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CONSTITUTIONAL LAW - VALIDITY OF STATE OCCUPATION TAX ON CONTRACTORS WITH THE FEDERAL GOVERNMENT

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COMMENTS

CONSTITUTIONAL LAW — VALIDITY OF STATE OCCUPATION TAX ON CONTRACTORS WITH THE FEDERAL GOVERNMENT — The increasing burden of both federal and state taxation during the past decade has multiplied the attempts by some of those affected to establish, in the courts, immunity from certain taxes. The limitations of the power of the governments to tax have, then, special significance for one who seeks, in that fashion, to challenge the imposition of a tax on himself. Two cases recently decided by the Supreme Court involved one of those limitations—that which denies to the states the power to enforce a tax which impedes the exercise of the powers of the federal government.

In the first of these cases,[1] a Pennsylvania construction company, admitted to do business in West Virginia, sought to restrain the collection of an annual privilege tax by that state.[2] The tax was measured by the gross receipts of the company from business done within the state. In so far as those gross receipts included amounts received from the federal government under contracts calling for the construction of certain locks and dams in one of the navigable rivers of the state, the company claimed an exemption on the grounds (1) that it was a federal instrumentality, and (2) that the tax was a direct burden on the exercise of one of the powers of the federal government. The tax was levied in addition to a license tax on foreign corporations admitted to do business in the state and ad valorem taxes upon the real and personal property of the company in the state.

In the second case,[3] again, a construction company sought to restrain collection of a similar occupation tax measured by gross receipts,[4] imposed by the state of Washington in addition to other taxes, in so far as the receipts came from the federal government under contracts for work on the Bonneville Dam Project in the state. The same reasons for the exemption were advanced.

In both cases, the Supreme Court, speaking through Chief Justice Hughes, denied the contentions of the taxpayers and sustained the constitutionality of the taxes, with four members of the Court dissenting.

I.

Without at least a passing glance at the origin and development of this limitation on the state's power to tax, the full import of these recent decisions is lost.[5]

[1] James v. Dravo Contracting Co., 302 U.S. 134, 58 S. Ct. 208 (1937).

[2] W. Va. Acts (1st Ex. Sess. 1933), c. 33, § 2(e), amending W. Va. Code (1931), § 11-13-2(e), provides: "Upon every person engaging in or continuing within this state in the business of contracting, the tax shall be equal to two per cent of the gross income of the business."

[3] Silas Mason Co. v. Tax Commission of Washington, 302 U.S. 186, 58 S. Ct. 233 (1937).

[4] Wash. Laws (Spec. Sess. 1933), c. 57, § 2-a, amending Laws (1933), c. 191, provides that: "every person engaging or continuing within this state in the business of rendering or performing services. . . . [shall pay] an annual tax or excise for the privilege of engaging in such business. . . . equal to the gross income of the business multiplied by five tenths of one per cent. . . ."

[5] In general, see Cohen and Dayton, "Federal Taxation of State Activities and State Taxation of Federal Activities," 34 YALE L. J. 807 (1925); Boudin, "The Taxation of Governmental Instrumentalities," 22 GEORGETOWN L. J. 1 (1933), 254 (1934); Stoke, "State Taxation and the New Federal Instrumentalities," 22 IOWA L. REV. 39 (1936); Brown, "State Taxation of Interstate Commerce, and Federal and State Taxation in Intergovernmental Relations—1932-1935," 24 GEORGETOWN L. J. 584 (1936); 23 VA. L. REV. 922 (1937).

The doctrine was enunciated first in *McCulloch v. Maryland*,[6] when the Supreme Court, without dissent, struck down a tax law enacted by the state of Maryland, requiring the United States Bank to pay tribute to the state government for the privilege of issuing notes. The argument of Chief Justice Marshall, who wrote the opinion, was twofold. First, he declared,[7] the powers of the federal government were not given by the people of a particular state. They were given by the people of all the states. Their exercise, then, should, in theory, be free from control through taxation or otherwise by any government except that which belongs to all. Second,[8] because the power to tax the means employed in the exercise of the powers of the federal government involved the power to destroy such means, and the power to destroy renders useless the power to create them, the assertion of this power in the state was plainly repugnant to the express declaration of the supremacy of the Constitution and the laws made in pursuance thereof. He concluded therefore that

