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TAXATION - IMMUNITY OF STATE OFFICERS FROM FEDERAL INCOME TAX-TRUSTEES OPERATING BOSTON ELEVATED RAILWAY COMPANY AS STATE OFFICERS

TAXATION — IMMUNITY OF STATE OFFICERS FROM FEDERAL INCOME TAX — TRUSTEES OPERATING BOSTON ELEVATED RAILWAY COMPANY AS STATE OFFICERS — A state law provided for public operation of the Boston Elevated Railway Company, with a board of trustees appointed by the governor with the advice and consent of the council. The salaries of the trustees were received from the company. The trustees were to manage and operate the company, having "possession of said properties in behalf of the Commonwealth." They were to fix rates of fare that would insure sufficient income to meet the cost of service including, in addition to operating expenses, specified rates of return on the investment. If the rates were insufficient for this purpose the deficit was to be paid by the Commonwealth and then assessed upon the cities and towns in which the company operated. *Held*, that the compensation of the board of trustees is not exempt from the federal income tax. *Helvering v. Powers*, 293 U. S. 214, 55 Sup. Ct. 171 (1934).

The principle that a state agency or instrumentality is not subject to federal taxation was first established in *Collector v. Day*.[1] While the case involved the question whether the salary of a state judge was subject to a federal income tax, the Court indicated that the immunity extended to all "the means and instrumentalities employed for carrying on the operations of their governments." In *South Carolina v. United States*,[2] an important limitation or modification of this principle of exemption of state instrumentalities from federal taxation was begun.[3] Immunity was now limited to those state agencies and instrumentalities which

[1] 11 Wall. (78 U. S.) 113 at 125, 20 L. ed. 122 (1870). In McCulloch v. Maryland, 4 Wheat. (17 U. S.) 316, 4 L. ed. 579 (1819), the Supreme Court had decided that a state tax on the issues of notes of the United States Bank was unconstitutional. The Court reasoned that though the Constitution contains no express provisions prohibiting such a tax, such a limitation was necessarily implied, as the government could not maintain its sovereignty if subjected to taxation by the states. Under our federal system, the doctrine of Collector v. Day does not seem to be a necessary nor logical corollary of McCulloch v. Maryland. Because the states may not tax national instrumentalities it does not necessarily follow that the national government may not tax state agencies. 1 WILLOUGHBY, THE CONSTITUTIONAL LAW OF THE UNITED STATES, 2d ed., 167 (1929).

[2] 199 U. S. 437, 26 Sup. Ct. 110 (1905). It seems as if a distinction might be made between a federal tax upon income accruing to a state from a state enterprise and a tax upon the income of an employee engaged in that enterprise. The courts have, however, treated the situations as analogous.

[3] In Metcalf & Eddy v. Mitchell, 269 U. S. 514, 46 Sup. Ct. 172 (1925), another limitation on Collector v. Day was established. The Court now held that persons engaged by a state as consulting engineers to advise regarding a proposed water supply and sewage disposal system were not "officers or employees" entitled to national income tax exemption with respect to compensation received from a state or political subdivision thereof for such services. Also see Reed v. Com'r of Internal Revenue, (C. C. A. 3d, 1929) 34 F. (2d) 263, aff'd in Lucas v. Reed, 281 U. S. 699, 50 Sup. Ct. 352 (1929), holding that an attorney representing a state in inheritance tax matters is not a state officer or employee and taxable; Blair v. Byers, (C. C. A. 8th, 1929) 35 F. (2d) 326, holding that an attorney retained by a board of waterworks trustees for part-time work must pay an income on the money received for such services.

were of a strictly governmental character.[4] The case did not, however, lay down any satisfactory test or formula to determine whether an activity or function is governmental and thus exempt from federal taxation.[5] While many cases involving the question have been decided since that time, no satisfactory test has yet been devised. Probably the most satisfactory test, and the one which seems to have guided the courts, is to grant immunity from federal taxation only to those activities which are historically governmental activities.[6] Applying this principle to the present case the decision would seem to be proper.[7] On the basis of authority the case would also seem to be properly decided.[8] With the increase

[4] While the Sixteenth Amendment, which was adopted in 1913, provides that, "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration," the Supreme Court has indicated that this has not extended the taxing power of the federal government over state agencies and instrumentalities of a governmental nature. Thus, items of income which were not taxable by the federal government before the Amendment was adopted were not taxable after its adoption. Brushaber v. Union Pacific R. R., 240 U. S. 1, 36 Sup. Ct. 236 (1916); Stanton v. Baltic Mining Co., 240 U. S. 103, 36 Sup. Ct. 278 (1916); Eisner v. Macomber, 252 U. S. 189, 40 Sup. Ct. 189 (1920); Peck & Co. v. Lowe, 247 U. S. 165, 38 Sup. Ct. 432 (1918); Evans v. Gore, 253 U. S. 245, 40 Sup. Ct. 550 (1920).

