

THE TAXING POWER
OF THE
FEDERAL AND STATE GOVERNMENTS

REPORT
TO THE
JOINT COMMITTEE ON INTERNAL
REVENUE TAXATION
PURSUANT TO
SECTION 1203 (b) (6), REVENUE ACT OF 1926

PRINTED FOR THE
EXAMINATION AND USE OF THE MEMBERS OF THE COMMITTEE

NOTE.—This report has been ordered printed for purposes of information and discussion, but it has not yet been considered or approved by the committee or any member thereof



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LETTER OF TRANSMITTAL

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, November 24, 1936.

To Members of the Joint Committee on Internal Revenue Taxation:

There is transmitted herewith a report on The Taxing Power of the Federal and State Governments, as prepared by the staff of the committee.

The report deals primarily with the limitations on the Federal and State taxing power under the Federal and State constitutions. However, the inherent limitations upon the Federal, State, and local Governments are also discussed. No attempt has been made to express individual opinions, the report merely developing the law as applied by the Supreme Court to actual cases.

In view of the large number of constitutional questions affecting taxation which have been considered by the Supreme Court in the last few years, it is believed that this report will be of particular interest to the members of the committee, especially as a ready reference to actual cases decided by the Supreme Court.

Very truly yours,

PAT HARRISON,
Chairman, Joint Committee on Internal Revenue Taxation.

LETTER OF SUBMITTAL

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, October 8, 1936.

HON. PAT HARRISON,
*Chairman, Joint Committee on
Internal Revenue Taxation,
Washington, D. C.*

MY DEAR MR. CHAIRMAN: There is submitted herewith a report containing a discussion of the powers of the Federal, State, and local Governments to impose and levy taxes. The report is divided into three parts, as follows:

Part I. Powers of the Federal Government.

Part II. Powers of the State governments.

Part III. Powers of counties, municipalities, and subdivisions.

The report discusses the inherent limitations upon the Federal, State, and local governments in addition to the limitations contained in the Federal and State Constitutions.

In a brief way this subject was covered in a preliminary report on "Double Taxation" prepared in 1932 by the staff of the Joint Committee on Internal Revenue Taxation at the direction of the Committee on Ways and Means and at the request of its Subcommittee on Double Taxation, of which Hon. Fred M. Vinson, of Kentucky, was chairman. However, since that time many constitutional questions have arisen which were not covered in the preliminary report. In fact, during the past few years the Supreme Court has had occasion to dispose of many constitutional questions which have been unsettled since the foundation of the country.

In the Federal field questions involving delegation of legislative power, the meaning of "general welfare" as used in the taxing clause of the Constitution, the effect of the tenth amendment upon the taxing power, the taxability of stock dividends, the right of court review of constitutional facts, the power of Congress to tax trusts created to avoid the estate or income tax, and the right of stockholders to maintain suits to enjoin collection of Federal taxes are all questions which have been recently considered and passed upon by the Supreme Court.

In the State field many constitutional questions have also recently been decided in the last few years. The effect of the police power of a State upon the provision of the Federal Constitution relating to the impairment of contracts, the right of the courts to set aside assessments made by State officers on the ground that they are arbitrary or excessive, the right of a State to discriminate against its own citizens in favor of citizens of other States, and the right of a State to tax property located, or income earned, outside its borders are all questions which have been recently considered by the Supreme Court.

Special consideration has been given in the report to the power of the Federal and State Governments to tax the income of Federal or State securities or the salaries of Federal and State employees. No attempt has been made in the report to express individual opinions, but merely to set forth the law as interpreted and construed by the courts. It is hoped that the report will furnish a ready reference to Members of Congress and the public as to the powers of the Federal, State, and local governments to levy and impose taxes.

In the preparation of the report valuable assistance was rendered by Mr. W. L. Wallace, attorney, and Mr. Carl A. Phillipps, technical assistant of the staff, in connection with the data relating to State constitutions.

Respectfully submitted.

COLIN F. STAM, *Counsel.*

Approved:

L. H. PARKER, *Chief of Staff.*

PROVISIONS OF FEDERAL CONSTITUTION RELATING TO TAXATION

Article 1, section 2, clause 3: "Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three-fifths of all other Persons."¹

Article 1, section 7, clause 1: "All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with amendments as on other bills."

Article 1, section 8, clause 1: "The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts, and excises shall be uniform throughout the United States."

Article 1, section 9, clause 4: "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration hereinbefore directed to be taken."

Article 1, section 9, clause 5: "No Tax or Duty shall be laid on Articles exported from any State."

Article 1, section 9, clause 6: "No Preference shall be given by any Regulation of Commerce or Revenue to the Ports of one State over those of another; nor shall Vessels bound to, or from, one State, be obliged to enter, clear, or pay Duties in another."

Article 1, section 10, clause 2: "No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws; and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Controul of the Congress."

Amendment Article XVI: "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."

¹The part of this clause relating to the mode of apportionment of Representatives among the several States was amended by the fourteenth amendment, sec. 2, and as to taxes on incomes, by the sixteenth amendment, which is quoted above.

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THE TAXING POWER OF THE FEDERAL AND STATE GOVERNMENTS

INTRODUCTION

The power to levy taxes for the support of governments has long been recognized as one of the most essential attributes of sovereignty. Without this no government is able to function properly. Its decrees are mere idle gestures, due to its inability to provide revenue to put them into execution. Before the adoption of the Constitution, the States (or the people) had the sovereign power to tax, but the Confederation created by the 13 colonies to carry on the Revolutionary War had no such power. To raise revenue the old Confederation was obliged to make requisitions upon the States, which respected or disregarded such requisitions at their pleasure. The framers of the Constitution, recognizing this fatal weakness, were careful to provide in the Federal Constitution for the levying of taxes directly by the National Government.

In this country we have a dual system of government—that is, a Federal Government and State governments. The revenues of the Federal Government must be obtained in the same territory, from the same people, and, in some instances, even from the same activities as are also reached by the States in order to support their local governments. Both the Federal and the State Governments are supreme in their sphere of action and are exempt from interference or control by each other. The taxing power of the Federal Government will first be discussed and then that of the States and their political subdivisions.

PART I. POWERS OF THE FEDERAL GOVERNMENT

A. SCOPE OF POWERS

1. REVENUE BILLS TO ORIGINATE IN HOUSE

The Federal Government is a government of delegated powers, which are defined and limited by the Constitution. It is divided into three branches—the executive, the legislative, and the judicial. “The legislative makes, the executive executes, and the judicial construes the laws.” The legislative branch—the Congress of the United States—has the sole power under the Constitution to levy taxes. The reason for this becomes apparent when one considers the conditions existing at the time of the adoption of the Constitution. The men who framed the Constitution had just emerged from the struggle for independence, the rallying cry of which had been “Taxation

without representation is tyranny." In other words, they were staunch advocates of the principle that the consent of those who were expected to pay the tax was essential to its validity. The Congress of the United States, and especially the House of Representatives, more truly represents the people than any other branch of the Government. It is peculiarly fitting, therefore, that the Constitution should provide that all bills for raising revenue should originate in the House of Representatives,¹ so that the tax so voted would fall upon the constituents of those who imposed it. Indeed, the Cotton Futures Act of August 18, 1914, was held to be unconstitutional in the case of *Hubbard v. Lowe*,² because it did not originate in the House of Representatives. The Supreme Court has held, however, that this requirement does not extend to bills for other than revenue purposes, although they incidentally create revenue.³ Furthermore, in *Flint v. Stone Tracy Co.*,⁴ the Supreme Court held that the Senate had the right to substitute a corporation tax for a plan of inheritance taxation as contained in the bill originally introduced in the House, for the reason that the bill properly originated in the House and the amendment made by the Senate was germane to its subject matter.

The power to appropriate is also derived from the taxing power, as subsequently pointed out in connection with the discussion of the general-welfare clause, and for that reason appropriation bills must also originate in the House of Representatives. It is interesting to note that the British also require bills for granting money to originate in the House of Commons. The following is quoted from De Lolme, *Constitution of England*, page 59, edition London, 1834:

All bills for granting money must have their beginning in the House of Commons; the Lords cannot take this object into their consideration but in consequence of a bill presented to them by the latter.

2. REVENUE BILLS DEFINED

Mr. Justice Story in his commentary on the Constitution, section 880, makes the following statement as to what is meant by bills for raising revenue in the constitutional sense:

What bills are properly "bills for raising revenue", in the sense of the Constitution, has been a matter of some discussion. A learned commentator supposes that every bill which indirectly or consequently may raise revenue is, within the sense of the Constitution, a revenue bill. He therefore thinks that the bills for establishing the post office and the mint, and regulating the value of foreign coin, belong to this class, and ought not to have originated—as in fact they did—in the Senate. But the principal construction of the Constitution has been against his opinion. And, indeed, the history of the origin of the power already suggested abundantly proves that it has been confined to bills to levy taxes in the strict sense of the words, and has not been understood to extend to bills for other purposes, which may incidentally create revenue. No one supposes that a bill to sell any of the public lands, or to sell public stock, is a bill to raise revenue, in the sense of the Constitution. Much less would a bill be so deemed which merely regulated the value of foreign or domestic coins, or authorized a discharge of insolvent debtors upon assignments of their estates to the United States, giving a priority of payment to the United States in cases of insolvency, although all of them might incidentally bring revenue into the Treasury.

¹ U. S. Constitution, art. 1, sec. 7, cl. 1.

² 226 Fed. 135, appeal dismissed, 242 U. S. 654.

³ *U. S. v. Norton* (91 U. S. 569); *Twin City National Bank v. Nebeker* (167 U. S. 196); *Rainey v. U. S.* (232 U. S. 310).

⁴ 220 U. S. 107.

In *Twin City Bank v. Nebeker*, cited *supra*, the Supreme Court held that an act of Congress providing a national currency secured by a pledge of bonds of the United States and which, in furtherance of that object, and also to meet the expenses attending the execution of the act, imposed a tax on the notes in circulation of the banking associations organized under the statute, is clearly not a revenue bill which the Constitution declares must originate in the House of Representatives.

3. DELEGATION OF LEGISLATIVE POWERS

Neither the President nor the courts have any power to impose taxes and the Congress has no authority to delegate such authority to them. This was clearly stated by the Supreme Court in the case of *Hampton and Co. v. U. S.*,⁵ in which the Court said that—

It is a breach of the national fundamental law if Congress gives up its legislative power and transfers it to the President or to the judicial branch.

It is not always easy to determine what is a legislative power, and this question has resulted in considerable litigation. The distinction usually drawn is between a power to make the law and a power to carry it into execution, to be exercised under such law. The first cannot be delegated, while the second can. For example, powers that cannot be delegated are the right to select the persons or objects to be taxed, or to determine the purpose for which the tax is to be imposed and the measure of taxation. On the other hand, administrative powers to enforce the law are frequently delegated to the executive department. In our first income-tax law many administrative powers of enforcement were conferred upon the Secretary of the Treasury, and the Supreme Court upheld the right of Congress to delegate such powers to the Secretary.⁶ Moreover, in the *Hampton case*, referred to above, the Supreme Court went a step further and upheld the flexible tariff provisions of section 315 (a) of the Tariff Act of 1922 as not being a delegation of legislative power. In that case the collector of customs increased the dutiable rate upon the importation of barium dioxide from 2 to 6 cents per pound in accordance with a proclamation of the President issued under authority of the flexible tariff provisions. Chief Justice Taft, who delivered the opinion of the Court, made the following statement:

It is conceded by counsel that Congress may use executive officers in the application and enforcement of a policy declared in law by Congress and authorize such officers in the application of the congressional declaration to enforce it by regulation equivalent to law. But it is said that this never has been permitted to be done where Congress has exercised the power to levy taxes and fix customs duties. The authorities make no such distinction. The same principle that permits Congress to exercise its rate-making power in interstate commerce by declaring the rule which shall prevail in the legislative fixing of rates, and enables it to remit to a rate-making body created in accordance with its provisions the fixing of such rates, justifies a similar provision for the fixing of customs duties on imported merchandise. If Congress shall lay down by legislative act an intelligible principle to which the person or body authorized to fix such rates is directed to conform, such legislative action is not a forbidden delegation of legislative power.

⁵ 276 U. S. 406.

⁶ *Brushaber v. Union Pacific Railroad Company* (240 U. S. 1).

However, in the case of the *Panama Refining Company v. Ryan*⁷ the Supreme Court made it clear that unless an act of Congress lays down a specific policy and establishes a definite standard for the executive department to follow, it will be declared unconstitutional as an unlawful delegation of legislative power. On the other hand, the Constitution prohibits the Congress from usurping the power vested in the executive or judicial branch of the Government. In this connection it is interesting to note that the Attorney General, in an opinion dated January 1, 1933,⁸ held that a committee of Congress was without authority to overrule a decision of the executive branch as to whether a refund of an internal-revenue tax was properly allowable under an act of Congress. But in a recent decision⁹ of the Supreme Court denying the power of the President to remove a Commissioner of the Federal Trade Commission except upon causes named in the Federal Trade Commission Act, the Court said:

The authority of Congress, in creating quasi-legislative or quasi-judicial agencies, to require them to act in discharge of their duties independently of executive control cannot well be doubted; and that authority includes, as an appropriate incident, power to fix the period during which they shall continue, and to forbid their removal except for cause in the meantime.

Included within such agencies are the Federal Trade Commission, the Interstate Commerce Commission, and the Court of Claims. In connection with the Federal Trade Commission, the Court made the following statement:

The Federal Trade Commission is an administrative body created by Congress to carry into effect legislative policies embodied in the statute in accordance with the legislative standard therein prescribed, and to perform other specified duties as a legislative or as a judicial aid. Such a body cannot in any proper sense be characterized as an arm or an eye of the executive. Its duties are performed without executive leave and, in the contemplation of the statute, must be free from executive control. In administering the provisions of the statute in respect of "unfair methods of competition"—that is to say in filling in and administering the details embodied by that general standard—the Commission acts in part quasi-legislatively and in part quasi-judicially. In making investigations and reports thereon for the information of Congress under section 6, in aid of the legislative power, it acts as a legislative agency. Under section 7, which authorizes the commission to act as a master in chancery under rules prescribed by the Court, it acts as an agency of the judiciary. To the extent that it exercises any executive function—as distinguished from executive power in the constitutional sense—it does so in the discharge and effectuation of its quasi-legislative or quasi-judicial powers, or as an agency of the legislative or judicial department of the Government.

The Joint Committee on Internal Revenue Taxation, established by the Revenue Act of 1926, acts as a legislative agency. To the extent that it exercises an executive function, it does so as an agent of the legislative branch of the Government.

With the judicial branch rests the final decision as to whether an act of Congress is constitutional. In the case of *McCulloch v. Maryland*¹⁰ the Supreme Court said:

Should Congress, in the execution of its powers adopt measures which are prohibited by the Constitution, or should Congress under the pretext of executing its powers pass laws for the accomplishment of objects not entrusted to the

⁷ 293 U. S. 388.

⁸ Congressional Record, vol. 76, p. 2446, 72d Cong., 2d sess.

Ra h b n v. United States (295 U. S. 602).

¹⁰ 1 Wheat. 316.

Government; it would become the painful duty of this tribunal, should a case requiring such a decision come before it, to say that such an act was not the law of the land.

And in the case of *Butler v. United States*,¹¹ holding the Agricultural Adjustment Act unconstitutional, the Supreme Court said:

When an act of Congress is appropriately challenged in the courts as not conforming to the constitutional mandate, the judicial branch of the Government has only one duty—to lay the article of the Constitution which is invoked beside the statute which is challenged and to decide whether the latter squares with the former.

4. POWER TO LEVY TAXES, DUTIES, IMPOSTS, AND EXCISES

(A) IN GENERAL

It being clear that the power to levy taxes is vested in Congress, the extent of such power will now be considered. The Constitution¹² provides that—

The Congress shall have power to lay and collect taxes, duties, imposts, and excises, to pay the debts, and provide for the common defense and general welfare of the United States.

It should be noted that under this power Congress is given authority to levy and collect taxes and duties, imposts, and excises. This classification is broad enough to include every kind of tax. It was Chief Justice Fuller who pointed out in the *Pollock case*¹³ that, although there had been from time to time intimations that there might be some tax which was not included within this classification, such a tax for more than 100 years of national existence had remained undiscovered.

(B) TAX DEFINED

Mr. Justice Field, in his opinion in the first *Pollock case*, made the following statement as to the meaning of the word "tax":

The inherent and fundamental nature and character of a tax is that of a contribution to the support of the Government, levied upon the principle of equal and uniform apportionment among the persons taxed, and any other exaction does not come within the legal definition of a tax.

Mr. Justice Roberts, in the majority opinion, in the *Butler v. U. S.* case, already cited, defined the word "tax" as follows:

A tax, in the general understanding of the term, and as used in the Constitution, signifies an exaction for the support of the Government. The word has never been thought to connote the expropriation of money from one group for the benefit of another. We may concede that the latter sort of imposition is constitutional when imposed to effectuate regulation of a matter in which both groups are interested and in respect of which there is a power of legislative regulation. But manifestly no justification for it can be found unless as an integral part of such regulation. The exaction cannot be wrested out of its setting, denominated an excise for raising revenue and legalized by ignoring its purpose as a mere instrumentality for bringing about a desired end. To do this would be to shut our eyes to what all others than we can see and understand.

¹¹ 297 U. S. 1.

¹² U. S. Constitution, art. I, sec. 8, cl. 1

¹³ 157 U. S. 680.

(C) REGULATION INSTEAD OF TAX

An example of a case where a levy could not be upheld as a tax but was sustained as a regulation of a subject within the granted powers of Congress was presented by the Supreme Court in the *Butler case*. In this connection the Court said:

It does not follow that as the act is not an exertion of the taxing power and the exaction not a true tax, the statute is void or the exaction uncollectible. For, to paraphrase what was said in the *Head Money cases* (*supra*), page 596, if this is an expedient regulation by Congress, of a subject within one of its granted powers, "and the end to be attained is one falling within that power, the act is not void, because, within a loose and more extended sense than was used in the Constitution", the exaction is called a tax.

In the *Head Money cases*, an exaction was collected under the Immigration Act of 1882, which was paid into a special fund called the immigrant fund, to be used by the Secretary of the Treasury for care of immigrants. In answering objections to the act, the Court said:

But the true answer to all these objections is that the power exercised in this instance is not the taxing power. The burden imposed on the shipowner by the statute is the mere incident of the regulation of commerce—of that branch of foreign commerce which is involved in immigration. * * *

It is true not much is said about protecting the shipowner. But he is the man who reaps the profit from the transaction, * * *. The sum demanded of him is not, therefore, strictly speaking, a tax or duty within the meaning of the Constitution. The money thus raised, though paid into the Treasury, is appropriated in advance to the uses of the statute, and does not go to the general support of the Government.¹⁴

In *Veazie Bank v. Fenno*,¹⁵ a Federal exaction on bank circulation was upheld under the power to regulate the currency. And in *Board of Trustees v. U. S.*,¹⁶ the Court, in upholding a duty levied upon scientific apparatus imported by the University of Illinois for use in one of its educational departments, said:

Because the taxing power is a distinct power and embraces the power to lay duties, it does not follow that duties may not be imposed in the exercise of the power to regulate commerce. * * * The principle invoked by the petitioner, of the immunities of State instrumentalities from Federal taxation, has its inherent limitations. * * * The fact that the State in the performance of State functions may use imported articles does not mean that importation is a function of the State government independent of Federal power. The control of importation does not rest with the State but with the Congress. * * * It is for the Congress to decide to what extent, if at all, the States and their instrumentalities shall be relieved of the payment of duties on imported articles.

(D) DIRECT AND INDIRECT TAXES DISTINGUISHED

The term "taxes", as used in the Constitution, is ordinarily understood to refer to direct taxes as distinguished from indirect taxes, which latter are regarded as comprising duties, imposts, and excises. The distinction is important, as direct taxes are subject to the rule of apportionment and indirect taxes to the rule of uniformity. These rules will be discussed later.

A tax levied upon or collected from persons because of their general ownership of property is a direct tax. However, a tax imposed

¹⁴ *Head Money cases* (112 U. S. 580).

¹⁵ 8 Wall. 533.

¹⁶ 289 U. S. 48.

upon the exercise of a single power over property incidental to ownership is an excise or indirect tax. For instance, the Supreme Court held that the gift tax imposed by the Revenue Act of 1924 is an indirect tax for the following reasons:

It is a tax laid upon the exercise of a single one of those powers incident to ownership, the power to give the property owned to another. Under this statute all the other rights and powers which collectively constitute property or ownership may be fully enjoyed free of tax.¹⁷

Taxes on lands, houses, and other permanent real estate have always been deemed to be direct taxes, and capitation or poll taxes are direct taxes by the express words of the Constitution.¹⁸ Taxes on personal property have been regarded as direct taxes since the *Pollock case*.¹⁹ Taxes on income from real property or personal property were held to be direct taxes by the Supreme Court.¹⁹ Taxes upon incomes from professions, trades, employments, and vocations have always been regarded as excises, or indirect taxes.¹⁹ The sixteenth amendment to the Constitution specifically provides that income taxes shall not be subject to the rule of apportionment. The courts have pointed out that the effect of this amendment is to remove taxes on incomes from real or personal property from the direct-tax class and put them in the class of duties, imposts, and excises.²⁰ As stock dividends (such as a dividend in common stock of a corporation issued to its common shareholders) have been held not to be income,²¹ a tax on stock dividends would be a direct tax and subject to the rule of apportionment.²² It has been contended, however, that a tax on the right of corporations to declare stock dividends would be in the nature of an excise, and, therefore, not subject to the rule of apportionment.

With the exception of the income tax on real and personal property, there has been little direct taxation in our national history, and even the income tax on real and personal property has been removed from the direct class to the indirect class by the sixteenth amendment. The first direct tax was imposed in 1787²³ upon "dwelling houses, lands, and slaves." This was followed in 1813²⁴ by a tax upon "lands, lots of ground with their improvements, dwelling houses, and slaves." A similar tax was levied in 1815.²⁵ No other direct taxes were levied until the outbreak of the Civil War. In 1861²⁶ Congress voted a direct tax on real estate. This tax was found to be very difficult to enforce, due in a large measure to the War Between the States, and an act of Congress, passed March 2, 1891, provided for a return of the money collected from such tax to the States. Many other taxes were imposed during the Civil War period which might be classed as direct taxes but which were not imposed as such. The Civil War tax on real estate was the last tax which Congress attempted to levy as a direct tax as such and collect by

¹⁷ *Bromley v. McCaughn* (280 U. S. 124).

¹⁸ U. S. Constitution, art. 1, sec. 9, cl. 4.

¹⁹ *Pollock v. Farmers' Loan & Trust Co.* (157 U. S. 429; 158 U. S. 601).

²⁰ *Cook v. Tait* (286 Fed. 409), *Evans v. Gore* (253 U. S. 245), *Brushaber v. Union Pacific Railroad Co.* (240 U. S. 1).

²¹ *Koshland v. Helvering* (56 Sup. Ct. 767).

²² *Eisner v. Macomber* (252 U. S. 189).

²³ 1 U. S. Stat. 597.

²⁴ 3 U. S. Stat. 23, 26.

²⁵ 3 U. S. Stat. 164.

²⁶ 12 U. S. Stat. 292.

apportionment among the States. The States have long regarded direct taxes as their chief source of revenue, although the tendency of the States recently seems to be toward increasing their indirect taxes.

We have attempted in a general way to explain the meaning of direct taxes. Since the power to levy taxes under the Constitution reaches every subject, it necessarily follows that all taxes which are not direct taxes must fall within the classification of duties, imposts, and excises, otherwise known as indirect taxes.²⁷

(E) DUTY DEFINED

The term "duty" in its widest significance is hardly less comprehensive than the term "tax." In its restricted sense it is synonymous with the term "impost."

(F) IMPOST DEFINED

An impost was defined by Chief Justice Marshall²⁸ as a "custom, or tax, levied on articles brought into a country." In other words, it is a duty on imported goods and merchandise.

(G) EXCISE DEFINED

An excise has been defined as a tax laid upon the manufacture, sale, or consumption of commodities within the country, upon licenses to pursue certain occupations, and upon corporate privileges.²⁹ Furthermore, as heretofore stated, the Supreme Court has held that a tax upon a particular use of property or the exercise of a single power over property incidental to ownership is an excise.³⁰ Among the taxes which have been upheld as excises are taxes upon legacies, successions, gifts and estates, carriages, use of foreign-built boats, transfers in contemplation of death, the privilege of doing business in a corporate capacity, bank circulation, capital employed in the business of banking, the business of insurance companies, club dues, manufacture and sale of tobacco and distilled spirits, the business of refining oil or sugar, the sale of certificates of stock, the privilege of selling property at an exchange, and the manufacture of oleo-margarine and filled cheese.

5. SPECIFIC LIMITATIONS UPON FEDERAL TAXING POWER

There are certain limitations upon the Federal Government's power to levy the taxes authorized under the Constitution. These limitations will be discussed in the following order:

- (a) General restriction upon sovereignty.
- (b) To pay the debts and provide for the common defense and general welfare.
- (c) Rule of apportionment.

²⁷ *Brushaber v. Union Pacific Railroad Co.* (240 U. S. 1); *License Tax Cases* (5 Wall. (U. S.) 462).

²⁸ *Brown v. Maryland* (12 Wheat. 419).

²⁹ *Flint v. Stone Tracy Co.* (220 U. S. 107).

³⁰ *Bromley v. McCaughn* (280 U. S. 124).

- (d) Rule of uniformity.
- (e) Prohibition upon export taxes.
- (f) The due-process clause of the fifth amendment.
- (g) The tenth amendment.
- (h) Income under the sixteenth amendment.
- (i) Compensation of the President and Federal judges.
- (j) State securities.
- (k) State functions.

(A) GENERAL RESTRICTION UPON SOVEREIGNTY

(1) JURISDICTION

(a) *In general.*

As pointed out by Judge Cooley, the Federal Government's power to tax cannot extend beyond its inherent power of sovereignty. In other words, its power to tax must depend upon jurisdiction. Jurisdiction may be based on several distinct grounds—citizenship of the owner, his domicile, the source of income, and the situs of property.³¹

(b) *Citizens.*

The Federal Government could not impose a tax upon the property of a nonresident alien located outside of the United States, but it has the power to levy a tax upon an American citizen wherever domiciled. For example, the income of an American citizen domiciled in Mexico was held subject to the Federal income tax, although such income was derived solely from property located outside of the United States.³² This same rule has been applied to excise taxes. In a leading case on this point the Supreme Court upheld the right of Congress to levy an excise tax upon the use of a foreign-built boat outside of the United States by an American citizen who had a permanent domicile in a foreign country.³³ Following this decision, the Board of Tax Appeals held that the Federal Government had the power to subject to the Federal estate tax personal property of a citizen of the United States located abroad.³⁴ The Revenue Act of 1932, section 501, taxes gifts by nonresident citizens of property located outside the United States, whether the property is real or personal, tangible or intangible. Perhaps the most recent statement of this doctrine of the power of the Federal Government to tax its citizens wherever resident is in the case of *Blackmer v. U. S.*,³⁵ in which the court used the following language:

While it appears that the petitioner removed his residence to France in the year 1924, it is undisputed that he was, and continued to be, a citizen of the United States. He continued to owe allegiance to the United States. By virtue of the obligations of citizenship, the United States retained its authority over him, and he was bound by its laws made applicable to him in a foreign country. Thus, although resident abroad, the petitioner remained subject to the taxing power of the United States.

(c) *Nonresident aliens.*

In the case of nonresident aliens and foreign corporations the power of the Federal Government to levy taxes depends upon whether there

³¹ Cooley, *Law of Taxation*, sec. 57; *Burnet v. Brooks* (288 U. S. 378).

³² *Cook v. Tait* (265 U. S. 47).

³³ *U. S. v. Bennett* (232 U. S. 299).

³⁴ *Guaranty Trust Co. of New York*, 21 B. T. A. 331.

³⁵ 284 U. S. 421.

is any property situated in the United States or whether there is any income from sources within the United States. The theory is that as such persons enjoy the protection of the laws of the United States with respect to such property or income, they may be taxed for the benefits thus received. In the *Brooks* case,³⁶ the Supreme Court held that the Federal Government has the power to tax for estate-tax purposes securities owned by a nonresident alien if the certificates evidencing such securities are physically present in this country. In *De Ganay v. Lederer*³⁷ the Supreme Court held that the United States may tax a nonresident alien upon income received from a trust res which, although intangible, was held and administered by resident trustees within the United States. In *Ingram v. Bowers*³⁸ the Circuit Court of Appeals held that royalties received by Enrico Caruso, an Italian, from the sale of victrola records, recorded in the United States but sold throughout the world, were subject to the Federal income tax upon income from sources within the United States.

The Board of Tax Appeals in appeal of Marine Insurance Co., Ltd. (1926),³⁹ held that a foreign corporation was not taxable on interest on Anglo-French and British Government bonds, collected by a New York trust company as trustee for the corporation. This was in accord with a ruling of the Treasury Department⁴⁰ holding that income received by a domestic trustee, derived from foreign securities and currently distributable to nonresident beneficiaries, was not subject to the Federal income tax. However, the Treasury does not apply this rule to a trust for accumulation or where the distribution of the income is discretionary with the trustee.⁴¹ But income accruing to a nonresident alien in the form of interest from bonds and dividends on the stock of domestic corporations is subject to the Federal income tax.^{41a} And stocks and bonds of a domestic corporation held by a nonresident alien outside of the United States are also subject to the Federal estate tax. See *Burnet v. Brooks*, already cited. Moreover, the Board of Tax Appeals upheld the right of Congress to tax a foreign shareholder of a foreign corporation on the dividends received from such foreign corporation which derived more than 50 percent of its income from United States sources, even though the corporations' earnings in this country were removed to England and commingled with other corporate funds and there paid out as dividends.^{41b}

(B) TO PAY THE DEBTS AND PROVIDE FOR THE COMMON DEFENSE AND
GENERAL WELFARE

To quote Justice Story in his commentary on the Constitution:

Congress has not an unlimited power of taxation; but it is limited to specific objects—the payment of the public debts, and providing for the common defense and general welfare. A tax, therefore, laid by Congress for neither of these objects would be unconstitutional as in excess of its legislative authority.

³⁶ *Burnet v. Brooks* (288 U. S. 378).

³⁷ 250 U. S. 376.

³⁸ 57 Fed. (2d) 65.

³⁹ 4 B. T. A. 867.

⁴⁰ I. T. 1642, II-1, C. B. 81.

⁴¹ G. C. M. X-I, C. B. 166; G. C. M. 11221, XI-2, C. B. 123 (1932).

^{41a} *Brushaber v. Union Pacific Railway Co.* (240 U. S. 1).

^{41b} Lord Forres et al., 25 B. T. A. 154.

(1) DEBTS DEFINED

The Supreme Court has given a very broad interpretation to the term "debts." They include for the purpose of this provision not only debts enforceable at law but also moral obligations. The meaning of "debts" within this constitutional provision was fully explained in the case of *U. S. v. Realty Co.*⁴² In that case the question before the Court was whether Congress could lawfully collect money by imposing customs duties on imported merchandise and then make a free gift of a part of the proceeds to sugar manufacturers to encourage the production of high-grade sugars. Justice Peckham, who delivered the opinion of the court, said:

What are the debts of the United States within the meaning of this constitutional provision? It is conceded and, indeed, it cannot be questioned that the debts are not limited to those which are evidenced by some written obligation or to those which are otherwise of a strictly legal character. The term "debts" includes those debts or claims which rest upon a merely equitable or honorary obligation and which would not be recoverable in a court of law if existing against an individual. The Nation, speaking broadly, owes a "debt" to an individual when his claim grows out of general principles of right and justice; when, in other words, it is based upon considerations of a moral or mere honorary nature, such as are binding on the conscience or the honor of an individual, although the debt could obtain no recognition in a court of law. The power of Congress extends at least as far as recognition and payment of claims against the Government which are thus founded. * * * Their recognition depends solely upon Congress, and whether it will recognize claims thus founded must be left to the discretion of that body. Payments to individuals, not of right or of a merely legal claim, but payments in the nature of gratuity, yet having some feature of moral obligation to support them, have been made by the Government by virtue of acts of Congress, appropriating the public money, ever since its foundation.

(2) GENERAL WELFARE DEFINED

The term "common defense" is self-explanatory, but the term "general welfare" is so broad as to be impossible of definition. There are several different theories involving the general-welfare clause:

a. The general-welfare clause is a power by itself and not a limitation upon the taxing power.

b. The general-welfare clause is a limitation upon the taxing power and can be exercised only for purposes within the field of other enumerated powers. This is called the Madisonian theory.

c. Under the general-welfare clause, Congress may levy taxes and appropriate money for anything embracing the general welfare, whether or not within the field of enumerated powers. This is called the Hamiltonian theory, as espoused by Mr. Justice Story.

Each of these contentions will be discussed separately.