> "the states have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by congress to carry into execution the powers vested in the general government."[9]

This position was reaffirmed five years later in *Osborn v. Bank of the United States*,[10] which involved a similar hostile attack on the bank. And then in *Weston v. City of Charleston*,[11] Marshall, who wrote the opinion holding a state tax on federal bonds invalid, pointed out the nature of the burden such a tax placed on the federal government. His position was that

> "The right to tax the contract to any extent, when made, must operate on the power to borrow, before it is exercised, and have a sensible influence on the contract . . . To any extent, however inconsiderable, it is a burden upon the operations of government."[12]

[6] 4 Wheat. (17 U.S.) 316 (1819).

[7] Ibid. at 427-431.

[8] Ibid. at 431-436. Marshall's feeling that the power to tax involved the power to destroy was amply justified at the time it was made. During the period 1816-1819, six of the states enacted tax laws directed solely against the United States Bank, laws intended to drive it from business within their borders. 1 WARREN, THE SUPREME COURT IN UNITED STATES HISTORY, rev. ed., 505 (1935). It was legislation of this character which was before the court in McCulloch v. Maryland.

[9] 4 Wheat. (17 U.S.) 316 at 436.

[10] 9 Wheat. (22 U.S.) 738 (1824).

[11] 2 Pet. (27 U.S.) 449 (1829). The taxing ordinance was plainly discriminatory for certain classes of bonds were excepted.

[12] Ibid. at 468.

Similar reasoning was followed in *Dobbins v. Erie County*,[13] where a state property tax on the value of a United States office was held invalid.

The Civil War and Reconstruction periods with their financial problems brought many cases involving state taxation before the Supreme Court. The line between burdensome and non-burdensome taxes began to be determined by the familiar pricking out process, and that process still continues. On the one side, property taxes on federal securities were held invalid.[14] It was thought such taxes were a burden on the borrowing power of the federal government, even though the taxes were non-discriminatory. The reasoning of Marshall in *Weston v. Charleston*[15] was relied on. Likewise, state taxes on property owned by the federal government were struck down.[16] State privilege taxes, too, were overthrown where the privilege taxed was given by the federal government and where its exercise was to be a means of carrying out government powers.[17] The same result followed where the

[13] 16 Pet. (41 U.S.) 435 (1842).

[14] Thus the capital stock of banks was held immune from taxation in so far as the capital stock included tax-exempt federal securities. People ex rel. Bank of Commerce v. New York Tax Comm., 2 Black. (67 U. S.) 620 (1863); People ex rel. Bank of Commerce v. New York Tax Comm. (Bank Tax Case), 2 Wall. (69 U. S.) 200 (1865). The rule laid down in these cases was followed in Home Savings Bank v. Des Moines, 205 U. S. 503, 27 S. Ct. 571 (1907); and in Farmers & Mechanics' Sav. Bank v. Minnesota, 232 U. S. 516, 34 S. Ct. 354 (1913).

In The Banks v. The Mayor, 7 Wall. (64 U.S.) 16 (1868), a state property tax on federal certificates of indebtedness issued by the Treasury to public creditors for supplies furnished the government during the war was struck down as a burden on the borrowing power. And in Bank v. Supervisors, 7 Wall. (74 U.S.) 26 (1868), a state property tax on United States notes—greenbacks—issued to circulate as currency was held bad. The court emphasized the likelihood that the tax would restrict free circulation and thus defeat Congressional purposes.

The doctrine of immunity was extended naurally enough to protect the exercise of other governmental powers than the borrowing power. In Indian Territory Illuminating Oil Co. v. Oklahoma, 240 U.S. 522, 36 S. Ct. 453 (1915), a state property tax on a lease held on Indian lands pursuant to an Act of Congress was held bad. Jaybird Mining Co. v. Weir, 271 U.S. 609, 46 S. Ct. 592 (1926), invalidated a property tax on ore severed by, and in bins of, a lessee of Indian lands.

[15] 2 Pet. (27 U.S.) 449 (1824).

