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Constitutional Law—Immunity of State Agency from Federal Taxation—Confused State of the Decision

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STUDENT NOTES

CONSTITUTIONAL LAW — IMMUNITY OF STATE AGENCY FROM FEDERAL TAXATION — CONFUSED STATE OF THE DECISIONS. — A recent case has raised again the troublesome and intricate question: just to what extent may the federal government impose a tax the burden of which will be borne by a state government, or one of its agencies? The Supreme Court has ruled that a federal tax upon the sale of an article to be paid by the seller becomes invalid when the buyer chances to be another of our governmental agencies.¹

Direct taxation of the federal government by a state is not permissible.² Nor may a state agency so tax the federal government.³ Conversely the federal government may not tax the states, or their agencies directly.⁴ There is no express prohibition of such taxation in the Constitution of the United States, but the rule is said to rest on "necessary implication" and is upheld by the great law of "self-preservation".⁵ This is drawn from the very structure of our governmental system, based on dual sovereignty, in which

¹ The Indian Motorcycle Co. sold a motorcycle to the city of Westfield, Massachusetts, for the latter's use in its police department. Under the Federal Revenue Act of 1924 which provided there "shall be levied, assessed, collected and paid upon the following articles sold or leased by the manufacturer, producer or importer, a tax", the Company paid a tax to the United States. Later it put in claim for rebate of the amount of the tax in the Court of Claims. On certification of the question from the Court of Claims the Supreme Court sustained the plaintiff's contention that such a tax was a direct burden by the federal government on an agency of the state and hence unconstitutional. *Indian Motorcycle Co. v. U. S.*, 283 U. S. 570, 51 S. Ct. 601 (1931). Mr. Justice Brandeis and Mr. Justice Stone dissented; Mr. Justice Holmes concurred solely on the authority of the case of *Panhandle Oil Co. v. Mississippi*, 277 U. S. 218, 48 S. Ct. 451 (1928), in which he had written the dissenting opinion of a five to four decision.

² *Van Brocklin v. Tennessee*, 117 U. S. 151, 6 S. Ct. 670 (1886).

³ *McCulloch v. Maryland*, 4 Wheat. 316, 4 L. Ed. 579 (1819) (Tax on notes of U. S. bank in a state bank); *Weston v. City of Charleston*, 2 Pet. 449, 7 L. Ed. 481 (1829) (municipal tax on U. S. securities); *Dobbins v. Commissioners of Erie County*, 16 Pet. 434, 10 L. Ed. 1023 (1842) (salaries of U. S. officials); *Case of Kansas Indians*, 5 Wall. 737, 18 L. Ed. 667 (1866) (lands held by Indians under patents issued under treaties with their tribes by U. S.); *Crandall v. Nevada*, 6 Wall. 35, 18 L. Ed. 744 (1867) (interstate passengers); *Weber v. Virginia*, 103 U. S. 344, 26 L. Ed. 565 (1880) (incorporeal right secured by patent as distinguished from the product); *California v. Central Pacific R. R. Co.*, 121 U. S. 1, 8 S. Ct. 1073 (1888) (Railroad franchise granted by U. S.); *Clallam County v. U. S.*, 263 U. S. 341, 44 S. Ct. 121 (1923) (property taxed during war when used to facilitate manufacture of aeroplanes for U. S.); *City of New Brunswick v. U. S.*, 276 U. S. 547, 48 S. Ct. 371 (1928) (tax on property of U. S. Housing Corp.)

⁴ *Collector v. Day*, 11 Wall. 113, 20 L. Ed. 122 (1870); *Pollock v. Farmers' Loan and Trust Co.*, 157 U. S. 429, 15 S. Ct. 673 (1895).

⁵ *Collector v. Day*, *supra* n. 4, at 127; 2 COOLEY, TAXATION (1924) § 606.

the independence of the states, within their legitimate spheres of action, and the independence of the federal government, within the powers granted to it by the Federal Constitution, are basic concepts. Thus any imposition of a burden by one of these governments curtails the independence of the other and infringes upon its sovereignty.