(a) *Whether a separate power.*

The term "general welfare" occurs in two places in the Constitution: First, in the preamble; and, second, in the taxing clause. In the preamble it is provided that "We, The People of the United States, in order to * * * promote the general Welfare * * * do ordain and establish this Constitution for the United States of America". The Supreme Court has held that the preamble is a mere statement of the purpose effected by the Constitution itself and con-

⁴² 163 U. S. 427.

tains no grant of power.⁴³ Therefore, if this power exists at all, it must be derived from the taxing clause already referred to. The history of the Constitutional Convention discloses that several attempts were made to include a welfare power in the Constitution but that these attempts were unsuccessful.⁴⁴ In this connection it is interesting to note the report of a speech made on June 16, 1798, on this clause by Albert Gallatin, of Pennsylvania, who was a member of the Constitutional Convention:

He was well informed that these words had originally been inserted in the Constitution as a limitation to the power of laying taxes. After the limitation had been agreed to and the Constitution was completed a member of the convention, being one of a committee of revisal and arrangement, attempted to throw these words into a distinct paragraph so as to create not a limitation but a distinct power. The trick, however, was discovered by a member from Connecticut, now deceased, and the words restored as they now stand. So that Mr. Gallatin said, whether he referred to the Constitution itself, to the most able defenders of it, or to the State conventions, the only rational construction which could be given to that clause was that it was a limitation, and not an extension of powers.⁴⁵

Hamilton, Madison, Jefferson, St. George Tucker, Mr. Justice Miller, and Mr. Justice Story all take the view that the "general-welfare clause" is not a power by itself but a limitation upon the taxing power.

On February 15, 1791, Thomas Jefferson, Secretary of State, said in his opinion upon the power of Congress to establish the Bank of the United States:

Congress are not to lay taxes ad libitum for any purpose they please; but only to pay the debts, or provide for the welfare of the Union. In like manner, they are not to do anything they please, to provide for the general welfare, but only to lay taxes for that purpose. To consider the latter phrase, not as describing the purpose of the first, but as giving a distinct and independent power to do any act they please, which might be for the good of the Union, would render all the preceding and subsequent enumerations of power completely useless. It would reduce the whole instrument to a single phrase, that of instituting a Congress with power to do whatever would be for the good of the United States; and, as they would be the sole judges of the good or evil, it would also be a power to do whatever evil they pleased. It is an established rule of construction, where a phrase will bear either of two meanings, to give it that which will allow some meaning to the other parts of the instrument, and not that which will render all the other useless. Certainly, no such universal power was meant to be given them. It was intended to lace them up strictly within the enumerated powers, and those without which, as means, these powers could not be carried into effect. It is known that the very power now proposed as a means, was rejected as an end by the Convention which formed the Constitution.

The Supreme Court in the *Hoosac Mills case*⁴⁶ also adopted this view, stating:

The view that the clause grants power to provide for the general welfare, independently of the taxing power, has never been authoritatively accepted. Mr. Justice Story points out that if it were adopted "it is obvious that under color of the generality of the words 'to provide for the common defense and general welfare' the Government of the United States is, in reality, a government of general and unlimited powers, notwithstanding the subsequent

⁴³ *Jacobsen v. Massachusetts* (197 U. S. 11); see also Story on the Constitution, 5th ed., sec. 462.

⁴⁴ Formation of the United States, pp. 466, 475, 616, 655, 660, 694, and 993.

⁴⁵ U. S. Annals of Congress, Fifth Congress, 1797-99, vol. 8, 1796; Framing the Constitution, Farrand, p. 182; A. B. A. Journal, August 1927.

⁴⁶ *Butler v. United States* (297 U. S. 1).

enumeration of specific powers." The true construction is that the only thing granted is the power to tax for the purpose of providing funds for payment of the Nation's debts and making provision for the general welfare.

(b) *The Madisonian theory.*

The Madisonian theory holds that the general-welfare clause is merely descriptive of the enumerated powers, and is, therefore, limited to purposes necessary for carrying out such enumerated powers. Under this theory Congress has no authority to tax and spend for any purpose which is not within the field of such enumerated powers. This theory has the support of Jefferson and St. George Tucker. It also appears to have the support of Chief Justice Marshall, for he said in *Gibbons v. Ogden*,⁴⁷ "Congress is not empowered to tax for those purposes which are within the exclusive power of the States." The Supreme Court in the *Hoosac Mills case*⁴⁸ concluded that this was not the correct view but this conclusion was obiter dicta, and was not necessary to the decision.

(c) *The Hamiltonian theory.*

The Hamiltonian theory has the support of Mr. Justice Story, Monroe, Willoughby, and many text writers. It also has the support of the Supreme Court, for in the *Hoosac Mills case* the Court said:

We shall not review the writings of public men and commentators or discuss the legislative practice. Study of all these leads us to conclude that the reading advocated by Mr. Justice Story is the correct one.

While this conclusion of the Court was obiter dicta, it is at least persuasive as to the attitude of the Court on this question. Mr. Justice Story in his commentary on the Constitution explains his reading as follows:

The distinction between the power to make internal improvements and the power to appropriate is that in the latter, Congress may appropriate to any purpose which is for the common defense or general welfare; but in the former it may engage in such undertakings only as a means or incident to its enumerated powers.

For instance, Congress may authorize the making of a canal as an incident to the power to regulate commerce, or authorize the purchase of buildings, customhouses, and public warehouses as incidents to the power to lay and collect taxes. However, Congress could not authorize Federal authorities to go into a State and create an educational department; but they could authorize the Federal Government to aid the States in their educational work, or make grants to the States for carrying out activities relating to the general welfare. The power to set up methods of disbursement and forms of audit and control and to create boards would be implied from the appropriating power.⁴⁹

(d) *Prevailing view.*

In concluding this discussion, it may be stated that the prevailing view is that the general welfare clause is not a power by itself but is a limitation upon the taxing power and that Congress may levy

⁴⁷ 9 Wheat. 1.

⁴⁸ *Butler v. U. S.* (297 U. S. 1).

⁴⁹ Willoughby, Constitutional Law, sec. 60; Story on the Constitution, 5th ed., secs. 975, 978, and 992; 4 Works of Alexander Hamilton (Lodge ed.) 151.

taxes and appropriate money for anything embracing the general welfare whether or not within the field of the other enumerated powers. Moreover, the power to make appropriations is derived from the taxing power. In *Field & Company v. Clark*,⁵⁰ the Supreme Court made the following comment as to this point:

Appellants contend that Congress has not power to appropriate money from the Treasury for the payment of these bounties. * * * The question of constitutional power thus raised depends principally, if not altogether, upon the scope and effect of that clause of the Constitution, giving Congress power to "lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defence and general welfare of the United States."

In the *Hoosac Mills case*, cited *supra*, the Court said:

The Congress is expressly empowered to lay taxes to provide for the general welfare. Funds in the Treasury as a result of taxation may be expended only through appropriation. (Art. I, sec. 9, cl. 7.) They can never accomplish the objects for which they were collected unless the power to appropriate is as broad as the power to tax. The necessary implication from the terms of the grant is that the public funds may be appropriated "to provide for the general welfare of the United States." These words cannot be meaningless, else they would not have been used. The conclusion must be that they were intended to limit and define the granted power to raise and to expend money.

The Supreme Court in the *Hoosac Mills case*, cited *supra*, stated that the question as to what constitutes the "general welfare of the United States" is a matter which rests with the courts for final decision. In this connection the Court, after quoting the following statement from Justice Story—

A power to lay taxes for the common defense and general welfare of the United States is not in common sense a general power. It is limited to those objects. It cannot constitutionally transcend them—

said:

When such a contention comes here we naturally require a showing that by no reasonable possibility can the challenged legislation fall within the wide range of discretion permitted to the Congress. How great is the extent of that range, when the subject is the promotion of the general welfare of the United States, we need hardly remark. But, despite the breadth of the legislative discretion, our duty to hear and to render judgment remains. If the statute plainly violates the stated principles of the Constitution we must so declare.

Protective tariff laws have been criticized on the ground that they did not provide for the general welfare. This contention was considered by the Supreme Court in *Hampton & Co.*, cited *supra*, in connection with the Tariff Act of 1922. The title of that act was "An act to provide revenue, to regulate commerce with foreign countries, to encourage the industries of the United States, and for other purposes." Chief Justice Taft in delivering the opinion of the Court made the following statement on this point:

Whatever we may think of the wisdom of a protective policy, we cannot hold it unconstitutional. So long as the motive of Congress and the effect of its legislative action are to secure revenue for the benefit of the General Government, the existence of other motives in the selection of the subjects of taxes cannot invalidate congressional action.

On the other hand, duties on importations may be imposed under the power to regulate commerce with foreign nations, as well as

⁵⁰ 143 U. S. 649.

under the taxing power.⁵¹ It seems clear that while the term "general welfare" is too broad to be susceptible of definition, it applies only to the general welfare of the United States as distinguished from the general welfare of a particular State. In this connection the Supreme Court has pointed out that Congress has no power to levy taxes to pay the debts of a State or to provide for its general welfare.⁵² Both purposes of taxation—the payment of the public debts and providing for the common defense and general welfare—are embraced in the general statement that the revenue must be levied and collected for a public purpose as distinguished from a private purpose.⁵³

(C) RULE OF APPORTIONMENT

(1) APPLICATION TO STATES

The Constitution requires that direct taxes shall be apportioned among the several States according to population. The purpose of this provision was to equalize the tax burden among the several States. In the South a land tax without apportionment would have been confiscatory at the time of the adoption of the Constitution, due to the fact that there was a large amount of land and very few people. On the other hand, such a tax would not have been so burdensome in the North where there was a large population and little land. The framers of the Constitution sought by a rule of apportionment to prevent this inequality by making the thickly settled communities carry the heaviest part of the burden and putting the lighter share on those which were sparsely inhabited. The rule of apportionment means that after Congress has decided on a sum to be raised by direct taxation, that sum must be divided among the States according to their respective populations and assessed in each State at a rate to be determined by dividing the total value of the property within the State subject to the tax into the amount apportioned to the State.⁵⁴ For example, the act of January 9, 1815,⁵⁵ levied a direct tax of \$6,000,000. Under the method of apportionment, New York was liable for the largest amount of the tax, namely, \$862,000; Pennsylvania was next with a liability of \$739,000; and Virginia third with a tax of \$738,000. The smallest liability was in the case of Georgia, its share of the direct tax burden amounting to \$56,000.

Mr. Justice Miller in his Lectures on the Constitution of the United States makes the following comment as to the method of collecting a direct tax:

* * * When a direct tax is laid, as was done in the beginning of the late war, and was the case shortly after the organization of our Government, the amount of money to be raised is first ascertained, then the population of each State is taken, according to the last census, after which it is a simple matter of division to find out the proportion or quota due from each State. A statute is then passed, declaring that each State shall pay to the Federal Government so much money, according to their ascertained proportion of the whole amount which it is proposed to raise.

⁵¹ *Board of Trustees of the University of Illinois v. U. S.* (289 U. S. 48).

⁵² *Passenger cases* (7 How. 283, 446).

⁵³ *Flint v. Stone Tracy Co.* (220 U. S. 107).

⁵⁴ *Hyllton v. U. S.* (3 Dall. 171); *Veazie Bank v. Fenno* (8 Wall. 553).

⁵⁵ 3 Stat. 164.

But suppose the State does not pay it? In regard to this it may be said that in all instances where a direct tax has been laid, except in the case of some of the States engaged in the late rebellion, the obligation has been promptly assumed, and each State has taken its own means of collecting the sum for which it was assessed. This amount was then paid into the National Treasury. But during that contest the States that did not sympathize with the loyal side did not want to help the Federal Government by raising money for its use. Congress, therefore, passed a law appointing commissioners, whose duty it was to go into those States as fast as they were subjugated, following up the armies, and ascertain the value of the landed estate as reported by their own tax officers. The assessment was then levied against this real property, and in many cases it was sold to pay the amount required. * * * (Pp. 236-237.)

* * * * *

The exercise by Congress during the Civil War of its power to impose direct taxes upon real estate within the States did not create a liability, upon the part of the States in which the land was situated, to pay the tax. The power to tax was exercised upon the property of private individuals within the State. * * * (P. 264.)

While the rule of apportionment appears to be equitable in the case of direct taxation, it is not suited to indirect taxation. This was revealed by the Supreme Court in the *Hylton Carriage case*.⁵⁶ In that case the court illustrated, in the opinion by Justice Chase, how inequitably the rule of apportionment would operate if applied to excise taxes by an example substantially as follows:

Suppose two States equal in census had to pay \$8,000 each and in one State there are 100 carriages and in the other 1,000. The owners of carriages in one State would pay ten times the tax of the owners in the other. A in one State would pay for his carriage \$8; but B in the other State would pay for his carriage \$80.

(2) APPLICATION TO DISTRICT OF COLUMBIA AND TERRITORIES

If a direct tax is imposed there is no power in Congress to exempt any State from its share of the burden. It is, however, within the discretion of Congress to determine whether the tax should be extended to the District of Columbia or the Territories, as the express wording of the Constitution requires apportionment only among the several States.⁵⁷

(D) RULE OF UNIFORMITY

(1) UNIFORMITY DEFINED

The Constitution requires that duties, imposts, and excises must be uniform throughout the United States. The term "uniformity" has been construed by the Supreme Court to mean geographical uniformity, the Court stating that "a tax is uniform when it operates with the same force and effect in every place where the subject of it is found."⁵⁸ That is, a tax cannot be levied at one rate in one locality and at another rate in another locality upon the same object or business, nor may Congress exempt from taxation taxpayers of a certain class located in one part of the country and not taxpayers of the same class living in another part of the country. In other words, the uni-

⁵⁶ 3 Dallas 171.

⁵⁷ *Loughborough v. Blake* (5 Wheat. 317).

⁵⁸ *Head Money cases* (112 U. S. 580).

formity rule does not require that excises, duties, and imposts, when levied, shall be intrinsically equal and uniform in their operation upon persons and property in the sense of the meaning of the words "equal and uniform", as now found in the constitutions of most of the States of the Union. All that is required is that if a subject is taxed in one place in the United States, it must be taxed in every other place in the United States where it is found and at the same rate. This is fully explained in *Knowlton v. Moore*, cited below, in which the Court quotes the following from a report made to the Maryland Legislature by Luther Martin on the proceedings of the Constitutional Convention of 1787:

Though there is a provision that all duties, imposts, and excises shall be uniform—that is, to be laid to the same amount on the same articles in each state—yet this will not prevent Congress from having it in their power to cause them to fall very unequally and much heavier on some states than on others, because these duties may be laid on articles but little or not at all used in some other states, and of absolute necessity for the use and consumption of others; in which case, the first would pay little or no part of the revenue arising therefrom, while the whole or nearly the whole of it would be paid by the last, to wit, the states which use and consume the articles on which imposts and excises are laid.

This was also brought out very clearly by Mr. Justice Miller in his Lectures on the Constitution of the United States (p. 240), in which, in referring to duties, imposts, and excises, he said:

They are not required to be uniform as between the different articles that are taxed, but uniform as between the different places and different States. Whiskey, for instance, shall not be taxed any higher in the State of Illinois, or Kentucky, where so much of the article is produced than it is in Pennsylvania. The tax must be uniform on the particular article; and it is uniform within the meaning of the constitutional requirement if it is made to bear the same percentage over all the United States.

The question of whether a tax is arbitrary or capricious or not based upon a reasonable classification will not arise under this provision of the Federal Constitution but under the due process clause of the fifth amendment. Thus, the allowance of deductions and exemptions to specified classes of taxpayers does not violate the due process clause if the classification is a reasonable one. For example, the Supreme Court has held that it was proper to exempt from the income tax imposed by the Revenue Act of 1913 the incomes of unmarried persons up to \$3,000 and the income of married persons up to \$4,000; to exempt from the income tax labor, agricultural, or horticultural organizations and mutual savings banks, and to tax other corporations; to allow a credit against the income tax for normal tax purposes and not for surtax purposes; to permit farmers to omit from their income returns the value of certain products of the farm used by them in sustaining their families during the taxable year; to require corporations to withhold and pay to the Government a tax on the interest due on bonds and mortgages and not to require the same from individuals; to allow individuals to deduct from their gross income dividends paid them by corporations and deny such right to corporations.⁵⁹ Moreover, the Supreme Court has also upheld a tax on the privilege of selling property at an exchange, as the privilege of selling property at an exchange was so different from that of mak-

⁵⁹ *Brushaber v. Union Pacific Railroad Co.* (240 U. S. 1).

ing a sale elsewhere that it constituted a reasonable ground for classification.⁶⁰ In *Knowlton v. Moore*,⁶¹ it was held that Congress could exempt from the tax on legacies and successions those falling below a certain amount, classify the rate of taxation according to relationship, and provide for a rate progressing by the amount of the legacy or share. A tax on the use of foreign-built boats and not in the use of domestic-built boats was also upheld as a reasonable classification.⁶²

(2) EFFECT OF STATE LAWS

The Supreme Court has pointed out that a tax does not lack uniformity because of the conflicting or adverse laws of the several States. In *Florida v. Mellon*⁶³ it was contended that the provisions of the Federal estate tax allowing credit for death taxes paid to the States up to 80 percent of the Federal tax violated the uniformity clause of the Constitution. The Supreme Court held that this contention was without merit, stating as follows:

The contention that the Federal tax is not uniform, because other States impose inheritance taxes while Florida does not, is without merit. Congress cannot accommodate its legislation to the conflicting or dissimilar laws of the several States, nor control the diverse conditions to be found in the various States, which necessarily work unlike results from the enforcement of the same tax. All that the Constitution (art. 1, sec. 8, clause 1) requires is that the law shall be uniform in the sense that by its provisions the rule of liability shall be alike in all parts of the United States.

A similar conclusion was reached in *Poe v. Seaborn*,⁶⁴ in which the Federal Government attempted in the absence of an express provision in the statute to force a citizen of the State of Washington to include all of the community property income in his income-tax return instead of permitting his wife to file a separate return reflecting therein her share of the community income which was vested in her under the State law. In *Phillips v. Commissioner*⁶⁵ it was contended that section 280 of the Revenue Act of 1926, providing for collection of income tax from transferees of the property of a taxpayer, was unconstitutional because the liability at law or in equity of a transferee is dependent upon the law of the State of incorporation, and that thus the section improperly delegates the Federal taxing power to the State legislatures; and, further, that the tax liability of the transferee as thus assessed and collected violates the rule of uniformity because differences in State laws may affect such liability. In answering these contentions the Supreme Court said:

The extent and incidence of Federal taxes not infrequently are affected by differences in State laws; but such variations do not infringe the constitutional prohibitions against delegation of the taxing power or the requirement of geographical uniformity.

(3) "UNITED STATES" DEFINED

The Constitution requires uniformity throughout the United States. The term "United States" has a limited application. While it un-

⁶⁰ *Nicol v. Ames* (173 U. S. 521).

⁶¹ 178 U. S. 87.

⁶² *Rainey v. United States* (232 U. S. 310).

⁶³ 273 U. S. 12.

⁶⁴ 282 U. S. 101.

⁶⁵ 283 U. S. 589.

doubtedly includes all of the States and the District of Columbia,^{65a} it has been held that it does not include territory ceded or acquired by the United States and not yet incorporated into the United States. For example, it was held that the rule of uniformity did not apply to Puerto Rico because that island had not been incorporated into the United States but was merely pertinent thereto as a possession.⁶⁶ This was also true in the case of the Philippines.⁶⁷ Nor does it apply to territory of a foreign state in the military occupation of the United States in time of war, nor to taxes for the benefit of a territory or business within such territory.⁶⁸ If a public enemy conquers and occupies a portion of the United States, the portion so occupied becomes foreign territory so far as revenue laws are concerned.^{68a} Alaska and Hawaii have been incorporated into the United States and are subject to the rule of uniformity. It should also be pointed out that a tax on shipments from one State to another, while not prohibited under the export clause of the Constitution, would probably violate the uniformity clause.⁶⁹ In other words, the term "exports" has been interpreted to mean only shipments to foreign countries.

(4) DISCRIMINATION BY ADMINISTRATIVE OFFICERS

The Court has pointed out that the action of an executive officer in administering the law may be so discriminatory as to result in a violation of this clause. Thus, in *Miller v. Standard Nut Margarine Company*⁷⁰ a suit was brought to prevent the collection of a tax on a product which the Commissioner of Internal Revenue was trying to hold taxable as oleomargarine. The injunction was allowed in the lower courts and an appeal was taken in one case by the Government to the Supreme Court. In other cases arising in different districts, where injunctions were also granted by the lower courts, the Government did not take any appeal. In this connection the Court said:

Petitioner acquiesced in the injunctions granted in Rhode Island and the District of Columbia and did not assess any tax upon identical products contemporaneously being made by complainants in such suits, and directed enforcement against respondent's entire product. Such discrimination conflicts with the principle underlying the constitutional provisions directing that excises laid by Congress should be uniform throughout the United States.

(E) PROHIBITION UPON EXPORT TAXES

The Constitution provides that no tax or duty shall be levied on articles exported from any State.⁷¹ James Madison said:

This prohibition resulted from the apparent impossibility of raising in that mode a revenue from the States, proportioned to their ability to pay it; the

^{65a} *Loughborough v. Blake* (5 Wheat. 317).

⁶⁶ *D. v. Jones v. Bidwell* (182 U. S. 244).

⁶⁷ *Curran v. Hesslein and Co. v. Edwards* (24 F. (2d) 989).

⁶⁸ *Binns v. United States* (194 U. S. 486); *Fleming v. Page* (9 How. 603).

^{68a} *United States v. Rice* (4 Wheat. 246).

⁶⁹ *Dooley v. United States* (183 U. S. 151).

⁷⁰ 284 U. S. 510.

⁷¹ United States Constitution, art. I, sec. 9, clause 5.

ability of some being derived in a great measure, not from their exports, but from their fisheries, from their freights, and from commerce at large in some of the branches altogether external to the United States; the profits from all of which, being invisible and intangible, would escape a tax on exports.

In other words, at the time of the adoption of the Constitution, the whole burden of a tax upon exports would have fallen upon the products produced in the South, as the North had practically nothing to export. This prohibition does not cover shipments to every place. It applies only to shipments to foreign countries and does not apply to shipments to possessions of the United States.⁷² There has been considerable litigation involving the meaning of this clause of the Constitution. The Supreme Court has interpreted the clause to mean that the exportation must be free from taxation and, therefore, as requiring "not simply an omission of a tax upon the articles exported, but also a freedom from any tax which directly burdens the exportation."⁷³ In those cases where the tax is not laid upon the articles themselves in the course of exportation, the true test of its validity is whether it so directly and closely bears on the process of exporting as to be in substance a tax on the exportation. The following have been held to be exempt from the operation of the taxing power:

- (1) Articles in the course of exportation;⁷⁴
- (2) The act or occupation of exporting;⁷⁵
- (3) Bills of lading for articles being exported;⁷⁶
- (4) Charter parties for the carriage of cargo from the States to foreign ports;⁷⁷ and
- (5) Policies of insurance on articles being exported.⁷⁸

The Supreme Court has also held that a sale of goods in the United States to a commission merchant for a foreign consignee for the sole purpose of export and consummated only when the goods are delivered to the exporting carrier, is a step in their exportation and cannot be taxed by the United States.⁷⁹ On the other hand, a general tax levied on all property alike and not upon goods in the course of exportation nor because of their intended exportation is not within the prohibition.⁸⁰ Thus, the application of the Federal income tax to income derived from the business of exporting has been upheld.⁸¹ A manufacturer's tax on filled cheese was held applicable to filled cheese manufactured for export.⁸² A tax on distilled spirits was applied to spirits intended for exportation⁸³ and a tax on cigarettes was applied to cigarettes for export.⁸⁴

In general, it may be stated that a tax on the manufacture of a product, as distinguished from the sale or removal of the product, would not fall within the prohibition upon exports. This was

⁷² *Swan and F. Co. v. U. S.* (190 U. S. 143); *Dooley v. U. S.* (183 U. S. 151).

⁷³ *Peck and Co., Inc. v. Lowe* (247 U. S. 165); *Fairbanks v. U. S.* (181 U. S. 283).

⁷⁴ *Turpin & Bros. v. Burgess* (117 U. S. 504).

⁷⁵ *Brown v. Maryland* (12 Wheat. 419).

⁷⁶ *Fairbanks v. U. S.* (181 U. S. 283).

⁷⁷ *United States v. Hvoslef* (237 U. S. 1).

⁷⁸ *Thames and M. Mercantile Insurance Co. v. U. S.* (237 U. S. 119).

⁷⁹ *Spalding & Bros. v. Edwards* (262 U. S. 66).

⁸⁰ *Turpin & Bros. v. Burgess* (117 U. S. 504).

⁸¹ *William E. Peck Co. v. Lowe* (247 U. S. 165); *Neuss, Hesslein and Co. v. Edwards* (24 Fed. (2d) 989).

⁸² *Cornell v. Coyne* (192 U. S. 418).

⁸³ *Thompson v. United States* (142 U. S. 471).

⁸⁴ *Anagyros v. Edwards* (26 Fed. (2d) 319).

brought out by the Supreme Court in the case of *Cornell v. Coyne*, already referred to, in which a tax on the manufacture of filled cheese under contract for export and actually exported was upheld.⁸⁵ Moreover, a stamp tax to identify goods intended for export is not invalid. For instance, the Supreme Court has held that an act of Congress requiring stamps to be placed on packages of manufactured tobacco intended for export and making a charge for the stamps was not a duty upon exports within the meaning of this clause. It was held that such a stamp was intended for no other purpose than to separate and identify the tobacco which the manufacturer desired to export, and thereby, instead of taxing it, to relieve it from the taxation to which other tobacco was subjected.⁸⁶

(F) THE DUE-PROCESS CLAUSE OF THE FIFTH AMENDMENT

(1) CONFISCATION OF PROPERTY

The fifth amendment of the Constitution provides, among other things, that no person shall be deprived of property without due process of law; nor shall private property be taken for public use without just compensation. It is generally true that the due-process clause of the Constitution is not a limitation upon the taxing power of Congress. However, the Supreme Court has pointed out⁸⁷ that this general rule has no application if the taxing provision is so palpably arbitrary and unreasonable as to lead to the conclusion that it is not an exercise of taxation but a confiscation of property; or what is equivalent thereto, is so wanting in basis for classification as to produce a gross and patent inequality. In other words, the classification must be reasonable and not arbitrary or capricious.

In selecting the subjects of taxation, Congress has almost unlimited discretion. It was Mr. Justice Day who pointed out⁸⁸—

In levying excise taxes the most ample authority has been recognized from the beginning to select some and omit other possible subjects of taxation, to select one calling and omit another, to tax one class of property and to forbear another.

For example, Congress has selected as subjects of taxation carriages which the owner kept for private use, sales or exchanges on boards of trade, transmission of property from the dead to the living, transfer of property by gift, agreements to sell shares of stock, tobacco manufactured for consumption, filled cheese manufactured for export, oleomargarine, bank circulation, business of refining sugar and oil, issues and transfers of stocks and bonds, the net income of domestic corporations from all sources and only such income of foreign corporations as is derived from sources within the United States. By the Revenue Act of 1932 taxes were levied on tires and inner tubes, toilet preparations, furs, jewelry, automobiles, radios, refrigerators, sporting goods, firearms, shells and cartridges, cameras, matches, candy,

⁸⁵ See also *American Manufacturing Co. v. St. Louis* (259 U. S. 459); *Indian Motorcycle Co. v. U. S.* (283 U. S. 570).

⁸⁶ *Pace v. Burgess* (92 U. S. 372).

⁸⁷ *Brushaber v. Union Pacific Railroad Co.* (240 U. S. 1).

⁸⁸ *Flint v. Stone Tracy Company* (220 U. S. 107).

chewing gum, soft drinks, electrical energy, gasoline, transportation of oil by pipe line, leases on safe-deposit boxes, checks, the use of boats, and transfers to avoid income taxes.

(2) CLASSIFICATION OF INCOME ACCORDING TO INVESTED CAPITAL

IN *La Belle Iron Works*,⁸⁹ the Supreme Court upheld the excess-profits tax provisions of the Revenue Act of 1917. It was claimed that the defining of invested capital according to the original cost of the property instead of its present value had the effect of violating the due-process clause of the fifth amendment, and claim was also made that it violated the equal protection of the laws. In overruling both contentions the Supreme Court stated:

The fifth amendment has no equal protection clause; and the only rule of uniformity prescribed with respect to duties, imposts, and excises laid by Congress is the territorial uniformity required by article I, section 8. * * * That the statute under consideration operates with territorial uniformity is obvious and not questioned.

And then went on to state:

Nor can we regard the act—in basing “invested capital” upon actual costs to the exclusion of higher estimated values—as productive of arbitrary discriminations raising a doubt about its constitutionality under the due-process clause of the fifth amendment. The difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the States under the equal-protection clause; much less of Congress under the more general requirement of due process of law in taxation. Of course, it will be understood that Congress has very ample authority to adjust its income taxes according to its discretion, within the bounds of geographical uniformity. Courts have no authority to pass upon the propriety of its measures; and we deal with the present criticism only for the purpose of refuting the contention, strongly urged, that the tax is so wholly arbitrary as to amount to confiscation.

(3) TAXING UNLAWFUL BUSINESS

Moreover, the fifth amendment does not relieve a taxpayer engaged in an unlawful business from making an income-tax return. If the form of the return called for answers that the taxpayer was privileged from making, he may raise an objection in the return, but could not on that account refuse to make any return at all. The Court pointed out that it would be an extreme, if not extravagant, application of the fifth amendment to say that it authorized a man to refuse to state the amount of his income because it had been made in crime; and stated that if the defendant desired to test that or any other point he should have tested it in the return so that it could be passed upon. He could not draw a conjurer’s circle around the whole matter by his own declaration that to write anything upon the Government blank would bring him into danger of the law.⁹⁰

(4) TAXING PARTNERSHIP AS CORPORATION

In *Burk-Waggoner Oil Association v. Hopkins*,⁹¹ the Supreme Court held that the Congress had a right to tax as a corporation an unincorporated joint-stock association, taking the form of a “Massa-

⁸⁹ 256 U. S. 377.

⁹⁰ *U. S. v. Sullivan* (274 U. S. 259).

⁹¹ 269 U. S. 110.

chusetts trust", which under the State law was technically a partnership. In this connection the Court said:

It is true that Congress cannot convert into a corporation an organization which by the law of its State is deemed a partnership. But nothing in the Constitution precludes Congress from taxing as a corporation an association which, although unincorporated, transacts its business as if it were incorporated. The power of Congress so to tax associations is not affected by the fact that, under the law of a particular State, the association cannot hold title to property, or that its shareholders are individually liable for the association's debts, or that it is not recognized as a legal entity. Neither the conception of unincorporated associations prevailing under the local law, nor the relation under the law of the association to its shareholders, nor their relation to each other and to outsiders, is of legal significance as bearing upon the power of Congress to determine how and at what rate the income of the joint enterprise should be taxed.

(5) DENIAL OF REFUNDS WHERE TAX PASSED ON

In *United States v. Jefferson Electric Manufacturing Company*,⁹² the Supreme Court upheld a provision of the 1928 act, section 424, requiring as a condition precedent to a refund of an automobile accessories tax, proof that the taxpayer had borne the burden of the tax and had not passed it on to his customers, saying:

The contention is made that subdivision (a) (2), when construed and applied as we hold it should be, infringes the due-process clause of the fifth amendment to the Constitution in that it strikes down rights accrued theretofore and still subsisting but not sued on prior to April 30, 1928. This contention is pertinent, because the cases now being considered were begun after April 30, 1928, and in each the tax in question was paid before section 424 was enacted, which was May 29, 1928.

If the tax was erroneous and illegal, as is alleged, it must be conceded that, under the system then in force, there accrued to the taxpayer when he paid the tax a right to have it refunded without any showing as to whether he bore the burden of the tax or shifted it to the purchasers. And it must be conceded also that section 424 applies to rights accrued theretofore and still subsisting but not sued on prior to April 30, 1928, and subjects them to the restriction that the taxpayer (a) must show that he alone has borne the burden of the tax, or (b) if he has shifted the burden to the purchasers, must give a bond promptly to use the refunded sum in reimbursing them. But it cannot be conceded that in imposing this restriction the section strikes down prior rights, or does more than to require that it be shown or made certain that the money when refunded will go to the one who has borne the burden of the illegal tax, and therefore is entitled in justice and good conscience to such relief. This plainly is but another way of providing that the money shall go to the one who has been the actual sufferer and therefore is the real party in interest.

We do not perceive in the restriction any infringement of due process of law. If the taxpayer has borne the burden of the tax, he readily can show it; and certainly there is nothing arbitrary in requiring that he make such a showing. If he has shifted the burden to the purchasers, they and not he have been the actual sufferers and are the real parties in interest; and in such a situation there is nothing arbitrary in requiring, as a condition to refunding the tax to him, that he give a bond to use the refunded money in reimbursing them. Statutes made applicable to existing claims or causes of action and requiring that suits be brought by the real rather than the nominal party in interest have been uniformly sustained when challenged as infringing the contract and due-process clauses of the Constitution.

(6) REVOCABLE TRUSTS—ESTATE TAX

In *Helvering v. Ciy Bank Farmers Trust Company*^{92a} the Supreme Court held that Congress had the power to include in the value of

⁹² 291 U. S. 386.

^{92a} 296 U. S. 85.

the gross estate, for estate tax purposes, the corpus of a trust established by the decedent prior to her death when under the terms of the trust instrument, the trust was revocable (1) by the grantor in conjunction with her husband (a beneficiary of the trust) and the trustee or (2) in conjunction with the trustee and her brother, if the husband were dead. After referring to the following provisions of section 302 (d) of the Revenue Act of 1926—

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

* * * * *

(d) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone, or in conjunction with any person, to alter, amend, or revoke, * * *.

the Court said:

We are next told that if the act means what it says, it taxes a transfer as one taking effect at death though made prior to death and complete when made; that to do this is arbitrary and deprives the taxpayer of property without due process.

