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TAXATION - EXEMPTION OF FEDERAL INSTRUMENTALITY FROM STATE GASOLINE TAX

TAXATION — EXEMPTION OF FEDERAL INSTRUMENTALITY FROM STATE GASOLINE TAX — An Alabama statute [1] provided that "Every distributor, refiner, retail dealer or storer of gasoline . . . shall pay an excise tax . . . upon the selling, distributing, storing or withdrawing from storage in this State for any use, gasoline. . . ." The plaintiff, a private corporation, sold gasoline to the United States for use in performing governmental functions [2] without reporting it for taxation. When the state demanded payment, the plaintiff brought this suit to restrain collection. *Held* (Justices Cardozo and Brandeis dissenting), the operation of the statute violates the constitutional principle safeguarding the federal government against state taxation. *Graves v. Texas Co.*, (U. S. 1936) 56 S. Ct. 818.

In *McCulloch v. Maryland*,[3] Mr. Chief Justice Marshall laid down the broad proposition that a state cannot in any manner tax an instrumentality of the United States; and the converse, the exemption of state instrumentalities, was

[1] Ala. Gen. Acts (1935), § 348, p. 509, schedule 156.1.

[2] The plaintiff has been selling gasoline to a large number of federal agencies which are listed in a footnote to the decision of the lower court in the principal case. Texas Co. v. Carmichael, (D. C. Ala. 1935) 13 F. Supp. 242.

[3] 4 Wheat. (17 U. S.) 316 (1819). The decision has often been given effect. Weston v. Charleston, 2 Pet. (27 U. S.) 449 (1829); Dobbins v. Erie County, 16 Pet. (41 U. S.) 435 (1842); Farmers' & Mechanics' Sav. Bank v. Minnesota, 232 U.S. 516, 34 S. Ct. 354 (1913); Indian Terr. Illum. Oil Co. v. Oklahoma, 240 U. S. 522, 36 S. Ct. 453 (1915); Gillespie v. Oklahoma, 257 U. S. 501, 42 S. Ct. 171 (1922); Panhandle Oil Co. v. Knox, 277 U. S. 218, 48 S. Ct. 451 (1928), noted 42 HARV. L. REV. 128 (1928), 27 MICH. L. REV. 225 (1928). Compare Trinityfarm Const. Co. v. Grosjean, 291 U. S. 466, 54 S. Ct. 469 (1934), noted 22 GEORGETOWN L. J. 868 (1934).

established later by *Collector v. Day*.[4] Thus at an early stage there was written into American constitutional doctrine an absolute limitation upon the general taxing power.[5] But the economic and political development of the country has rendered difficult the literal application of Marshall's rule.[6] The extension of immunity from taxation not only deprives the state and federal governments of important sources of revenue [7] but might itself have the "power to destroy." [8]

[4] 11 Wall. (78 U. S.) 113 (1871). Also see, Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 S. Ct. 673 (1895); South Carolina v. United States, 199 U. S. 437, 26 S. Ct. 110 (1905); Indian Motocycle Co. v. United States, 283 U. S. 570, 51 S. Ct. 601 (1931), noted 10 N. C. L. REV. 106 (1931); Burnet v. Coronado Oil & Gas Co., 285 U. S. 393, 52 S. Ct. 443 (1932), noted 41 YALE L. J. 1093 (1932). Compare, Metcalf & Eddy v. Mitchell, 269 U. S. 514, 46 S. Ct. 172 (1926); Group No. 1 Oil Corp. v. Bass, 283 U. S. 279, 51 S. Ct. 432 (1931), noted 5 So. CAL. L. REV. 254 (1932); Burnet v. A. T. Jergins Trust, 288 U. S. 508, 53 S. Ct. 439 (1933).

[5] Said Chief Justice Marshall in McCulloch v. Maryland, 4 Wheat. (17 U. S.) 316 at 432 (1819): "If the states may tax one instrument, employed by the government in the execution of its powers, they may tax any and every other instrument." Then uttering the famous dictum that "the power to tax involves the power to destroy," he found on the theory that the United States is constructively without the local, territorial jurisdiction of the individual states, in every respect, and for every purpose a total failure of power in the states. See Dowling, Cheatham and Hale, "Mr. Justice Stone and the Constitution," 36 COL. L. REV. 351 at 353 (1936).