But only direct infringements of sovereignty by taxation are unconstitutional.⁶ That is, if the tax is laid directly on the other government, its agencies or its operations, the tax is not allowed. But if the tax is laid upon some subject clearly within the control of the taxing government, although it may be measured or determined by some subject which could not be directly taxed and is tax immune, then the tax is valid, for the burden is only indirectly on the taxed government. Thus a state income tax on royalties created by a federal patent is deemed a direct tax, and consequently invalid.⁷ But a tax for a corporation's privilege to do business within a state is valid, even though measured by net income which includes income from copyrights issued by the federal government.⁸ By the use of such a distinction to determine the constitutionality of a tax in these cases the result is that the form of the tax assumes paramount importance, whereas there seems to be no difference in the practical effect of the tax. But where the court could discern legislative intent on the part of one government to reach a tax-immune subject of another government through the guise of a valid tax, they have looked through the form and declared the tax invalid.⁹ These varied results can be supported only by employing the subtle distinctions of legal technicalities, rather incapable of ordinary comprehension.¹⁰ But even should the Court not find this legislative intent; they have, in at least

⁶ Knowlton v. Moore, 178 U. S. 41, 20 S. Ct. 747 (1900) (Tax on succession); Snyder v. Bettman, 190 U. S. 249, 23 S. Ct. 803 (1903) (Fed. tax on bequest to municipality valid); Cornell v. Coyne, 192 U. S. 418, 24 S. Ct. 383 (1904) (Fed. tax on manufacture of cheese valid, although made especially for export purposes which Congress could not tax); Lash's Products Co. v. U. S., 278 U. S. 175, 49 S. Ct. 100 (1929) (tax on the manufacture of goods measured by the price for which sold); Wheeler Lumber Bridge & Supply Co. v. U. S., 281 U. S. 572, 50 S. Ct. 419 (1930) (Fed. tax on transportation of goods sold to municipality valid); Willcuts v. Bunn, 282 U. S. 216, 51 S. Ct. 125 (1931) (income tax on profits made by sale of non-taxable municipal bonds held not direct tax on city and valid); Educational Films Corporation v. Ward, 282 U. S. 379, 51 S. Ct. 170 (1931) (Privilege tax on corporation measured by net income which included income from royalties under federal copyrights held no direct burden on U. S. and valid tax).

⁷ Long v. Rockwood, 277 U. S. 142, 48 S. Ct. 463 (1928).

⁸ Educational Films Corporation v. Ward, *supra* n. 6.

⁹ Macallen Co. v. Massachusetts, 279 U. S. 620, 49 S. Ct. 432 (1929).

¹⁰ Powell, *An Imaginary Judicial Opinion* (1931) 44 HARV. L. REV. 889.

one case, seen fit to declare a tax, which was in form only an indirect tax of the federal government, invalid; because, in fact, it was a direct burden as they saw it.¹¹ Previous language of this same Court has indicated an intention to consider in the cases the practical effect of the tax in determining its validity.¹²

The majority of the Court in the *Indian Motorcycle Co.* case thought that the federal tax was on the sale alone—a direct burden on the state,¹³ and, therefore, controlled by the doctrine of the *Panhandle Oil Co.* case. Mr. Justice Stone refused so to consider the tax but regarded it as a tax on the manufacture and sale,¹⁴ and consequently an indirect burden on the state and governed by the doctrine of the *Wheeler Lumber Bridge & Supply Co.* case.¹⁵ As a matter of fact the tax in the *Indian Motorcycle Co.* case was a sales tax, and the legislature in enacting it so considered it.¹⁶ And as an economic principle the burden of a sales tax is said by some authorities to be shifted to the buyer.¹⁷ Under the general rule, then, this tax would be invalid, amounting to a burden on an agency of the state. However, whether a sales tax is so shifted is the subject of involved controversy among other economic theorists;¹⁸ and it is doubtful if the Court should have assumed the point when arriving at their decision in the *Indian Motorcycle Co.* case.

¹¹ *Panhandle Oil Co. v. Mississippi*, *supra* n. 1 (Excise tax on vendors of gasoline measured by the number of gallons sold held to be a direct burden on the U. S. when the federal government purchased gasoline in that state); *Grayburg Oil Co. v. Texas*, 278 U. S. 620, 49 S. Ct. 185 (1928) (Memorandum decision relying on authority of *Panhandle* case).

¹² *Union Pacific R. R. Co. v. Peniston*, 18 Wall. 5, 36, 21 L. Ed. 787 (1873); *Western Union Telegraph Co. v. Texas*, 105 U. S. 460, 26 L. Ed. 1067 (1882). "Our decision must depend not upon the form of the taxing scheme, or any characterization of it adopted by the courts of the state, but rather upon the practical operation and effect of the tax as applied and enforced." *Wagner v. City of Covington*, 251 U. S. 95, 102, 40 S. Ct. 93, 94 (1919); *Shaffer v. Carter*, 252 U. S. 37, 55, 40 S. Ct. 221, 226 (1919).

