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Constitutional Law - Intergovernmental Tax Immunities - Erosion of Distinction Between Taxation of Property and of Privilege

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CONSTITUTIONAL LAW—INTERGOVERNMENTAL TAX IMMUNITIES—EROSION OF DISTINCTION BETWEEN TAXATION OF PROPERTY AND OF PRIVILEGE—Plaintiff Murray Corporation, a manufacturer of airplane parts for the federal government, was assessed a tax by the city of Detroit under the General Property Tax Act of Michigan,[1] based in part on the value of materials which the corporation had in its possession. Legal title to these materials was in the federal government.[2] The corporation paid the taxes under protest and sued for a refund, contending that the taxes infringed the federal government's immunity from state taxation to the extent the taxes were based on the value of government property. The district court entered judgment for Murray and the Court of Appeals for the Sixth Circuit affirmed.[3] On appeal to the United States Supreme Court, *held,* reversed, four justices dissenting. Although on its face a tax on property, in essence the tax is on possession of property which plaintiff used in profit-making

1 Mich. Comp. Laws (1948) §211.1 et seq. See especially §211.40.

2 Under the terms of the contract, "*title* to all parts, materials, inventories, work in progress and nondurable tools . . . *shall forthwith vest in the government.*" See Point I of Justice Whittaker's dissent, principal case at 514.

3 (6th Cir. 1956) 234 F. (2d) 380.

activities. Since it thus has the same effect as a privilege tax which has uniformly been upheld, the tax is valid.[4] *Detroit v. Murray Corporation of America,* 355 U.S. 489 (1958), reh. den., Justice Frankfurter dissenting, 26 U.S. LAW WEEK 3357 (1958).

Since *McCulloch v. Maryland,*[5] where the conflict between a state's power to tax and the right of the federal government to be free from such taxation was first presented, the cases have distinguished between a tax on government property, which is invalid,[6] and a tax on a person for the privilege of using or dealing with such property, which is valid.[7] This basic point of departure, i.e., that a tax cannot be laid upon "the Government, its property or officers,"[8] or, re-phrased, "that possessions . . . of the Federal Government . . . are not subject to any form of state taxation"[9] has been said to be "a bright straight line running undeviatingly through the decisions of the [United States Supreme] Court."[10] Thus, a state can tax activities of private persons even though these activities may involve the use of government property and the value or amount of such property becomes the partial or exclusive measure for the tax.[11] A criterion that had formerly been used in determining whether or not a given statute violated the *McCulloch* prohibition was whether the economic incidence of the tax fell on the federal government.[12] Such a burden invalidated the tax. This concept of broad implied tax immunity has since been discarded[13] as unworkable when it was realized that ultimately the burden always falls on the government in some measure. The criteria which the Court seemed to be applying prior to the present case were (1) no tax which

4 In two companion cases, United States v. Detroit, 355 U.S. 466 (1958), and United States v. Township of Muskegon, 355 U.S. 484 (1958), the Court sustained Michigan statutes taxing persons *using* exempt (government-owned) real property, even though the value of the use taxed was measured by the value of the exempt property. In these cases the statute was explicit in taxing the *use* of such property. The Court, speaking through Justice Black, saw no basic distinction between the taxes in these cases and the tax in the principal case. Principal case at 493.

5 4 Wheat. (17 U.S.) 316 (1819).

6 McCulloch v. Maryland, note 5 supra; United States v. Allegheny County, 322 U.S. 174 (1944). Similarly, a federal tax on a state function has been invalidated, Collector v. Day, 11 Wall. (78 U.S.) 113 (1870).

7 Esso Standard Oil Co. v. Evans, 345 U.S. 495 (1953); Curry v. United States, 314 U.S. 14 (1941); Trinityfarm Construction Co. v. Grossjean, 291 U.S. 466 (1934). See also United States v. Detroit, note 4 supra, and United States v. Muskegon, note 4 supra.