The section was first introduced into the Revenue Act of 1924 and reenacted in that of 1926. Mrs. James created her trust in 1930. She was, therefore, upon notice of the law's command, and there can be no claim that the statute is retroactive in its application to her transfer.

The inquiry is whether it is arbitrary and unreasonable to prescribe for the future that, as respects the estate tax, a transfer, complete when made, shall be deemed complete only at the transferor's death, if he reserves power to revoke or alter exercisable jointly with another.

The respondent insists that a power to recall an absolute and complete gift only with the consent of the donee is in truth no power at all; that in such case the so-called exercise of the power is equivalent to a new gift from the donee to the donor. And so it is claimed that the statute arbitrarily declares that to exist which in fact and law is nonexistent. The position is untenable. The purpose of Congress in adding clause (d) to the section as it stood in an earlier act was to prevent avoidance of the tax by the device of joining with the grantor in the exercise of the power of revocation someone whom he believed would comply with his wishes. Congress may well have thought that a beneficiary who was of the grantor's immediate family might be amenable to persuasion or be induced to consent to a revocation in consideration of other expected benefits from the grantor's estate. Congress may adopt a measure reasonably calculated to prevent avoidance of a tax. The test of validity in respect of due process of law is whether the means adopted is appropriate to the end. A legislative declaration that a status of the taxpayer's creation shall, in the application of the tax, be deemed the equivalent of another status falling normally within the scope of the taxing power, if reasonably requisite to prevent evasion, does not take property without due process. But if the means are unnecessary or inappropriate to the proposed end, are unreasonably harsh or oppressive, when viewed in the light of the unexpected benefit, or arbitrarily ignore recognized rights to enjoy or to convey individual property, the guarantee of due process is infringed.

* * * * *

In view of the evident purpose of Congress we find nothing unreasonable or arbitrary in the provisions of section 302 (d) of the Revenue Act of 1926 as applied in the circumstances of this case. It was appropriate for Congress to prescribe that if, subsequent to the passage of that act, the creator of a trust estate saw fit to reserve to himself jointly with any other person the power of revocation or alteration, the transaction should be deemed to be testamentary in character; that is, treated for the purposes of the law as intended to take effect in possession or enjoyment at the death of the settlor.

(7) RETROACTIVE TAXES

(a) *In general.*

But there have been a few instances in which Congress has exceeded its powers and the provisions of the fifth amendment have been invoked to invalidate a taxing statute. An example of this was presented in the case of *Nichols v. Coolidge*,⁹³ in which the Supreme Court held that the Revenue Act of 1918 was invalid insofar as it attempted to include in the gross estate of a decedent the corpus of an irrevocable trust distributable at death but executed before the Government imposed any estate tax. In this connection the Court made the following comment:

And we must conclude that section 402 (c) of the statute here under consideration, insofar as it requires that there shall be included in the gross estate the value of property transferred by a decedent prior to its passage merely because the conveyance was intended to take effect in possession or enjoyment at or after his death, is arbitrary, capricious, and amounts to confiscation.

For the same reason, the Supreme Court held that the gift-tax provisions of the Revenue Act of 1924 were unconstitutional, insofar as they attempted to tax gifts made before the enactment of that act. The Court said:

It seems wholly unreasonable that one who in entire good faith and without the slightest premonition of such consequences, made absolute disposition of his property by gifts should thereafter be required to pay a charge for so doing.⁹⁴

However, mere retroactivity is not in itself sufficient to invalidate a taxing statute. This was brought out by the Supreme Court in two cases dealing with the taxation for estate-tax purposes of transfers in contemplation of death and tenancies by the entireties.⁹⁵ In both cases the transfers had been made and the tenancies created prior to the taxing statute, but at such times there was a similar statute in force to which they would have been subject had the decedent died then. In upholding the validity of the tax, the Supreme Court laid down the rule that if the transfer or tenancy was subject to an excise when made, a mere increase in the tax pursuant to a policy of which the donor was forewarned at the time he elected to exercise the privilege does not change its character. It is only when the nature of the tax burden imposed could not have been understood and foreseen by the taxpayer at the time of the transaction which occasioned the tax that retroactivity will render the tax invalid. It is interesting to note that practically all of our income-tax laws have been retroactive in the sense that they apply to income for the year preceding the adoption of the taxing statute. The right to impose such retroactive legislation has been recognized for many years. In the case of *Stockdale v. Atlantic Insurance Co.*,⁹⁶ the Supreme Court made the following comment on this point:

The right of Congress to have imposed this tax by a new statute, although the measure of it was governed by the income of the past year, cannot be doubted; much less can it be doubted that it could impose such a tax on the income of the current year, though part of that year had elapsed when the statute was passed.

⁹³ 274 U. S. 531. See also *Helvering v. Helmholz* (296 U. S. 93), *White v. Poor* (296 U. S. 98), and *Bingham v. United States* (296 U. S. 211).

⁹⁴ *Blodgett v. Holden* (275 U. S. 142), *Untermeyer v. Anderson* (276 U. S. 440).

⁹⁵ *Milliken v. U. S.* (283 U. S. 15); *Phillips v. Dime Trust and Safe Deposit Company* (284 U. S. 160).

⁹⁶ 20 Wall. 323.

The joint resolution of July 4, 1864 (13 Stat. L. 417), imposed a tax of 5 percent upon all income of the previous year, although one tax on it had already been paid, and no one doubted the validity of the tax or attempted to resist it. This view was reaffirmed in the case of *Brushaber v. Union Pacific Railroad Co.*,⁹⁷ in which the court upheld the right to tax income during the period from March 1, 1913, the effective date of the sixteenth amendment, to December 31, 1913, although the Revenue Act of 1913 which imposed such tax was not enacted until October 3, 1913.

A few of our excise taxes have also been retroactive. For example, the corporation excise tax in 1909 was not enacted until August 5, 1909, although it applied to income for the whole calendar year, and the munitions manufacture tax of the Revenue Act of 1916, passed September 8, 1916, was retractive to January 1 of that year. Moreover, the capital-stock tax increase in the Revenue Act of 1918, passed February 24, 1919, was made retroactive to July 1, 1918.

(b) *Correction of mistakes of administrative officers.*

The Court has also pointed out that the Congress has the right to cure retroactively a defect in administration which had resulted in the collection of a tax after the statute of limitations had run and to deny recovery to the taxpayer for the amount paid. This was brought out in the case of *Graham v. Goodcell*⁹⁸ upholding the validity of section 611 of the Revenue Act of 1928 permitting collection of internal-revenue taxes assessed prior to June 2, 1924, where claims for abatement of such taxes had been filed by the taxpayer. In this connection, the Court said:

It is apparent, as the result of the decisions, that a distinction is made between a bare attempt of the legislature retroactively to create liabilities for transactions which, fully consummated in the past, are deemed to leave no ground for legislative intervention, and the case of a curative statute aptly designed to remedy mistakes and defects in the administration of government where the remedy can be applied without injustice. Where the asserted vested right, not being linked to any substantial equity, arises from the mistake of officers purporting to administer the law in the name of the Government, the legislature is not prevented from curing the defect in administration simply because the effect may be to destroy causes of action which would otherwise exist. "The power is necessary that Government may not be defeated by omissions or inaccuracies in the exercise of functions necessary to its administration." * * * This principle covers the present case. The petitioners had been indebted to the Government for the amount which was subsequently collected. They had asked for a review of the assessment and collection was postponed. The Treasury Department had mistakenly assumed that the statute of limitations did not apply to distraint proceedings and before the mistake was discovered the period of limitation had expired. The Congress could correct this defect in administration without violating any substantial equity, and this was accomplished by section 611 of the Revenue Act of 1928 (26 U. S. C. A., sec. 2611).

(c) *Summary of rules.*

From the foregoing the following rules may be deduced as to the power of Congress to impose retroactive taxation:

(1) Congress may not tax a transaction retroactively if at the time of the transaction there was no statute in force levying a tax of the same character on such transaction.

⁹⁷ 240 U. S. 1.

⁹⁸ 282 U. S. 409.

(2) Congress may increase a tax retroactively if a tax of the same character was in effect at the time the transaction subject to the tax was entered into.

(8) DENIAL OF COURT REVIEW

The denial by Congress of the right of a taxpayer to have a judicial review of the facts and the law involving a constitutional question may also constitute a violation of this clause in view of the decision of the Supreme Court in the case of *St. Joseph Stock Yards Company v. United States*,⁹⁹ in which the Court made the following comment as to the power of the Secretary of Agriculture to fix rates for services rendered by the Stock Yards Co. to its customers:

The fixing of rates is a legislative act. In determining the scope of judicial review of that act there is a distinction between action within the sphere of legislative authority and action which transcends the limits of legislative power. Exercising its rate-making authority the legislature has a broad discretion. It may exercise that authority directly or through the agency it creates or appoints to act for that purpose in accordance with appropriate standards. The Court does not sit as a board of revision to substitute its judgment for that of the legislature or its agents as to matters within the province of either. When the legislature itself acts within the broad field of legislative discretion its determinations are conclusive. When the legislature appoints an agent to act within that sphere of legislative authority, it may endow the agent with power to make findings of fact which are conclusive, provided the requirements of due process which are specially applicable to such an agency are met, as in according a fair hearing and acting upon evidence, and not arbitrarily. In such cases the judicial inquiry into the facts goes no further than to ascertain whether there is evidence to support the findings and the question of the weight of the evidence in determining issues of fact lies with the legislative agency acting within its statutory authority.

But the Constitution fixes limits to the rate-making power by prohibiting the deprivation of property without due process of law or the taking of private property for public use without just compensation. When the legislature acts directly, its action is subject to judicial scrutiny and determination in order to prevent the transgression of these limits of power. The legislature cannot preclude that scrutiny or determination by any declaration or legislative finding. Legislative declaration or finding is necessarily subject to independent judicial review upon the facts and the law by courts of competent jurisdiction to the end that the Constitution as the supreme law of the land may be maintained. Nor can the legislature escape the constitutional limitation by authorizing its agent to make findings that the agent has kept within that limitation. Legislative agencies, with varying qualifications, work in a field peculiarly exposed to political demands. Some may be expert and impartial, others subservient. It is not difficult for them to observe the requirements of law in giving a hearing and receiving evidence. But to say that their findings of fact may be made conclusive where constitutional rights of liberty and property are involved, although the evidence clearly establishes that the findings are wrong and constitutional rights have been invaded, is to place those rights at the mercy of administrative officials and seriously to impair the security inherent in our judicial safeguards. That prospect, without multiplication of administrative agencies, is not one to be lightly regarded. It is said that we can retain judicial authority to examine the weight of evidence when the question concerns the right of personal liberty. But if this be so, it is not because we are privileged to perform our judicial duty in that case and for reasons of convenience to disregard it in others. The principle applies when rights either of person or of property are protected by constitutional restrictions. Under our system there is no warrant for the view that the judicial power of a competent court can be circumscribed by any legislative arrangement designed to give effect to administrative action going beyond the limits of constitutional author-

ity. This is the purport of the decisions above cited with respect to the exercise of an independent judicial judgment upon the facts where confiscation is alleged.

(All citations omitted in the above quotation.)

But save as there may be an exception for issues presenting claims of constitutional right, such administrative findings on issues of fact are accepted by the court as conclusive if the evidence was legally sufficient to sustain them and there was no irregularity in the proceedings. As already pointed out, the Supreme Court has held that the Board of Tax Appeals is not a court but an executive or administrative board, upon the decision of which the parties are given an opportunity to base a petition for review to the courts after the administrative inquiry has been had and decided. Not only has the scope of review provided under the Board of Tax Appeals procedure been held to be adequate in the case of a taxpayer's liability but also in the case of the liability of the transferee of the property of a taxpayer.¹⁰⁰

(9) PROHIBITION OF SUITS TO ENJOIN ASSESSMENT OR COLLECTION OF TAX

(a) *Inadequate remedy at law.*

Under an old statute¹⁰¹ Congress has provided that "no suit for the purpose of restraining the assessment or collection of any tax may be maintained in any court." In referring to the purpose of this statute the Supreme Court said:¹⁰²

Independently of, and in cases arising prior to the enactment of the provision (act of Mar. 2, 1867, 14 Stat. 475) which became R. S. 3224, this Court in harmony with the rule generally followed in courts of equity held that a suit will not lie to restrain the collection of a tax upon the sole ground of its illegality. The principal reason is that, as courts are without authority to apportion or equalize taxes or to make assessments, such suits would enable those liable for taxes in some amount to delay payment or possibly to escape their lawful burden and so to interfere with and thwart the collection of revenues for the support of the Government. And this Court likewise recognizes the rule that, in cases where complainant shows that in addition to the illegality of an exaction in the guise of a tax there exist special and extraordinary circumstances sufficient to bring the case within some acknowledged head of equity jurisprudence, a suit may be maintained to enjoin the collector. Section 3244 is declaratory of the principle first mentioned and is to be construed as near as may be in harmony with it and the reasons upon which it rests * * *. This Court has given effect to § 3224 in a number of cases. It has never held the rule to be absolute, but has repeatedly indicated that extraordinary and exceptional circumstances render its provisions inapplicable. (Citations omitted.)

One of the recent cases in which an injunction has been granted, despite the provisions of R. S. 3224, is that of *Miller v. Standard Nut Margarine Company*, already referred to. In that case the company had made a product which had been repeatedly determined by the Commissioner of Internal Revenue and adjudged in the courts as not subject to tax. For more than a year the company had sold its products relying upon the holding that they were not taxable. Subsequently the Commissioner reversed his former action and held

¹⁰⁰ *Phillips v. Commissioner* (283 U. S. 589), *Old Colony Trust Company v. Commissioner* (279 U. S. 716).

¹⁰¹ Revised Statutes, sec. 3224.

¹⁰² *Miller v. Standard Nut Margarine Company* (284 U. S. 509).

the products taxable as oleomargarine. If required to pay the tax, the loss to the company would be 7 cents per pound. Before the Commissioner reversed his old ruling the company had sold so much of its products that the tax would have amounted to more than it could pay. The Supreme Court held that "the enforcement of the act against respondent would be arbitrary and oppressive, would destroy its business, ruin it financially, and inflict loss for which it would have no remedy at law." In the case of *Hill v. Wallace*,¹⁰³ the collection of the tax under the Future Trading Act was also enjoined, since it would be impracticable for brokers to pay the tax thereby imposed on each separate sale of grain and then bring suit to recover the payment.

(b) *Exaction as a penalty.*

In addition, the Supreme Court has also granted injunctive relief in cases where the tax has been construed to be a penalty and not a tax. In *Lipke v. Lederer*,¹⁰⁴ Lipke paid all revenue taxes required by law for the year ending June 30, 1920. He held a retail liquor license under the laws of the State. On December 28, 1920, he was arrested for selling liquor. On March 18, 1921, he was notified of the assessment of a tax against him and the notice he received contained the statement that if the tax was not paid within 10 days a penalty would be added to the tax. On March 31 he received a second demand that if the tax was not paid within 10 days collection would be made by seizure and sale of his property. To restrain execution of the threat suit was brought, Lipke alleging that he was wholly without remedy at law to prevent such seizure of his property. The Supreme Court in granting the injunction held that the so-called taxes were in effect penalties and that collection of such penalties for crime through the secret findings and summary action of executive officers would disregard guarantees of due process of law and trial by jury.

(c) *Stockholders' suits.*

Then the Court has also granted relief to shareholders of corporations seeking to prevent corporations from paying corporate taxes into the Treasury. Thus, in *Pollock v. Farmers Loan and Trust Company*,¹⁰⁵ a bill in equity was filed by Charles Pollock on behalf of himself and other shareholders to prevent the Farmers Loan & Trust Co. from voluntarily paying the income tax imposed by the act of 1894 into the Federal Treasury, on the ground that the tax was unconstitutional, and an injunction was granted. This was also true with respect to a bill in equity filed by a shareholder of the Union Pacific Railroad Co.¹⁰⁶ to prevent that company from complying with the Revenue Act of 1913; and in the case of a shareholder of the Carter Coal Co.,¹⁰⁷ which brought a suit against the Carter Coal Co. to prevent the company from accepting the Coal Code and paying the taxes levied against it under the Bituminous Coal Conservation Act of 1935.

¹⁰³ 259 U. S. 44.

¹⁰⁴ 259 U. S. 557; see also *Regal Drug Company v. Wardell* (260 U. S. 386).

¹⁰⁵ 157 U. S. 429.

¹⁰⁶ *Brushaber v. Union Pacific Rwy. Company* (240 U. S. 1).

¹⁰⁷ *Carter v. Carter Coal Company* (56 Sup. Ct. 855).

In that case, the Court said the shareholders had a right to bring a suit of this character under authority of *Ashwander v. Tennessee*,¹⁰⁸ decided on February 17, 1936. In this last case, a preferred shareholder of the Alabama Power Co. brought a suit to prevent the company from carrying out a contract with the Tennessee Valley Authority. In upholding the right of the shareholder to the injunction the Court said:

Plaintiffs did not simply challenge the contract of January 4, 1934, as improvidently made, as an unwise exercise of the discretion vested in the board of directors. They challenged the contract both as injurious to the interests of the corporation and as an illegal transaction, violating the fundamental law. In seeking to prevent the carrying out of the contract, the suit was directed not only against the power company but against the Authority and its directors upon the ground that the latter, under color of the statute, were acting beyond the powers which the Congress could validly confer. In such a case it is not necessary for stockholders—when their corporation refuses to take suitable measures for its protection—to show that the managing board or trustees have acted with fraudulent intent or under legal duress. To entitle the complainants to equitable relief, in the absence of an adequate legal remedy, it is enough for them to show the breach of trust or duty involved in the injurious and illegal action. Nor is it necessary to show that the transaction was ultra vires the corporation. The illegality may be found in the lack of lawful authority on the part of those with whom the corporation is attempting to deal. Thus, the breach of duty may consist in yielding, without appropriate resistance, to governmental demands which are without warrant of law or are in violation of constitutional restrictions. The right of stockholders to seek equitable relief has been recognized when the managing board or trustees of the corporation have refused to take legal measures to resist the collection of taxes or other exactions alleged to be unconstitutional; or because of the failure to assert the rights and franchises of the corporation against an unwarranted interference through legislative or administrative action. The remedy has been accorded to stockholders of public-service corporations with respect to rates alleged to be confiscatory. The fact that the directors in the exercise of their judgment, either because they were disinclined to undertake a burdensome litigation or for other reasons which they regarded as substantial, resolved to comply with the legislative or administrative demands, has not been deemed an adequate ground for denying to the stockholders an opportunity to contest the validity of the government requirements to which the directors were submitting.

In *Smith v. Kansas City Title Company* (255 U. S. 180), a shareholder of the title company sought to enjoin the directors from investing its funds in the bonds of Federal land banks and joint stock land banks upon the ground that the act of Congress authorizing the creation of these banks and the issue of bonds was unconstitutional, and hence that the bonds were not legal securities in which the corporate funds could lawfully be invested. The proposed investment was not large, only \$10,000 in each of the classes of bonds described. And it appeared that the directors of the title company maintained that the Federal Farm Loan Act was constitutional and that the bonds were "valid and desirable investments." But neither the conceded fact as to the judgment of the directors nor the small amount to be invested, shown by the averments of the complaint—availed to defeat the jurisdiction of the Court to decide the question as to the validity of the act and of the bonds which it authorized. The Court held that the validity of the act was directly drawn in question and that the shareholder was entitled to maintain the suit. The Court said: "The general allegations as to the interest of the shareholder, and his right to have an injunction to prevent the purchase of the alleged unconstitutional securities by misapplication of the funds of the corporation, give jurisdiction under the principles settled in *Pollock v. Farmers' Loan and Trust Co.* and *Brushaber v. Union Pacific R. R. Co.*, *supra*." The Court then proceeded to examine the constitutional question and sustained the legislation under attack. A similar result was reached in *Brushaber v. Union Pacific R. R. Co.*, *supra*. A close examination of these decisions leads inevitably to the conclusion that they should either be followed or be frankly overruled. We think that they should be followed

and that the opportunity to resort to equity, in the absence of an adequate legal remedy in order to prevent illegal transactions by those in control of corporate properties should not be curtailed because of reluctance to decide constitutional questions.

We find no distinctions which would justify us in refusing to entertain the present controversy. It is urged that plaintiffs hold preferred shares and that, for the present purpose, they are virtually in the position of bondholders. The rights of bondholders, in case of injury to their interests through unconstitutional demands upon, or transactions with, their corporate debtor, are not before us. Plaintiffs are not creditors but shareholders (with equal voting power share for share with the common-stock holders, according to the findings) and thus they have a proprietary interest in the corporate enterprise which is subject to injury through breaches of trust or duty on the part of the directors who are not less the representatives of the plaintiffs because their shares have certain preferences. It may be, as in this case, that the owner of all the common stock has participated in the transaction in question and the owners of preferred stock may be the only persons having a proprietary interest in the corporation who are in a position to protect its interests against what is asserted to be an illegal disposition of its property. A court of equity should not shut its door against them. (Citations omitted.)

(d) *Effect of unconstitutional statute.*

However, the mere allegation that a tax is unconstitutional is not sufficient to authorize an injunction restraining collection of the tax. Thus, in *Bailey v. George*,¹⁰⁹ the Supreme Court held that section 3224 of the revised statutes forbade an injunction to prevent the collection of the child-labor tax on the ground that the Child Labor Act was unconstitutional, although in an opinion rendered the same day in connection with a suit for refund of such tax, the Court held that the Child Labor Act was unconstitutional. But after the Court has held a taxing statute unconstitutional, it will permit a suit to enjoin the collection of a tax imposed by such statute. This was brought out in the case of *Rickert Rice Mills v. Fontenot*,¹¹⁰ in which the Court held that the Government could not collect taxes imposed by the Agricultural Adjustment Act from the Rickert Rice Mills, as such taxes had already been declared unconstitutional in *Butler v. United States*,¹¹¹ the Court stating "as yet the petitioner has not paid the taxes to the respondent, and in view of the decision in the *Butler case*, hereafter cannot be required so to do. If the respondent should now attempt to collect the tax by distraint he would be a trespasser."

(e) *Premature suits.*

The following from the opinion of the Supreme Court in the case of *Carter v. Carter Coal Company*, already referred to, as to whether the suits to restrain collection of the tax under the Bituminous Coal Conservation Act of 1935 were prematurely brought may also be of interest:

That the suits were not prematurely brought also is clear. Section 2 of the act is mandatory in its requirement that the commission be appointed by the President. The provisions of section 4 that the code be formulated and promulgated are equally mandatory. The so-called tax of 15 percent is definitely imposed and its exaction certain to ensue.

In *Pennsylvania v. West Virginia* (262 U. S. 553, 592-595) suits were brought by Pennsylvania and Ohio against West Virginia to enjoin the defendant State

¹⁰⁹ 259 U. S. 16; see also *Dodge v. Osborn* (240 U. S. 118), *Louisiana v. McAdoo* (234 U. S. 627).

¹¹⁰ 297 U. S. 110.

¹¹¹ 297 U. S. 1.

from enforcing an act of her legislature upon the ground that it would injuriously affect or cut off the supply of natural gas produced in her territory and carried by pipe lines into the territory of the plaintiff States and there sold and used. These suits were brought a few days after the West Virginia act became effective. No order had yet been made under it by the Public Service Commission, nor had it been tested in actual practice. But it appeared that the act was certain to operate as the complainant State apprehended it would. This Court held that the suit was not premature. "One does not have to await the consummation of threatened injury to obtain preventive relief. If the injury is certainly impending that is enough."

Price v. Society of Sisters (268 U. S. 510, 535-536) involved the constitutional validity of the Oregon Compulsory Education Act, which required every parent or other person having control of a child between the ages of 8 and 16 years to send him to the public school of the district where he resides. Suit was brought to enjoin the operation of the act by corporations owning and conducting private schools on the ground that their business and property was threatened with destruction through the unconstitutional compulsion exercised by the act upon parents and guardians. The suits were held to be not premature, although the effective date of the act had not yet arrived. We said, "The injury to appellees was present and very real, not a mere possibility in the remote future. If no relief had been possible prior to the effective date of the act, the injury would have become irreparable. Prevention of impending injury by unlawful action is a well-recognized function of courts of equity."

(10) VALIDITY OF DISTRAINT PROCEEDINGS

But except in the case of a stockholder's suit based on misapplication of the funds of a corporation, or other exceptional circumstances of which equity will take cognizance, an injunction will not lie to prevent collection of the tax. The Court has upheld the right of the collector to collect taxes by distraint, leaving the taxpayer to his remedy by way of refund.¹¹²

(G) THE TENTH AMENDMENT

(1) CHILD LABOR CASES

There are a few cases in which the Supreme Court has held that a taxing statute was invalid because it violated the provisions of the tenth amendment, which provides that "the powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States, respectively, or to the people." The first case to bring out this principle was that of *Hammer v. Dagenhart*,¹¹³ holding unconstitutional an act of Congress prohibiting transportation in interstate commerce of goods made at a factory in which 30 days prior to removal of the goods children under certain ages had been permitted to work. In this case the Court said:

The grant of power to Congress over the subject of interstate commerce was to enable it to regulate such commerce and not to give it authority to control the States in their exercise of the police power over local trade and manufacture.

Having failed to have this act sustained, the next attempt of Congress to regulate child labor was under the taxing power. An act was passed imposing an excise tax of 10 percent of the net profits from the sales of products of a factory or mine in a taxable year if children below a certain age had been permitted to work in such fac-

¹¹² *Murray's Lessee v. Hoboken Land & Improvement Co.* (18 How. 272).

¹¹³ 247 U. S. 251.

tory or mine during such taxable year. In the *Child Labor Tax case* ¹¹⁴ the Supreme Court also held this act unconstitutional, stating:

In the case at the bar, Congress in the name of a tax which on the face of the act is a penalty seeks to do the same thing, and the effort must be equally futile.

The analogy of the *Dagenhart case* is clear. The congressional power over interstate commerce is, within its proper scope, just as complete and unlimited as the congressional power to tax, and the legislative motive in its exercise is just as free from judicial suspicion and inquiry. Yet when Congress threatened to stop interstate commerce in ordinary and necessary commodities, unobjectionable as subjects of transportation, and to deny the same to the people of a State in order to coerce them into compliance with Congress' regulation of state concerns, the court said this was not in fact regulation of interstate commerce, but rather that of state concerns and was invalid. So here the so-called tax is a penalty to coerce people of a state to act as Congress wishes them to act in respect of a matter completely the business of the state government under the federal Constitution.

(2) FUTURE TRADING ACT CASES

The next case involving this question, *Hill v. Wallace*,¹¹⁵ held invalid a tax of 20 cents a bushel on all futures, but excepted from its application sales on boards of trade (designated as contract markets by the Secretary of Agriculture) on fulfillment by such boards of certain conditions and requirements set forth in the act. In that case, the Court said:

The act is in essence and on its face a complete regulation of boards of trade, with a penalty of 20 cents a bushel on all "futures" to coerce boards of trade and their members into compliance. When this purpose is declared in the title to the bill, and is so clear from the effect of the provisions of the bill itself, it leaves no ground upon which the provisions we have been considering can be sustained as a valid exercise of the taxing power.

The case of *Trusler v. Crooks*,¹¹⁶ considered section 3 of the act referred to in *Hill v. Wallace*, *supra*, the other parts of the act having been declared unconstitutional in the latter case. Section 3 on its face appeared to be a tax, providing as follows:

That in addition to the taxes now imposed by law there is hereby levied a tax amounting to 20 cents per bushel on each bushel involved therein, whether the actual commodity is intended to be delivered or only nominally referred to, upon each and every privilege or option for a contract either of purchase or sale of grain, intending hereby to tax only the transactions known to the trade as "privileges", "bids", "offers", "puts and calls", "indemnities", or "ups and downs."

But the Court also held this section unconstitutional, stating:

The major part of this plan was condemned in *Hill v. Wallace*, and section 3 being a mere feature without separate purpose, must share the invalidity of the whole * * *.

This conclusion seems inevitable when consideration is given to the title of the act, the price usually paid for such options, the size of the prescribed tax (20 cents per bushel), the practical inhibition of all transactions within the terms of section 3, the consequent impossibility of raising any revenue thereby, and the intimate relation of that section to the unlawful scheme for regulation under guise of taxation. The imposition is a penalty, and in no proper sense a tax.

¹¹⁴ 259 U. S. 20.

¹¹⁵ 259 U. S. 44.

¹¹⁶ 269 U. S. 475.

This case shows that in determining whether or not a tax is a penalty, the Court will consider the whole scheme in its entirety, even going to the title of the act.

(3) NARCOTIC ACT CASES

Another case having some bearing on this question is that of *Nigro v. United States*,¹¹⁷ in which the Supreme Court upheld the validity of section 2 of the Narcotic Act, making it unlawful for a person to sell drugs except in pursuance of a written order of the person to whom the articles are sold on a form issued by the Commissioner of Internal Revenue, but said:

Since that time (the time of the *Doremus case*), this Court has held that Congress by merely calling an act a taxing act cannot make it a legitimate exercise of taxing power under section 8 of article I of the Federal Constitution.

In *Linder v. United States*,¹¹⁸ the Supreme Court held that a physician who gives an addict moderate amounts of morphine could not be held liable to a penalty prescribed under the narcotic law on the ground that direct control of medicinal practice in the States is beyond the power of the Federal Government. In this case, the Court made the following comment:

* * * Congress cannot, under the pretext of executing delegated power, pass laws for the accomplishment of objects not entrusted to the Federal Government. And we accept as established doctrine that any provision granted by the Constitution, not naturally and reasonably adapted to the effective exercise of such power but solely reserved to the States, is invalid and cannot be enforced.

(4) LIQUOR TAX CASE

In *United States v. Constantine*¹¹⁹, a \$1,000 special excise tax imposed upon liquor dealers and brewers for carrying on their business in violation of State law was a penalty and an invasion of the police power reserved to the States under the tenth amendment.

(5) AGRICULTURAL ADJUSTMENT ACT CASE

The Supreme Court on January 6, 1936,¹²⁰ held the Agricultural Adjustment Act unconstitutional because it was a statutory plan to regulate and control agriculture, a matter reserved to the States. In this connection the Court said:

The act invades the reserved rights of the States. It is a statutory plan to regulate and control agricultural production, a matter beyond the powers delegated to the Federal Government. The tax, the appropriation of the funds raised, and the direction for their disbursement are but parts of the plan. They are but means to an unconstitutional end.

* * * * *

The power of taxation, which is expressly granted, may, of course, be adopted as a means to carry into operation another power also expressly granted. But resort to the taxing power to effectuate an end which is not legitimate, not within the scope of the Constitution, is obviously inadmissible.

¹¹⁷ 276 U. S. 332.

¹¹⁸ 268 U. S. 5.

¹¹⁹ 296 U. S. 287.

¹²⁰ *United States v. Butler* (297 U. S. 1).

(6) GUFFEY COAL ACT CASE

Following this decision the Bituminous Coal Conservation Act of 1935 was held unconstitutional by the Supreme Court in *Carter v. Carter Coal Co.*¹²¹ In this case the Court held that a so-called excise tax of 15 percent on the sale price of coal at the mine, or in the case of captive coal the fair market value, with its draw-back allowance, imposed by the Guffey Coal Act, was clearly not a tax but a penalty, the purpose of which was to force compliance with regulatory matters over which the Federal Government had no control.

(H) INCOME UNDER THE SIXTEENTH AMENDMENT

(1) DESCRIPTION OF AMENDMENT

The sixteenth amendment provides that "The Congress shall have power to lay and collect taxes on income, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." This amendment was proposed to the legislatures of the several States by the Sixty-first Congress on July 31, 1909 (36 Stat. 184). It was declared by proclamation of the Secretary of State, dated February 25, 1913, to have been ratified by the necessary number of States (37 Stat. 1785), but for convenience was made effective by the Congress at the beginning of the next month, namely, March 1, 1913. In referring to the amendment the Court said:

As repeatedly held, this did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the States of taxes laid on income.

A proper regard for its genesis, as well as its very clear language, requires also that this amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real and personal. This limitation still has an appropriate and important function and is not to be overridden by Congress or disregarded by the courts.

In order, therefore, that the clauses cited from article I of the Constitution may have proper force and effect, save only as modified by the amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not "income", as the term is there used; and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised.¹²² [Citations omitted.]

It is therefore necessary to determine whether a tax is on income or on property because of ownership. If the tax is upon property because of ownership, it will be held unconstitutional unless apportioned according to population.

(2) INCOME DEFINED PRIOR TO SIXTEENTH AMENDMENT

The Supreme Court first defined "income" under the Corporation Excise Tax Act of 1909, in the case of *Stratton's Independence Lim-*

¹²¹ 56 Sup. Ct. 855.

¹²² *Eisner v. Macomber* (252 U. S. 206).

ited v. Howbert.¹²³ In that case a corporation engaged in extracting ore-bearing gold and other precious metals sold \$284,682.85 worth of ore during 1909. The cost of extracting, mining, and marketing the ore was \$190,939.42, and the value of said ores so extracted in the year 1909 when in place in said mine and before extraction was \$93,743.43. This was the difference between the gross sales and the cost of extracting, mining, and marketing the ore. The company claimed that the value of the ore in place constituted a part of its capital and the value of the ore when removed was not, therefore, income but was depletion of its capital. The Supreme Court, in handing down its decision, defined income as follows:

For income may be defined as the gain derived from capital, from labor, or from both combined, and here we have combined operations of capital and labor.