[5] While the Court referred to the distinction of governmental and corporate capacities of municipalities in the tort field, that basis was not adopted. Neither has it been followed by the courts in the cases which have arisen since that time. See Magill, "Tax Exemption of State Employees," 35 YALE L. J. 956 at 964 (1926); Doddridge, "Distinction Between Governmental and Proprietary Functions of Municipal Corporations," 23 MICH. L. REV. 325 (1925).

[6] In Flint v. Stone Tracy Co., 220 U. S. 107 at 172, 31 Sup. Ct. 342 at 357 (1911), the Court said: "The true distinction is between the attempted taxation of those operations of the States essential to the execution of its governmental functions, and which the State can only do itself, and those activities which are of a private character."

[7] In Flint v. Stone Tracy Co., 220 U. S. 107 at 172, 31 Sup. Ct. 342 (1911), the Court said: "It is no part of the essential governmental functions of a State to provide means of transportation, supply artificial light, water and the like."

[8] In the tort and other fields, street railways have uniformly been classed as a corporate or proprietary function. See Doddridge, "Distinction Between Governmental and Proprietary Functions of Municipal Corporations," 23 MICH. L. REV. 325 (1925); Borchard, "Governmental Responsibiltiy in Tort," 36 YALE L. J. 1, 757, 1039 (1926-1927). A contrary view as to the nature of a street railway was taken in Frey v. Woodworth, (D. C. E. D. Mich. 1924) 2 F. (2d) 725, dismissed in the Supreme Court on the motion of the solicitor general in Woodworth v. Frey, 270 U. S. 669, 46 Sup. Ct. 347 (1926). The Court held that the City of Detroit in operating a street railway was engaged in a governmental function. The Court based its decision on the ground that a street railway was an extension of the maintenance of highways. For criticism of this view see: 38 HARV. L. REV. 793 (1925); 25 COL. L. REV. 653 (1925); 73 UNIV. PA. L. REV. 419 (1925). *Cf.* City of Seattle v. Poe, (D. C. W. D. Wash. 1925) 4 F. (2d) 276.

In the present case the fact that in 1919 nearly $4,000,000 was paid by the state of Massachusetts to this company as a deficiency resulting from public operation, and that in the subsequent years up to 1929 the income received was not sufficient for

in functions performed by states and municipalities, the need of a rather strict delimitation of the category of tax-immune, governmental activities would also appear to be economically desirable.[9] It is suggested that the most satisfactory solution of this problem would be that a federal tax on a state instrumentality would be prohibited only if it was discriminatory, or if it actually burdened the sovereignty of the state.[10] This would appear to be a more significant consideration than the question of whether the activity is governmental or corporate. Since we cannot expect the courts to abandon he principle laid down in *McCulloch v. Maryland*,[11] and its corollary, as stated in *Collector v. Day*, the next most desirable solution seems to be a strict limitation of the category of governmental activities.

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full reimbursement, might have been considered as tending to put this activity in the governmental class. This is one of the tests which is applied in the tort field to determine whether a function is governmental or corporate. While the fact of this deficit was referred to in the present case, it was dismissed without comment.

[9] That the granting of immunity from federal taxation to all state activities, both governmental and corporate, might result in undue encroachment upon the federal revenues was emphasized in South Carolina v. United States, 199 U. S. 437, 26 Sup. Ct. 110 (1905). The recent trend towards state-administered liquor systems indicates the extent to which the states might encroach upon the sources of federal revenue if the scope of tax-immune activities was not limited. Ohio v. Helvering, 292 U. S. 360, 54 Sup. Ct. 725 (1934).

[10] As stated by Mr. Justice Holmes, as long as the Supreme Court sits, the power to tax is not the power to destroy. Dissenting opinion in Panhandle Oil Co. v. State of Mississippi, 277 U. S. 218 at 223, 48 Sup. Ct. 451 at 453 (1928). See 81 UNIV. PA. L. REV. 194 (1932).

[11] 4 Wheat. (17 U. S.) 316, 4 L. ed. 579 (1819).