8 James v. Dravo Contracting Co., 302 U.S. 134 at 149 (1937).

9 United States v. Allegheny County, note 6 supra, at 177.

10 Opinion of Justice Frankfurter, principal case at 499.

11 See note 7 supra.

12 Dobbins v. Commissioners, 16 Pet. (41 U.S.) 434 (1842); Collector v. Day, note 6 supra; New York ex rel. Rogers v. Graves, 299 U.S. 401 (1937); Indian Motorcycle Co. v. United States, 283 U.S. 570 (1931); Graves v. Texas Co., 298 U.S. 393 (1936).

13 James v. Dravo Contracting Co., note 8 supra; Helvering v. Mountain Producers Corp., 303 U.S. 376 (1938); Graves v. New York ex rel. O'Keefe, 306 U.S. 466 (1939); Alabama v. King and Boozer, 314 U.S. 1 (1941).

was on its face a property tax was valid, and (2) even though the tax purported to be an excise tax, the Court would "look through form and behind labels to substance."[14] Regardless of the state's determination of the nature of the tax, it was ultimately characterized by the Court.[15] Thus, the constitutionality of a tax depended upon the wording of the statute unless the wording was used to disguise the actual incidence of the tax. State taxes have been upheld, however, even though the intention of the state was to reach exempt property, as long as the tax was in fact one on a privilege.[16]

The principal case promulgates a new test, which in operation may eliminate most limitations on intergovernmental taxation. Thus, although "the taxes imposed on Murray were styled a personal property tax by the Michigan statutes,"[17] since the "operation and practical effect"[18] of the tax was the same as if it were a tax on the privilege of using or possessing personal property, the statute is sustained because ". . . the State could obviate such grounds for invalidity by merely adding a few words to its statutes."[19] When, however, the measure of a tax is the value of the property possessed, the "operation and practical effect" of a tax on the possession of the property is virtually identical with that of a tax on the property possessed.[20] Thus, the basic difference between a property tax and a privilege tax has been its form, and if form is now to be discarded when the "practical effect" of the two taxes is the same, then there is no standard at all. The Court protests allegiance to the doctrine of *McCulloch v. Maryland*,[21] yet in the principal case the entire burden of the tax is on the federal government, the tax is measured by the value of the federal property, and the tax purports to be a general property tax, although not directly on the government but on the person in possession of the property.[22] Whether the Court intended to modify *McCulloch* is doubtful, but

14 See principal case at 492.

15 Lawrence v. State Tax Commission, 286 U.S. 276 at 280 (1932); Wisconsin v. J. C. Penney Co., 311 U.S. 435 at 443-445 (1940).

16 "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." Pacific Co. v. Johnson, 285 U.S. 480 at 495-496 (1932).

17 Principal case at 492.

18 Id. at 493.

19 Ibid.

20 See American Motors Corp. v. Kenosha, 356 U.S. 21 (1958), a 5-to-4 per curiam decision based on the principal case, which upholds a Wisconsin tax on facts almost identical to the principal case. The Wisconsin Supreme Court, writing before the principal case had been decided, sustained its tax as a property tax on the ground that while title was in the federal government, the "ownership" was still in the corporation. A dissenting opinion followed the lines of the dissent in the principal case. 274 Wis. 315 (1957).

21 Id. at 495.

22 To the effect that the tax was actually assessed against the property in view of

that appears to be the practical effect of the decision and state and lower federal courts may have future difficulty in finding any tax asserted against private firms or individuals invalid even though the tax appears to be on government property. Unless the Court did intend to modify *McCulloch,* it would have been preferable to have maintained the prior test based on form (a workable test, at least, despite its weaknesses) than to have left the area in its present nebulous state.

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the remedies available for nonpayment, and was not on possession of the property, see the dissenting opinion of Justice Whittaker, principal case at 524-530, and dissent of Justice Frankfurter in support of grant of a rehearing, 26 U.S. LAW WEEK 3357, 3358 (1958).