It was held that the company had secured a gain from capital and labor combined, and the depletion of capital claimed by the company was not permitted as an offset in arriving at the income subject to tax. The action of the Government in treating as income the difference between the gross sales (\$284,682.85) and the cost of extracting, mining, and marketing the ore (\$190,939.42) was upheld. Another case arising under the same act held that income was realized upon the sale or conversion of capital assets. This case was *Doyle v. Mitchell Brothers Co.*,¹²⁴ which is discussed under the heading of Capital Gains. Following the adoption of the sixteenth amendment the Supreme Court was again called upon to define income.

(3) INCOME DEFINED AFTER SIXTEENTH AMENDMENT

In *Eisner v. Macomber*, already referred to, the Supreme Court, in referring to the meaning of income under the sixteenth amendment, said:

The fundamental relation of "capital" to "income" has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop; the former depicted as a reservoir supplied from springs, the latter as the outlet stream, to be measured by its flow during a period of time. For the present purpose we require only a clear definition of the term "income", as used in common speech, in order to determine its meaning in the amendment; and having formed also a correct judgment as to the nature of a stock dividend, we shall find it easy to decide the matter at issue.

After examining dictionaries in common use, we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909—"Income may be defined as the gain derived from capital, from labor, or from both combined", provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the *Doyle case* (pp. 183, 185).

Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The Government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word "gain", which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived—"derived from capital"—"the gain derived from capital", etc. Here we have the essential matter; not a gain accruing to capital, not a growth or increment of value in the investment, but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested or employed, and coming in, being "derived"; that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit, and

¹²³ 231 U. S. 415.

¹²⁴ 247 U. S. 179.

disposal; that is, income derived from property. Nothing else answers the description.

The same fundamental conception is clearly set forth in the sixteenth amendment—"incomes, from whatever source derived"—the essential thought being expressed with a conciseness and lucidity entirely in harmony with the form and style of the Constitution" (citations omitted).¹²⁵

And in *United States v. Safety Car Heating and Lighting Company* ^{125a} the Court held that a mere claim for profits on account of a patent infringement made the subject of a suit brought prior to March 1, 1913, but not settled until 1925, could not be considered income accrued prior to March 1, 1913, even though the taxpayer was on the accrual basis. In holding that the taxpayer did not receive from this source until 1925, the Court said:

In February 1913, if our analysis of the facts is accurate, there was a contested and contingent claim for profits, not fairly to be characterized as income for that year or earlier. In 1925 this inchoate and disputed claim became consummate and established. It was now something more than a claim. It was income fully accrued, and taxable as such. Till then the patentee had its capital, the patent, and an expectancy of income, or income, more accurately, in the process of becoming. Thereafter it had something different. No doubt the income thus accrued derived sustenance and value from the soil of past events. We do not identify the seed with the fruit that it will yield.

Income within the meaning of the sixteenth amendment is the fruit that is born of capital, not the potency of fruition. With few exceptions, if any, it is income as the word is known in the common speech of men. When it is that, it may be taxed, though it was in the making long before (citations omitted).

But if a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income, even though he may still be held liable to restore its equivalent.^{125b}

From the foregoing it is clear that income under the sixteenth amendment is not synonymous with gross receipts. Before there can be any income, there must be a gain. In order to determine whether there has been a gain, and the amount of gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital investment. This has been brought out not only in decisions construing statutes enacted prior to the sixteenth amendment, but also in decisions construing statutes enacted since that amendment. (See *Doyle v. Mitchell Brothers* and other cases discussed under the heading of Capital Gains. See also *Burnet v. Logan*,^{126a} in which the Supreme Court held that the taxpayer had a right to the return of her capital investment before she had taxable income.) But it is not necessary to postpone the assessment of a tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or of a given transaction, will result in a gain. This was brought out in the case of *Burnett v. Sanford & Brooks Co.*¹²⁶ In that case, Sanford & Brooks Co., a Delaware corporation engaged in business for profit, was from 1913 to 1915, inclusive, acting for the Atlantic Dredging Co. in carrying out a contract for dredging the Delaware River, entered into by that company with the United States. In making its income returns for the years 1913 to 1916 the taxpayer added to

¹²⁵ *Eisner v. Macomber* (252 U. S. 206, 207, 208).

^{125a} 297 U. S. 88.

^{125b} *North American Oil Consolidated v. Burnet* (286 U. S. 424); see also, *Spring City Foundry Co. v. Com.* (292 U. S. 182).

^{126a} 283 U. S. 404.

¹²⁶ 282 U. S. 359.

gross income for each year the payments made under the contract that year and deducted its expenses paid that year in performing the contract. The total expenses exceeded the payments received by \$176,271.88. For 1913, 1915, and 1916 the tax returns showed net losses; that for 1914 showed net income. In 1915 work under the contract was abandoned, and suit was brought to recover the expenses incurred by the company in connection with the contract. From the total recovery the taxpayer received in 1916 the sum of \$192,577.59, which included the \$176,271.88 by which its expenses under the contract had exceeded its receipts from it and accrued interest amounting to \$16,305.71. The taxpayer did not include either of these items in gross income for 1916, and the Commissioner of Internal Revenue asserted deficiency assessments for such amounts. In upholding the action of the Commissioner, the Court, after deciding that the statute required these items to be included in gross income for 1916, stated:

But respondent insists that if the sum which it recovered is the income defined by the statute, still it is not income taxation of which without apportionment is permitted by the sixteenth amendment, since the particular transaction from which it was derived did not result in any net gain or profit. But we do not think the amendment is to be so narrowly construed. A taxpayer may be in receipt of net income in one year and not in another. The net result of the 2 years, if combined in a single taxable period, might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period or of a given transaction will be a gain or a loss.

The sixteenth amendment was adopted to enable the Government to raise revenue by taxation. It is the essence of any system of taxation that it should produce revenue ascertainable and payable to the Government at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation. It is not suggested that there has ever been any general scheme for taxing income on any other basis. The computation of income annually as the net result of all transactions within the year was a familiar practice, and taxes upon income so arrived at were not unknown before the sixteenth amendment. * * * It is not to be supposed that the amendment did not contemplate that Congress might make income so ascertained the basis of a scheme of taxation such as had been in actual operation within the United States before its adoption. While conceivably a different system might be devised by which the tax could be assessed, wholly or in part, on the basis of the finally ascertained results of particular transactions, Congress is not required by the amendment to adopt such a system in preference to the more familiar method, even if it were practicable. It would not necessarily obviate the kind of inequalities of which respondent complains. If losses from particular transactions were to be set off against gains in others, there would still be the practical necessity of computing the tax on the basis of annual or other fixed taxable periods, which might result in the taxpayer being required to pay a tax on income in one period exceeded by net losses in another.

(4) NECESSITY FOR DEDUCTIONS

Moreover, with the exception of capital investments required to be deducted in arriving at gross income, other deductions are regarded as being entirely within the discretion of the Congress. In referring to this subject the Court, in *Helvering v. Independence Life Insurance Company*,¹²⁷ said:

Unquestionably Congress has power to condition, limit, and deny deductions from gross income in order to arrive at the net that it chooses to tax.

¹²⁷ 292 U. S. 371.

In that case the Court upheld as constitutional a provision of the income-tax statute disallowing a deduction for taxes, expenses, and depreciation with respect to a building owned and occupied in whole or in part by a life-insurance company, unless such company included in its gross income the rental value of the space so occupied. The Court referred to its earlier decisions holding that deductions for depletion are allowed not as a matter of right but as a matter of grace by the Congress. It distinguished its decision in the *National Life Insurance Company case*¹²⁸ on the ground that a provision of the statute requiring abatement of a 4-percent deduction by the amount of interest from tax-exempt securities had the effect of imposing a direct tax on the income of the tax-exempt securities.

There are many other cases in which the Court has expressed the view that deductions are a matter of legislative grace. In the case of the *New Colonial Ice Company v. Helvering*,¹²⁹ the Court, in refusing to allow a corporation a deduction for a net loss of its predecessor, said:

Whether and to what extent deductions shall be allowed depends upon the legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.

We will now discuss the following specific items and determine whether or not they constitute income under the sixteenth amendment.

(5) CAPITAL GAINS

(a) *Prior to sixteenth amendment.*

As already pointed out, the Supreme Court has held that profit gained through a sale or conversion of capital assets constitutes income. This was first brought out in the *Doyle case*¹³⁰ which involved the corporation excise tax of 1909. In that case a lumber-manufacturing company acquired certain timberlands in 1903 and paid for them approximately \$20 per acre. Owing to the increase in market price of stumpage, the market value of the timberland on December 31, 1908, had increased to about \$40 per acre. After the passage of the Excise Tax Act of 1909 and preparatory to making a return of income for the year 1909, the company revalued its timber stumpage at approximately \$40 per acre. Under the 1909 act, which was effective as of January 1, 1909, the company made a return of income for the years 1909, 1910, 1911, and 1912, and in each instance deducted from its gross receipts the market value as of December 31, 1908, of the stumpage cut and converted during the year covered by the tax. The Commissioner of Internal Revenue having allowed a deduction of the cost of the timber in 1903, and having refused to allow as a deduction the difference between that cost and the fair market value of the timber on December 31, 1908, the question before the court was whether this difference (made on the basis of the additional tax) was income for the years in which it was converted into money within the meaning of the act. The court upheld the position

¹²⁸ 277 U. S. 508.

¹²⁹ 292 U. S. 345; see also *Taxation of Gross Income Under the Sixteenth Amendment*, notes, *Columbia Law Review*, February 1936, p. 275.

¹³⁰ 247 U. S. 179.

of the taxpayer and made the following statement as to the definition of income:

Understanding the term in this natural and obvious sense, it cannot be said that a conversion of capital assets invariably produces income. If sold at less than cost, it produces rather loss or outgo. Nevertheless in many, if not in most, cases there results a gain that properly may be accounted as a part of the "gross income" received "from all sources"; and by applying to this the authorized deductions we arrive at "net income." In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration.

A similar situation arose in the case of *Hays v. Gauley Mountain Coal Co.*¹³¹ In that case the coal company purchased in 1902 shares of stock in another coal company which it sold in 1911, realizing a profit of \$210,000. The Court held that so much of the profit from the sale of the stock as accrued subsequent to the effective date of the 1909 act was income received during the year 1911. The same conclusion was reached in the case of the *United States v. Cleveland, Cincinnati, Chicago & St. Louis Railway Co.*,¹³² in which a railway company purchased in 1900 shares of stock in another railway company, which it sold in 1909, realizing a profit of \$814,000. The part of the profit which accrued after January 1, 1909, was held to be income received during the year 1909.

(b) *After sixteenth amendment.*

In *Southern Pacific Co. v. Lowe*¹³³ the Supreme Court held that income had no broader meaning under the 1913 act than it had under the act of 1909. As already pointed out, the sixteenth amendment became effective on March 1, 1913. Therefore, in determining what is "income" under the sixteenth amendment, it is necessary to exclude capital values attributable to any period prior to March 1, 1913, just as it was necessary under the act of 1909 to exclude capital value attributable to any period prior to January 1, 1909, the effective date of the 1909 act. As stated in *Lucas v. Alexander*,¹³⁴ such portion of a gain realized by a taxpayer as is attributable to and accrued during the period antedating March 1, 1913, must, for income-tax purposes, be deemed an accretion to capital not taxable by the income-tax acts enacted under the sixteenth amendment. In other words, to determine whether there is income under the sixteenth amendment, it is necessary to substitute for the original capital investment of the taxpayer who held property on March 1, 1913, the fair market value of the property as of that date in cases where the capital investment is less than such value. A case involving this point, namely, *Goodrich v. Edwards*,¹³⁵ arose under the Revenue Act of 1916. In that case the taxpayer purchased 1,000 shares of stock in a mining company, for which he paid \$500. The stock was worth \$695 on March 1, 1913, and it was sold on March 1, 1916, for approximately \$14,000. The Commissioner assessed a tax on the difference between the March 1, 1913, value and the selling price. The Court upheld the assessment, saying: "It is plain that this assessment was on the part accruing after March

¹³¹ 247 U. S. 189.

¹³² 247 U. S. 195.

¹³³ 247 U. S. 330.

¹³⁴ 279 U. S. 573.

¹³⁵ 255 U. S. 527.

1, 1913, the effective date of the act, realized to the owner by the sale after deducting his capital investment." In another transaction involved in the same case the taxpayer owned stock in one corporation which in 1912 he exchanged for stock in a reorganized company of the then value of about \$291,000. The market value of such stock on March 1, 1913, was about \$148,000. The taxpayer sold the stock in 1916 for \$269,000, being \$22,000 less than its value then acquired, but \$121,000 more than its value on March 1, 1913. The Government assessed taxes on the difference between the March 1, 1913, value and the selling price, notwithstanding the fact that the selling price was less than the cost. The Court held the assessment invalid for the reason that the taxpayer realized no gain from its original capital investment.

A similar conclusion was reached in *Walsh v. Brewster*,¹³⁶ where bonds purchased in 1899 were sold in 1916 for more than their March 1, 1913, value but at the same amount for which they were originally acquired. As no gain was realized on the investment, the tax was held invalid. In a second transaction involved in the same case the taxpayer had purchased certain bonds in 1902 and 1903 for approximately \$231,000, which he sold in 1916 for about \$276,000. Their market value on March 1, 1913, was \$164,000. The tax was assessed upon the difference between the selling price and the market value of the bonds on March 1, 1913. It was held that the gain of the taxpayer was only the difference between his investment of \$231,000 and the amount realized by the sale—\$276,000. Under authority of *Goodrich v. Edwards*, he was taxable only on \$45,000, the difference between the purchase and sale price.

While these cases were decided on statutory grounds, it appears that the acts in question are as broad as the constitutional grant giving the Congress authority to tax income without apportionment. In the case of a loss from the sale or other disposition of capital assets, a different rule seems to apply. There appears to be no constitutional prohibition against the Congress restricting the deductibility of a loss, and the Court's decisions on this point are controlled entirely by statutory provisions. There were two cases involving losses which arose under the Revenue Act of 1918. In one case, *U. S. v. Flannery*,¹³⁷ the taxpayer sold stock for more than its cost but for less than its fair market value on March 1, 1913. Therefore, in that case there was no actual loss from the investment. In the other case, *McCaughn v. Ludington*,¹³⁸ there was an actual loss, for the stock was sold for less than its cost or fair market value as of March 1, 1913; but the fair market value as of March 1, 1913, was also greater than the cost of the stock. The Supreme Court held that under the language of the Revenue Act of 1918 the taxpayer was entitled to a loss only where an actual loss was sustained from the investment.

In *MacLaughlin v. Alliance Insurance Company*,¹³⁹ a Pennsylvania stock fire and marine insurance corporation received a profit from the sale in 1928 of property acquired prior to that year. The Commissioner of Internal Revenue assessed a tax against the company, which was arrived at by including in the taxable income all of the gains

¹³⁶ 255 U. S. 536.

¹³⁷ 268 U. S. 98.

¹³⁸ 268 U. S. 106.

¹³⁹ 286 U. S. 244.

attributable to the increase in value of the property after March 1, 1913, and realized by the sale in 1928. The company contended that only so much of the gain as accrued after the effective date of the Revenue Act of 1928 could constitutionally be taxed, and it was upheld in this contention by the lower court. The Supreme Court, in denying the claim of the taxpayer and upholding the position of the Government, said:

The tax under this and earlier revenue acts was imposed upon net income for stated accounting periods, here the calendar year 1928, and it is only gain realized from the sale or other disposition of property, which is included in the taxable income. Realization of the gain is the event which calls into operation the taxing act, although part of the profit realized in one accounting period may have been due to increase of value in an earlier one. While increase in value of property not realized as gain by its sale or other disposition may, in an economic or bookkeeping sense, be deemed an addition to capital in a later period, it is, nevertheless, a gain from capital investment which, when realized, by conversion into money or other property, constitutes profit which has consistently been regarded as income within the meaning of the sixteenth amendment and taxable as such in the period when realized.

Here there is no question of a tax on enhancement of value occurring before March 1, 1913, the effective date of the income tax act of that year, for the collector asserts no right to tax such increase in value. The fact that a part of the taxed gain represented increase in value after that date, but before the present taxing act, is without significance. Congress, having constitutional power to tax the gain, and having established a policy of taxing, it may choose the moment of its realization and the amount realized for the incidence and the measurement of the tax. Its failure to impose a tax upon the increase in value in the earlier years, assuming without deciding that it had the power, cannot preclude it from taxing the gain in the year when realized, any more than in any other case, where the tax imposed is upon realized, as distinguished from accrued, gain. If the gain became capital by virtue of the increase in value in the years before 1928, and so could not be taxed as income, the same would be true of the enhancement of value in any one year after the adoption of the taxing act, which was realized and taxed in another. But the constitutionality of a tax so applied has been repeatedly affirmed and never questioned. The tax being upon realized gain, it may constitutionally be imposed upon the entire amount of the gain realized within the taxable period, even though some of it represents enhanced value in an earlier period before the adoption of the taxing act. (Citations omitted.)

Then, too, the Court held that a taxpayer did not acquire property prior to March 1, 1913, by securing an option to purchase the property before that date. The property was not acquired until the option was exercised in 1916, and any gain from the sale of such property accrued to the taxpayer after that date.^{139a}

(c) *Casual sales.*

Unlike the British statutes, income results under the sixteenth amendment whether the gain is derived from a casual sale or from the business of buying and selling capital assets. This question was disposed of by the Court in *Merchants' Loan and Trust Company v. Smietanka*.¹⁴⁰ That case involved the sale by a trustee of an estate of certain shares of corporate stock. The cash value of these shares on March 1, 1913, was about \$562,000, and they were sold on February 2, 1917, for over a million dollars. The Commissioner treated the difference between the value of the stock on March 1, 1913, and the amount for which sold in 1917 as income for that year. The taxpayer argued that income as used in the sixteenth amendment does not

^{139a} *Helvering v. San Joaquin Trust and Investment Company* (297 U. S. 496).

¹⁴⁰ 255 U. S. 509.

include the gain from capital realized by a single isolated sale of property, but includes only profits realized from sales by one engaged in buying or selling as a business—a merchant, a real-estate agent, or a broker. The Court in disposing of this contention said:

It is sufficient to say of this contention that no such distinction was recognized in the Civil War Income Tax Act of 1867, or in the act of 1894, declared unconstitutional on an unrelated ground; that it was not recognized in determining income under the Excise Tax Act of 1909, as the cases cited, *supra*, show; that it is not to be found, in terms, in any of the income-tax provisions of the Internal Revenue Acts of 1913, 1916, 1917, or 1919; that the definition of the word "income" as used in the sixteenth amendment, which has been developed by this Court, does not recognize any such distinction; that in departmental practice, for now 7 years, such a rule has not been applied; and that there is no essential difference in the nature of the transaction or in the relation of the profit to the capital involved, whether the sale or conversion be a single, isolated transaction or one of many. (Citations omitted.)

The foregoing discussion establishes the proposition that mere appreciation in the value of property does not constitute income. A capital gain in order to be income must be realized by a sale or other conversion of the property. The Congress may tax the entire amount of a capital gain in the year of sale, even though part of the gain may represent an increase in value accruing in prior years, so long as such increase in value did not accrue before March 1, 1913, the effective date of the sixteenth amendment.

(6) DIVIDENDS

(a) *Cash dividends.*

A dividend declared in cash in ordinary course has been held by the Supreme Court to be income to the shareholder. This was established in *Lynch v. Hornby*.¹⁴¹ In that case Hornby was a shareholder in the Cloquet Lumber Co. (capitalized at \$1,000,000—10,000 shares, par \$100). This company owned timber tracts in 1914 which it was operating and which had greatly increased in value. Hornby owned 434 shares of the stock of the company which he had acquired in 1906. In 1914 the corporation distributed \$650,000 in dividends, of which \$240,000 represented current earnings and \$410,000 the proceeds of property of which the company owned or had an interest in prior to March 1, 1913. Hornby's share of the distribution out of surplus existing on March 1, 1913, was \$17,794, and his share out of the current earnings was \$10,416. He contended that that part of the dividend which represented surplus earned by the corporation prior to March 1, 1913, was not subject to tax. The Supreme Court held that the dividend was taxable to Hornby in its entirety, stating:

* * * and we deem it equally clear that Congress was at liberty under the amendment to tax as income, without apportionment, everything that became income, in the ordinary sense of the word, after the adoption of the amendment, including dividends received in the ordinary course by a stockholder from a corporation, even though they were extraordinary in amount and might appear upon analysis to be a mere realization in possession of an inchoate and contingent interest that the stockholder had in a surplus of corporate assets previously existing. Dividends are the appropriate fruit of stock ownership, are commonly reckoned as income, and are expended as such by the stockholder without regard to whether they are declared from the most recent earnings, or from a surplus accumulated from the earnings of the past, or are based

¹⁴¹ 247 U. S. 339.

upon the increased value of the property of the corporation. The stockholder is, in the ordinary case, a different entity from the corporation, and Congress was at liberty to treat the dividends as coming to him *ab extra*, and as constituting a part of his income when they came to hand.

Thus, a dividend paid in ordinary course is income to the shareholder in the constitutional sense, even though paid out of earnings or profits or operations accrued prior to March 1, 1913. In fact, in the *Canfield case*¹⁴² the Supreme Court pointed out that the exemption granted by Congress in the case of dividends paid out of pre-March 1, 1913, earnings was "a concession to the equity of stockholders with respect to receipts as to which they had no constitutional immunity."

(b) *Dividends in kind.*

A dividend in kind declared in ordinary course has also been held to be income to the shareholder by the Supreme Court. This was settled by the case of *Peabody v. Eisner*.¹⁴³ In that case, Charles A. Peabody as the owner of 1,100 shares of the Union Pacific Railroad Co. received as a dividend from the company, stock of the Baltimore & Ohio Railroad Co. which was owned by the Union Pacific Railroad Co. at the time of the declaration of the dividend. The Supreme Court held that this dividend was taxable to the shareholder, as it was "a distribution of assets in specie and is governed by the same rule applicable to a like distribution in money."

(c) *Stock dividends.*

In *Eisner v. Macomber*,¹⁴⁴ the Supreme Court held that a dividend in the common stock of a corporation paid to its common-stock holders was not income within the meaning of the sixteenth amendment. It was pointed out that such a dividend was not income because by its payment no severance of corporate assets was accomplished and the preexisting proportionate interest of the stockholders remained unaltered. In this connection the Court said:

A "stock dividend" shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. Far from being a realization of profits of the stockholder, it tends rather to postpone such realization in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.

The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the sixteenth amendment.

In its decision the Court stated that its earlier decision of *Collector v. Hubbard*,¹⁴⁵ rendered pursuant to the Civil War income-tax acts, insofar as it might be construed to uphold the right of Congress to tax without apportionment a stockholder's interest in accumulated earnings prior to the declaration of the dividend, must be regarded

¹⁴² *Helvering v. Canfield* (291 U. S. 163).

¹⁴³ 247 U. S. 347.

¹⁴⁴ 252 U. S. 189.

¹⁴⁵ 12 Wall. 1.

as overruled by *Pollock v. Farmers' Loan and Trust Company*.¹⁴⁶ Conceding *Collector v. Hubbard* was inconsistent with the doctrine of that case, because it sustained a direct tax upon property not apportioned among the States, the Government nevertheless insisted that the sixteenth amendment removed this obstacle and contended that the *Hubbard case* is now authority for the power of Congress to levy a tax on the stockholders' share in the accumulated profits of the corporation even before division by the declaration of a dividend of any kind. In rejecting this contention of the Government the Supreme Court said:

* * * Manifestly, this argument must be rejected, since the amendment applies to income only, and what is called the stockholders' share in the accumulated profits of the company is capital, not income. As we have pointed out, a stockholder has no individual share in accumulated profits, nor in any particular part of the assets of the corporation prior to dividend declared.

But the Supreme Court has made a sharp distinction between a stock dividend which involved no change in the proportionate interest of the shareholder and one that did involve a change in such proportionate interest. In *Koshland v. Helvering*,¹⁴⁷ the Supreme Court held that a preferred stockholder of the Columbia Steel Corporation who received a dividend in common stock of the corporation had received a taxable dividend under the sixteenth amendment. In distinguishing this type of dividend from the type of dividends held to be exempt from taxation under the decision of *Eisner v. Macomber* and other decisions, the Court said:

We are dealing solely with an income-tax act. Under our decisions the payment of a dividend of new common shares, conferring no different rights or interests than did the old—the new certificates, plus the old, representing the same proportionate interest in the net assets of the corporation as did the old—does not constitute the receipt of income by the stockholder. On the other hand, where a stock dividend gives the stockholder an interest different from that which his former stock holdings represented he receives income. The latter type of dividend is taxable as income under the sixteenth amendment. Whether Congress has taxed it as of the time of its receipt is immaterial for present purposes.

(d) *Stock rights.*

Stock rights to subscribe for stock of the class already held have been held by the Supreme Court¹⁴⁸ to be analogous to nontaxable stock dividends, the Court stating that the "subscription right of itself constituted no gain, profit, or income taxable without apportionment under the sixteenth amendment." However, the taxability of rights to subscribe to a different class of stock or stock in a different corporation has not been settled by the Supreme Court.

(e) *Sale of nontaxable stock dividends and stock rights.*

While certain classes of stock dividends and stock rights have been held not to be income under the sixteenth amendment, a sale of such at a profit is income in like manner as a gain derived from the sale of the original shares. However, it is not permissible for the Government to treat such stock dividends or stock rights as something new and independent of the old shares and as if such dividends or rights had actually cost the shareholder nothing, leaving the entire

¹⁴⁶ 158 U. S. 601.

¹⁴⁷ 56 Sup. Ct. 767.

¹⁴⁸ *Miles v. Safe Deposit Company* (259 U. S. 252).

proceeds of the sale taxable as a gain. This, according to the Supreme Court, "would ignore the essence of the matter." In arriving at the cost of a nontaxable stock dividend or a nontaxable stock right the cost of the old stock must be apportioned between the old and the new shares or rights according to some equitable method (*Miles v. Safe Deposit Company*, referred to above). But in the case of a taxable stock dividend an allocation of the original cost of the old stock between the old stock and the taxable stock dividend is not required. This was decided in the *Koshland case*, already referred to. In that case the preferred shareholder who received a dividend in common stock and later sold the preferred stock was not required to reduce the cost basis of the preferred stock in arriving at the gain from the sale of such preferred stock.

(f) *Liquidating dividends.*

In the case of liquidating dividends, income is realized only to the extent that the amount received by the shareholder in liquidation exceeds the cost or March 1, 1913, value of his stock, whichever is greater. This was settled by the decision of the Supreme Court in the case of *Lynch v. Turrish*.¹⁴⁹ In that case the amount received by the shareholder on liquidation of the corporation was more than the purchase price of his stock but not in excess of the March 1, 1913, value of the stock. The Court held that no income was realized to the shareholder upon such liquidation because the proceeds which he received in liquidation did not exceed the March 1, 1913, value of his stock. In *Hellmich v. Hellman*¹⁵⁰ the Court in construing the provisions of the Revenue Act of 1921 held that gains realized by shareholders from distributions of assets in liquidation were subject to a normal tax to the same extent as if they had sold their stock to third persons. If the shareholder acquired his stock after March 1, 1913, the difference between what he paid for his stock and the amount received upon liquidation (if in excess of cost) is income to him, even though such liquidating amount might include earnings or profits accumulated prior to March 1, 1913. This is the rule of the present income-tax statute and has been incorporated in many revenue acts in the past.

(g) *Taxability of dividend to the declaring corporation.*

While a dividend is income to the shareholder, the declaration of a dividend does not result in any income to the corporation declaring such dividend. This question arose in the case of *General Utilities and Operating Company v. Helvering*.¹⁵¹ In that case the Government contended that the corporation made a profit by distributing to its own shareholders certain stock of the Islands Edison Co. which it theretofore owned. The agreed value of the stock at the date of declaration was greatly in excess of its cost. The Government's theory was that upon the declaration of the dividend the corporation became indebted to the shareholders for the amount of the dividend, and the discharge of that liability by delivery of property costing less than the amount of the debt constituted income. The Supreme Court

¹⁴⁹ 247 U. S. 221.

¹⁵⁰ 276 U. S. 233.

¹⁵¹ 56 Sup. Ct. 185.

held that no taxable gain was derived from such distribution, stating:

Both tribunals below rightly decided that petitioner derived no taxable gain from the distribution among its stockholders of the Islands Edison shares as a dividend. This was no sale; assets were not used to discharge indebtedness.

(h) *Nontaxable intercompany dividends.*

There are some cases where the declaration of a dividend ^{to} by a parent corporation ^{to} a subsidiary does not result in income to the subsidiary. This was so held by the Supreme Court in *Southern Pacific Co. v. Lowe*.¹⁵² In that case the Southern Pacific Co., a Kentucky corporation, owned all of the capital stock of the Central Pacific Railroad Co., a Utah corporation, and was in actual possession of the railways and other assets of the Central Pacific and in charge of operations, which were conducted under a lease providing that the Southern Pacific corporation, as lessee, should pay an annual rental. The Central Pacific corporation had nothing to do with its own funds, the Southern Pacific handling all its funds and advancing money to the Central Pacific as the occasion might require. Due to the accumulation of such rental and the conversion of certain capital assets of the Central Pacific Co., that company showed upon its books a large surplus accumulated prior to March 1, 1913, principally in the form of a debit against the Southern Pacific. In 1914 certain dividends were declared and paid out of this surplus, but the payment was merely constructive, being accomplished by bookkeeping entries, reducing the surplus of the Central Pacific and decreasing the indebtedness of the Southern Pacific by the amount of the dividend. The Supreme Court held that such dividends were not income to the Southern Pacific, stating:

We base our conclusion in the present case upon the view that it was the purpose and intent of Congress, while taxing "the entire net income arising or accruing from all sources" during each year, commencing the 1st day of March 1913 to refrain from taxing that which, in mere form only, bore the appearance of income accruing after that date, while in truth and in substance it accrued before; and upon the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and in other capacities. While the two companies were separate legal entities, yet in fact, and for all practical purposes, they were merged, the former being but a part of the latter, acting merely as its agent, and subject in all things to its proper direction and control. And, besides, the funds represented by the dividends were in the actual possession and control of the Southern Pacific as well before as after the declaration of the dividends.

In another case, *Gulf Oil Corporation v. Lewellyn*,¹⁵³ the Gulf Oil Corporation was a holding company owning some or all of the stock of a number of subsidiaries engaged in the production, transportation, refining, and marketing of oil. In the latter part of 1912 and the early part of 1913 several of the subsidiaries had large surpluses composed of earnings in prior years. Practically all of these sums were invested in plant, equipment, inventory, etc., and were necessary for the conduct of the business. There were a great many inter-company loans, apparently in large amounts. Dividends were de-

¹⁵² 247 U. S. 330.

¹⁵³ 248 U. S. 71.

clared and paid by the subsidiaries out of such earnings. The payment of the dividends did not involve the actual transfer of the funds in any case but constituted mere bookkeeping entries whereby the indebtedness of the subsidiaries to each other for intercompany loans became indebtedness to the parent. The Court held that these distributions did not constitute income to the holding company for the following reasons:

Disregarding the forms gone through, the result was merely that the petitioner became the holder of the debts previously due from one of its companies to another. It was no richer than before but its property now was represented by stock in and debts due from its subsidiaries, whereas formerly it was represented by the stock alone, the change being effected by entries upon the respective companies' books. The earnings thus transferred had been accumulated and had been used as capital before the taxing year (*Lynch v. Turrish*, 247 U. S. 221, 228).

It is true that the petitioner and its subsidiaries were distinct beings in contemplation of law, but the facts that they were related as parts of one enterprise, all owned by the petitioner, that the debts were all enterprise debts due to members, and that the dividends represented earnings that had been made in former years and that practically had been converted into capital, unite to convince us that the transaction should be regarded as bookkeeping rather than as "dividends declared and paid in the ordinary course by a corporation" (*Lynch v. Hornby*, 247 U. S. 339, 346). The petitioner did not itself do the business of its subsidiaries and have possession of their property, as in *Southern Pacific Company v. Lowe* (247 U. S. 330), but the principle of that case must be taken to cover this.

While the Court based its decisions in these cases upon the Revenue Act of 1913, it is believed that they are controlling as to the meaning of income under the sixteenth amendment, since the Court has already pointed out in *Eisner v. Macomber* that income under the 1913 act is as broad as the constitutional grant under the sixteenth amendment. However, these cases are based upon peculiar facts and, therefore, may be regarded as exceptional and not applying to the usual cases involving distribution of dividends by a subsidiary corporation to its parent.

(7) REORGANIZATIONS

In a number of cases arising under the 1917 and prior revenue acts the Supreme Court has held that the exchange of stock in one corporation for stock in another corporation pursuant to a corporate reorganization had resulted in income to the shareholder. These cases are *U. S. v. Phellis*,¹⁵⁴ *Rockefeller v. U. S.*,¹⁵⁵ *Cullinan v. Walker*,¹⁵⁶ and *Marr v. U. S.*¹⁵⁷ In another case, *Weiss v. Stearns*,¹⁵⁸ the Supreme Court held that the exchange did not result in taxable income to the shareholder. The basis of all these decisions seems to be that if the shareholder received securities which changed his interest, taxable income will result; otherwise not. In the *Marr* case the Court analyzed the basis for its conclusion in all of these cases as follows:

In each of the five cases named, as in the case at bar, the business enterprise actually conducted remained exactly the same. In *United States v. Phellis*, in *Rockefeller v. United States*, and in *Cullinan v. Walker*, where the additional

¹⁵⁴ 257 U. S. 156.