[16] McGoon v. Scales, 9 Wall. (76 U.S.) 23 (1869) (land owned by the federal government not subject to state taxation). Accord: Van Brocklin v. Tennessee, 117 U.S. 151, 6 S. Ct. 670 (1885). In Clallam County v. United States, 263 U.S. 341, 44 S. Ct. 121 (1923), taxes on personal and real property of a government-owned war-time corporation were held invalid.

[17] California v. Central Pacific Ry., 127 U.S. 1, 8 S. Ct. 1073 (1887) (the assessed valuation of the railway included the value of franchises given the railway by the federal government); Leloup v. Port of Mobile, 127 U.S. 640, 8 S. Ct. 1380 (1887) (license tax on a telegraph company held void as a tax on the privilege of carrying government messages); Owensboro Nat. Bank v. Owensboro, 173 U.S. 664,

tax was on a privilege exercised by the government itself as a means of executing its powers.[18] Likewise, state taxes, in whatever form, directed at income from federal instrumentalities were held invalid.[19]

On the other side, in accord with Marshall's dictum in *McCulloch v. Maryland*,[20] property of a federal instrumentality was held to be subject to a non-discriminatory state property tax, even though such property was used by the agency in carrying out Congressional purposes.[21] This result has been consistently followed.[22] And whatever the form of the tax, so long as it was not imposed on the federal instru-

19 S. Ct. 537 (1899) (tax on the franchise of a national bank held invalid because it did not meet Congressional requirements); Williams v. Talladega, 226 U.S. 404, 419, 33 S. Ct. 116 (1912) (license tax on the privilege of carrying intrastate governmental messages by telegraph held invalid).

[18] Telegraph Co. v. Texas, 105 U.S. 460 (1881) (tax on each telegraph message sent void as to messages sent by the government); Federal Land Bank v. Crosland, 261 U. S. 374, 43 S. Ct. 385 (1922) (state privilege tax on recording of mortgages in addition to the normal recording fee held invalid as to mortgages made by the Federal Land Bank); Panhandle Oil Co. v. State of Mississippi ex rel. Knox, 277 U.S. 218, 48 S. Ct. 451 (1927) (state privilege tax on dealers in gasoline measured by number of gallons sold held invalid so far as sales were to federal governmental agencies); Graves v. Texas Co., 298 U.S. 393, 56 S. Ct. 818 (1935) (state tax held to be in effect on sales and therefore so far as sales were to the federal government, the tax was invalid).

[19] Gillespie v. Oklahoma, 257 U.S. 501, 42 S. Ct. 171 (1921) (state tax on net income from oil lease given by the government for the benefit of Indian wards held invalid); Miller v. Milwaukee, 272 U.S. 713, 47 S. Ct. 280 (1926) (state tax on that portion of corporate dividends equal to the exempt portion of corporate income held invalid); Northwestern Mut. Life Ins. Co. v. Wisconsin, 275 U.S. 136, 48 S. Ct. 55 (1927) (purported privilege tax measured by a given per cent of gross receipts of domestic corporations held invalid in so far as gross receipts came from tax exempt bonds); Macallen Co. v. Massachusetts, 279 U.S. 620, 49 S. Ct. 432 (1928) (purported privilege tax on corporations measured by a given per cent of net income held invalid as an attempt to reach tax exempt income, in view of special facts).

[20] 4 Wheat. (17 U.S.) 316 at 436 (1819), quoted supra at note 9.

[21] Thomson v. Pacific R. R., 9 Wall. (76 U.S.) 579 (1869) (property taxes on state chartered railroad corporation obliged to give special performance to the federal government in execution of governmental powers); Railroad Co. v. Peniston, 18 Wall. (85 U.S.) 5 (1873) (property taxes on a railroad company chartered by Congress).