¹³ "We think it is laid on the sale and on that alone." *Indian Motorcycle Co. v. U. S.*, *supra* n. 1, at 51 S. Ct. 602. "Here the tax is laid directly on the sale to a government agency. Sale and purchase constitute a single transaction, in which the purchaser is an essential participant." *Id.*, at 604.

¹⁴ *Supra* n. 13, at 605.

¹⁵ *Wheeler Lumber Bridge & Supply Co. v. U. S.*, *supra* n. 6.

¹⁶ H. R. Rep. No. 1, 69th Cong. 1st Sess., at p. 16; Sen. Rep. No. 398, 68th Cong. 1st Sess., at p. 40.

¹⁷ Comstock, *TAXATION IN THE MODERN STATE* p. 121; *Bulletin, National Tax Association 1923-24*, p. 174.

¹⁸ *Indian Motorcycle Co. v. U. S.*, *supra* n. 13, at 605. Proceedings of the National Tax Association, 1920, "Report of Industrial Conference Committee" p. 175-179; "Discussion of Federal Taxation" p. 212, 266. *Ibid.*, 1923, "Problems in National Taxation" p. 297-298. *Ibid.*, 1924, "The Incidents of Business Taxation" p. 315-356; "The Shifting of Taxes" p. 306-315. *Ibid.*, 1929, "General versus Selective Sales Taxes" p. 406-407.

In the *Panhandle Oil Co* case and in the *Indian Motorcycle Co.* case the Court determined as a practical matter whether the tax, though not in form, was, in fact, a direct burden on the taxed government and thus ascertained its validity. Then the majority adopted the view that if the right to tax was once admitted in such a case, there would be no power ever to limit it,¹⁹ and the burden of the tax being directly borne by the taxed government, it was invalid, regardless of the extent or reasonableness of the burden. The minority view suggests that the Court should determine the tax *in fact* was an unreasonable burden upon the city; and their test of invalidity would depend upon the degree to which the tax impaired the efficiency of the state or its agency in performing its governmental function.²⁰ This idea has found expression in other cases²¹ and is the principle behind Mr. Justice Holmes' statement that "the power to tax is not the power to destroy while this court sits".²² The view of the majority in these cases is liberal enough to look at the tax as a practical matter and determine whether in fact it is a direct burden on the taxed government; but it will not go farther and determine as a practical matter whether this direct burden is in fact a *real* burden on the taxed government. The minority principle of looking to the degree of the burden seems to have been adopted in at least one instance where the state power to tax is permitted only to a degree where it does not interfere with interstate commerce,²³ even though the Court has refused to look at the situations as analogous.²⁴ The approach of the minority in the *Indian Motorcycle Co.* case, name-

¹⁹ *McCulloch v. Maryland*, *supra* n. 3; *Grandall v. Nevada*, *supra* n. 3; *U. S. v. B. & O. R. R. Co.*, 17 Wall. 322, 327 (1873); *Farmers and Merchants Savings Bank v. Minnesota*, 232 U. S. 516, 525, 34 S. Ct. 354 (1914); *Johnson v. Maryland*, 254 U. S. 501, 505, 42 S. Ct. 16 (1920); *Gillespie v. Oklahoma*, 257 U. S. 501, 505, 42 S. Ct. 171 (1922).

²⁰ *Supra* n. 13, at 605.

²¹ *Panhandle Oil Co. v. Mississippi*, *supra* n. 1, at 223.

"It cannot be that a state tax which remotely affects the efficient exercise of a federal power is for that reason alone inhibited by the Constitution The Federal Constitution must receive a practical construction. Its limitations and its implied prohibitions must not be extended so far as to destroy the necessary powers of the states, or prevent their efficient exercise." *Union Pacific R. R. Co. v. Peniston*, *supra* n. 12, at 30.

"Neither government may destroy the other or curtail it in any substantial manner. Hence the limitation upon the taxing power of each must receive a practical construction which permits both to function with the minimum of interference each with the other." *Metcalf & Eddy v. Mitchell*, 269 U. S. 514, 523, 46 S. Ct. 172, 174 (1926).

²² *Panhandle Oil Co. v. Mississippi*, *supra* n. 1, at 223.

²³ *Western Union Telegraph Co. v. Kansas*, 216 U. S. 1, 30 S. Ct. 190, 54 L. Ed. 356 (1910); *Pullman Co. v. Kansas*, 216 U. S. 56, 30 S. Ct. 232 (1910); *Ludwig v. Western Union Telegraph Co.*, 216 U. S. 146, 30 S. Ct. 180 (1910).

²⁴ *Johnson v. Maryland*, *supra* n. 19; *Gillespie v. Oklahoma*, *supra* n. 19.

ly determination of the validity of a tax by the degree which it interferes with the functioning of the taxed government, appears to be more in line with economic pragmatism.

