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CONSTITUTIONAL LAW-TAX EXEMPTION CONTRACT

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RECENT DECISIONS

CONSTITUTIONAL LAW—TAX EXEMPTION CONTRACTS—A charter granted in 1863 by the State of Georgia to the Atlantic Coast Line Railroad Company provided as follows: "The stock of said company shall be subject to a tax not exceeding ½ per cent per annum on the net proceeds of its investments." In 1931, the Georgia legislature levied a tax of 5½ per cent on corporate net income. The railroad brought an action seeking to have an assignment under this tax declared invalid, on the theory that the tax as applied to the plaintiff railroad violated the contract clause of the federal Constitution.[1] The Georgia Supreme Court concluded that the tax exemption of the 1863 charter did not apply.[2] On appeal, *held*, affirmed. The Supreme Court agreed with the state court's opinion that in view of the fact that the income tax had not been a part of the state system of taxation at the time of the charter, it could not have been within the legislative intent. *Atlantic Coast Line Railroad Co. v. Phillips*, (U.S. 1947) 67 S.Ct. 1584.

Part of the early American reaction against governmental activity was a legislative willingness to bargain away the state's taxing power by granting exemptions by corporate charter or statute to public service corporations.[3] The right of the state to make an exemption contract and its corresponding duty to respect it were early recognized.[4] But difficulties have arisen in judicial construction of the extent of such immunity.[5] A preliminary problem concerns the scope of federal review. Although the Supreme Court has no jurisdiction to review if the state court reaches its decision without giving effect to the state statute in question, it reserves the right to determine for itself whether or not the state court has actually done this.[6] The general rule is that the Supreme Court will follow the state court's interpretation of the local statute claimed to impair an exemption contract.[7] However, growing out of its early feeling that the contract clause might in a large degree be nullified if the federal courts were also bound by state decisions construing the existence and scope of the contract,[8] the Supreme Court has always ruled that it will decide these questions independently.[9] This doctrine has been applied even when

[1] "No State shall . . . pass any . . . Law impairing the Obligation of Contracts," Art. I, § 10.

[2] Thompson v. Atlantic Coast Line R.R. Co., 200 Ga. 856, 38 S.E. (2d) 744 (1946).

[3] 22 MINN. L. REV. 888 (1938); M. H. Merrill, "Application of the Obligation of Contract Clause to State Promises," 80 UNIV. PA. L. REV. 639 (1932).

[4] New Jersey v. Wilson, 7 Cranch (11 U.S.) 164 (1812).

[5] See the cases collected in 82 L. Ed. 82 (1937).

[6] Columbia Ry., Gas & Elec. Co. v. South Carolina, 261 U.S. 236, 43 S.Ct. 306 (1923), discussed in 36 HARV. L. REV. 882 (1923); McCullough v. Virginia, 172 U.S. 102, 19 S.Ct. 134 (1898).

[7] Ohio Life Insurance and Trust Co. v. Debolt, 16 How. (57 U.S.) 416 (1853); Commrs. Wicomico County v. Bancroft, 203 U.S. 112, 27 S.Ct. 21 (1906).

[8] 35 COL. L. REV. 440 (1935).

[9] Jefferson Branch Bank v. Skelly, 66 U.S. 436 (1861); Funkhouser v. Preston Co., 290 U.S. 163, 54 S.Ct. 134 (1933); Milwaukee E. R. & L. Co. v.

the state court has invalidated the tax legislation and therefore sustained the federal right.[10] Today, the Court, perhaps because of a growing sympathy with the state attitude in regard to tax exemptions, is likely to accept the state court's interpretation of the contract, unless clearly wrong.[11] Once the Supreme Court has jurisdiction of the case it must determine whether the exemption granted was in the form of a contract, supported by consideration.[12] The presumption has always been against the existence of any contract.[13] Moreover, the Supreme Court has declared that the state must not be assumed to have bargained away its taxing power unless this clearly appears.[14] Any reasonable doubts are resolved in favor of the state.[15] In a long line of decisions following *New Jersey v. Wilson*,[16] the Court invalidated state tax legislation as a violation of previous contract exemptions.[17] Prominent among these were the Ohio tax cases [18] and the *Macallen* case of 1929.[19] But the decision in *Hale v. Iowa*

Wisconsin, 252 U.S. 100, 40 S.Ct. 306 (1920); Louisville & Nashville Ry. v. Palmes, 109 U.S. 244, 3 S.Ct. 193 (1883). This is true even when the constitution of a state has become part of the contract. For the suggestion that the Supreme Court may regard as binding state decisions where the doctrine laid down by them is so established as to be a rule of property in that state, see Shelby County v. Union & Planters' Bank, 161 U.S. 149, 16 S.Ct. 558 (1896).

