxes involved and that there is no implied constitutional immunity insofar as independent contractors are concerned. It is significant to note that in the *King & Boozer* case the Court came to this conclusion under "the Constitution, unaided by Congressional legislation." It seems clear to me that Congress, under its constitutional power, has the authority to immunize independent contractors of the government from state taxation by legislation. The Supreme Court recognized this power in *Borg-Warner* when it stated, "Of course this is not to say that Congress, acting within the proper scope of its power, cannot confer immunity by statute where it does not exist constitutionally." Again, in shifting the problem of governmental immunity from taxation, insofar as the taxation is not directly upon the federal government, to Congress, the Court in the *Murray* case stated "the Congress is the proper agency, . . . to make the difficult policy decisions necessarily involved in determining whether and to what extent private parties who do business with the government should be given immunity from state taxes."

The Supreme Court, in *Carson, Commissioner of Finance & Taxation v. Roane-Anderson Company,*[20] expressly upheld this power of Congress. In that case Tennessee sales and use taxes had been levied on independent contractors of the Atomic Energy Commission. Section 9(b) of the Atomic Energy Act of 1946[21] provided, at that time, that "The Commis-

[17] Sen. 6, 85th Cong., 2d Sess., passed Senate March 4, 1958.
[18] James v. Dravo Contracting Co., 302 U.S. 134 (1937).
[19] Alabama v. King & Boozer, a partnership, 314 U.S. 1 (1941).
[20] Carson, Commissioner of Finance & Taxation v Roane-Anderson Company, 342 U.S. 232 (1952)..
[21] Atomic Energy Act of 1946, 60 STAT. 765, prior to the amendment of Aug. 13, 1953, c. 432, 67 STAT. 575.

sion, and the property, activities, and income of the Commission, are hereby expressly exempted from taxation in any manner or form by any state, county, municipality, or any subdivision thereof." The Supreme Court, in affirming the decision of the Supreme Court of Tennessee, which had held that these taxes were prohibited by the above provisions of the Atomic Energy Act, stated: "The meaning of 'activities' as applied either to an individual or to a government agency may be broad enough to include what is done through independent contractors as well as through agents" and that " 'activities' means all authorized methods of performing the governmental function."

Prior to the Supreme Court decisions it was not clear whether the Supreme Court or Congress would ultimately make the very difficult decision as to the scope of the immunity of government contractors from taxes levied on government property in their possession. The Supreme Court has now declared in no uncertain terms that Congress should make these policy decisions. Legislation in this field, however, will not be easy to formulate. Over a period of many years the federal government has convened conferences, committees, boards and sundry bodies charged with finding a way to alleviate the burdens placed on certain localities by federal property and federal activities in their areas. No satisfactory solution has been found to date. Nevertheless, I feel that Congress must now act and solve this problem. By legislation Congress also can help resolve the questions of discrimination against the government and measurement which, in my opinion, have not been finally resolved by the Supreme Court. Congress can do this by specially providing when, and to what extent, government property may be taxed.

In conclusion, I am hopeful that the many problems of the state taxing authorities and the federal government in the complex field of taxation of government property will be solved in an equitable manner, giving due regard to both the benefits and the burdens occasioned states and municipalities by the location of government property and activities.