The practical effect of the doctrine announced in the *Indian Motorcycle Co.* case is to allow a private individual to escape an otherwise perfectly legitimate tax. Nearly every case in which the invalidity of a tax has been urged on the ground that it burdens a government has been raised by a private individual in attempting to avoid the tax.²⁵ The effect of the doctrine is "to relieve individuals from a tax, at the expense of the government imposing it, and without substantial benefit to the government for whose advantage the immunity is invoked".²⁶ If the burden were real, it would be natural to expect the government burdened to complain rather than an individual; this is one practical reason for preferring the minority view of the cases.

The tax imposed by the federal government in the *Indian Motorcycle Co.* case on the city is not one levied on the taxed government as such, but only falls upon the latter because it has entered into the relation of buyer with the Motorcycle Co., the seller. It is only because of this relationship and a theory of economics that the federal tax becomes a burden on the city and invalid. It would seem that the tax is more of an economic burden than a legal burden from which the city is entitled to relief. It is difficult to see why either state or federal government should be a privileged purchaser in the markets of the country.

The whole line of cases which distinguish between the validity and invalidity of these governmental taxes by determining whether the tax is directly or indirectly a burden on the taxed government seem to be rather futile. In cases where the tax is permissible because imposed at a point where the burden on the taxed government is indirect,²⁷ and in cases where the tax is not permissible because the point of imposition makes the burden a direct one on the taxed government²⁸ there is no real economic difference. Just as sure as the tax burden was passed on in the *Indian Motorcycle Co.* case in the seller's price of the article, so was the transportation

²⁵ *Lash's Products Co. v. U. S.*, *supra* n. 6; *Wheeler Lumber Bridge & Supply Co. v. U. S.*, *supra* n. 6; *Panhandle Oil Co. v. Mississippi*, *supra* n. 1, *Grayburg Oil Co. v. Texas*, *supra* n. 1, *Willeuts v. Bunn*, *supra* n. 6, *Indian Motorcycle Co. v. U. S.*, *supra* n. 1.

²⁶ *Indian Motorcycle Co. v. U. S.*, *supra* n. 1, at 51 S. Ct. 604.

²⁷ *Supra* n. 6.

²⁸ *Long v. Rockwood*, *supra* n. 7; *Panhandle Oil Co. v. U. S.*, *supra* n. 1, *Grayburg Oil Co. v. Texas*, *supra* n. 11; *Indian Motorcycle Co. v. U. S.*, *supra* n. 1.

cost passed along to the city in the *Wheeler Lumber Bridge & Supply Co.* case. And perhaps in both cases there was no burden passed along.²⁹ Under these decisions the point at which the tax is levied determines its validity rather than any logical reasoning; and a greater stress is laid on considerations of the form of the tax than on its practical effect.

Finally, although it was not proper for the Court to consider the question in the *Indian Motorcycle Co.* case,³⁰ and although the previous cases have all accepted the situation, one must wonder at the plaintiff's position in court. If the burden of the tax is on the city so as to make the tax unconstitutional, it follows that the city, not the plaintiff, has been damaged by the tax imposition and should sue. However, if the plaintiff has been damaged by the tax imposition on him, then the burden of the tax has not been passed on to the city. But if the burden has not fallen on the city the tax is not unconstitutional and the plaintiff should recover nothing. The recovery by the plaintiff appears to be due to a "vicious circle" of reasoning.

The casual inspection of these cases reveal that slight interference with the immunity of one government is caused by such a tax as in the *Indian Motorcycle Co.* case. By their doctrine the cases maintain the sovereignty of the taxed government by granting to it complete immunity from the taxing government. But it is just as true that such immunity granted to the taxed government necessarily curtails the taxing power of the other government, so that the taxing government is deprived of sovereignty to the extent of the immunity of the taxed government from the tax. The rule of the *Indian Motorcycle Co.* case made to preserve the sovereignty of the state government would seem to operate conversely just as well in favor of the federal government to maintain the latter's sovereignty. Should not the true test of the validity of such taxation depend on the reasonableness of the burden imposed rather than on the mere existence of the burden? Though the result of the principle announced again in *Indian Motorcycle Co. v. U. S.* may be justified on the grounds of cold logic and the principle of *stare decisis*, nevertheless, the practical appeal of the minority view convinces.

—HENRY P. SNYDER.

²⁹ *Supra* n. 18.

³⁰ As the case arose in the Supreme Court on certification of the question of the constitutionality of such a tax, it was the only point regularly before that Court for its decision.