¹⁵⁵ 257 U. S. 176.

¹⁵⁶ 262 U. S. 134.

¹⁵⁷ 268 U. S. 639.

¹⁵⁸ 265 U. S. 242.

value in new securities distributed was held to be taxable as income, there had been changes of corporate identity; that is, the corporate property, or a part thereof, was no longer held and operated by the same corporation; and, after the distribution, the stockholders no longer owned merely the same proportional interest of the same character in the same corporation. In *Eisner v. Macomber* and in *Weiss v. Stearn*, where the additional value in new securities was held not to be taxable, the identity was deemed to have been preserved. In *Eisner v. Macomber* the identity was literally maintained. There was no new corporate entity. The same interest in the same corporation was represented after the distribution by more shares of precisely the same character. It was as if the par value of the stock had been reduced and 3 shares of reduced par-value stock had been issued in place of every 2 old shares; that is, there was an exchange of certificates but not of interests. In *Weiss v. Stearn* a new corporation had, in fact, been organized to take over the assets and business of the old. Technically there was a new entity, but the corporate identity was deemed to have been substantially maintained because the new corporation was organized under the laws of the same State, with presumably the same powers as the old. There was also no change in the character of securities issued. By reason of these facts, the proportional interest of the stockholder after the distribution of the new securities was deemed to be exactly the same as if the par value of the stock in the old corporation had been reduced, and 5 shares of reduced par-value stock had been issued in place of every 2 shares of the old stock. Thus, in *Weiss v. Stearn*, as in *Eisner v. Macomber*, the transaction was considered, in essence, an exchange of certificates representing the same interest, not an exchange of interests.

In the case at bar the new corporation is essentially different from the old. A corporation organized under the laws of Delaware does not have the same rights and powers as one organized under the laws of New Jersey. Because of these inherent differences in rights and powers, both the preferred and the common stock of the old corporation is an essentially different thing from stock of the same general kind in the new. But there are also adventitious differences substantial in character. A 6-percent, nonvoting preferred stock is an essentially different thing from a 7-percent, voting preferred stock. A common stock subject to the priority of \$20,000,000 preferred and a \$1,200,000 annual dividend charge is an essentially different thing from a common stock subject only to \$15,000,000 preferred and a \$1,050,000 annual dividend charge. The case at bar is not one in which after the distribution the stockholders have the same proportional interest of the same kind in essentially the same corporation.

(8) ALIMONY

Amounts paid to a divorced wife under a decree for alimony are not regarded by the Court as income of the wife but in discharge of the general obligation to support, which is made specific by decree (*Gould v. Gould*,¹⁵⁹ *Audubon v. Shufelt*,¹⁶⁰ and *Douglas v. Willcuts*).¹⁶¹ While the Court in holding alimony not to be income to the recipient was construing the provisions of the Revenue Act of 1913, the Court has pointed out that it was clear that in that act Congress intended to exert its power to the fullest extent permitted by the sixteenth amendment.

(9) ILLEGAL GAINS

Gains from illegal operations constitute income. This was held to be income in *United States v. Sullivan*.¹⁶² In that case the Court in upholding a tax on income derived from the operation of a business in violation of the National Prohibition Act said:

We see no reason to doubt the interpretation of the act, or any reason why the fact that a business is unlawful should exempt it from paying the taxes that if lawful it would have to pay.

¹⁵⁹ 245 U. S. 151.

¹⁶⁰ 181 U. S. 575.

¹⁶¹ 296 U. S. 1.

¹⁶² 274 U. S. 259.

And in *U. S. v. Constantine*,^{162a} the Court said:

The United States has the power to levy excises upon occupations, and to classify them for this purpose; and need look only to the fact of the exercise of the occupation or calling taxed, regardless of whether such exercise is permitted or prohibited by the laws of the United States or by those of a State. The burden of the tax may be imposed alike on the just and the unjust. It would be strange if one carrying on a business the subject of an excise should be able to excuse himself from payment by the plea that in carrying on the business he was violating the law. The rule has always been otherwise.

But while Congress has the power to tax unlawful activities to the same extent as lawful activities, if a higher exaction is imposed against such unlawful activities because of their unlawfulness, the additional amount is a penalty and not a tax. This was brought out in the *Constantine case*, already referred to, in which the Court said:

Where, in addition to the normal and ordinary tax fixed by law, an additional sum is to be collected by reason of conduct of the taxpayer violative of the law, and this additional sum is grossly disproportionate to the amount of the normal tax, the conclusion must be that the purpose is to impose a penalty as a deterrent and punishment of unlawful conduct.

In other words, for purposes of taxation Congress cannot classify activities into two divisions, lawful and unlawful, and under the guise of a tax subject the unlawful activity to a higher rate of tax than the legitimate activity. The additional burden against the unlawful activity would be a penalty and not collectible as a tax.

(10) GIFTS, BEQUESTS, OR DEVISES

The Supreme Court has not passed directly upon the question as to whether or not a gift, bequest, or devise constitutes income. The Commissioner of Internal Revenue interpreted "income" under the act of 1864 to include the "receipt of gifts", but not to include bequests or devises because they were subject to legacy and succession duties. Under section 28 of the act of August 15, 1894,¹⁶³ "money and the value of personal property acquired by gift" was required to be included in income for the purpose of the income tax. However, the income-tax provisions of the Revenue Act of 1894 were held unconstitutional on the ground that the income tax was a direct tax and subject to the rule of apportionment. Since all of the income-tax acts enacted after the sixteenth amendment have excluded gifts, bequests, and devises from gross income, the Supreme Court has not had an opportunity directly to dispose of the question. However, the decisions of the Court defining income do not appear to embrace the concept of a gift. (See *Eisner v. Macomber*.) There is in the case of a gift no gain from the capital or labor of the taxpayer or a sale or conversion of a capital asset. In *Taft v. Bowers*¹⁶⁴ the Supreme Court upheld the right of Congress to tax the donee upon the sale of property acquired by gift for the difference between the sale price of such property and its cost to the donor. The Court pointed out that in such a case there was only a single investment of capital—that made by the donor—and when through the sale or conversion by the donee the appreciation or increase was separated therefrom, it became in-

^{162a} 296 U. S. 287.

¹⁶³ Ch. 349, 28 Stat. 553.

¹⁶⁴ 278 U. S. 470.

come from that investment in the hands of the recipient subject to taxation according to the very words of the sixteenth amendment. To use the words of the Court in referring to the donee—

when she sold the stock she actually got the original sum invested plus the entire appreciation, and out of the latter only was she called on to pay the tax demanded.

And in referring to this same case in *Helvering v. City Bank Farmers Trust Co.*, decided November 11, 1935, the Court said:

Although property received by gift from another is capital in the hands of the donee the gain upon a sale may be measured by the cost to the donor rather than the value at the time of acquisition by the donee.^{164a}

Furthermore, in *Edwards v. Cuban Railroad Company*¹⁶⁵ the Supreme Court held that physical properties and money subsidies paid to the Cuban Railroad Co. by the Republic of Cuba were not income within the sixteenth amendment. On this point the Court stated:

* * * The subsidy payments were proportionate to mileage completed; and this indicates a purpose to reimburse plaintiff for capital expenditures. All—the physical properties and the money subsidies—were given for the same purposes. It cannot reasonably be held that one was contribution to capital assets and that the other was profit, gain, or income. Neither the laws nor the contracts indicate that the money subsidies were to be used for the payment of dividends, interest, or anything else properly chargeable to or payable out of earnings or income. The subsidy payments taxed were not made for services rendered or to be rendered. They were not profits or gains from the use or operation of the railroad, and do not constitute income within the meaning of the sixteenth amendment.

But income does not lose its character as such because it is received as the result of a gift, bequest, or devise. In *Irwin v. Gavit*¹⁶⁶ the decedent left the residue of his estate in trust, a part of the income from which was to be paid to Gavit during his life. The Court held that the bequest to Gavit was taxable income because it was to be paid out of income from a definite fund. The Court concluded that the gift was of money to be derived from income and to be paid and received as income by the donee. Furthermore, in *Helvering v. Butterworth*,¹⁶⁷ the Court held that a widow who accepts the provisions of her husband's will and receives part or all of the income from an established trust in lieu of her statutory rights is a beneficiary and taxable upon the income received by her from the trust. However, in the case of an annuity, which although in fact paid out of income might be paid out of the corpus of the estate, a different rule applies. In the case of *Burnet v. Whitehouse*,¹⁶⁸ James Gordon Bennett provided in his will as follows:

I also give and bequeath to the said Sybil Douglas, wife of William Whitehouse, an annuity of five thousand dollars.

and then provided:

I authorize and empower said executors or executor to retain and hold any personal property which may belong to me at the time of my death and to set aside and hold any part thereof to provide for the payment and satisfaction of any annuity given by me.

^{164a} 296 U. S. 85.

¹⁶⁵ 268 U. S. 628.

¹⁶⁶ 268 U. S. 161.

¹⁶⁷ 290 U. S. 365.

¹⁶⁸ 283 U. S. 148.

Since the gift did not depend upon income but was a charge upon the whole estate during the life of the legatee to be satisfied like any ordinary bequest, the Court held it was not taxable as income to the legatee. A similar conclusion was reached in *Helvering v. Pardee*.¹⁶⁹ The annuity provided by the will for Mrs. Pardee was payable at all events. It did not depend upon income from the trust estate. She elected to accept this in lieu of her statutory rights. She chose to assume the position of an ordinary legatee. Payments made to Mrs. Pardee by the fiduciary were not necessarily made from income. The charge was upon the estate as a whole; her claim was payable without regard to income received by the fiduciary. Payments to her were not distributions of income but in discharge of a gift or legacy.

(11) PAYMENT OF DEBTS

The Supreme Court has held that income was received by a taxpayer when pursuant to a contract a debt or other obligation was discharged by another for his benefit. The transaction was regarded as being the same in substance as if the money had been paid to the taxpayer and he had transmitted it to his creditor. *Old Colony Trust Company v. Commissioner*; ¹⁷⁰ *U. S. v. Boston & Maine Railroad Company*.¹⁷¹

(12) ROYALTIES FROM LEASE EXECUTED BEFORE THE SIXTEENTH AMENDMENT

Royalties received after the adoption of the sixteenth amendment by the owner of coal lands under mining leases executed before the adoption of such amendment constitute income and not a return of capital.¹⁷²

(13) PAYMENT BY LESSEE OF LESSOR'S TAX

A payment by a lessee under the terms of a lease, of the net income tax assessable against the lessor, constitutes income to the lessor.¹⁷³

(14) REDEMPTION OF BONDS

Gains to a corporation by purchasing and redeeming its bonds at a price less than that for which sold, constitute income.¹⁷⁴

(15) INVENTORY SALES

Where goods on hand at the end of taxable year are inventoried below cost at their then market value, amounts in excess of such inventory value realized from sales in subsequent years are to be accounted for as taxable income in the year in which they are realized.¹⁷⁵

¹⁶⁹ 290 U. S. 365.

¹⁷⁰ 279 U. S. 716.

¹⁷¹ 279 U. S. 732.

¹⁷² *Bankers Pocohontas Coal Company v. Burnet* (287 U. S. 308).

¹⁷³ *United States v. Boston and Maine R. Company* (279 U. S. 732).

¹⁷⁴ *U. S. v. Kirby Lumber Company* (284 U. S. 1); see also *Helvering v. American Chicle Co.* (291 U. S. 426).

¹⁷⁵ *U. S. Cartridge Company v. U. S.* (284 U. S. 511).

(16) TAXABILITY OF PERSONS OTHER THAN THE OWNER OF THE INCOME

There are some cases which uphold the right of Congress to tax a person other than the owner of the income. These cases are classified as follows:

(a) *Assignment of income.*

The Supreme Court has held that a taxpayer may not be relieved of liability for income tax on his salary or other income by assigning it to someone else. In the case of *Lucas v. Earl*,¹⁷⁶ a husband and a wife contracted that any property they had or might thereafter acquire in any way, either by earnings (including salaries, fees, etc.) or any rights by contract or otherwise, should be treated as owned by them as joint tenants. Notwithstanding this contract the Court held the Government had a right to tax the husband in full upon his professional fees or other compensation earned subsequently to the date of the contract. In this connection the Court said:

Assuming the validity of the contract under the local law, it still remained true that the husband's professional fees, earned in years subsequent to the date of the contract, were his individual income derived from salary, wages, or compensation.

To the same effect is *Burnet v. Lenninger*,¹⁷⁷ in which the Court upheld the right of the Government to tax a husband on his entire distributive share of the profits of a partnership, notwithstanding the fact that he had assigned a part of such profits to his wife.

(b) *Revocable trusts.*

In the case of a revocable trust the income may be taxed to the grantor, notwithstanding the fact that it is actually enjoyed by someone else. In *Corliss v. Bowers*¹⁷⁸ the Court, in upholding the right of the Government to tax the income from a revocable trust to the grantor, said:

The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income whether he sees fit to enjoy it or not.

(c) *Irrevocable trusts.*

Not only may the income of a revocable trust be taxed to the grantor but also the income from an irrevocable trust in certain cases. Thus, in *Burnet v. Wells*,¹⁷⁹ the Supreme Court held that the grantor of an irrevocable trust is subject to a tax on the income which the trustee uses (pursuant to the directions of the trust instrument) for payment of insurance premiums on the life of the grantor. The trustee was directed to collect the insurance proceeds upon the death of the insured, purchase therewith securities from the estate of the grantor, and hold such securities for the benefit of certain designated persons. In upholding the tax on the grantor the Court said:

* * * Liability does not have to rest upon the enjoyment by the taxpayer of all the privileges and benefits enjoyed by the most favored owner at a given

¹⁷⁶ 281 U. S. 111.

¹⁷⁷ 285 U. S. 136.

¹⁷⁸ 281 U. S. 376; see also *Reinecke v. Smith* (289 U. S. 172).

¹⁷⁹ 289 U. S. 670.

time or place. * * * Government in casting about for proper subjects of taxation is not confined by the traditional classification of interests or estates. It may tax not only ownership but any right or privilege that is a constituent of ownership. * * * Liability may rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis. A margin must be allowed for the play of legislative judgment.

Following that decision the Court held that income paid from a trust estate to a wife in lieu of alimony was income to the husband. It was pointed out that the court's decree awarding alimony to the wife placed the obligation on the husband to devote the income in question through the medium of the trust to the use of his divorced wife. The creation of a trust by the taxpayer as the channel for the application of the income to the discharge of his obligation leaves the nature of the transaction unaltered as to the taxability of such income to the husband. The court pointed out that in such a case the net income of a trust fund paid to the wife stands substantially on the same footing as if the husband had received the income personally and had been required by decree to make payment directly to the wife. Following this doctrine the Supreme Court has also held that where the income from a trust was to be applied for the support, maintenance, and education of the grantor's children and also where the income of the trust was to be applied in payment of the grantor's debts, it may still be taxed to the grantor.¹⁸⁰

(17) EFFECT OF AMENDMENT AS TO CONVERTING INCOME TAX FROM A DIRECT TAX TO AN EXCISE OR INDIRECT TAX

As already pointed out, the effect of the sixteenth amendment has been to remove the income tax on property from the direct tax class and put it in the class of an excise or indirect tax. The only reason that the income tax was regarded as a direct tax in the first place was because the Court in the *Pollock case*¹⁸¹ went back and looked at the property from which the income was derived and held, in effect, that a tax on the income was a tax upon the property itself. In other words, a tax on income while in common understanding was direct merely on the income and only indirect on the property, was regarded by the Supreme Court as direct on the property in the constitutional sense. The decisions of the Supreme Court indicate that the income tax would never have been regarded as a direct tax but for the fact that it was regarded as a tax upon the property itself. The later decisions of the Court forbid the further application of the rule requiring a consideration of the sources from which the taxed income is derived, by which rule alone such taxes were removed from the excise tax class and put into the direct tax class. The amendment, therefore, had the effect of taking a tax upon income derived from sources which had theretofore made it a direct tax out of that category and putting it into the class of excises, duties, and imposts. The reason for this conclusion will now be discussed. For purposes of the discussion the subject is divided into two parts. The

¹⁸⁰ *Helvering v. Sweitzer* (296 U. S. 551); *Helvering v. Stokes* (296 U. S. 551); *Helvering v. Blumenthal* (296 U. S. 552).

¹⁸¹ *Pollock v. Farmers' Loan & Trust Company* (157 U. S. 557).

first part deals with the classification of the income tax prior to the sixteenth amendment, and the second part with its classification after that amendment.

(a) *Income tax prior to the sixteenth amendment.*

Mr. Justice Fuller, in *Pollock v. Farmers' Loan & Trust Co.*,¹⁸² stated the classification of taxes under the Constitution as follows:

In the matter of taxation, the Constitution recognizes the two great classes of direct and indirect taxes and lays down two rules by which their imposition must be governed, namely, the rule of apportionment as to direct taxes; and the rule of uniformity as to duties, imposts, and excises.

The conclusions of the Supreme Court as to whether an income tax was a direct tax before the adoption of the sixteenth amendment are summed up in the second case of *Pollock v. Farmers' Loan & Trust Co.*,¹⁸³ as follows:

Our conclusions may therefore be summed up as follows:

First. We adhere to the opinion already announced—that taxes on real estate being indisputably direct taxes, taxes on the rents or income of real estate are equally direct taxes.

Second. We are of the opinion that taxes on personal property or on the income of personal property are likewise direct taxes.

Third. The tax imposed by sections 27 to 37, inclusive, of the act of 1894, so far as it falls on the income of real estate and of personal property, being a direct tax within the meaning of the Constitution and therefore unconstitutional and void, because not apportioned according to representation, all those sections, constituting one entire scheme of taxation, are necessarily invalid.

The Supreme Court did not hold in the *Pollock case* that a tax on incomes from professions, trades, employments, or vocations was a direct tax. This was brought out by Mr. Justice White in *Brushaber v. Union Pacific Railroad Co.*,¹⁸⁴ in which, in referring to the *Pollock case*, he said:

* * * Moreover, in addition, the conclusion reached in the *Pollock case* did not in any degree involve holding that income taxes generically and necessarily came within the class of direct taxes on property, but, on the contrary, recognized the fact that taxation on income was in its nature an excise entitled to be enforced as such unless and until it was concluded that to enforce it would amount to accomplishing the result which the requirement as to apportionment of direct taxation was adopted to prevent, in which case the duty would arise to disregard form and consider substance alone, and hence subject the tax to the regulation as to apportionment which otherwise as an excise would not apply to it. Nothing could serve to make this clearer than to recall that in the *Pollock case*, insofar as the law taxed incomes from other classes of property than real estate and invested personal property—that is, income from “professions, trades, employments, or vocations” (158 U. S. 637), its validity was recognized; indeed, it was expressly declared that no dispute was made upon that subject, and attention was called to the fact that taxes on such income had been sustained as excise taxes in the past (id., p. 635). The whole law was, however, declared unconstitutional on the ground that to permit it to thus operate would relieve real estate and invested personal property from taxation and “would leave the burden of the tax to be borne by professions, trades, employments, or vocations; and in that way what was intended as a tax on capital would remain in substance a tax on occupations and labor” (id., p. 637), a result which, it was held, could not have been contemplated by Congress.

¹⁸² 157 U. S. 557.

¹⁸³ 158 U. S. 601.

¹⁸⁴ 240 U. S. 1.

In view of the foregoing, it seems clear that prior to the adoption of the sixteenth amendment a tax on incomes from real and personal property was regarded as a direct tax under the Constitution, but that a tax on incomes from professions, trades, employments, or vocations was regarded as an indirect tax or excise.

(b) *Income tax after the sixteenth amendment.*

Shortly after the decisions of the Supreme Court in the *Pollock v. Farmers' Loan & Trust Co.* cases, the sixteenth amendment was adopted. This amendment reads as follows:

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 decisions of the Supreme Court rendered after that amendment seem clearly to justify the conclusion that the effect of the sixteenth amendment is to take an income tax on incomes from real and personal property out of the category of direct taxes and to put it in the indirect class of excises, duties, and imposts. As pointed out before, the Supreme Court has never held that a tax on incomes from salaries, trades, avocations, or employments is a direct tax.

To justify the conclusion that the income tax is no longer a direct tax in the constitutional sense may be cited the case of *Brushaber v. Union Pacific Railroad Co.*,¹⁸⁵ in which it was contended that the income-tax provisions of the Revenue Act of 1913 violated the sixteenth amendment.

In that case the Supreme Court traced the history leading up to the adoption of the sixteenth amendment and stated that the income tax of 1894 was held unconstitutional in the *Pollock case* for the following reasons:

Concluding that the classification of direct was adopted for the purpose of rendering it impossible to burden by taxation accumulations of property, real or personal, except subject to the regulation of apportionment, it was held that the duty existed to fix what was a direct tax in the constitutional sense so as to accomplish this purpose contemplated by the Constitution (157 U. S. 581). Coming to consider the validity of the tax from this point of view, while not questioning at all that in common understanding it was direct merely on income and only indirect on property, it was held that, considering the substance of things, *it was direct on property in a constitutional sense, since to burden an income by a tax was, from the point of substance, to burden the property from which the income was derived, and thus accomplish the very thing which the provision as to apportionment of direct taxes was adopted to prevent.* [Italics ours.]

The Court, after quoting the sixteenth amendment, then goes on to state:

It is clear on the face of this text that it does not purport to confer power to levy income taxes in a generic sense—an authority already possessed and never questioned—or to limit and distinguish between one kind of income taxes and another, but that the whole purpose of the amendment was to relieve all income taxes when imposed from apportionment from a consideration of the source whence the income was derived. Indeed, in the light of the history which we have given and of the decision in the *Pollock case*, and the ground upon which the ruling in that case was based, there is no escape from the conclusion that the amendment was drawn for the purpose of doing away for the future with the principle upon which the *Pollock case* was decided; that is, of determining whether a tax on income was direct not by a consideration of the burden placed

¹⁸⁵ 240 U. S. 1.

on the taxed income upon which it directly operated, but by taking into view the burden which resulted on the property from which the income was derived, since in express terms the amendment provides that income taxes, from whatever source the income may be derived, shall not be subject to the regulation of apportionment. From this in substance it indisputably arises, first, that all the contentions which we have previously noticed concerning the assumed limitations to be implied from the language of the amendment as to the nature and character of the income taxes which it authorizes finds no support in the text and are in irreconcilable conflict with the very purpose which the amendment was adopted to accomplish. Second, that the contention that the amendment treats a tax on income as a direct tax, although it is relieved from apportionment and is necessarily therefore not subject to the rule of uniformity, as such rule only applies to taxes which are not direct, thus destroying the two great classifications which have been recognized and enforced from the beginning, is also wholly without foundation since the command of the amendment that all income taxes shall not be subject to apportionment by a consideration of the sources from which the taxed income may be derived forbids the application to such taxes of the rule applied in the *Pollock case* by which alone such taxes were removed from the great class of excises, duties, and imposts subject to the rule of uniformity, and were placed under the other or direct class. This must be unless it can be said that although the Constitution, as a result of the amendment, in express terms excludes the criterion of source of income, that criterion yet remains for the purpose of destroying the classifications of the Constitution by taking an excise out of the class to which it belongs and transferring it to a class in which it cannot be placed consistently with the requirements of the Constitution. Indeed, from another point of view, the amendment demonstrates that no such purpose was intended, and on the contrary shows that it was drawn with the object of maintaining the limitations of the Constitution and harmonizing their operation. We say this because it is to be observed that although from the date of the *Hylton case*, because of statements made in the opinions in that case, it had come to be accepted that direct taxes in the constitutional sense were confined to taxes levied directly on real estate because of its ownership, the amendment contains nothing repudiating or challenging the ruling in the *Pollock case* that the word "direct" had a broader significance, since it embraced also taxes levied directly on personal property because of its ownership, and therefore the amendment at least impliedly makes such wider significance a part of the Constitution, a condition which clearly demonstrates that the purpose was not to change the existing interpretation except to the extent necessary to accomplish the result intended; that is, the prevention of the resort to the sources from which a taxed income was derived in order to cause a direct tax on the income to be a direct tax on the source itself, and thereby to take an income tax out of the class of excises, duties, and imposts, and place it in the class of direct taxes.

Another case in support of the contention that the income tax is no longer a direct tax is that of *Stanton v. Baltic Mining Co.*¹⁸⁶ In that case, which also involved the constitutionality of the income-tax provisions of the act of 1913, it was still contended that the income tax was a direct tax.

In disposing of this contention, the Court made the following statement:

* * * But, aside from the obvious error of the proposition, intrinsically considered, it manifestly disregards the fact that by the previous ruling it was settled that the provisions of the sixteenth amendment conferred no new power of taxation, but simply prohibited the previous complete and plenary power of income taxation possessed by Congress from the beginning from being taken out of the category of indirect taxation to which it inherently belonged, and being placed in the category of direct taxation subject to apportionment by a consideration of the sources from which the income was derived; that is, by testing the tax not by what it was, a tax on income, but by a mistaken theory deduced from the origin or source of the income taxed. Mark, of course, in saying this we are not here considering a tax not within the provisions of the sixteenth

¹⁸⁶ 240 U. S. 103.

amendment; that is, one in which the regulation of apportionment or the rule of uniformity is wholly negligible because the tax is one entirely beyond the scope of the taxing power of Congress, and where consequently no authority to impose a burden, either direct or indirect, exists. In other words, we are here dealing solely with the restriction imposed by the sixteenth amendment on the right to resort to the source whence an income is derived in a case where there is power to tax for the purpose of taking the income tax out of the class of indirect, to which it generically belongs, and putting it in the class of direct, to which it would not otherwise belong, in order to subject it to the regulation of apportionment * * *.

The Supreme Court also reaffirmed its conclusion that the income tax was not a direct tax in the case of *Tyee Realty Co. v. Anderson*.¹⁸⁷

This same contention was also disposed of in *Cook v. Tait*,¹⁸⁸ in which the district court made the following statement:

Upon the assumption that an income tax is a direct tax, and is levied upon property outside the United States, the plaintiff's reasoning is clear and simple. It is true that, if sound, it carries us farther than is necessary for a decision of this case, for apparently it would deny the right to tax so much of the income of a resident as comes from property located in foreign lands. One adverse criticism upon it is that it is clearly established that since the adoption of the sixteenth amendment, an income tax is never a direct tax. The effect of that change in the Constitution was to take a tax upon income derived from sources which had theretofore made it a direct tax out of that category, and put it in the class of excises, duties, and imposts. *Brushaber v. Union Pacific R. R. Co.* (240 U. S. 1-19, 36 Sup. Ct. 236, 60 L. Ed. 493, Ann. Cas. 1917B, 713; L. R. A. 1917D, 414); *Stanton v. Baltic Mining Co.* (240 U. S. 103-112, 36 Sup. Ct. 278, 60 L. Ed. 546) * * *.

To support further the conclusion that the income tax is not a direct tax, it is desired to point out that the Supreme Court has applied the rule of uniformity to income taxes, which rule under the Constitution is limited to excises, duties, and imposts. This is brought out in the *Brushaber* case, already cited, and in the case of *Poe v. Seaborn*,¹⁸⁹ and in the case of *La Belle Iron Works*.¹⁹⁰ It is not believed that the cases of *Towne v. Eisner*¹⁹¹ and *Eisner v. Macomber*¹⁹² affect this conclusion. In those cases the Supreme Court held that a stock dividend was not income. Since the sixteenth amendment relates only to income, that amendment could not affect a tax based upon something other than income.

(I) COMPENSATION OF THE PRESIDENT AND FEDERAL JUDGES

There has been considerable discussion relating to the power of Congress to tax the salaries of the President and judges of the United State courts. The Constitution provides¹⁹³ that the compensation of the President shall not be increased or diminished during his term of office. In the case of judges of constitutional courts created under Article III of the Constitution, it is provided that their compensation shall not be diminished during their continuance in office.¹⁹⁴ So far as the power of taxation is concerned, the question has arisen as to whether the taxing of the salaries of the President and Federal judges

¹⁸⁷ 240 U. S. 115.

¹⁸⁸ 286 Fed. 409, affirmed 265 U. S. 47.

¹⁸⁹ 282 U. S. 101.

¹⁹⁰ 256 U. S. 377.

¹⁹¹ 245 U. S. 418.

¹⁹² 252 U. S. 189.

¹⁹³ United States Constitution, art. 2, sec. 1, cl. 7.

¹⁹⁴ United States Constitution, art. 3, sec. 1.

constitutes a diminution of salary within the meaning of the constitutional provisions referred to. This question was discussed by Justice Field in the *Pollock case*.¹⁹⁵ The first case directly deciding this point was that of *Evans v. Gore*¹⁹⁶ and related to the salary of a United States district judge for the western district of Kentucky. This judge was appointed by the President, with the advice and consent of the Senate, in 1899. He was clearly a judge of a constitutional court within the meaning of Article III of the Constitution. The Government taxed his salary under the Revenue Act of 1918, which included as income for the purpose of the income tax the salary of the President of the United States and of the judges of the Supreme and inferior courts of the United States. The Supreme Court held that the taxation of such income amounted to a diminution of salary and therefore came within the constitutional prohibition. This case settled the question as to the taxability of the salaries of the President and Federal judges appointed prior to the enactment of the taxing statute. It left open the question as to whether Congress had the right to tax the salaries of the President and Federal judges appointed after the taxing act became effective. This last question came before the Supreme Court in the case of *Miles v. Graham*,¹⁹⁷ in which a judge of the Court of Claims sued to recover the income tax paid on his salary for the years 1919 and 1920. This judge assumed office on September 1, 1919, which was after the date of the enactment of the Revenue Act of 1918 (Feb. 24, 1919), under authority of which the Government collected the tax. The Supreme Court also held this tax invalid, stating:

Does the circumstance that the defendant in error's appointment come after the taxing act require a different view concerning his right to exemption? The answer depends upon the import of the word "compensation" in the constitutional provision. The words and history of the clause indicate that the purpose was to impose upon Congress the duty definitely to declare what sum shall be received by each judge out of the public funds and the times for payment. When this duty has been complied with, the amount specified becomes the compensation which is protected against diminution during his continuance in office.

The court then pointed out that the salary of the judge of the Court of Claims was fixed by an act of Congress passed February 25, 1919,¹⁹⁸ at \$7,500 a year, and concluded as follows:

The power of Congress definitely to fix the compensation to be received at stated intervals by judges thereafter appointed is clear. It is equally clear, we think, that there is no power to tax a judge of a court of the United States on account of the salary prescribed for him by law.

This last decision seems to indicate that if Congress has definitely fixed the salary of a judge in a statute, prior to his appointment, such salary cannot be diminished by subjecting it to an income tax. The difficulty with this decision is that the Supreme Court in a later case¹⁹⁹ pointed out that the Court of Claims was not a constitutional court established under article III of the Constitution, but a legislative court. However, the district courts, the circuit courts of ap-

¹⁹⁵ 157 U. S. 429.

¹⁹⁶ 253 U. S. 245.

¹⁹⁷ 268 U. S. 501.

¹⁹⁸ Ch. 29, 40 Stat. 1156, 1157.

¹⁹⁹ *Ex parte Bakelite Corp.* (279 U. S. 438); *Williams v. U. S.* (289 U. S. 553).

peals, and the Supreme Court are constitutional courts,²⁰⁰ including the Supreme Court of the District of Columbia and the United States Court of Appeals for the District of Columbia, and judges of those courts, even though retired (*Booth v. U. S.*)²⁰⁰ are exempt from income tax. Judges of legislative courts do not appear to come within the constitutional prohibition. Among the legislative courts might be mentioned the Court of Customs and Patent Appeals and the Territorial courts. In the *Old Colony Trust Company case*,²⁰¹ the Supreme Court held that the United States Board of Tax Appeals was not a court. From the foregoing, it appears that the constitutional prohibition applies only to the President and judges of constitutional courts established pursuant to article III of the Constitution.

In the Revenue Act of 1932 Congress has by legislation attempted to overcome the constitutional limitation by requiring the President and judges taking office after the date of the enactment of that act (June 6, 1932) to include the compensation received as such in their gross income, and has amended all acts fixing such compensation accordingly. Thus Congress has by such action definitely declared what sum shall be received out of the public funds as compensation for the President and Federal judges taking office after June 6, 1932. This sum consists of a certain amount less the income tax payable on such amount by reason of the inclusion of such amount in gross income for income-tax purposes.

