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## CONSTITUTIONAL LAW - IMPAIRMENT OF OBLIGATION OF CONTRACTS - TAX ON INCOME OF BONDS GRANTED STATUTORY TAX EXEMPTION

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CONSTITUTIONAL LAW — IMPAIRMENT OF OBLIGATION OF CONTRACTS  
— TAX ON INCOME OF BONDS GRANTED STATUTORY TAX EXEMPTION —  
Plaintiffs were holders of certain tax exempt bonds issued under authority of  
the state of Iowa.<sup>1</sup> After the issue of the bonds a statute was passed imposing a

<sup>1</sup> Iowa Code (Supp. 1915), § 1304 (1); Code (1935), § 6944 (5) and (22),  
§ 4753-a13.

"personal net income tax" upon persons resident within the state.<sup>2</sup> The state board of assessment and review assessed this tax against \$36,892.75 interest on the tax exempt bonds. The appellants, alleging that such an application of the law impaired the obligations of contracts of exemption, brought suit. Upon a ruling in favor of the assessment by the Iowa Supreme Court, appellants appealed to the United States Supreme Court. *Held*, the contract of exemption was properly interpreted by the Iowa Supreme Court as not including the tax in question. Therefore the contractual obligation was not impaired.<sup>3</sup> *Hale v. Iowa State Board of Assessment and Review*, 302 U. S. 95, 58 S. Ct. 102 (1937).

While every tax exemption statute does not create a contract,<sup>4</sup> a statute providing that bonds shall be tax exempt, passed before the bonds are sold, does create a contract between the state and the purchaser.<sup>5</sup> Such a contract is protected by the Federal Constitution and cannot be impaired.<sup>6</sup> When such a dispute comes before the United States Supreme Court that Court may determine for itself the effect and meaning of the contract as well as its existence.<sup>7</sup> This, however, does not prevent the high court from leaning toward agreement with the state courts on matters of this kind and accepting their judgment unless clearly wrong.<sup>8</sup> In the past the Supreme Court has ruled that tax exemption contracts were not impaired by a franchise tax measured by

<sup>2</sup> Iowa Code (1935), § 6943-f4.

<sup>3</sup> Justice Sutherland dissenting. "Such an all-embracing exemption cannot be avoided by the invention of a new tax. To me it seems evident that if any tax be imposed upon the bonds, the contract is impaired. It likewise seems evident that the tax here imposed is on the bonds themselves." 302 U. S. at 110. Justices McReynolds and Butler concurred in the dissent.

<sup>4</sup> 2 COOLEY, TAXATION, 4th ed., § 701 (1924).

<sup>5</sup> 2 COOLEY, TAXATION, 4th ed., § 702 (1924).

<sup>6</sup> "The sound and true rule is, that if the contract, when made, was valid by the laws of the state, as then expounded by all the departments of its government, and administered by its courts of justice, its validity and obligations cannot be impaired by any subsequent act of the legislature of the state, or decision of its courts, altering the construction of the law." *Ohio Life Ins. & Trust Co. v. Debolt*, 16 How. (57 U. S.) 416 at 432, 14 L. Ed. 997 (1853); *Dodge v. Worlsey*, 18 How. (59 U. S.) 331, 15 L. Ed. 401 (1855); *Wright v. Georgia R. R. & Banking Co.*, 216 U. S. 420, 30 S. Ct. 242 (1909); *Wright v. Louisville & N. R. R.*, 236 U. S. 687, 35 S. Ct. 475 (1915).

<sup>7</sup> "In reaching a conclusion on that point we decide for ourselves independently of the decision of the state court, whether there is a contract, and whether its obligations are impaired; and if the decision of the question as to the existence of the alleged contract requires a construction of state constitution and laws, we are not necessarily governed by previous decisions of the state courts, upon the same or similar points, except where they have been so firmly established as to constitute a rule of property. Such has been the uniform and well established doctrine of this court." *Louisville & Nashville Ry. v. Palmer*, 109 U. S. 244 at 256, 3 S. Ct. 193 (1883).

<sup>8</sup> *Phelps v. Board of Education of West New York*, 300 U. S. 319, 57 S. Ct. 483 (1937); *Dodge v. Board of Education*, 302 U. S. 74, 58 S. Ct. 98 (1937); *Violet Trapping Co., Inc. 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).

the income from tax exempt securities along with other income.<sup>9</sup> This is a logical result from the well established rule that tax exemption statutes are to be construed in favor of taxation.<sup>10</sup> The specific holding of the Iowa court that this tax exemption applies only to property taxes on the bonds themselves is not clearly out of line with previous Iowa decisions<sup>11</sup> or those of other courts<sup>12</sup> including the Supreme Court.<sup>13</sup> Its interpretation should therefore be upheld under the premise laid down by the Supreme Court as to the following of state courts in interpretation of contracts when that interpretation is not clearly wrong. It is clear that the principal case marks another step toward the obliteration by judicial process of the benefits of tax exemption statutes.

*Amos J. Coffman*

<sup>9</sup> *Pacific Co. Ltd. v. Johnson*, 285 U. S. 480, 52 S. Ct. 424 (1932); 28 ILL. L. REV. 612 (1934); *Flint v. Stone Tracy Co.*, 220 U. S. 107, 31 S. Ct. 342 (1911); *Educational Films Corp. v. Ward*, 282 U. S. 379, 51 S. Ct. 170 (1930). But see *The Macallen Company v. Massachusetts*, 279 U. S. 620, 49 S. Ct. 432 (1929); *Miller v. Milwaukee*, 272 U. S. 713, 47 S. Ct. 280 (1926); and *Powell*, "The Macallen Case—and Before," 8 NAT. INCOME TAX MAG. 47 (1930).

<sup>10</sup> 1 COOLEY, TAXATION, 4th ed., § 60 (1924); 2 *id.*, § 672.

<sup>11</sup> *Sioux City v. School District*, 55 Iowa 150, 7 N. W. 488 (1880); *Edwards & Walsh Construction Co. v. Jasper County*, 117 Iowa 365, 90 N. W. 1006 (1902); *Iowa Mutual Tornado Ins. Assn. v. Gilbertson*, 129 Iowa 658, 106 N. W. 153 (1906); *State v. City of Des Moines*, 221 Iowa 642, 266 N. W. 41 (1936); *Samuelson v. Horn*, 221 Iowa 208, 265 N. W. 168 (1936).

<sup>12</sup> *Van Dyke v. Wisconsin Tax Commissioner*, 217 Wis. 528, 259 N. W. 700 (1935); *Clyde v. Wendell*, 232 N. Y. 550, 134 N. E. 567 (1921).

<sup>13</sup> See cases cited note 9, *supra*.