With respect to immunity from state taxes, the Supreme Court in Johnson v. Maryland, 254 U. S. 51 at 55, 41 S. Ct. 16 (1920), said: "The decision in that case [McCulloch v. Maryland, 4 Wheat. (17 U. S.) 316 (1819)] was not put upon any consideration of degree but upon the entire absence of power on the part of the States to touch, in that way, at least, the instrumentalities of the United States . . . and that is the law today. . . ."

[6] In recent years the Court has expressed opposition to expansion of Marshall's doctrine. "This Court, in drawing the line which defines the limits of the powers and immunities of state and national governments, is not intent upon a mechanical application of the rule that government instrumentalities are immune from taxation, regardless of the consequences to the operations of government. . . ." Educational Films Corp. v. Ward, 282 U. S. 379 at 391, 51 S. Ct. 170 (1931). Also see the statement by Justice Stone in his dissenting opinion in Indian Motocycle Co. v. United States, 283 U. S. 570 at 580, 51 S. Ct. 601 (1931): "The implied immunity of one government, either national or state, from taxation by the other should not be enlarged. . . . The practical effect of enlargement is commonly to relieve individuals from a tax, at the expense of the government imposing it, without substantial benefit to the government for whose theoretical advantage the immunity is invoked. . . ."

Again in Metcalf & Eddy v. Mitchell, 269 U. S. 514 at 522, 46 S. Ct. 172 (1926), Justice Stone states that "not every person who uses his property or derives a profit, in his dealings with the government, may clothe himself with immunity from taxation on the theory that either he or his property is an instrumentality of government within the meaning of the rule."

[7] See 1 N. J. L. REV. 98 (1935) where it is suggested that a universal application of Marshall's doctrine would create a serious financial crisis. It is estimated that today there is invested in tax-exempt securities over thirty-one billion dollars. As a result proposals have been made suggesting a constitutional amendment to eliminate tax-exempt securities. 10 ST. JOHN'S L. REV. 45 (1935). Also see Crewe, "Sidelights on Intergovernmental Exemptions," 11 TAX MAG. 210 (1933).

[8] "The power to tax is the one great power upon which the whole national fabric

Thus, the major problem confronting the courts has been to prevent the federal and state units from treading on each others toes without at the same time closing important avenues of taxation.[9] The resulting clash between precedent and practicality has created confusion in the cases. For example, while the United States may not tax the bonds or interest thereof issued by the state or municipal corporations,[10] nevertheless it may include in its income tax the profits derived from the sale of such securities.[11] Similarly, while a state may not collect a tax on gasoline sold to the United States,[12] yet a state may collect such a levy on gasoline used by a corporation in operating machinery under a contract with the Federal Government.[13] And while the Court declared that royalties from patents issued by the United States to an individual could not be taxed as income,[14] nevertheless, in an opinion only three years later it permitted a state to measure a corporate franchise tax on the company's net income, including that derived from copyright royalties.[15] Though the course of a century has brought no guiding principle, it has seen the doctrine relating to the immunity of governmental instrumentalities evolve from a "total failure" of power into an inquiry whether the exercise of the power produces "undue interference." [16] The latter view is to be preferred in that it establishes a flexible standard under which the Court may consider the economic consequences

is based. It is as necessary to the existence and prosperity of a nation as is the air he breathes to the natural man. It is not only the power to destroy, but it is also the power to keep alive." Nicol v. Ames, 173 U. S. 509 at 515, 19 S. Ct. 522 (1899).

[9] "To give both to the power and to the immunity such a practical construction as will not unduly restrict the power of the government imposing the tax, or the exercise of the function of the government which may be affected by it, is the problem necessarily involved in determining the extent of the immunity. . . ." Educational Films Corp. v. Ward, 282 U. S. 379 at 388, 51 S. Ct. 170 (1931).

[10] Weston v. Charleston, 2 Pet. (27 U. S.) 449 (1829); Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 S. Ct. 673 (1895). The theory upon which these cases rest is that to tax the bonds or interest is to increase the cost of governmental financing and so interfere with a government instrumentality.

[11] Willcuts v. Bunn, 282 U. S. 216, 51 S. Ct. 125 (1931). Here a tax on the profits to the investor on his resale of government securities was not considered a real and substantial burden upon the power to borrow money and therefore valid.

[12] Panhandle Oil Co. v. Knox, 277 U. S. 218, 48 S. Ct. 451 (1928).

[13] Trinityfarm Const. Co. v. Grosjean, 291 U. S. 466, 54 S. Ct. 469 (1934).

[14] Long v. Rockwood, 277 U. S. 142, 48 S. Ct. 463 (1928).