(J) STATE SECURITIES

(1) DEVELOPMENT OF DOCTRINE OF STATE IMMUNITY

The Federal Government has no power to tax the obligations or the interest therefrom of a State or political subdivision. This limitation is not based upon any express prohibition in the Constitution but is implied from the independence of the National and State Governments within their respective spheres and from the provisions of the Constitution looking toward the maintenance of our dual system of government. It first developed from the doctrine announced by the Supreme Court in *McCulloch v. Maryland*,²⁰² decided in 1819. In that case Chief Justice Marshall, who rendered the opinion, held that a State could not constitutionally impose a tax upon notes issued by the Bank of the United States. For the same reason it was held in 1829²⁰³ that the city of Charleston could not tax securities issued by the United States. In 1870 the Supreme Court, in an opinion rendered by Mr. Justice Nelson in *Collector v. Day*,²⁰⁴ made it clear that this prohibition was reciprocal in character and that, therefore, Congress has no power under the Constitution to tax State officers or employees. In that case the Federal Government assessed an income tax levied under the act of 1864 against the salary of J. M. Day, a judge of the Court of Probate and Insolvency for the County of Barn-

²⁰⁰ *O'Donohue v. U. S.* (289 U. S. 516); *Booth v. U. S.* (291 U. S. 339).

²⁰¹ *Old Colony Trust Co. v. Commissioner* (279 U. S. 716); *Helvering v. Rankin* (295 U. S. 131).

²⁰² 4 Wheat. 316.

²⁰³ *Weston v. Charleston* (2 Peters, 449).

²⁰⁴ 11 Wall. 113.

stable, Mass. The salary was fixed by law and payable out of the treasury of the State. Day paid the tax and brought suit to recover. In holding the tax unconstitutional, the Supreme Court relied upon the case of *McCulloch v. Maryland* and the *Dobbins case*, already cited. Its argument may be summed up by the following statement taken from the opinion:

It is admitted that there is no express provision in the Constitution that prohibits the General Government from taxing the means and instrumentalities of the States, nor is there any prohibiting the States from taxing the means and instrumentalities of that Government. In both cases the exemption rests upon necessary implication and is upheld by the great law of self-preservation; as any government, whose means employed in conducting its operations is subject to the control of another and distinct government, can exist only at the mercy of that government. Of what avail are these means if another power may tax them at discretion?

Two years later the case of *United States v. Railroad Company* was decided,²⁰⁵ which held that the Federal Government could not levy a tax on revenue paid to the city of Baltimore. However, it was not until the *Pollock case*²⁰⁶ that the Supreme Court specifically held that the Federal Government could not tax the income from securities issued by States or political subdivisions thereof. Chief Justice Fuller, who delivered the opinion of the Court, made the following statement as to this point:

It is contended that, although the property or revenues of the States or their instrumentalities cannot be taxed, nevertheless the income derived from State, county, and municipal securities can be taxed. But we think the same want of power to tax the property or revenues of the States or their instrumentalities exists in relation to a tax on the income from their securities, and for the same reason; * * *. It is obvious that taxation on the interest therefrom would operate on the power to borrow before it is exercised, and would have a sensible influence on the contract, and that the tax in question is a tax on the power of the States and their instrumentalities to borrow money, and consequently repugnant to the Constitution.

The *Pollock case* held the 1894 act unconstitutional, not only on the ground that it taxed the income from State securities but also on the ground that a tax on the income from property was a direct tax and, therefore, invalid because not apportioned according to population. This last ground was the primary cause of the adoption of the sixteenth amendment, which provides that "The Congress shall have the 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 first draft of this amendment did not contain the clause "from whatever source derived", this being inserted later. For some time it was contended that this clause permitted the taxation of the income from State bonds by the Federal Government. In an article appearing in *Fortune* magazine of October 1933, Mr. Murray I. Gurfein, assistant United States attorney for the southern district of New York, makes the following comment as to this point:

After the resolution had been passed by Congress and while ratification was pending, Governor Hughes, of New York (the present Chief Justice), raised this question. He informed his legislature that he thought that the amendment was broad enough to permit the taxation of income from State securities and that

²⁰⁵ 17 Wall. 322.

²⁰⁶ 157 U. S. 429.

it should, therefore, not be ratified. The Hughes message raised a storm of debate. Elihu Root denied that the amendment was subject to such construction. Senator Borah also disagreed with Governor Hughes. Professor Seligman argued that the *only* purpose of the amendment was to permit an income tax not apportioned according to population. On the other hand, Senator Brown, sponsor of the amendment, thought that the Hughes construction was tenable, but that the amendment ought, nevertheless, to be ratified. Eminent members of the bar, opposing the amendment, presented a memorial to the New York Legislature in accord with the Hughes view. Governors of other States who made public declarations were divided in opinion. In the face of these legalistic conflicts the amendment was ratified.

(2) PRESENT STATUS

However, since the sixteenth amendment applies only to the Federal Government and not to the States, it could not be construed as giving the States any authority to tax the income from Federal securities. Moreover, in 1920, the Supreme Court, in *Evans v. Gore*,²⁰⁷ held that the sixteenth amendment conferred no new power on Congress to tax as income something which Congress could not tax as income prior to the adoption of the sixteenth amendment. In this connection Justice Van Devanter said:

Thus the genesis and words of the amendment unite in showing that it does not extend the taxing power to new or excepted subjects, but merely removes all occasion otherwise existing for an apportionment among the States of taxes laid on income, whether derived from one source or another.

That the Federal Government has no power to tax the income of State securities, notwithstanding the provisions of the sixteenth amendment, is further established in the case of the *National Life Insurance Company v. United States*.²⁰⁸ In that case an act of Congress taxing incomes of insurance companies granted a deduction for income-tax purposes equal to 4 percent of their reserve. Under the terms of the statute this deduction was considerably restricted if the taxpayer received income from tax-exempt securities. The Court held that such a method of taxation constituted a discrimination against the holders of tax-exempt securities and was, therefore, invalid. Other cases, *Willcuts v. Bunn*,²⁰⁹ *Indian Motorcycle Company v. U. S.*,²¹⁰ and *Educational Films Corp. v. Ward*,²¹¹ all reaffirm the principle that the Federal Government has no power to tax the securities of a State or political subdivision or the income therefrom. In an opinion rendered by the Supreme Court on May 25, 1936,²¹² in connection with a water-improvement district of the State of Texas seeking relief under a Federal bankruptcy statute, the Court said:

Notwithstanding the broad grant of power "to lay and collect taxes", opinions here plainly show that Congress could not levy a tax on the bonds issued by respondent or upon income derived therefrom.

* * * * *

The difficulties arising out of our dual form of government, and the opportunities for different opinions concerning the relative rights of State and National Governments are many; but for a very long time this court has steadfastly adhered to the doctrine that the taxing power of Congress does not extend

²⁰⁷ 253 U. S. 245; see also *Eisner v. Macomber* (252 U. S. 189).

²⁰⁸ 277 U. S. 508.

²⁰⁹ 282 U. S. 216.

²¹⁰ 283 U. S. 570.

²¹¹ 282 U. S. 379.

²¹² *Ashton et al. v. Cameron Co., Water Improvement District No. 1* (56 Supreme Court 892).

to the States or their political subdivisions. The same basic reasoning which leads to that conclusion, we think, requires like limitation upon the power which springs from the bankruptcy clause.

(3) INDIRECT EFFECT ON BORROWING POWER

But the Court will not invalidate a tax where it only remotely interferes with the borrowing power of the States. Thus, in *Denman v. Slayton*,²¹³ the Supreme Court upheld the provisions of the Revenue Act of 1921 denying deductions of interest on money borrowed to purchase or acquire tax-exempt securities of a State or political subdivision even though the Federal Government could not tax the interest from such securities. Furthermore, in *Willcuts v. Bunn* it was held that the Federal Government could tax as income the gain from the sale of the securities of a State or political subdivision. Also the Court has held that Congress has the power to reach by means of privilege taxes State securities or the income therefrom. Thus, in *Greiner v. Lewellyn*,²¹⁴ it was held that municipal bonds owned by the decedent may be included in the gross estate for the purpose of the Federal estate tax on the ground that an estate tax is a tax on the privilege of transferring property at death, and not a tax on the securities themselves. And in *Flint v. Stone Tracy Co.*,²¹⁵ the Supreme Court upheld the corporation excise tax of 1909 which taxed the privilege of carrying on or doing business by corporations, but measured the tax by the net income of the corporation from all sources. Since the subject of the tax was an exercise of a franchise or privilege, the court held it was proper for Congress to include in the measure of the tax the income from tax-exempt securities, although such income could not be directly taxed.

(4) SUGGESTED REMEDIES

Several remedies have been suggested to overcome this constitutional limitation. Briefly, these are as follows:

First, the Federal Government could tax the income from subsequent issues of its own securities and the States could tax the income from subsequent issues of their securities. This would not violate the constitutional provision. Of course, the States could not tax the income from past issues, as the Constitution specifically provides that no State shall impair the obligations of a contract. Furthermore, the Federal Government could not tax its past issues, for to do so would constitute a violation of the due process clause of the fifth amendment. This suggestion has certain practical difficulties, for unless both the States and the Federal Government acted simultaneously it would permit one government to gain an additional field for revenue at the expense of the other.

Second, the rate of tax might be computed upon the total income of the taxpayer, including his income from tax-exempt securities, and then applied only to the taxable income. While this plan has possibilities, it is believed that it violates the principle announced by the

²¹³ 282 U. S. 514.

²¹⁴ 258 U. S. 384.

²¹⁵ 220 U. S. 107.

Supreme Court in the *National Life Insurance Company case*, cited supra, in which the Court said:

One may not be subjected to greater burdens upon his taxable property solely because he owns some that is free.

Third, Congress might grant to the States the power to tax the income from Federal securities if the States would grant a similar privilege to the Federal Government. However, this plan is not entirely free of constitutional doubts, since the Supreme Court has stated that "Neither consent nor submission by the States can enlarge the powers of Congress; none can exist except those which are granted. (*Butler v. United States*, decided Jan. 6, 1936.²¹⁶) The sovereignty of the State essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation."²¹⁷ On the other hand, the Federal Government gives the States the power to tax national bank shares, and this has been upheld by the courts.²¹⁸

Fourth, there is a possibility that the income from tax-exempt securities might be reached through an excise tax measured by the net income from all sources. In the case of corporations, it seems clear that this can be done. As already pointed out, the Corporation Excise Tax of 1909 taxed the privilege of carrying on or doing business by corporations. The tax was measured by the net income of the corporation from all sources. Since the subject of the tax was the exercise of a franchise or privilege, the Supreme Court held that Congress had the power to include in the measure of the tax the income from tax-exempt securities, although such income could not be directly taxed.²¹⁹ Moreover, some of the States through corporation excise taxes are now taxing the income from Federal securities by measuring the excise by the net income of the corporation from all sources. In at least two of the States, namely, California and New York, their power to do this has been upheld by the Supreme Court.²²⁰ In the California case, the Supreme Court made the following statement as to this point:

The owner may enjoy his exempt property free of tax, but if he asks and receives from the State the benefit of the taxable privilege as the implement of that enjoyment, he must bear the burden of the tax which the State exacts as its price.

So far as individuals are concerned, there is a possibility that the income received by them from tax-exempt securities may also be reached through an excise. To do this, we must first find a taxable privilege upon which to base the excise. It seems clear that all trades, avocations, and employments by which individuals acquire a livelihood may be made the subject of an excise or privilege tax. Accordingly, if Congress levied an excise on individuals engaged in any business, occupation, trade, avocation, or employment, it seems entirely possible that such tax could be measured by the net income of the individual from all sources, including the income from tax-exempt securities. As stated by the Supreme Court in the *Stone*

²¹⁶ 297 U. S. 1.

²¹⁷ *Ashton v. Cameron Company, Water Improvement District No. 1* (56 Sup. Ct. 892).

²¹⁸ See cases cited in *Baltimore National Bank v. State Tax Commission of Maryland* (297 U. S. 209).

²¹⁹ *Flint v. Stone Tracy Company* (220 U. S. 107).

²²⁰ *Pacific Company v. Johnson* (285 U. S. 480).

Tracy Co. case, "there is no rule which permits a court to say that the measure of a tax for the privilege of doing business, where income from property is the basis, must be limited to that derived from property used in the business." It is up to Congress to determine the measure of the excise and it seems entirely possible that the measure of such excise could be the net income of the individual from all sources, including tax-exempt securities.

By this scheme, most of the income from tax-exempt securities could be reached. Those persons that would escape would be only those who do not engage in any trade, avocation, or employment, but merely hold securities. This scheme would also not extend to State employees engaged in governmental functions of the State, for such occupations being governmental in character could not be reached even through an excise.

Fifth, tax-exempt securities might be subject to a higher estate tax than other property of the decedent on the theory that such securities had escaped income tax during the decedent's lifetime. However, it is believed that this plan would fall counter to the *National Life Insurance case*, already referred to.

Sixth, the States and the Federal Government could pass a constitutional amendment giving both the authority to tax the securities of each other. This last suggestion would undoubtedly overcome all legal objections. However, from a practical standpoint, it might be impossible to secure a sufficient number of States to agree to the adoption of such an amendment unless certain restrictions were placed on the rate of tax which could be imposed on the income of such securities.

(K) STATE FUNCTIONS

(1) DEVELOPMENT OF DOCTRINE OF STATE IMMUNITY

In addition to the implied constitutional prohibition against interfering with the borrowing power of a State or political subdivision by subjecting its securities to Federal taxation, the Federal Government also has no authority to tax the property of a State or any political subdivision thereof, or the means or instrumentalities employed by the State or political subdivision in carrying out its essential functions of government. This prohibition, like that relating to the taxation of State bonds, arises from the independence of the National and State governments within their respective spheres and from the provisions of the Constitution which look to the maintenance of the dual system.²²¹ This prohibition also had its origin in the case of *McCulloch v. Maryland*, already referred to under the heading of "Taxing State Securities", and has been affirmed on numerous occasions by the Supreme Court. In the *Pollock case*, cited supra, the Supreme Court made the following statement as to this point:

As the States cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States have no power under the Constitution to tax either the instrumentalities or the property of a State.

²²¹ *Indian Motorcycle Co. v. U. S.* (283 U. S. 570).

(2) EFFECT ON PRIVILEGES GRANTED BY STATE

But while the Federal Government has no power to tax the property of a State or political subdivision, this immunity from taxation does not extend to the property of a private corporation even though such private corporation is an instrumentality of a State or political subdivision and such property is used in carrying out some governmental purpose.²²²

Furthermore, the fact that the subject of the Federal tax is a privilege granted exclusively by the State does not render the tax invalid unless the privilege was granted to carry out an essential governmental function of the State or political subdivision. This was brought out in *Flint v. Stone Tracy Company*²²³ in connection with the corporation excise tax of 1909. The Court made the following statement as to this point:

While the tax in this case, as we have construed the statute, is imposed upon the exercise of the privilege of doing business in a corporate capacity, as such business is done under authority of State franchises, it becomes necessary to consider in this connection the right of the Federal Government to tax the activities of private corporations which arise from the exercise of franchises granted by the State in creating and conferring powers upon such corporations. We think it is the result of the cases heretofore decided in this Court that such business activities, though exercised because of State-created franchises, are not beyond the taxing power of the United States.

The same argument was made in *Knoulton v. Moore*,²²⁴ in which it was contended that the transmission of property by death is exclusively subject to the regulatory authority of the several States and that, therefore, Congress had no power to tax inheritances in any form. But the Court pointed out that such a contention was wholly unsound, as conveyances, mortgages, leases, pledges, and, indeed, all property and the contracts which arise from its ownership, are subject more or less to State regulation, and that, therefore, under such a rule there would be very few objects which the Federal Government could reach by taxation.

(3) GOVERNMENTAL AND NON-GOVERNMENTAL FUNCTIONS DEFINED

The power of the Federal Government to tax the functions of a State or political subdivision, or the State employees engaged in carrying out such functions, depends upon whether or not such functions are of an essential governmental character. States and political subdivisions have two kinds of power; one that is governmental and public, and one that is proprietary and private. In the exercise of the former, the State and its political subdivisions are clothed with sovereignty and are immune from Federal taxation, but in the exercise of the latter power the State or political subdivision is treated as a private individual and, therefore, subject to Federal taxation. A State or political subdivision cannot escape Federal taxation by engaging in businesses which constitute a departure from usual governmental functions even though such enterprises are undertaken for what the State concedes to be for the public benefit.²²⁵ Just what

²²² *Susquehanna Power Company v. State Tax Commission* (283 U. S. 291).

²²³ 220 U. S. 107.

²²⁴ 178 U. S. 41.

²²⁵ *Helvering v. Powers* (293 U. S. 214).

are essential governmental functions cannot be stated in terms of universal application. As pointed out in *Metcalf and Eddy v. Mitchell*,²²⁶ this limitation upon Federal and State Governments must be given such a practical construction as will not unduly impair the taxing power of one or the appropriate exercise of its functions by the other. It is well settled that the exercise of such rights as the establishment of a judiciary, the employment of persons to administer and execute laws, and to provide for police protection are essential governmental functions and, therefore, cannot be taxed by the Federal Government,²²⁷ and that the salary of a State officer or employee engaged in the exercise of an essential governmental function is not subject to Federal taxation.²²⁸ Nor may the Federal Government require judicial process of a state court to bear a Federal stamp tax.^{228a} (See discussion under "Taxing State Securities.") But consulting engineers advising States with regard to water and sewerage projects or attorneys especially employed by States or political subdivisions to litigate certain cases are not State employees but independent contractors and are subject to taxation by the Federal Government.²²⁹

Furthermore, as heretofore stated, if a State or State agency engages in a private enterprise it is subject to tax to the same extent as a private individual. This was settled in *South Carolina v. United States*,²³⁰ upholding Federal occupational taxes upon agents of the State of South Carolina engaged in dispensing liquors. The Supreme Court reached a similar conclusion in *Ohio v. Helvering*,²³¹ where the State had established a department of liquor control and sought an injunction to restrain the enforcement of Federal statutes imposing taxes upon dealers in intoxicating liquors. The State sought to distinguish the case of South Carolina, because in Ohio the State-owned stores were operated by civil-service employees of the State government and hence the question was said to concern the taxation of the State itself. The argument was unavailing and the Court rested its ruling upon the broad ground that when the State becomes a dealer in intoxicating liquors it falls within the reach of the tax as one validly imposed by the Federal statute. In the recent case of *Helvering v. Powers*, cited *supra*, the Supreme Court held that the compensation of the members of the board of trustees of the Boston Elevated Railway Co. was subject to taxation by the Federal Government for the reason that the operation of a street railway was not an essential governmental function of the State. In the *Flint v. Stone Tracy Company case*,²³² the Court held that it was no part of the essential governmental functions of a State to provide means of transportation and to supply artificial light, water, and the like. Thus, the courts hold that the operation of street railways, waterworks, light and power plants, wharves, piers, and harbors are not essential governmental functions and are, therefore, subject to taxation by the Federal Government.²³³

²²⁶ 269 U. S. 514.

²²⁷ *Flint v. Stone Tracy Co.* (220 U. S. 107); *Indian Motorcycle Co. v. U. S.* (283 U. S. 570).

²²⁸ *Collector v. Day* (11 Wall. 113); see also *Ward v. Maryland* (12 Wall. 418).

^{228a} *Warren v. Paul* (22 Ind. 276).

²²⁹ *Metcalf and Eddy v. Mitchell* (269 U. S. 514, 521); *Lucas v. Howard* (280 U. S. 526); *Lucas v. Reed* (281 U. S. 699).

²³⁰ 199 U. S. 437.

²³¹ 292 U. S. 360.

²³² 220 U. S. 107.

²³³ Income Tax Mimeograph 3838. Revised Jan. 17, 1936.

(4) INCOME FROM SALE OF STATE LEASES

In a case decided April 11, 1932,²³⁴ the Supreme Court held that the lessee's income from the sale of oil and gas products under a lease of State school lands was not taxable by the Federal Government, since the lease constituted a governmental instrumentality of the State and to tax the income of the lessee arising therefrom would amount to an imposition upon the lease itself. However, the application of this principle has been considerably narrowed by other decisions. For instance, profits from the sale of oil and gas produced from leases executed by the State of Texas, held under Texas law to be sales of oil and gas in place, are subject to Federal income tax.²³⁵ Moreover, income received by the lessee of lands belonging to the city of Long Beach, Calif., originally acquired by the city for maintaining a water plant and later leased in part to a private corporation for oil and gas development, was held taxable to the corporation.²³⁶ Furthermore, gains from the sale of such leases by the private corporations are also subject to Federal taxation.²³⁷

(5) SALES TO STATES

The Federal Government has no authority to levy a tax on the sale by a manufacturer of any article when made directly to a State or municipality for use in the exercise of an essential governmental function. This was decided by the Supreme Court in the *Indian Motorcycle case*, cited supra, in which the Court held that the Federal Government is without power to tax a sale of a motorcycle by a manufacturer to a city for its police service. It was held in that case that although the tax was imposed directly on the manufacturer, the burden of the tax fell upon the city. The constitutional prohibition is not extended so as to prohibit a tax on the manufacture of articles which are purchased by a State or political subdivision. Here the connection between the purchase by the State and the tax on the manufacturer is too remote to constitute an interference with a State function.²³⁸ This same principle was also applied by the Supreme Court in holding that the Federal Government had the right to levy a tax upon the transportation of lumber purchased by several counties in Iowa and Nebraska for use in the construction or repair of bridges along public highways within the counties, the Court stating that "the transportation was not a part of the sale but preliminary to it and wholly the vendor's affair."²³⁹

(6) FEDERAL LIMITATION PERIOD IN THE CASE OF STATES

Not only is a State or political subdivision exempt from taxation in the exercise of its essential governmental functions, but it is not subject to the Federal statute of limitations in suing to recover such taxes when illegally collected by the Federal Government. This was brought out in the *South Carolina case*, in which the Government

²³⁴ *Burnet v. Coronada Oil & Gas Company* (285 U. S. 393).

²³⁵ *Group No. 1 Oil Corporation v. Bass* (283 U. S. 279).

²³⁶ *Burnet v. Jergins Trust* (288 U. S. 508).

²³⁷ *Marland v. U. S.* (3 Fed. Supp. 611).

²³⁸ *Cornell v. Coyne* (192 U. S. 418); *American Manufacturing Co. v. St. Louis* (250 U. S. 459).

²³⁹ *Wheeler Lumber Bridge & Supply Co. v. U. S.* (281 U. S. 572).

argued that the State of South Carolina could not maintain an action because it had not complied with the Federal statute of limitations requiring claim for refund to be made to the Commissioner of Internal Revenue within a certain time as a condition precedent to the bringing of suit.

In answering this argument the Court of Claims concluded as follows:

There are a number of minor questions in the case which were exhaustively argued by counsel on both sides, such as (on the part of the defendants) that the claimant should have presented its claim to the Commissioner of Internal Revenue for the remission of the tax as illegally collected; such as (on the part of the claimant), that the statute (14 St. L., p. 163, sec. 44) imposing this excise uses only the term "corporation", and was not intended to apply to a State. But it seems plain, if a State is a power above and exempt from the operation of the revenue laws, that it cannot be compelled to resort to them for redress; and, conversely, that if a State is not a power constitutionally exempt from all national taxation in its commercial transactions, but is, like other persons and corporate bodies, subject to the conditions which the law imposes, the court cannot read into the statute an exemption which is not needed by reasonable construction or by the ordinary principles of justice, and which will be an arbitrary departure from the plain, positive language of the statute.²⁴⁰

It is, of course, very difficult in many cases to draw the line between essential governmental functions and proprietary or private functions. Each case must stand upon its own footing, and, as pointed out, must be given such a practical construction as to permit both Federal and State Governments to function with the minimum of interference from each other.

(7) BEQUESTS TO STATES

While the Federal Government may not tax the property of a State, the Supreme Court has held that bequests to States or political subdivisions may be made the subject of a Federal death duty. Thus, in *Snyder v. Bettman*,²⁴¹ the Supreme Court held that Congress had the power to subject to an inheritance tax a legacy bequeathed to the city of Springfield, Ohio, for the purpose of maintaining a public park. It is interesting to note that the inheritance tax was collected from the property in the hands of the executor, and that in this connection the Court made the following statement:

As the tax in the case under consideration is collected from the property while in the hands of the executor (sec. 30), who is required to liquidate it "before payment and distribution to the legatees", we do not regard it as a tax upon the municipality, though it may operate incidentally to reduce the bequest by the amount of the tax. Such incidental effects are common to many, if not all, forms of taxation—indeed it may be said generally that few taxes are wholly paid by the person upon whom they are directly and primarily imposed.

Having determined, then, that Congress has the power to tax successions; that the States have the same power, and that such power extends to bequests to the United States, it would seem to follow logically that Congress has the same power to tax the transmission of property by legacy to States, or their municipalities, and that the exercise of that power in neither case conflicts with the proposition that neither the Federal nor the State Government can tax the property or agencies of the other, since, as repeatedly held, the taxes imposed are not upon property, but upon the right to succeed to property.

²⁴⁰ *South Carolina v. U. S.*, 39 Court of Claims 257, Aff. 199 U. S. 437).

²⁴¹ 196 U. S. 249.

(S) RECENT STATEMENT OF DOCTRINE

The Supreme Court has pointed out that in each case the power of a State is subordinate to the constitutional exercise of the granted Federal power. Thus, while a State, in operating a State-owned, State belt railroad, is acting within a power reserved to the States, its power to fix intrastate railroad rates must yield to the power of the National Government when the regulation of such rates is appropriate to the regulation of interstate commerce. The Court, in referring to the constitutional immunity of State instrumentalities from Federal taxation, stated:

That immunity is implied from the nature of our Federal system and the relationship within it of State and National Governments, and is equally a restriction on taxation by either of the instrumentalities of the other. Its nature requires that it be so construed as to allow to each government reasonable scope for its taxing power, see *Metcalf & Eddy v. Mitchell*, (269 U. S. 514, 522-524), which would be unduly curtailed if either by extending its activities could withdraw from the taxing power of the other subjects of taxation traditionally within it. *Helvering v. Powers*, (293 U. S. 214, 225); *Ohio v. Helvering*, (292, U. S. 360); *South Carolina v. United States*, (199 U. S. 437); see *Murry v. Wilson Distilling Company* (213 U. S. 151, 173), explaining *South Carolina v. United States*, *supra*. Hence, we look to the activities in which the States have traditionally engaged as marking the boundary of the restriction upon the Federal taxing power. But there is no such limitation upon the plenary power to regulate commerce. The State can no more deny the power if its exercise has been authorized by Congress than can an individual.²⁴²

6. EFFECT OF TREATIES UPON FEDERAL TAXING POWER

Some mention should be made as to the effect of treaties with foreign countries upon the Federal taxing power. Under the Constitution²⁴³, a treaty is placed upon the same footing as an act of Congress. If the two are inconsistent, the one last in date will be controlling. For example, a statute declaring that Russian hemp imported into this country shall pay a duty of \$40 per ton was held by the Supreme Court to repeal the stipulation in a prior treaty with Russia which in effect declared that the duty on Russian hemp should not be more than \$25.²⁴⁴ The courts have also held that a steamship clearing from Bremen, a port in the Hanseatic League, was liable for tonnage duties imposed by a Federal statute, as it was of a later date than a treaty.²⁴⁵ These cases seem to indicate that treaties are not a limitation upon the Federal taxing power.

7. DOUBLE TAXATION AS AFFECTING THE FEDERAL TAXING POWER

The question of the power of the Federal Government to impose so-called "double taxation" has provoked considerable discussion among tax experts and laymen alike. Regardless of any equitable considerations which might influence congressional action in a matter of this kind, it seems clear that Congress has the power to levy double taxes. This was held in the early case of *Patton v. Brady*,²⁴⁶ in which the Supreme Court upheld an additional excise tax imposed

²⁴² *United States v. California* (297 U. S. 175).

²⁴³ *United States Constitution*, art. VI, cl. 2.

²⁴⁴ *Ropes v. Clinch* (8 Blatch. 304).

²⁴⁵ *North German Lloyd Steamship Co. v. Hedden* ((C. C. N. J. 1890) 43 Fed. 17).

²⁴⁶ 184 U. S. 608.

by Congress upon manufactured tobacco, even though such tobacco had passed from the hands of the manufacturer to a dealer at the time of the enactment of the act. In that case the court said:

Our conclusion, then, is that it is within the power of Congress to increase an excise, as well as a property tax, and that such an increase may be made at least while the property is held for sale and before it has passed into the hands of the consumer; that it is no part of the function of a court to inquire into the reasonableness of the excise either as respects the amount or the property upon which it is imposed.

In the past Congress has imposed a great many taxes of this character. They are known as floor taxes. For example, the Revenue Act of 1918, section 604, imposed a floor tax of \$3.20 upon distilled spirits held on February 24, 1919, by any person and intended for sale for beverage purposes. This was in addition to the internal-revenue tax which had been paid on such spirits prior to the enactment of the Revenue Act of 1918. A floor tax was also imposed by section 604 of the Revenue Act of 1918 upon rectified spirits. Floor taxes were also imposed by the Liquor Taxing Act of 1934 on distilled spirits, wines, and grape brandy and wine spirits used in the fortification of wines. The principle of double taxation has also been applied to income taxes. Thus, in *Hellmich v. Hellman*,²⁴⁷ the Supreme Court upheld the right of Congress to subject to the normal tax gains by stockholders from the distribution of assets of a corporation in liquidation, even though such gains consisted of accumulated earnings and profits upon which a normal tax had already been paid by the corporation. Also, in the *Packard Motor Co. case*,²⁴⁸ the Court of Claims held that Congress had the power to tax in full the 1918 consolidated net income of affiliated corporations filing a consolidated return, even though a portion of such net income had already been taxed when such companies filed returns as separate corporations in 1917. The same conclusion was reached by Federal Judge Woolsey, of the Circuit Court of Appeals for the Third Circuit, in a suit, decided September 29, 1933, brought by the Aluminum Co. of America and affiliated corporations to recover \$650,632.38 in income and excess-profits taxes for the year 1918. The Board of Tax Appeals has also applied the principle of double taxation to sales of property upon the installment basis. In the case of *Blum, (Inc.)*,²⁴⁹ the board held that a taxpayer changing from the accrual to the installment basis was required for income-tax purposes to report payments received in prior years, notwithstanding the fact that an income tax had already been paid on such profits for the prior years when they were reported on the accrual basis.

In considering the question of double taxation, it is necessary to view the picture not only from the standpoint of the Federal Government but also from the standpoint of the individual who is required to pay the tax. Both the Federal Government and the States in many instances impose a tax upon the same subject, so that from the viewpoint of the taxpayer a double tax may be said to be imposed in such cases. However, the Supreme Court has pointed out that neither the Federal

²⁴⁷ 276 U. S. 233.

²⁴⁸ 39 Fed. (2d) 991, certiorari denied, 51 Sup. Ct. 27.

²⁴⁹ 7 B. T. A. 737.

Government nor a State is under any constitutional obligation to make allowances on account of the taxes imposed by the other.²⁵⁰ Therefore, it seems clear that there is no legal objection to the imposition of double taxation. The objections to such form of taxation must be based upon practicable and equitable grounds.

B. FEDERAL TAXES HELD CONSTITUTIONAL

In closing this discussion of the Federal taxing power, it is deemed desirable to list some of the important Federal taxes which have been upheld as constitutional and the citations to the decisions sustaining them. They are as follows:

1. INCOME TAX

The income tax with its exemptions and graduated rates was upheld as constitutional in *Brushaber v. Union Pacific Railroad Company*,²⁵¹ construing the Revenue Act of 1913.

2. CORPORATION EXCISE TAX

A tax on the privilege of doing business in corporate capacity, measured by net income from all sources, was upheld as constitutional in *Flint v. Stone Tracy Company*,²⁵² construing the act of 1909.

3. EXCESS PROFITS TAX

An excess profits tax based upon the relation of net income to invested capital was upheld in *La Belle Iron Works v. U. S.*,²⁵³ construing the Revenue Act of 1917.

4. CAPITAL STOCK TAX

The capital stock tax, based upon the fair average value of the stock of a corporation, was upheld in *Ray Consolidated Copper Company v. U. S.*²⁵⁴

5. SUCCESSION AND LEGACY TAXES

A succession tax imposed by the Civil War acts was upheld in *Scholey v. Rew*.²⁵⁵ A legacy tax imposed by the act of 1898 was upheld in *Knowlton v. Moore*.²⁵⁶ This last tax had graduated rates and gave recognition to the principle of consanguinity.

6. ESTATE TAX

The Federal estate tax imposed by the Revenue Act of 1916 with its graduated rates and exemptions was upheld in *New York Trust Company v. Eisner*.²⁵⁷

²⁵⁰ *Frick v. Pennsylvania* (268 U. S. 473).

²⁵¹ 240 U. S. 1.

²⁵² 220 U. S. 107.

²⁵³ 256 U. S. 377.

²⁵⁴ 268 U. S. 373.

²⁵⁵ 23 Wall. 301, 347.

²⁵⁶ 178 U. S. 481.

²⁵⁷ 256 U. S. 345; see also *U. S. v. Doremus* (249 U. S. 89), and *Alston v. U. S.* (274 U. S. 289).

7. OCCUPATIONAL TAXES

The power of the Federal Government to levy taxes on occupations was upheld in the *License Tax cases*²⁵⁸ and *U. S. v. Doremus*.²⁵⁹

8. OLEOMARGARINE

The oleomargarine tax was upheld in *McCray v. U. S.*²⁶⁰

9. BANK CIRCULATION

The tax on bank circulation was upheld in *Veazie Bank v. Fenno*²⁶¹ and *Merchant's National Bank v. U. S.*²⁶²

10. SALES AT EXCHANGES

A tax on sales at exchanges was upheld in *Nichols v. Ames*.²⁶³

11. BUSINESS OF INSURANCE COMPANIES

A tax on the business of insurance companies was upheld in *Pacific Insurance Company v. Soule*.²⁶⁴

12. BUSINESS OF REFINING SUGAR

A tax on the business of refining sugar was upheld in *Spreckles Sugar Refining Company v. McClain*.²⁶⁵

C. SUMMARY OF LIMITATIONS ON FEDERAL TAXING POWER

In concluding the discussion of the power of the Federal Government to levy taxes, it seems proper to summarize certain important principles which should always be kept in mind:

First. The power to levy taxes is a legislative power vested in Congress, which cannot be delegated to the President or to the courts.