[22] Western Union Tel. Co. v. Massachusetts, 125 U.S. 530, 8 S. Ct. 961 (1887), and Western Union Tel. Co. v. Taggart, 163 U.S. 1, 16 S. Ct. 1054 (1895) (property taxes on telegraph company property maintained pursuant to act of Congress and used for government purposes); Hibernia Savings & Loan Society v. San Francisco, 200 U.S. 310, 26 S. Ct. 265 (1906) (property tax on checks drawn by the United States treasurer payable to a private person but not yet cashed) [cf. Bank v. Supervisors, 7 Wall. (74 U.S.) 26 (1868), discussed supra, note 14]; Dyer v. City of Melrose, 215 U.S. 594, 30 S. Ct. 410 (1909) (property tax on bank deposit of naval officer which included a salary deposit); Choctaw, O. & G. Ry. v. Mackey, 256 U.S. 531, 41 S. Ct. 582 (1920) (special assessment for street improvement levied against depot property of the railway which was the successor to a company chartered by Congress to develop Indian coal lands); Susquehanna Power Co. v. State Tax Comm., 283

mentality, but upon an independent interest, any burden has been regarded as indirect and incidental, and the tax has been upheld.[23] Even where the tax was on a privilege given by the federal government, it has been held not an unconstitutional burden if the privilege given was to be exercised for the benefit of the recipient rather than as an agent of the government to carry out Congressional purposes.[24]

Much of the development of the doctrine limiting state powers took place in a similar and not unrelated situation. *Collector v. Day*[25] found the court limiting, by analogy, the power of the federal government to tax state instrumentalities. Such a limitation seems quite out of the spirit of the argument in *McCulloch v. Maryland*.[26] Yet this

U.S. 291, 51 S. Ct. 434 (1930) (tax on lands flooded by building of a power dam under license from the federal government); Indian Territory Illuminating Oil Co. v. Board of Equalization, 288 U. S. 325, 53 S. Ct. 388 (1932) (property tax on crude oil, produced under Indian oil lease, stored in tanks on the company's land) [cf. Jaybird Mining Co. v. Weir, 271 U.S. 609, 46 S. Ct. 592 (1926), discussed supra, note 14]; Taber v. Indian Territory Illuminating Oil Co., 300 U.S. 1, 57 S. Ct. 334 (1936) (property tax on equipment of lessee of Indian oil lands). But see Clallam County v. United States, 263 U.S. 341, 44 S. Ct. 121 (1923), discussed supra note 16, and Stoke, "State Taxation and the New Federal Instrumentalities," 22 IOWA L. REV. 39 (1936).

[23] Van Allen v. Assessors, 3 Wall. (70 U.S.) 573 (1865) (tax on interest of shareholders in national bank held not to be a tax on federal securities even though the whole capital stock of the bank was tax exempt bonds); Home Ins. Co. v. New York, 119 U.S. 129, 8 S. Ct. 1385 (1886) (franchise tax on domestic corporations measured in part by the value of the capital stock which included tax exempt bonds); Plummer v. Coler, 178 U.S. 115, 20 S. Ct. 829 (1900) (tax on legacy consisting of federal bonds); Educational Films Corp. v. Ward, 282 U.S. 379, 51 S. Ct. 170 (1930) (tax on privilege of doing business measured by net income including income from tax exempt bonds) [cf. Macallan Co. v. Massachusetts, 279 U.S. 620, 49 S. Ct. 432 (1928), discussed supra, note 18]; Alward v. Johnson, 282 U.S. 509, 51 S. Ct. 273 (1930) (privilege tax measured by gross receipts including income from government mail contract) [cf. Northwestern Mut. Life Ins. Co. v. Wisconsin, 275 U.S. 136, 48 S. Ct. 55, discussed supra, note 18]; Trinityfarm Construction Co. v. Grosjean, 291 U.S. 466, 54 S. Ct. 469 (1933) (excise tax on gasoline purchased by a contractor for use on a federal government project held valid).

[24] Fidelity & Deposit Co. v. Pennsylvania, 240 U. S. 319, 36 S. Ct. 298 (1915) (privilege tax measured by gross receipts which included premiums paid on fidelity bonds running to the government); Fox Film Corp. v. Doyal, 286 U.S. 123, 52 S. Ct. 546 (1931) (tax on the privilege of doing business measured by gross receipts, all of which were copyright royalties); Lexington Water Power Co. v. Query, 288 U.S. 178, 53 S. Ct. 326 (1932) (tax on production and sale of electric energy produced under permit from the federal government); Federal Compress & Warehouse Co. v. McLean, 291 U.S. 17, 54 S. Ct. 267 (1933) (excise tax measured by capacity, on warehouse operating under permit from federal government).