[10] U.S. Mortgage Company v. Matthews, 293 U.S. 232, 55 S.Ct. 168 (1934).

[11] Hale v. Iowa State Bd. of Assessment, 302 U.S. 95, 58 S.Ct. 102 (1937); Phelps v. Bd. of Education, 300 U.S. 319, 57 S.Ct. 483 (1937); Dodge v. Bd. of Education, 302 U.S. 74, 58 S.Ct. 98 (1937); Violet Trapping Co. v. Grace, 297 U.S. 119, 56 S.Ct. 386 (1936); Tampa Water Works Co. v. Tampa, 199 U.S. 241, 26 S.Ct. 23 (1905).

[12] Seton Hall College v. South Orange, 242 U.S. 100, 37 S.Ct. 54 (1916); Grand Lodge v. New Orleans, 166 U.S. 143, 17 S.Ct. 523 (1897); West Wisconsin R. R. Co. v. Supervisors, 93 U.S. 595 (1876); Salt Co. v. E. Saginaw, 13 Wall. (80 U.S.) 373 (1871); Christ Church v. Philadelphia, 24 How. (65 U.S.) 300 (1860); Rochester R. Co. v. Rochester, 205 U.S. 236, 27 S.Ct. 469 (1907).

[13] New York Rapid Transit Corp. v. City of New York, 303 U.S. 573, 58 S.Ct. 721 (1938). For other judicial limitations on the contract, see Mercantile Bank v. Tennessee, 161 U.S. 161, 16 S.Ct. 461 (1896); Wright v. Georgia R. and Banking Co., 216 U.S. 420, 30 S.Ct. 242 (1910); Great Northern Ry. Co. v. Minnesota, 216 U.S. 206, 30 S.Ct. 344 (1910); Covington v. Kentucky, 173 U.S. 231, 19 S.Ct. 383 (1899).

[14] Providence Bank v. Billings, 4 Pet. (29 U.S.) 514 (1830); Tucker v. Ferguson, 22 Wall. (89 U.S.) 527 (1874); Ford v. Delta & Pine Land Co., 164 U.S. 662, 17 S.Ct. 230 (1897).

[15] Humphrey v. Pegues, 16 Wall. (83 U.S.) 244 (1872).

[16] See note 4.

[17] Gordon v. Appeal Tax Court, 3 How. (44 U.S.) 132 (1845); Home of the Friendless v. Rouse, 8 Wall. (75 U.S.) 430 (1869); Washington University v. Rouse, 8 Wall. (75 U.S.) 439 (1869); St. Anna's Asylum v. New Orleans, 105 U.S. 362 (1881); Wright v. Georgia R. Co., 216 U.S. 420, 30 S.Ct. 242 (1909); Tomlinson v. Branch, 15 Wall. (82 U.S.) 460 (1873); New Jersey v. Yard, 95 U.S. 104 (1877); University v. People, 99 U.S. 309 (1878).

[18] Piqua Branch Bank v. Knoop, 16 How. (57 U.S.) 369 (1853); Ohio Life Insurance and Trust Co. v. Debolt, 16 How. (57 U.S.) 416 (1853); Mechanics' & Traders' Bank v. Debolt, 18 How. (59 U.S.) 380 (1855); Jefferson Branch Bank v. Skelly, 66 U.S. 436 (1861); McGee v. Mathis, 4 Wall. (71 U.S.) 143 (1866).

[19] The Macallen Co. v. Massachusetts, 279 U.S. 620, 49 S.Ct. 432 (1929).

State Board of Assessment [20] indicated that there had been a marked change in the judicial attitude. The new trend was to limit the exemption contract to the particular kind of taxes known at that time and therefore to allow the levy of a new type of tax not specifically mentioned in the exemption contract.[21] The unanimity of the principal case suggests that a complete break has been made and that a policy of extremely strict construction will be applied not only to the existence of the contract, but also to its scope. Probably the strongest reason for the changed attitude was expressed as early as 1869 by Justice Miller.[22] His dissent from the then majority attitude emphasized the complete dependence of government on the taxing power as a policy argument against upholding exemption contracts. In view of the increasing responsibilities of government and the consequent increasing need for revenue, such an attitude should be welcomed.

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[20] 302 U.S. 95, 58 S.Ct. 102 (1937).

[21] Adams Mfg. Co. v. Storen, 304 U.S. 307, 58 S.Ct. 913 (1938); Pacific Co. v. Johnson, 285 U.S. 480, 52 S.Ct. 424 (1932); People of New York ex rel. Clyde v. Gilchrist, 262 U.S. 94, 43 S.Ct. 501 (1923).

[22] Washington University v. Rouse, 8 Wall. (75 U.S.) 439 (1869).