Second. Congress can impose nearly every kind of tax. There are, however, certain exceptions to this general rule. Thus, arbitrary and capricious taxes cannot be imposed, or taxes on exports to foreign countries, or taxes on State functions, or taxes for private purposes.

Third. If Congress levies direct taxes they must be apportioned among the several States according to population.

Fourth. If Congress levies indirect taxes, they are subject to the rule of uniformity; that is, the taxes must operate "with the same force and effect in every place (in the United States) where the subject of it is found."

Fifth. Double taxation is not prohibited to Congress, although it may refuse to impose double taxation in many instances upon equitable or practical grounds.

Sixth. There is no constitutional prohibition against retroactive taxation if a tax of the same character was in effect at the time the transaction subject to the tax was entered into.

²⁵⁸ 5 Wall. 462.

²⁵⁹ 249 U. S. 89.

²⁶⁰ 195 U. S. 27.

²⁶¹ 8 Wall. 555.

²⁶² 101 U. S. 1.

²⁶³ 173 U. S. 109.

²⁶⁴ 7 Wall. 333.

²⁶⁵ 192 U. S. 397.

PART II. POWERS OF THE STATE GOVERNMENTS

The power of a State to levy taxes differs materially from that of the Federal Government. As we have shown, the Federal power is derived from the Federal Constitution, whereas that of a State is based upon its inherent right of sovereignty. The power of a State, however, is subject to certain limitations, which are either inherent (because applicable to all sovereigns) or are embodied in the Federal or State Constitutions. These limitations will be discussed in the following order:

- A. Inherent limitations;
- B. Limitations under the Federal Constitution; and
- C. Limitations under the State constitutions.

A. INHERENT LIMITATIONS

Perhaps the best exposition of the inherent limitations upon the taxing power of a State is found in the opinion of Justice Field in the case of the *State Tax on Foreign-held Bonds*,²⁶⁶ in which he said:

The power of taxation, however vast in its character and searching in its extent, is necessarily limited to subjects within the jurisdiction of the State. These subjects are persons, property, and business. Whatever form taxation may assume, whether as duties, imposts, excises, or licenses, it must relate to one of these subjects. It is not possible to conceive of any other, though as applied to them, the taxation may be exercised in a great variety of ways. It may touch property in every shape, in its natural condition, in its manufactured form, and in its various transmutations. And the amount of the taxation may be determined by the value of the property, or its use, or its capacity, or its productiveness. It may touch business in the almost infinite forms in which it is conducted, in professions, in commerce, in manufactures, and in transportation. Unless restrained by provisions of the Federal Constitution, the power of the State as to the mode, form, and extent of taxation is unlimited, where the subjects to which it applies are within her jurisdiction.

It should also be borne in mind that no State has the power to levy a tax except for a public purpose.²⁶⁷ As an added precaution, some State constitutions contain a provision that taxes shall be laid for public purposes only. Some constitutions, further, provide that the purpose for which a tax is imposed must be stated in the law imposing it. But such a provision is unnecessary, for an imposition laid for a private purpose is not a "tax" within the common acceptance of the term and would violate a basic principle upon which all of our State governments rest.

B. LIMITATIONS UNDER THE FEDERAL CONSTITUTION

1. CONFLICT WITH FEDERAL LAWS AND TREATIES

The Federal Constitution²⁶⁸ provides that "this Constitution, and the laws of the United States which shall be made in pursuance

²⁶⁶ 15 Wall. 319.

²⁶⁷ *Loan Association v. Topcka* (20 Wall. 655); *Parkersburg v. Brown* (106 U. S. 487); *Cole v. LeGrange* (113 U. S. 1); *Green v. Frazier* (253 U. S. 233).

²⁶⁸ United States Constitution, art. VI, cl. 2.

thereof, and all treaties made, under authority of the United States, shall be the supreme law of the land.” It has accordingly been held that every act of Congress or treaty made pursuant to the Federal Constitution is supreme and renders invalid all laws of the State or provisions of the State constitution in conflict therewith.²⁶⁹ A State statute imposing taxes which is in conflict with a Federal law or treaty is, of course, invalid. However, anyone who would strike down a State statute as obnoxious to the Federal Constitution must show that the alleged unconstitutional feature injures him.²⁷⁰ An interesting example of a State law being in conflict with a treaty is found in the recent case of *Nielson v. Johnson*.²⁷¹ In that case the State of Iowa enacted an inheritance tax law imposing a tax on property passing to nonresident aliens, regardless of amount, and exempted property passing to citizens of the State up to \$15,000. This statute was held invalid, as conflicting with a treaty with Denmark.

The State law is not invalid unless the Federal Act covers the same field. An Illinois statute forbidding persons to receive or sell farm produce on commission within Illinois unless licensed was upheld,²⁷² notwithstanding the fact that a Federal statute required every person engaged in the business of receiving in interstate or foreign commerce perishable agricultural commodities for sale on commission, to procure a license from the Secretary of Agriculture. It was pointed out that the Federal statute, while covering to some extent the same ground as the State law, did not call for the giving of any bond by a licensee. Moreover, the Federal statute provided that any other statute, whether State or Federal, dealing with the same subject should remain in effect unless inconsistent or repugnant thereto. Thus, the court held that the act of Congress not only omitted the requirement of a bond but affirmatively saved the provision of the State statute as to that form of security.

2. TAXING FEDERAL AND STATE SECURITIES

(a) DEVELOPMENT OF DOCTRINE OF FEDERAL IMMUNITY

The Constitution ²⁷³ gives Congress the power to borrow money on the credit of the United States. This is a limitation upon State taxing power. A State has no right by taxation to burden this power, either directly or indirectly. For instance, it is elementary that bonds or other securities of the United States may not be taxed by State authorities, for if this were permitted the power of Congress to borrow money on the credit of the United States would be burdened and might be destroyed for that purpose. In the case of *Weston v. Charleston* ²⁷⁴, the court held that stock issued for loans made to the Government of the United States is not liable to be

²⁶⁹ *Gibbons v. Ogden* (9 Wheat. 1).

²⁷⁰ *Heald v. District of Columbia* (259 U. S. 114); *Premier-Pabst Sales Co. v. Grosscup* (56 Sup. Ct. 593).

²⁷¹ 279 U. S. 47.

²⁷² *Hartford Accident and Indemnity Co. v. Illinois* (56 Sup. Ct. 685).

²⁷³ U. S. Constitution, art. I, sec. 3, cl. 2.

²⁷⁴ 2 Pet. 449; see also *Bank of Commerce v. New York* (2 Black. 620); *Bank Tax case* (2 Wall. 200).

taxed by State or municipal corporations. In this connection, the court made the following statement:

The American people have conferred the power of borrowing money on their Government, and by making that Government supreme, have shielded its action, in the exercise of this power, from the action of the local government.

United States notes, although issued as currency, are nevertheless national obligations and are exempt from State taxation^{274a} and the Federal Government may exempt bonds of its instrumentalities, created pursuant to constitutional authority, from State taxation.^{274b}

Furthermore, as pointed out by the Supreme Court in *Missouri ex rel. Missouri Insurance Co. v. Gehner*,²⁷⁵ since the tax-exempt feature tends to increase and is reflected in the market price of Government securities, a State tax burden thereon would adversely affect the terms upon which money may be borrowed to execute the purposes of the general Government. In that case, the Court held that a State may not subject one to a greater burden upon his taxable property merely because he owns tax-exempt securities.

The facts were that an Ohio statute levied a tax on the net value of the personal assets of insurance companies in excess of the legally required reserve necessary to reinsure its outstanding risks and of any unpaid policy claims. An insurance company made a return pursuant to this act. The total value of its personal property was approximately \$448,000, including \$94,000 in United States bonds. The legal reserve and unpaid claims amounted to about \$334,000. It deducted such bonds, reserve, and claims, leaving about \$20,000 to be taxed. The board of equalization and the State courts refused to accept this computation, claiming that the company's liabilities were chargeable against all its assets—taxable and nontaxable alike—and should be apportioned accordingly. In accordance with this conclusion, the State court arrived at a taxable net value by the following method:

It divided the total taxable assets, \$496,265.33 (\$349,000, municipal and mortgage bonds; \$5,265.33, cash; and \$142,000, real estate) by the total assets, \$590,265.33 (\$349,000, municipal and mortgage bonds; \$5,265.33, cash; \$94,000, United States bonds; and \$142,000, real estate). The result was \$0.84. The total liabilities, \$333,486.69, were then multiplied by \$0.84. The result was \$280,128.81. This was subtracted from \$354,265.33, the total taxable personal assets, leaving \$74,136.52 as the taxable net value.

In other words, the State court held that the law required the reserve and unpaid claims to be reduced by the proportion that the value of the United States bonds bore to the total assets, and by this method used the value of the United States bonds to increase the taxable amount. The Supreme Court held the statute as so construed invalid, stating that "because the ownership of United States bonds is made the basis of denying the full exemption which is accorded to those who own no such bonds, this amounts to an infringement of the guaranteed freedom from taxation. It is clear that the value of appellant's Government bonds was not disregarded in making up the estimate of taxable net values." A State tax on shares measured only by a portion of the net assets of a corporation but including in

^{274a} *Bank of New York v. Supervisors* (7 Wall. 26).

^{274b} *Smith v. Kansas City Title & Trust Company* (255 U. S. 180).

²⁷⁵ 281 U. S. 313.

such net assets Federal securities was also held invalid by the Supreme Court.²⁷⁶ In this connection, the Court said:

It is clear that the tax is not measured by each shareholder's aliquot proportion of all the assets of the company. If amongst those assets are found shares of stock of Pennsylvania corporations which, or whose shares, have been declared exempt by the State, this exemption is effected in the instant case by taking them wholly or partially out of the net assets which are the base for the tax. * * * The State has exempted certain assets on the theory that to measure the tax in part by their value would in effect be to tax them twice. * * * If the tax is lifted from the shares of certain trust companies because these companies own only stocks already taxed or relieved from taxation by the State, and shares in other trust companies are taxed among whose assets there are United States bonds or other securities entitled to exemption because issued by Federal instrumentalities which are figured in the base of the tax, it is impossible to avoid the conclusion that the law discriminates in favor of the former and against the latter solely by reason of ownership of such Federal securities.

While States may not tax national banks, Congress has given them the right to tax the shares of such banks at the domicile of the owner by including them in the valuation of the personal property of the person or corporation to whom they belonged, at the place where the bank was located with certain restrictions to prevent discrimination. (See discussion under heading "Taxing Shares of National Banks", on p. 100.)

(b) REACHING FEDERAL SECURITIES THROUGH STATE PRIVILEGE TAXES

However, some of the States through corporation excise taxes are taxing the income from Federal securities by measuring the excise by the net income of the corporation from all sources. In at least two of the States, namely, California and New York, their power to do this has been upheld by the Supreme Court.²⁷⁷ In the California case, the Supreme Court made the following statement as to this point:

The owner may enjoy his exempt property free of tax, but if he asks and receives from the State the benefit of the taxable privilege as the implement of that enjoyment, he must bear the burden of the tax which the State exacts as its price.

(c) REQUESTS OF FEDERAL SECURITIES

Moreover, the Supreme Court has upheld the right of a State to subject Federal bonds to an inheritance tax, stating that the effect of such a tax upon the borrowing power of the Federal Government was too remote to render it unconstitutional.²⁷⁸

(d) STATE SECURITIES HELD BY RESIDENTS

Furthermore, the Supreme Court has held that one State can tax the bonds of another State when owned by a citizen of the former State because there is no provision of the Constitution which prohibits such taxation.²⁷⁹ The reason for this was stated in the *Pollock case*,²⁸⁰ as follows:

The question in *Bonaparte v. Tax Court* (104 U. S. 592) was whether the registered public debt of one State, exempt from taxation by that State or actually

²⁷⁶ *Schuylkill Trust Company v. Pennsylvania* (296 U. S. 113).

²⁷⁷ *Pacific Co. v. Johnson* (285 U. S. 480); *Educational Films Corp. v. Ward* (282 U. S. 379).

²⁷⁸ *Plummer v. Coler* (178 U. S. 115).

²⁷⁹ *Bonaparte v. Appeal Tax Court* (104 U. S. 592).

²⁸⁰ 157 U. S. 429.

taxed there, was taxable by another State when owned by a citizen of the latter, and it was held that there was no provision of the Constitution of the United States which prohibited such taxation. The States had not covenanted that this could not be done, whereas, under the fundamental law, as to the power to borrow money, neither the United States on the one hand nor the States on the other can interfere with that power as possessed by each and an essential element of the sovereignty of each.

3. PROHIBITION UPON TONNAGE DUTIES

Under the Constitution ²⁸¹ it is provided that no State shall, without the consent of Congress, lay a duty of tonnage. The Supreme Court, in the case of *Clyde Mallory Lines v. Alabama*,²⁸² made the following comment as to this clause:

It seems clear that the prohibition against the imposition of any duty of tonnage was due to the desire of the framers to supplement article I, section 10, clause 2, denying to the States power to lay duties on imports or exports, by forbidding a corresponding tax on the privilege of access by vessels to the ports of a State, and to their doubts whether the commerce clause would accomplish that purpose. If the States had been left free to tax the privilege of access by vessels to their harbors the prohibition against duties on imports and exports could have been nullified by taxing the vessels transporting the merchandise. At the time of the adoption of the Constitution "tonnage" was a well understood commercial term signifying in America the internal cubic capacity of a vessel. And duties of tonnage and duties on imports were known to commerce as levies upon the privilege of access by vessels or goods to the ports or to the territorial limits of a State and were distinct from fees or charges by authority of a State for services facilitating commerce, such as pilotage, towage, charges for loading and unloading cargoes, wharfage, storage, and the like.

Hence the prohibition against tonnage duties has been deemed to embrace all taxes and duties regardless of their name or form, and even though not measured by the tonnage of the vessel, which operate to impose a charge for the privilege of entering, trading in, lying in a port. But it does not extend to charges made by State authority, even though graduated according to tonnage, for services rendered to and enjoyed by the vessel, such as pilotage, or charges for the use of locks on a navigable river, or fees for medical inspection. (All citations omitted.)

However, a State may charge a reasonable fee for the policing of a harbor so as to insure the safety and facility of movement of vessels using it. This differs from a wharfage charge, which is also not a duty of tonnage,²⁸³ in that a wharfage charge benefits only the particular vessel using the wharf, whereas the benefit which flows from regulations to protect and facilitate traffic in a busy harbor inures to all who enter it.²⁸⁴ A charge for the use of locks on a navigable river is also not a duty of tonnage.²⁸⁵ But a State cannot demand that the master or warden of a port shall receive a fee.²⁸⁶ It can, however, charge a toll for passing through the improved waters of a State²⁸⁷ and require keepers of ferries to pay a license.²⁸⁸ It may also impose a quarantine fee and a pilot fee for performing pilot services, or, as already pointed out, a fee for the policing of a harbor so as to insure the safety and facility of movement of vessels using it.²⁸⁹

²⁸¹ United States Constitution, art. I, sec. 10, cl. 3.

²⁸² 296 U. S. 261.

²⁸³ *Northwestern Union Packet Co. v. St. Louis* (100 U. S. 457).

²⁸⁴ See note 282.

²⁸⁵ *Huse v. Glover* (119 U. S. 543).

²⁸⁶ *Ouachita and M. River Packet Co. v. Aiken* (121 U. S. 448).

²⁸⁷ *Wiggins Ferry Co. v. E. St. Louis* (107 U. S. 365).

²⁸⁸ *Morgan's L. & T. R. & S. S. Co. v. Board of Health* (118 U. S. 455).

²⁸⁹ *The Queen* (206 Fed. 148, cert. den. 231 U. S. 750); *Clyde Mallory Lines v. Alabama* (296 U. S. 261).

4. IMPAIRMENT OF OBLIGATIONS OF A CONTRACT

(a) EFFECT ON STATE CONTRACTS

The Federal Constitution²⁹⁰ provides that no State shall impair the obligations of a contract. An early case on this point related to a political subdivision of a State, which is subject to the same limitations as the State. In 1871 the city of Charleston, by ordinance, directed the city to retain out of dividends on city stock a tax assessed on all the real and personal property in the city. The Supreme Court held the ordinance void, as an impairment of the obligations of a contract of the city with its creditors.²⁹¹ Furthermore, when the laws of a State provide that a foreign corporation complying with certain conditions shall be subject to the same liabilities and duties as domestic corporations of the same character, the State cannot impose a higher tax on the foreign corporations than is imposed upon the domestic corporation.²⁹² In referring to this subject, Judge Cooley said:²⁹³

So far as the power of taxation is concerned, it has been so often decided by the Supreme Court, though not without remonstrance on the part of State courts, that an agreement by a State, for a consideration received or supposed to be received, that certain property, rights, or franchises shall be exempt from taxation, or to be taxed only at a certain agreed rate, is a contract protected by the Constitution, that the question can no longer be considered an open one. In any case, however, there must be a consideration, so that the State can be supposed to have received a beneficial equivalent; for it is conceded on all sides that, if the exemption is made as a privilege only, it may be revoked at any time. And it is but reasonable that the exemption be construed with strictness.

(b) EFFECT ON PRIVATE CONTRACTS

It seems clear that if a State issues bonds providing that they shall be exempt from certain taxes it cannot thereafter impose such taxes on such bonds without violating this clause of the Constitution. However, the Supreme Court holds that a State may impose a lawful tax on a new subject or an increased tax on an old one without impairing the obligations of the contract even though such a tax may increase the debt of one person and lessen the security of the other, or may impose additional burdens upon one class and relieve the burdens of another.²⁹⁴ Thus, a tax on insurance premiums was held not to impair the obligations of an insurance contract;²⁹⁵ a tax upon a distributing agent by a city did not impair the obligations of a contract between the agent and his employer;²⁹⁶ a tax on royalties received from mines did not impair the obligations of a contract between lessor and lessee;²⁹⁷ also, a transfer tax upon the exercise of a power of appointment was held not to violate the obligations of a contract.²⁹⁸

²⁹⁰ United States Constitution, art I, sec. 10, cl. 1.

²⁹¹ *Murray v. Charleston* (96 U. S. 432).

²⁹² *American Smelting Co. v. Colorado* (204 U. S. 103).

²⁹³ Cooley's Constitutional Limitations, 8th ed., vol. 1, p. 571.

²⁹⁴ *North Missouri Railroad Co. v. Maguire* (20 Wall. 46).

²⁹⁵ *Home Insurance Co. v. Augusta* (93 U. S. 120).

²⁹⁶ *Kehrer v. Steward* (197 U. S. 60).

²⁹⁷ *Lake Superior Consolidated Iron Mines v. Lord* (271 U. S. 577); *Barwise, et al., v. Sheppard, et al.*, decided by Supreme Court on Nov. 9, 1936.

²⁹⁸ *Chanler v. Kelsey* (205 U. S. 466).

(c) EFFECT ON POWER OF EMINENT DOMAIN

While this prohibition upon the impairment of the obligations of a contract has a very wide scope it has never been construed as a limitation upon the power of eminent domain which cannot be contracted away by the State. Some few of the State constitutions have provisions to this effect. To permit a State to divest itself by contract of the right to exert its authority in governmental matters would, according to the Supreme Court, be a renunciation of power to legislate for the preservation of society or to secure the performance of essential governmental duties. Thus, the power of eminent domain acts more or less as a check upon the power of a State to make contracts.²⁹⁹

(d) EFFECT ON POLICE POWER

Furthermore, this clause is also not a limitation upon the police powers of a State.³⁰⁰

5. DISCRIMINATION AGAINST CITIZENS

(a) CITIZENS OF OTHER STATES

The fourth amendment of the Constitution³⁰¹ requires that citizens of each State shall be entitled to all the privileges and immunities of citizens in the several States. This provision prevents a State from taxing citizens of other States who own property or carry on business within its territorial limits at a higher rate than its own citizens are taxed under similar conditions. However, the Supreme Court has held that corporations are not citizens within the meaning of this provision.³⁰² There are many cases in which a State taxing statute has been held invalid under this clause. Thus, a Maryland statute prohibiting persons not permanent residents from selling goods within the State other than agricultural products grown and goods manufactured in such State was held invalid.³⁰³

An annual license tax of \$100 imposed in each county of Alabama upon a person engaged in railway construction in the State who had his chief office outside the State was held to be a discrimination for the reason that a person in the same business but having his office within the State was subject to a similar license tax of only \$25.³⁰⁴ Furthermore, a New York income-tax provision was held to violate this clause when it denied to all nonresidents the exemptions accorded to residents; that is, \$1,000 to single persons, \$2,000 to married persons, and \$200 for dependents.³⁰⁵ However, this clause has been held not to apply in the case of a State tax imposed upon the net income of nonresidents derived from property within the State on the theory that as to nonresidents it is purely a tax upon the property and busi-

²⁹⁹ *Pennsylvania Hospital v. Philadelphia* (245 U. S. 20); *Galveston Wharf Co. v. Galveston* (260 U. S. 473).

³⁰⁰ *Home Building and Loan Association v. Blaisdell* (290 U. S. 398); *Nebia v. New York* (291 U. S. 502).

³⁰¹ United States Constitution, art. IV, sec. 2, cl. 1.

³⁰² *Paul v. Virginia* (8 Wall. 168).

³⁰³ *Ward v. Maryland* (12 Wall. 418).

³⁰⁴ *Chalker v. Birmingham Railroad Co.* (249 U. S. 522).

³⁰⁵ *Shaffer v. Carter* (252 U. S. 37).

ness within the State to which citizens of the State are not subject, while in the case of citizens and residents it is purely a personal tax measured by their income.³⁰⁵ And it has been held that the State has the right in its income-tax law to confine a deduction for expenses, losses, etc., to such as are connected with income arising from sources within the State.³⁰⁶ Nor does a State statute taxing the business of hiring persons to labor outside of the State limits violate this clause as there is no discrimination between citizens of other States and citizens of that State.³⁰⁷ Nor is a State statute imposing a transfer tax on the property of a nonresident decedent located in that State invalid.³⁰⁸

(b) CITIZENS OF OWN STATE

The privileges and immunities secured by the fourth article of the Constitution prevent a State from discriminating against citizens of other States. But the fourteenth amendment goes much further and prohibits any State from abridging the privileges or immunities of citizens of the United States, whether its own citizens or others. No attempt has been made by the courts to define comprehensively or to enumerate the privileges or immunities which the fourteenth amendment protects. But the Supreme Court has recently held that the Vermont Income and Franchise Act of 1931, insofar as it taxes interest on loans made by Vermont citizens outside the State and exempts loans made within the State, violates this provision of the Constitution.³⁰⁹

However, in the same case, the State statute, insofar as it taxed dividends on stock of foreign corporations but exempted from the tax dividends from domestic corporations, was upheld because the franchise tax and the property tax which the State of Vermont imposed upon its corporations was held to be substantially equivalent to the tax on dividends of foreign corporations, since foreign corporations not doing business or holding property within the State are not subject to the State franchise or property tax.

6. PROHIBITION UPON IMPORTS AND EXPORTS

Under the Constitution³¹⁰ no State, without the consent of Congress, is permitted to lay any imposts or duties on imports, or exports except what may be absolutely necessary for executing its inspection laws. By this provision the States gave up their right to levy taxes on articles imported from or exported to foreign countries.³¹¹ This clause has no application to goods transported from one State to another.³¹² Furthermore, the term "imports or exports" as used in this clause refers only to property. It might be noted, however, that a State would have no authority to tax immigrants brought into this country.³¹³ A bill of exchange is not an

³⁰⁵ *Shaffer v. Carter* (252 U. S. 37).

³⁰⁶ *Travis v. Yale and T. Mfg. Co.* (252 U. S. 60).

³⁰⁷ *Williams v. Fears* (179 U. S. 270).

³⁰⁸ *Commonwealth v. Fleet* (152 Va. 353, cert. den. 279 U. S. 867).

³⁰⁹ *Colgate v. Harvey* (296 U. S. 404).

³¹⁰ United States Constitution, art. I, sec. 10, cl. 2.

³¹¹ *Patapsco Guano Co. v. Board of Agriculture* (171 U. S. 345).

³¹² *Coe v. Errol* (116 U. S. 517).

³¹³ *New York v. Compagnie Generale Transatlantique* (107 U. S. 59).

import or an export, as it is not transmitted through the ordinary channels of commerce but by mail.³¹⁴ Nor is a legacy payable to a nonresident alien.³¹⁵

Not only is a State prohibited from levying a direct tax upon the goods imported or exported but it is also prohibited from levying an indirect tax by burdening the right to dispose of them. Goods do not lose their character as imports or exports until they have passed from the control of the importer or exporter or have been broken up by him from the original package. This is the famous "unbroken package doctrine" which was first announced by the Supreme Court in *Brown v. Maryland*.³¹⁶ However, as soon as the goods have reached their destination and are held for sale they are no longer imports or exports and a State has the same right to subject them to taxation as any other property located within its limits.³¹⁷ While the Court has intimated that the unbroken package doctrine as applied to interstate commerce has come to be regarded more artificial than sound, it still appears effective as to imports or exports.³¹⁸ Among the taxes which have been held invalid under this clause are a tax on the sale of foreign goods by an auctioneer in original packages and before they become incorporated into the general property of the State;³¹⁹ a stamp tax on bills of lading as applied to goods sent to a foreign country;³²⁰ a tax on German warehouse receipts for whisky exported to Germany;³²¹ and a tax on the gross receipts from the sale of goods to be shipped in foreign commerce.^{321a}

7. DENIAL OF DUE PROCESS

(a) ARBITRARY STATE ACTION

It is interesting to note that in a great many cases going to the Supreme Court, it is alleged as one of the grounds for relief that the taxing statute violates the fourteenth amendment in that it deprives the taxpayer of property without due process of law. One purpose of this provision of the fourteenth amendment was to extend to citizens and residents of the State the same protection against arbitrary State action as is afforded them against arbitrary Federal action by the fifth amendment.³²² While a corporation is not a citizen within the meaning of the privileges and immunities clause, it is a person within the meaning of the due-process clause.³²³ However, a State may impose conditions upon the right of a foreign corporation to enter a State to do a local business, but it may not impose such conditions as require the relinquishment of constitutional rights^{323a} and

³¹⁴ *Nathan v. Louisiana* (8 How. 73).

³¹⁵ *Mager v. Grima* (8 How. 490).

³¹⁶ 12 Wheat. 419.

³¹⁷ *American Steel and Wire Company v. Speed* (192 U. S. 520).

³¹⁸ *Whitfield v. Ohio* (297 U. S. 431).

³¹⁹ *Cook v. Pennsylvania* (97 U. S. 573).

³²⁰ *Amy v. California* (24 How. 174).

³²¹ *Selliger v. Kentucky* (213 U. S. 200).

^{321a} *Crew Levick Co. v. Pennsylvania* (245 U. S. 292).

³²² *Heiner v. Donnan* (285 U. S. 312).

³²³ *Grosjean v. American Press Co., Inc. et al.* (297 U. S. 233).

^{323a} *Frost v. Railroad Com.* (271 U. S. 583); see also *Hemphill v. Orloff* (277 U. S. 537); *Am. Ry. Exp. Co. v. Virginia* (282 U. S. 440); *Fidelity & Deposit Co. of Md. v. Tofoya* (270 U. S. 426).

a State may not take from a foreign corporation its property without due process of law.^{323b} If, as in the case of a Federal law, a State statute results in such a flagrant and palpable inequality between the burden imposed and the benefit received as to amount to the arbitrary taking of property without just compensation, it will be held to violate this clause of the Constitution. Thus, the Supreme Court held unconstitutional a provision of the Wisconsin inheritance tax statute providing that all gifts made within 6 years prior to the date of the donor's death were in contemplation of death and, therefore, taxable regardless of the actual facts in the case.³²⁴ A Massachusetts excise tax on successions was held repugnant to this clause insofar as it applied to successions under trust deeds taking effect prior to the enactment of the taxing law.³²⁵ Furthermore, a Wisconsin statute was held to be in violation of this clause in requiring a joint return from husband and wife. Under that statute, the wife was required to include all of her income in one return with that of her husband in order to determine their tax liability. In holding that such a statute was invalid, the Supreme Court said that a State had no right to measure a tax on a person's property or income by reference to another person's property or income.³²⁶

(b) ABRIDGING FREEDOM OF PRESS

The due-process clause of the fourteenth amendment also prevents the States from abridging the freedom of speech or of the press. In fact, certain fundamental rights safeguarded against Federal action by the first eight amendments are also safeguarded against State action by the due-process clause of the fourteenth amendment. So a State license tax for the privilege of engaging in the business of selling, or making any charge for advertising, measured by the extent of the circulation of the publication in which the advertisements were carried, was held to violate this clause.³²⁷ It was pointed out that the tax was not measured or limited by the volume of advertisements. It is measured alone by the extent of the circulation of the publications in which the advertisements were carried, with the plain purpose of penalizing the publishers and curtailing the circulation of a selected group of newspapers.

(c) JURISDICTIONAL LIMITATIONS

Another purpose of this clause is to prevent one State from infringing upon the jurisdiction of another. The application to the States of the rule of due process in this respect—

comes from the fact that their spheres of activity are enforced and protected by the Constitution and therefore it is impossible for one State to reach out and tax property in another without violating the Constitution, for where the power of the one ends the authority of the other begins.³²⁸

^{323b} *McFarland v. Am. Sugar Ref. Co.* (241 U. S. 79).

³²⁴ *Schlesinger v. Wisconsin* (270 U. S. 230).

³²⁵ *Coolidge v. Long* (282 U. S. 582); *Guaranty Trust Co. v. Blodgett* (287 U. S. 509).

³²⁶ *Hooper v. Wisconsin Tax Commission* (284 U. S. 206).

³²⁷ *Grosjean v. American Press Company, Inc., et al* (297 U. S. 233).

³²⁸ *Burnet v. Brooks* (288 U. S. 378).

The following will show some of the limitations upon the States caused by the due-process clause:

(1) REAL PROPERTY TAXES

No State may tax real property located in another State, regardless of the domicile of the owner.³²⁹ Real property is taxable only by the State in which it is situated. But the State in which the real property is situated may divide the land in different interests and tax each interest separately; that is, it may tax both the legal and the equitable interests.³³⁰ Moreover, a State may tax land on the basis of legal ownership without regard to equitable ownership. Thus, a State may tax the entire value of mortgaged land against the resident mortgagor, regardless of the value of the equity of redemption.³³¹

(2) PERSONAL PROPERTY TAXES

(a) *Tangible personal property.*

No State may tax tangible personal property located in another State, regardless of the domicile of the owner.³³² Tangible personal property may be taxed only by the State in which it is situated. Such property includes cash and coin in a safe deposit box,³³³ a ship permanently within the waters of a State,³³⁴ and construction machinery brought into the State for a particular job.³³⁵ In the case of rolling stock, the Supreme Court has held that the basis of the jurisdiction is the habitual employment of that particular property within the State. When a fleet of cars is habitually employed in several States—the individual cars constantly running in and out of the State—it cannot be said that any one of the States is entitled to tax the entire number of cars regardless of their use in other States. In such a case, each State may tax its proper share of the property employed therein, and this amount may be determined by taxing the number of cars which, on an average, are found to be physically present within the State.³³⁶ Furthermore, it is interesting to note that the Supreme Court has recently held that a collection of paintings loaned for exhibition purposes to a Pennsylvania museum for an undetermined period by a resident of the State of New York acquired an actual situs in Pennsylvania and were, therefore, subject to the Pennsylvania inheritance tax.³³⁷

(b) *Intangible personal property.*

In general, no State may tax intangibles unless the owner is domiciled in such State. This is true regardless of the physical location of the property. This principle was applied in 1873 in the case of *State Tax on Foreign Held Bonds*,³³⁸ in which it was held that the

³²⁹ *Louisville and Jeffersonville Ferry Co. v. Kentucky* (188 U. S. 385); *First National Bank of Boston v. State of Maine* (284 U. S. 312).

³³⁰ *Savings and Loan Society v. Multnomah County* (169 U. S. 421).

³³¹ *Paddell v. New York* (211 U. S. 446).

³³² *Union Refrigerator Transit Company v. Kentucky* (199 U. S. 194); *Frick v. Pennsylvania* (268 U. S. 473); *Senior v. Braden* (295 U. S. 422).

³³³ *Blodgett v. Silberman* (277 U. S. 1).

³³⁴ *Old Dominion S. S. Co. v. Virginia* (198 U. S. 299).

³³⁵ *Gromer v. Standard Dredging Company* (224 U. S. 362).

³³⁶ *Johnson Oil Refining Company v. Oklahoma* (290 U. S. 158).

³³⁷ *City Bank Farmers' Trust Company v. Schnader* (291 U. S. 24).

³³⁸ 15 Wall. 300.