[25] 11 Wall. (78 U.S.) 113 (1870) (federal tax upon income of a state judicial officer held invalid as a burden on an instrumentality of the state government).

[26] See supra at note 7. And see Veazie Bank v. Fenno, 8 Wall. (75 U.S.) 533 (1869).

reciprocal application of the rule has prevailed since,[27] and precedents in the one situation have been used in the other, though not without vigorous criticism.[28]

Throughout these decisions there seems to be but the single principle enunciated by Marshall—that the states have no power to impede or hinder the execution of federal powers. The great difficulty lies in the proper application of the principle, as is so often true, and it was this problem of application that divided the Court in the instant cases.

2.

The factors which determine whether a state tax imposes a burden on federal functions are varied and uncertain, changing with each case. It has been said the proper test is a practical one[29]—does the operation

[27] Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, 583, 15 S. Ct. 673 (1894) (federal tax on general income including that from state and municipal bonds held bad under the rule of Weston v. City of Charleston) [cf. cases cited in note 19]; Indian Motocycle Co. v. United States, 283 U. S. 570, 51 S. Ct. 601 (1930) [excise tax paid by seller to the federal government on the sale of a motorcycle to a municipal police department held bad on authority of Panhandle Oil Co. v. Knox, 277 U.S. 218, 48 S. Ct. 451 (1927), discussed supra, note 18]. The exceptions to the exemption rule are many and the tendency in recent years has been to limit exemptions sharply. Greiner v. Lewellyn, 258 U.S. 384, 42 S. Ct. 324 (1921) (federal estate tax on net assets including state and municipal bonds held valid) [cf. Plummer v. Coler, 178 U.S. 115, 20 S. Ct. 829 (1900), discussed supra, note 23]; Metcalf & Eddy v. Mitchell, 269 U.S. 514, 46 S. Ct. 172 (1925) (federal income tax on incomes derived from independent contracts with state governments held good); Wheeler Lumber Bridge & Supply Co. v. United States, 281 U.S. 572, 50 S. Ct. 419 (1930) (federal tax on transportation held valid on a shipment f.o.b. point of delivery, where delivery was to a county government) [cf. Indian Motocycle Co. v. United States, supra]; Willcutts v. Bunn, 282 U.S. 216, 51 S. Ct. 125 (1930) (federal income tax on profit derived from sale of state bonds held valid and not a tax on a state instrumentality); Group No. 1 Oil Co. v. Bass, 283 U.S. 279, 51 S. Ct. 432 (1930) (federal income tax on net profits from operation of oil lease of state school lands held valid, because the lease amounted to a sale) [cf. Gillespie v. Oklahoma, 257 U.S. 501, 42 S. Ct. 171 (1921), discussed supra, note 19]; Burnet v. A. T. Jergins Trust, 288 U.S. 508, 53 S. Ct. 439 (1932) (income tax on profits of oil lessee of city government held valid because the city's lease was a proprietary function). In general on this distinction, see comment in 23 VA. L. REV. 922 (1937); Helvering v. Powers, 293 U.S. 214, 55 S. Ct. 171 (1934) (income tax on salary of state officer appointed manager of municipal railway, because the function was a proprietary one); Liggett & Meyers Tobacco Co. v. United States, 299 U.S. 383, 57 S. Ct. 239 (1936) (tobacco excise tax on manufactures held valid as to tobacco sold to a state institution) [cf. Indian Motocycle Co. v. United States, supra].

[28] See, for instance, the dissent of Stone, J., in Indian Motocycle Co. v. United States, 283 U. S. 570, 51 S. Ct. 601 (1930); and see Boudin, "Taxation of Governmental Instrumentalities," 22 GEORGETOWN L. J. 254 (1934).

[29] Willcutts v. Bunn, 282 U. S. 216, 51 S. Ct. 125 (1930); Graves v. Texas Company, 298 U. S. 393, 56 S. Ct. 818 (1935).

of the tax as a practical matter hinder the execution of governmental powers? That a state tax if enforced would have such effect in cases like *McCulloch v. Maryland* and *Bank v. Osborn* seems indisputable. In such instances, the tax would force the cessation of activity necessary to effectuate the Congressional purpose.