[15] Educational Films Corp. v. Ward, 282 U. S. 379, 51 S. Ct. 170 (1931); Fox Film Corp. v. Doyal, 286 U. S. 123, 52 S. Ct. 546 (1932), noted 31 MICH. L. REV. 137 (1932). Also see 1 N. J. L. REV. 98 (1935).

[16] In Railroad Co. v. Peniston, 18 Wall. (85 U. S.) 5 at 36 (1873), the Court stated: "exemption of Federal agencies from State taxation is dependent, not upon the nature of the agents, or upon the mode of their constitution, or upon the fact that they are agents, but on the effect of the tax; that is, upon the question whether the tax does in truth deprive them of the power to serve the government as they were intended to serve it, or does it hinder the efficient exercise of their power. . . ." For an excellent article reviewing the recent cases and concluding that a tax will not now be overthrown "unless either discriminatory or else seriously and practically, rather than

of each case. The decision in the instant case follows the language of a bare majority in *Panhandle Oil Co. v. Knox* [17] where a state excise tax assessed on the number of gallons sold was disallowed on sales to a federal agency. The Alabama tax, however, has been interpreted as an excise upon the privilege of storage measured by withdrawals.[18] Thus the *Panhandle* decision is carried to new bounds by the rule of the principal case that "A tax upon anything so essential to the sale of gasoline to the United States [as storage followed by withdrawal [19]] is as objectionable as would be a tax upon the sale itself." The view of the minority that the burden is only remote seems more desirable as a closer approach to reality.[20] It is true that the tax increases somewhat the cost to the federal government,[21] but the effect will be the same as other state taxes, admittedly valid, which increase the cost of gasoline.[22] Furthermore, since the real reason for the limitation upon the taxing power is to insure self-preservation of the governments,[23] exemption should be limited to those cases in which the tax directly burdens the exercise of governmental functions.[24]

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merely theoretically, burdensome," see Brown, "Federal and State Taxation—1930-1932," 81 UNIV. PA. L. REV. 247 at 256 ff. (1933).

Justice Stone has consistently maintained that the limitation upon taxing power must receive a practical construction and that an inquiry should be made in each case to determine whether a tax actually produces "undue interference" with governmental functions. See Dowling, Cheatham and Hale, "Mr. Justice Stone and the Constitution," 36 COL. L. REV. 351 at 353 (1936).

[17] 277 U. S. 218, 48 S. Ct. 451 (1928). See comment, 23 ILL. L. REV. 707 (1929), and also 77 UNIV. PA. L. REV. 115 (1928).

[18] Ervin v. State of Alabama, (C. C. A. 5th, 1935) 80 F. (2d) 432; State v. City of Montgomery, 228 Ala. 93, 151 So. 856 (1933); Pan American Petroleum Corp. v. State of Alabama, (C. C. A. 5th, 1933) 67 F. (2d) 590.

[19] It is difficult to see how a storer of gasoline who is connected with the Federal Government merely by happening to be its vendor can be called an instrumentality of the Government.

[20] It would seem that a tax on storage would be "not a part of the sale but preliminary to it and wholly the vendor's affair." Wheeler Lumber Bridge & Supply Co. v. United States, 281 U. S. 572 at 579, 50 S. Ct. 419 (1930).

[21] Justice Holmes in his dissenting opinion in Panhandle Oil Co. v. Knox, 277 U. S. 218, 48 S. Ct. 451 (1928), argues that the Federal Government when it comes into a state to purchase should contribute in the same proportion that every other purchaser contributes for the privileges it uses.

[22] In Wheeler Lumber Bridge & Supply Co. v. United States, 281 U. S. 572, 50 S. Ct. 419 (1930), the Court upheld a federal tax on transportation charges for materials sold and shipped to state instrumentalities on the ground that the tax was not on the materials or the sale but on a preliminary service rendered the seller. Also see the dissenting opinion of Justice Stone in Indian Motocycle Co. v. United States, 283 U. S. 570, 51 S. Ct. 601 (1931).

[23] "The purpose is the preservation to each government, within its own sphere, of the freedom to carry on those affairs committed to it by the Constitution, without undue interference by the other." Educational Films Corp. v. Ward, 282 U. S. 379 at 392, 51 S. Ct. 170 (1931).

[24] For a general discussion, see Boudin, "The Taxation of Governmental Instrumentalities," 22 GEORGETOWN L. J. 1 and 254 (1933-1934).