In any case less clear than one of the type mentioned, there is immediate difficulty in determining whether the tax is a burden in the constitutional sense. The language of Marshall in *Weston v. City of Charleston*[30] seems to suggest that the tax there imposed hindered the government's exercise of the borrowing power by placing the government in a less favorable bargaining position. That may well have been the effect because that tax was discriminatory. Yet even where the tax is non-discriminatory, the same feeling has been expressed in recent cases that if the government is unable to make as favorable terms in the face of the tax as it could were there no tax, then the tax is a burden on the exercise of the government's powers.[31] In the instant case, however, where this was the ultimate contention of the taxpayer, the Chief Justice said:

> "But if it be assumed that the gross receipts tax may increase the cost to the Government, that fact would not invalidate the tax. With respect to that effect, a tax on the contractor's gross receipts would not differ from a tax on the contractor's property and equipment necessarily used in the performance of the contract. Concededly, such a tax may be validly laid. Property taxes are naturally, as in this case, reckoned as a part of the expense of doing the work."[32]

The soundness of this position seems clear.[33] As pointed out by

[30] Quoted supra, at note 12.

[31] Panhandle Oil Co. v. Knox, 277 U. S. 218, 48 S. Ct. 451 (1927); Graves v. Texas Company, 298 U. S. 393, 56 S. Ct. 818 (1935); Gillespie v. Oklahoma, 257 U. S. 501, 42 S. Ct. 171 (1921).

[32] James v. Dravo Contracting Co., 302 U. S. 134 at 160, 58 S. Ct. 208 (1937). See the dissent by Holmes, J., in Panhandle Oil Co. v. Knox, 277 U. S. 218, 48 S. Ct. 451 (1927); and Trinityfarm Construction Co. v. Grosjean, 291 U. S. 604, 54 S. Ct. 712 (1933). In Liggett & Meyers Tobacco Co. v. United States, 299 U. S. 383, 57 S. Ct. 239 (1936), increased cost to a state government because of the federal excise tax on manufactures was held no burden justifying exemption. To the same effect is Wheeler Lumber Bridge & Supply Co. v. United States, 281 U. S. 572, 50 S. Ct. 419 (1930).

[33] The cases cited in notes 21 and 22. The unsatisfactory character of this test of the burden is further revealed in the criticism of Stone, J., in his dissent in Indian Motocycle Co. v. United States, 283 U. S. 570 at 581, 51 S. Ct. 601 (1930), where he pointed out that "whether the burden of any tax paid by the seller is actually passed on to the buyer depends upon considerations so various and complex as to preclude the assumption *a priori* that any particular tax at any particular time is passed on. In some

Justice Holmes in his dissent in the *Panhandle Oil Company* case,[34]

> "When the Government comes into a State to purchase I do not perceive why it should be entitled to stand differently from any other purchaser. It avails itself of the machinery furnished by the State and I do not see why it should not contribute in the same proportion that every other purchaser contributes for the privileges that it uses. It has no better or other right to use them than anyone else. The cost of maintaining the State that makes the business possible is just as necessary an element in the cost of production as labor or coal."

Holmes' suggestions are heresy considered along with those technical arguments[35] on which Marshall relied in the first case raising the problem. Holmes felt there was no difficulty to be encountered with the proposition that the power to tax involves the power to destroy. In his dissent in the *Panhandle Oil Company* case, he asserted that the power to tax is not the power to destroy so long as the Supreme Court sits, for the power to tax is no longer regarded as the absolute power it was thought to be in Marshall's time. Just as the courts act as a check on the legislative bodies which fix rates, and thus insure fair and reasonable rates, so can the Court act to invalidate a tax the operation of which interferes with the execution of federal functions.[36] And as pointed out above, increased cost to the government is no criterion of such interference.

So far as the other argument of *McCulloch v. Maryland* is concerned, that taxation of the federal government by the people of one state amounts to taxation of the people of all the states by the people of one state, Holmes' statement that if the government of all the people chooses to take advantage of the machinery furnished by a single state it ought to contribute is a pertinent reply. If the govern-

conditions of the market, the burden remains with the seller, or even may be shifted back from the seller to the producer by the reduction of the producer's price, rather than forward to the consumer by an increase in the seller's price." The authorities cited by the justice for this proposition include all the modern writers on taxation. See especially, SELIGMAN, SHIFTING AND INCIDENCE OF TAXATION, 5th ed., 218-219, 253-254 (1924). The same uncertainty attending the determination of the ultimate bearer of a sales tax prevails whatever the form of the tax. See Seligman, op. cit., for a discussion of the incidence of each of the kinds of tax.

[34] 277 U. S. 218 at 224, 48 S. Ct. 451 (1927).

[35] See supra, at notes 7 and 8.

[36] In McCulloch v. Maryland, 4 Wheat. (17 U. S.) 316 at 428 (1819), it is said that a state legislature acts upon its constituents, which is in general a sufficient security against erroneous and oppressive taxation. Then so long as a tax is nondiscriminatory, this security which is afforded the constituents of a legislature is afforded the federal instrumentality.

ment of all the people does not contribute, the state taxing system is thrown out of gear, inequality and injustice result from establishment of exemptions, and some individuals pay a disproportionate share of the cost of both governments.

3.

If increased cost to the government is not an unconstitutional interference, in what other way can the operation of a state tax impede the exercise of federal functions? It is submitted that ordinarily a state tax which in terms or effect[37] is discriminatory will be the only kind having that effect. In such a case, as in *McCulloch v. Maryland* and *Bank v. Osborn*, the chosen instrumentality of the federal government cannot successfully endure in the economic struggle, and the Congressional purpose is defeated. But such discriminatory taxes are bad for other reasons, and reliance need not be placed on the ground under discussion in order to invalidate them.

Seldom if ever has a case appeared where the government needed preferential treatment to secure proper execution of its plans.[38] And if such preferential treatment is deemed necessary, then as an adjunct of its power to carry out the scheme, Congress ought to have the power to establish in its discretion an express exemption.[39] Then responsibility for the results of such exemption is determined.

The decisions in the instant cases do much to establish firmly the trend away from exemption which is noticeable in the recent cases. The importance of that trend cannot be exaggerated.[40] The increasing governmental costs demand an ever-widening tax base, and the taxpayers are entitled to substantial equality.[41] Nor should the state governments

[37] The tax would be discriminatory in effect, for instance, if the subject matter of the tax were some unique relation.

[38] In The Banks v. The Mayor, 7 Wall. (74 U. S.) 16 (1868), discussed supra note 14, conceivably a preference was needed to insure prompt and free circulation of the greenbacks, which was the Congressional aim.

[39] Congress may deny its instrumentalities exemptions if it chooses. See for instance, Van Allen v. Assessors, 3 Wall. (70 U. S.) 573 (1865), discussed supra note 23, and Owensboro Bank v. Owensboro, 173 U. S. 664, 19 S. Ct. 537 (1899), discussed supra note 17. Of course, if granted for the Congressional instrumentality, the same exemption ought to extend to similar state instrumentalities; otherwise, the result is a discrimination against those state instrumentalities.

[40] In the instant cases, the United States government appeared as amicus curiae, and argued through Solicitor-General Reed that any non-discriminatory state tax ought to be good. In recent cases where the validity of a state tax is involved, the federal government has appeared as amicus curiae, realizing that because of the reciprocal exemption doctrine, its own taxing power may be further limited by the creation of a new exemption.

[41] Fifteen billions of dollars of federal securities are wholly exempt from taxation, twenty-two billions are partially exempt, while nineteen billions of state and municipal bonds are wholly exempt. There is an estimated loss to the federal government of seventy millions a year because of the inability to tax these state bonds. 6 U. S. NEWS

be denied a fair opportunity to develop tax systems adequate to their needs.[42] Certainly the doctrine of exemption enunciated in the cases is an obstacle to any comprehensive scheme of state tax reform. The present cases minimize the effect of that doctrine.

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1 (May 9, 1938). Of course, in so far as the states would have to pay higher interest rates if their securities were subject to federal taxation, this loss to the federal government and its taxpayers is a gain for the state governments and their taxpayers.

[42] Chief Justice Chase, who wrote the opinion in Thomson v. Pacific Railway, 9 Wall. (76 U. S.) 579 at 591 (1869), recognizes this necessity in denying the claim for exemption put forth there.