State of the domicile of the debtor had no right to tax a debt owing to a nonresident creditor. There, the interest paid by resident obligors upon obligations held by a nonresident was held taxable only at the domicile of the creditor. In *Bonaparte v. Appeal Tax Court*,³³⁹ it was held that a bond of one State owned by a citizen of another State was taxable by the latter State. Subsequent decisions of the Supreme Court involving State death taxes adhere to this principle, and the Supreme Court has held that the same rules apply to property taxes as to death taxes in this respect.³⁴⁰ However, there are certain exceptions to this rule. The Supreme Court has intimated in a number of cases that shares of stock or other intangibles may be so used in a State as to give them a situs analogous to the actual situs of tangible personal property.³⁴¹ In *Virginia v. Imperial Coal Sales Company, Inc.*,³⁴² the Imperial Sales Corporation, a Virginia corporation, was conducting the sole business of selling coal for foreign corporations. Its principal office was in Virginia, where the proceeds of its accounts receivable were collected and deposited in a bank. The Supreme Court held that such property was regarded as situated in Virginia and that, therefore, Virginia had a right to tax such property. In that case the Supreme Court said:

It is not the character of the property that makes it subject to such a tax, but the fact that the property has its situs within the State, and that the owner should give appropriate support to the government that protects it. That duty is not less when the property is intangible than when it is tangible.

In *Wheeling Steel Corporation v. Fox*,³⁴³ the Supreme Court held that a Delaware corporation which had its general business office in West Virginia, where its directors' and stockholders' meetings were held, was subject to tax by West Virginia upon its accounts receivable and bank deposits because it had established in West Virginia a "commercial domicile" in that State. While the corporation had manufacturing plants and sales offices in other States, what was done at those plants and offices was determined and controlled from the center of authority at Wheeling, W. Va. Moreover, in the case of trust property, the State of the domicile of the beneficiary of the trust has no right to tax an interest in such property if the trust res is located outside the State and administered by a nonresident trustee.³⁴⁴ In *Senior v. Braden*,³⁴⁵ it was held that Ohio had no power to tax ownership of a land trust certificate in a trust estate, the corpus of which consisted of land outside the State. Intangible personal property has been held to include bonds, stock, savings accounts, and open accounts,³⁴⁶ also a seat on the New York Stock Exchange.³⁴⁷

³³⁹ 104 U. S. 592.

³⁴⁰ *First National Bank of Boston v. State of Maine* (284 U. S. 312).

³⁴¹ *Farmers' Loan and Trust Company v. Minnesota* (280 U. S. 204); *Beidler v. South Carolina* (282 U. S. 1); *First National Bank of Boston v. State of Maine* (cited supra).

³⁴² 292 U. S. 619.

³⁴³ 56 Sup. Ct. 773.

³⁴⁴ *Safe Deposit and Trust Company v. Virginia* (280 U. S. 83).

³⁴⁵ 295 U. S. 442.

³⁴⁶ *Blodgett v. Silberman* (277 U. S. 1); *Farmers' Loan and Trust Company v. Minnesota* (280 U. S. 204); *Beidler v. South Carolina* (282 U. S. 1).

³⁴⁷ *Citizens National Bank v. Durr* (257 U. S. 99).

(3) DEATH TAXES

(a) *Real property and tangible personal property.*

As already pointed out, similar rules apply to death taxes as apply to property taxes. Real property and tangible personal property are taxable only in the State where located, regardless of the State in which the decedent was domiciled at the time of his death.³⁴⁸

(b) *Intangible personal property.*

Intangible personal property is taxable generally only by the State in which the decedent was domiciled. The first case involving such property was that of the *Farmers' Loan and Trust Company v. Minnesota*.³⁴⁹ This case held that the State of Minnesota could not subject to a State death tax negotiable bonds and certificates of indebtedness issued by such State and two of her municipalities but which were owned by an individual domiciled in New York at the time of her death. It was held that New York was the only State which could levy a death tax in such a case. This case was followed by *Baldwin v. Missouri*.³⁵⁰ There the testator, domiciled in Illinois at the time of death, had credits for cash deposited in banks located in Missouri, and certain bonds of the United States and promissory notes all physically located within Missouri at the time of death. The court held that these credits, bonds and notes was not subject to taxation by Missouri. In *Beidler v. South Carolina Tax Commission*,³⁵¹ it was held that a debt owing to a resident of Illinois by a South Carolina corporation at the time of his death, consisting of a large sum upon an open, unsecured account, entered on the corporation books kept in South Carolina, was taxable only by Illinois, the State of domicile. Finally, in *First National Bank of Boston v. Maine*,³⁵² it was held that shares of stock in a Maine corporation owned by an individual domiciled in Massachusetts at the time of his death was taxable only by Massachusetts for inheritance tax purposes. But the court intimated in these cases that intangible property may be used in such a way as to acquire an actual situs for inheritance tax purposes, and in such case it will be subject to an inheritance tax only by the State in which it is physically situated. (See discussion under heading "Intangible personal property.") The California Supreme Court in *Estate of McCreery*,³⁵³ held that California could subject to an inheritance tax, stock in a California corporation belonging to a nonresident alien, represented by certificates physically present in California but having no business situs there. In *Wachovia Bank and Trust Co. v. Doughton*,³⁵⁴ it was held that an inheritance tax could not be imposed by the State of North Carolina upon the exercise by a resident of North Carolina of a testamentary power of appointment in respect of property held in trust in Massachusetts.

³⁴⁸ *Frick v. Pennsylvania* (268 U. S. 473).

³⁴⁹ 280 U. S. 204.

³⁵⁰ 281 U. S. 586.

³⁵¹ 282 U. S. 1.

³⁵² 284 U. S. 312.

³⁵³ 220 Cal. 26.

³⁵⁴ 272 U. S. 567.

(c) Property outside State as measure of tax.

But it appears that a State may determine its rate of tax on property within the State by taking into account property outside the State. For instance, under a New Jersey statute, involving an inheritance tax upon a nonresident with property located outside of that State, the New Jersey tax was first ascertained on the entire estate as if it were the estate of a resident, with all the decedent's property, both real and personal, located there. The tax was then apportioned and assessed in the proportion that the taxable New Jersey estate bore to the entire estate. Thus, if the entire State had a value which put it in the class for which the rate was 3 percent, that rate was to be applied to the value of the property within the State in computing the tax on its transfer, although its value separately taken would put it within the class for which the rate was 2 percent. This method was upheld by the Supreme Court in *Maxwell v. Bugbee*.³⁵⁵

(4) STOCK TRANSFER TAXES

While a State may not levy a death tax or a property tax in respect of shares of stock of a domestic corporation owned by a person domiciled in another State, it may levy a tax upon the transfer of such stock on the books of the corporation. This is a tax which "flows from the power of the State to control and condition the operations of the corporation which it creates."³⁵⁶ A state has the power to levy an excise tax upon instruments created within the State. Thus, notes of a domestic corporation signed and issued in South Carolina and mailed to banks without the State could be taxed under the documentary stamp tax law of that State.³⁵⁷

(5) INCOME TAX

(a) Income earned within State.

The law is still unsettled as to how far a State may go in taxing income outside of its borders without violating the due-process clause. It seems clear that a State has the power to levy a tax upon the income of a nonresident if such income is derived from property situated within the State or from a business carried on within the State. In *Shaffer v. Carter*,³⁵⁸ the plaintiff, a citizen of Illinois and a resident of Chicago in that State, was engaged in the oil business in Oklahoma, having purchased, owned, developed, and operated a number of oil and gas mining leases, and being the owner in fee of certain oil-producing land in that State. From properties thus owned and operated during the year 1916, he received a net income of \$1,500,000. The question involved was whether the State of Oklahoma could levy a tax upon such income, and the Court, in upholding the power of the State of Oklahoma to levy the tax, made the following statement:

That the State, from whose laws property and business and industry derive the protection and security without which production and gainful occupation

³⁵⁵ 250 U. S. 525; see also *Frick v. Pa.* (268 U. S. 473).

³⁵⁶ *First National Bank of Boston v. Maine* (284 U. S. 312); *Rhode Island Hospital Trust Co. v. Doughton* (270 U. S. 69).

³⁵⁷ *Graniteville Manufacturing Company v. Query* (283 U. S. 376).

³⁵⁸ 252 U. S. 37.

would be impossible, is debarred from exacting a share of those gains in the form of income taxes for the support of the government, is a proposition so wholly inconsistent with fundamental principles as to be refuted by its mere statement. That it may tax the land but not the crop, the tree but not the fruit, the mine or well but not the product, the business but not the profit derived from it, is wholly inadmissible.

In another case, decided the same day as *Shaffer v. Carter*, namely, *Travis v. Yale and Towne Manufacturing Company*,³⁵⁹ a Connecticut corporation doing business in New York had employees who were residents of Connecticut or New Jersey but who were occupied in whole or in part in the complainant's business in New York. The question before the court was whether New York could require the corporation to deduct and withhold from the salaries and wages payable to such employees the income taxes levied against such salaries or wages by the New York statute. The Supreme Court held that the State of New York has "jurisdiction to impose a tax of this kind upon the incomes of nonresidents arising from any business, trade, profession, or occupation carried on within its borders, enforcing payment so far as it can be the exercise of a just control over persons and property within the State, as by a garnishment of credits (of which the withholding provision of the New York law is the practical equivalent)."

(b) *Income earned without State.*

On the other hand, the Supreme Court held that the State of Mississippi had the right to levy a tax upon a citizen and resident of Mississippi of so much of his net income for 1929 as arose from the construction by him of public highways in the State of Tennessee³⁶⁰. But in *Senior v. Braden*, cited supra, the Ohio intangible tax on income from land trust certificates representing an interest in land located outside the State was held invalid. And in *Lynch v. State of New York*,³⁶¹ the appellate division of the Supreme Court of the State of New York, held that New York had no right to subject a resident of the State of New York to an income tax upon rental received by such resident from real property situated in the State of Ohio, on the theory that a tax on the rental would amount to a tax on the land itself. But on July 8, 1936, the New York Court of Appeals rendered an opinion holding that interest on mortgage notes and rents from real estate was subject to the State income tax, notwithstanding the fact that the real estate was located in another State.³⁶² Furthermore, an advisory opinion of a New Hampshire Court,³⁶³ held that the State of New Hampshire could not tax a resident of that State upon the income from foreign land or from chattels situated outside that State. It is also interesting to note that the Wisconsin Supreme Court has held that where shares of stock in a foreign corporation held by a nonresident increased in value prior to the gift of such shares to a Wisconsin resident, such increase was not taxable to a Wisconsin resident upon his sale of such stock.³⁶⁴

³⁵⁹ 252 U. S. 60.

³⁶⁰ *Lawrence v. State Tax Commission* (286 U. S. 276).

³⁶¹ 237 App. Div. 763, affirmed 263 N. Y. 533; dismissed on jurisdictional grounds, 292 U. S. 616.

³⁶² *Cohn, People of the State of New York ex rel. v. Graves et al.*

³⁶³ 84 N. H. 559, 149 Atl. 321.

³⁶⁴ *Siesel v. Wisconsin Tax Commission* (217 Wisc. 661).

(c) Trust income.

In the case of income received by a local trustee for the benefit of nonresident beneficiaries, the general rule is that the State under whose laws the trust is created has authority to fix the situs (see *Hutchins v. Commissioner*,³⁶⁵ and *Harvard Trust Company v. Commissioner*³⁶⁶). These cases point out that while the situs of the trust of intangible property generally follows the person of the trustee, the situs may by reason of domiciliary law be fixed where the trust was created and is being administered under court direction. Thus, even though the trustees resided in Massachusetts, it was held that the situs of the trust for income-tax purposes was in New York, where the trust was being administered and to whose courts the trustees were accountable. In *State ex rel. Mariner v. Hampel*,³⁶⁷ the property of a corporation, consisting of mines and land in Michigan, was transferred to trustees, who held the property in trust for the shareholders of the corporation, who became beneficiaries of the trust. It was held that Wisconsin could not subject the beneficiaries residing in that State to an income tax on account of the rents received from Michigan lands, as the rents were derived from property and business transacted within the latter State. In *People ex rel. Whitney v. Graves*,³⁶⁸ the appellate division of the New York Supreme Court held that New York had jurisdiction to tax a resident of the State of Massachusetts on the profits from the sale of his individual interest in a New York Stock Exchange membership.

(d) Income of domestic corporations.

In the case of corporations, the same rules appear to apply as in the case of individuals. A domestic corporation, being a creature of the State, appears to be taxable on income arising from sources outside the State. This was so held by the South Carolina Supreme Court in *Crescent Manufacturing Company v. Tax Commission*.³⁶⁹ In a case decided on March 2, 1936,³⁷⁰ the Supreme Court in referring to its decisions said:

They also show that a State may tax net income derived from a domestic corporation's business—intrastate, interstate, and foreign.

(e) Net income tax distinguished from franchise tax.

But the Court makes a distinction between a tax on net income and a franchise tax, measured by net income. In this connection, the Court made the following statement in the same case:

and net income justly attributable to all classes of business done within the State may be used as the measure of a tax imposed to pay the State for the use thereon of the corporate franchise granted by it,

and then went on to state in referring to the specific case:

As above shown, net income from appellants' intrastate, interstate, and foreign business attributable to California may be taken into account in computing the tax. As the taxing jurisdiction of California extends to that income, the use thereof to compute the tax may not be said to be arbitrary, capricious, or in violation of the due-process clause of the fourteenth amendment.

³⁶⁵ 272 Mass. 422.

³⁶⁶ 284 Mass. 225.

³⁶⁷ 172 Wisc. 67.

³⁶⁸ 283 N. Y. Supp. 219.

³⁶⁹ 129 S. C. 480, 124 S. E. 761; see also *U. S. Glue Co. v. Town of Oak Creek* (247 U. S. 321).

³⁷⁰ *Matson Navigation Company v. California* (297 U. S. 441).

The Court also draws a distinction between a net income tax and a tax on gross income, stating in the same case—

a State tax on gross earnings derived from interstate commerce is a burden upon that commerce and repugnant to the commerce clause.

The reason for this distinction is explained by the Court in *U. S. Glue Company v. Town of Oak Creek*:³⁷¹

The difference in effect between a tax measured by gross receipts and one measured by net income, recognized by our decisions, is manifest and substantial, and it affords a convenient and workable basis of distinction between a direct and immediate burden upon the business affected and a charge that is only indirect and incidental. A tax upon gross receipts affects each transaction in proportion to its magnitude and irrespective of whether it is profitable or otherwise. Conceivably it may be sufficient to make the difference between profit and loss, or to so diminish the profit as to impede or discourage the conduct of the commerce. A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and losses, and the tax cannot be heavy unless the profits are large. Such a tax, when imposed upon net incomes from whatever source arising, is but a method of distributing the cost of government, like a tax upon property, or upon franchise treated as property; and if there be no discrimination against interstate commerce, either in the admeasurement of the tax or in the means adopted for enforcing it, it constitutes one of the ordinary and general burdens of government, from which persons and corporations otherwise subject to the jurisdiction of the States are not exempted by the Federal Constitution because they happen to be engaged in commerce among the States.

(f) *Income of foreign corporations.*

So far as foreign corporations are concerned, it appears that they are taxable only with respect to income from sources within the State. In *Hans Rees Sons Co. v. North Carolina*,³⁷² the Supreme Court held that a North Carolina statute as applied to a New York corporation was unconstitutional because the statutory method of apportionment—

as applied to the appellant's business for the years in question operated unreasonably and arbitrary in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State.

A tax levied by North Carolina upon the net income of interstate railways doing business in North Carolina in accordance with the following formula:

And when their business is in part within and in part without the State, their net income within the State shall be ascertained by taking their "gross operating revenues" within the State, including in their gross "operating revenues" within this State the equal mileage proportion within this State of their interstate business, and deducting from their gross "operating revenues" the proportionate average of "operating expenses" or "operating ratio" for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts—³⁷³

was upheld because the formula as adopted was fair upon its face and the railroad company failed to make a showing that such a formula would operate unfairly against it. But the Court expressed the opinion that revenue could be apportioned between one State and another by a method more accurate than that of a mileage prorata, however useful such a formula may be in expressing a relation between revenue and expenses.

³⁷¹ 247 U. S. 328.

³⁷² 283 U. S. 123.

³⁷³ *N. & W. Railway v. North Carolina* (56 Sup. Ct. 625).

(g) Double taxation of same income.

The question of whether or not more than one State will be permitted to tax the same income has not been settled by the Supreme Court. Now that many of the States are levying income taxes, this question will undoubtedly arise in the near future. In case it is held that only one State can tax such income, the question will have to be determined as to whether such State is the State of domicile or the State from which the income is derived.

(D) DENIAL OF COURT REVIEW

There are some cases where the denial of a judicial hearing will result in a denial of due process in cases involving questions of constitutional law or constitutional facts. This subject has already been discussed under the due process clause as a limitation upon the Federal taxing power in connection with the *St. Joseph Stock Yards case*. However, in the case of the *Great Northern Railway Company v. Weeks*,³⁷⁴ the Supreme Court found in a State tax case that an assessment of railroad properties by the State board of equalization was arbitrarily made and grossly excessive in disregard of the taxpayer's rights under the due-process clause of the fourteenth amendment. In this connection the Court said:

In the cases such as this, courts are not permitted to weigh evidence of value. They may not substitute their opinions for the findings of assessing officers or boards. But, when the jurisdiction of the district court is appropriately invoked, it is its duty to decide upon the merits of the taxpayer's claim that the assessment of his property was arbitrarily made and is grossly excessive. It clearly appears that the board failed to give reasonable weight to the falling off of petitioner's traffic, gross earnings, operating income, the extraordinary shrinkage in values of railroad properties, the prices of commodities and securities generally. The value of petitioner's property varied with the profitability of its use, present and prospective (*Cleveland, &c. Railway Co. v. Backus* (154 U. S. 439, 445), *Southern Ry. Co. v. Kentucky* (274 U. S. 76, 81-82).

* * * * *

The board persistently disregarded known conditions essential to the just ascertainment of value.

8. EQUAL PROTECTION OF THE LAWS

(A) PURPOSE OF PROVISION

The fourteenth amendment also contains a provision that no State shall deny to any person within its jurisdiction the equal protection of the laws. While a corporation is not a person within the meaning of the privileges and immunities clause, it is a person within the meaning of this clause.³⁷⁵ If this provision were applied literally, it would undoubtedly seriously cripple the taxing power of a State. However, the Supreme Court has pointed out that it was not intended by this clause to require a State to adopt an iron rule of uniformity or to prevent the classification of property for purposes of taxation. Equal protection of the laws is accomplished if the classification is a reasonable one; that is, not based upon arbitrary distinctions, and

³⁷⁴ 297 U. S. 135.

³⁷⁵ *Grosjean v. American Press Co., Inc., et al.* (297 U. S. 233).

there is equality within the classification itself.³⁷⁶ But the classification must rest upon some ground or difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike. A State statute taxing its citizens on interest on money loaned outside the State but exempting from tax interest on money loaned within the State, was held to violate this clause.³⁷⁷ A discrimination in favor of a certain class, which is plainly arbitrary, oppressive, or capricious, and made to depend upon differences of color, race, nativity, religious opinions, political affiliations, or other considerations having no possible connection with the duties of citizens as taxpayers, would be pure favoritism and a denial of the equal protection of the laws.³⁷⁸ To tax white horses and not other horses would violate this clause because there is no reasonable basis on which such a classification could be made for the purpose of taxation.³⁷⁹ If a State treats all persons in the same class alike, it may classify for purposes of taxation "properties, businesses, trades, callings, or occupations."³⁸⁰ We will mention a few of the cases in which the Supreme Court has invalidated a statute because of this clause. After a foreign corporation has come into a State in compliance with its laws and has acquired property therein, a State will violate this provision if it imposes an additional excise tax for the privilege of doing business with the State in case such a tax is not imposed upon domestic corporations of like character.³⁸¹ But the right to exclude a foreign corporation cannot be used to tax it upon property over which the State has no control, nor to interfere with interstate commerce,³⁸² or require a waiver of constitutional rights.^{382a} Nor can a State subject nonresidents to a personal income tax but deny to them the personal exemption and credit for dependents allowed to residents.³⁸³

(B) DECISIONS HOLDING CLAUSE VIOLATED

A gross sales tax, graduated solely by reference to the volume of transactions and imposed with respect to all retail merchants, whether individuals, partnerships, or corporations, was held unconstitutional.³⁸⁴ Moreover, while a State may levy a graduated chain-store tax, it will not be permitted to impose heavier taxes where multiple stores of a single owner are located in more than one county.³⁸⁵ Furthermore, a license tax upon the sale of automobiles within the State where the rate of tax was made to depend upon the amount of assets which the vendor had within the State, was held invalid,³⁸⁶ and a law requiring a person insuring with a foreign corporation not doing business within the State to pay a tax also constituted a violation of

³⁷⁶ *Shaffer v. Carter* (252 U. S. 37) ; *Hopkins v. Southern California Telephone Co.* (275 U. S. 393).

³⁷⁷ *Colgate v. Harvey* (296 U. S. 404).

³⁷⁸ *American Sugar Refining Company v. Louisiana* (179 U. S. 89).

³⁷⁹ *Kentucky Finance Corporation v. Paramount Auto Exchange Corporation* (262 U. S. 544).

³⁸⁰ *State Tax Comm. v. Jackson* (283 U. S. 527).

³⁸¹ *Southern Railroad Co. v. Greene* (216 U. S. 400) ; *Hanover Fire Ins. Co. v. Carr* (272 U. S. 484).

³⁸² *Anglo-Chilean Nitrate Sales Corporation v. Alabama* (288 U. S. 218).

^{382a} *Barron v. Burnside* (121 U. S. 186).

³⁸³ *Travis v. Yale and Towne Mfg. Co.* (252 U. S. 61).

³⁸⁴ *Stewart Dry Goods Co. v. Lewis* (294 U. S. 550).

³⁸⁵ *Liggett v. Lee* (288 U. S. 517).

³⁸⁶ *Bethlehem Motor Corporation v. Flynt* (256 U. S. 421).

this clause.³⁸⁷ A State statute conflicts with this provision if it exempts from taxation domestic corporations doing business solely within the State but taxes domestic corporations doing business both within and without the State.³⁸⁸ A State statute arbitrarily giving no par value shares a value of \$100 each, irrespective of the property behind them, so as to impose an annual tax on foreign corporations doing business within the State violates this clause.^{388a} But where such a tax was based on the proportion of issued shares which was represented by property within the State divided by total property it was upheld.^{388b} Even in a case where there is a lawful tax, the taxpayer may be denied equal protection of the laws through the manner of its assessment or collection. Thus, if the property of a corporation were assessed under a State drainage statute on a different basis from lands used for agricultural purposes and at an exorbitant figure, equal protection of the laws is denied,³⁸⁹ and if the property of a State has been systematically underassessed, the assessment of similar property of a single individual at its full value will be set aside.³⁹⁰

(C) DECISIONS HOLDING CLAUSE NOT VIOLATED

On the other hand, there are many cases in which the Supreme Court has held that the taxpayer has not been denied equal protection of the laws under a taxing statute. Recently, the high court denied review of a case in which Chicago property owners challenged taxes on real estate in Cook County on the ground that personal property does not bear its full proportion of the tax burden. The following have been held not to violate this provision of the Constitution:

1. Assessing savings banks in a manner different from other classes of banks or taxing State banks while exempting national banks.³⁹¹
2. An inheritance tax statute classifying lineals, collaterals, and strangers in blood, and subjecting them to a different rate of taxation.³⁹²
3. Classifying property for inheritance tax purposes according to the real and personal property situated within the State.³⁹³
4. The imposition of an additional transfer tax on investments escaping their share of tax burden during life of investor and held by him at his death.³⁹⁴
5. Exempting from inheritance taxation religious and educational institutions of the State and taxing religious and educational institutions of other States.³⁹⁵

³⁸⁷ *St. Louis Cotton Compress Co. v. Arkansas* (260 U. S. 346).

³⁸⁸ *F. S. Royster Guano Co. v. Virginia* (253 U. S. 412).

^{388a} *Air-Way Electric Appliance Co. v. Day* (266 U. S. 71).

^{388b} *New York, N. Y. v. Latrobe* (279 U. S. 421).

³⁸⁹ *Risty v. Chicago, R. I. & P. R. Co.* (270 U. S. 378).

³⁹⁰ *Bohler v. Calloway* (267 U. S. 479); *Sioux City Bridge Co. v. Dakota County* (260 U. S. 441).

³⁹¹ *Farmers' and M. Savings Bank v. Minnesota* (232 U. S. 516); *Union Bank and Trust Co. v. Phelps* (288 U. S. 181).

³⁹² *Magoun v. Illinois Trust & Savings Bank* (170 U. S. 283); *Campbell v. California* (200 U. S. 87); *Billings v. Illinois* (188 U. S. 101).

³⁹³ *Beers v. Glynn* (211 U. S. 477).

³⁹⁴ *Watson v. State Comptroller* (254 U. S. 122).

³⁹⁵ *Board of Education v. Illinois* (203 U. S. 553).

6. Taxing anthracite and not bituminous coal.³⁹⁶

7. Discriminating between memberships in local and foreign stock exchanges.³⁹⁷

8. Classifying merchants according to the maximum and minimum amount of sales.³⁹⁸

9. Taxing large chain stores more heavily than small ones and upon a graduated basis.³⁹⁹ But to increase the tax where the chain extended beyond the county lines of a State was held invalid in *Liggett Co. v. Lee*, cited below.

10. Taxing chain gasoline filling stations at graduated rates.⁴⁰⁰

11. Confining deductions of expenses, losses, etc., in the case of nonresidents for purposes of State income tax to such as are connected with income arising from sources within the taxing State.⁴⁰¹

12. Taxing automobiles moving in caravans differently from automobiles moving singly.⁴⁰²

13. Taxing domestic corporations and not taxing foreign corporations engaged exclusively in interstate or foreign commerce in the State.⁴⁰³

14. Distributing proceeds of State income tax among towns, counties, and taxing districts to make up loss sustained by withdrawal from their taxing power of a tax on intangible property, the income from which was taxed by the State, although such proceeds might be used for local proprietary purposes and not confer any benefit on taxpayers in other taxing subdivisions.⁴⁰⁴

15. Allowing deductions from income to individuals and corporations but denying them to personal service corporations.⁴⁰⁵

Many other cases might be mentioned in which the Supreme Court has held that a State statute did not deny equal protection of the laws. As pointed out before, the test in all of these cases must be that the classification for taxation purposes is not arbitrary or unreasonable and that it operates uniformly upon all subjects falling within such class.

9. INTERFERENCE WITH INTERSTATE AND FOREIGN COMMERCE

The Federal Government is granted under the Constitution ⁴⁰⁶ the power to regulate commerce with foreign nations, among the several States, and with the Indian tribes. This is another limitation upon the taxing power of a State.

While it may tax property located in the State and used in carrying on commerce, it has no authority to tax foreign and interstate commerce as such.⁴⁰⁷ If the property is actually in transit to a foreign country or to another State, it is exempt from taxation. This prohibition upon the State applies not only to a tax laid on the transportation of the article of commerce but also to the receipts

³⁹⁶ *Heister v. Thomas Colliery Co.* (260 U. S. 245).

³⁹⁷ *Citizens National Bank v. Durr* (257 U. S. 99).

³⁹⁸ *Clark v. Titusville* (184 U. S. 330).

³⁹⁹ *State Tax Comm. v. Jackson* (283 U. S. 527); *Liggett Co. v. Lee* (288 U. S. 517).

⁴⁰⁰ *Fox v. Standard Oil Co. of New Jersey* (294 U. S. 87).

⁴⁰¹ *Travis v. Yale and Towne Mfg. Co.* (252 U. S. 60).

⁴⁰² *Moy v. Binghamon*, decided by the Supreme Court on May 18, 1936.

⁴⁰³ *Matson Navigation Company v. California* (297 U. S. 441).

⁴⁰⁴ *Dane v. Jackson* (256 U. S. 589).

⁴⁰⁵ *Atlantic Coast Line v. Doughton* (262 U. S. 413).

⁴⁰⁶ United States Constitution, art. I, sec. 8, cl. 3.

⁴⁰⁷ *N. J. Bell Telephone Co. v. State Board of Taxes and Assessments* (280 U. S. 338).

derived from such transportation or the business or occupation of carrying it on, regardless of the instrumentalities or means employed to that end.⁴⁰⁸ To determine when an article ceases to be subject to the State taxing power because it is in interstate or foreign commerce, is sometimes very difficult. The Supreme Court has stated that the moment of time when the State power ceases is when the article commences its final movement for transportation from the State of its origin to that of its destination. Thus, in *Heisler v. Thomas Colliery Co.*,⁴⁰⁹ it was held that anthracite coal when prepared and ready for shipment or market but not yet moved from the place of production, was not in interstate commerce and was, therefore, still subject to the taxing power of the State of Pennsylvania. A State tax computed on the value of gas at the well before it enters interstate commerce was also upheld by the Supreme Court.⁴¹⁰ On the other hand, it was held that oil stored in tanks for export shipment after transportation from another State was not subject to State taxation, since the storage was a part of the continuous interstate shipment.⁴¹¹ However, if the subjects of taxation can be separated so as to distinguish between commerce within and without the State, a tax on the commerce within the State will be upheld. Thus, an occupation tax may be lawfully imposed on one engaged both in interstate and intrastate commerce, if it is clear that one engaged solely in interstate commerce would not be taxed.⁴¹²

In the *East Ohio Gas Company case* the Court held that as soon as gas is placed in the distributing plants of a State to be furnished to local consumers it loses its interstate commerce character. In this connection the Court said:

The transportation of gas from wells outside Ohio by the lines of the producing companies to the State line and thence by means of appellant's high-pressure transmission lines to their connection with its local systems is essentially national, not local, in character, and is interstate commerce within as well as without the State. The mere fact that the title or the custody of the gas passes while it is enroute from State to State is not determinative of the question where interstate commerce ends. But when the gas passes from the distribution lines into the supply mains it necessarily is relieved of nearly all the pressure put upon it at the stations of the producing companies, its volume thereby is expanded to many times what it was while in the high-pressure interstate transmission lines, and it is divided into the many thousand relatively tiny streams that enter the small service lines connecting such mains with the pipes on the consumers' premises. So segregated the gas in such service lines and pipes remains in readiness or moves forward to serve as needed. The treatment and division of the large compressed volume of gas is like the breaking of an original package, after shipment in interstate commerce, in order that its contents may be treated, prepared for sale, and sold at retail. It follows that the furnishing of gas to consumers in Ohio municipalities by means of distribution plants to supply the gas suitably for the service for which it is intended is not interstate commerce but a business of purely local concern exclusively within the jurisdiction of the State. (Citations omitted.)

The Supreme Court also upheld a Massachusetts statute as applied to a Delaware corporation which maintained its principal office in Massachusetts, which was used as headquarters for salesmen who

⁴⁰⁸ See note 407.

⁴⁰⁹ 260 U. S. 245.

⁴¹⁰ *Hope Natural Gas Co. v. Hall* (274 U. S. 284); *Utah P. & L. Co. v. Pfof* (286 U. S. 165).

⁴¹¹ *Carson Petroleum Co. v. Vial* (279 U. S. 95).

⁴¹² *E. Ohio Gas Co. v. Ohio* (283 U. S. 465); *Sprout v. South Bend* (277 U. S. 163).

solicited orders in Massachusetts and other States.⁴¹³ The corporate books and records of the company were kept in Massachusetts where its treasurer was located, its directors' meetings held, and dividends declared. The Court held that these corporate activities in Massachusetts were not interstate commerce and might be made the basis of an excise tax by that State. But a tax laid indiscriminately upon each instrument, such as a telephone instrument, regardless of its use in interstate or intrastate commerce is invalid because its application necessarily burdens interstate commerce.⁴¹⁴

In a recent case,⁴¹⁵ the Supreme Court said:

The distinction drawn by those cases between an occupation tax valid because laid only on local business and one void because laid inseparably upon the whole business, is clearly shown in the discussion of the two classes of taxes involved. Taxes for the privilege of doing local business measured by the gross income of such business have frequently been laid upon concerns engaged in both intrastate and interstate business; and have, for half a century, been sustained without inquiry whether withdrawal from the local business would compel discontinuance of the interstate. That an occupation tax upon a foreign telegraph company measured by earnings from its local business is valid, was indicated * * * in cases involving interstate railroads and telegraph companies. Similarly, a so-called franchise tax for the privilege of doing intrastate business, measured by a percentage of the value of property subject also to an ad valorem tax, was sustained as against both foreign and domestic railroads.

No decision of this Court lends support to the proposition that an occupation tax upon local business, otherwise valid, must be held void merely because the local and interstate branches are for some reason inseparable. (All citations omitted.)

But a State statute prohibiting any distributor from importing, receiving, using, selling, or distributing any motor fuel unless such distributor held an uncanceled annual license issued by the State comptroller was held invalid as applied to an interstate carrier doing no intrastate business of any description, on the ground that such a statute imposed a direct burden upon interstate commerce,⁴¹⁶ and a State tax on gross earnings derived from interstate commerce is a burden upon that commerce and repugnant to the commerce clause.^{416a} See also discussion under 7 (a) (5) relating to denial of due process in the case of State income taxes.

In the case of gasoline or cattle, the Supreme Court has held that it is subject to State taxation when the interstate transportation has ended and the commodity comes to rest within the State, provided it is not discriminated against as compared with domestic gasoline or cattle. A State may validly tax the use to which gasoline is put in withdrawing it from storage within the State and placing it in the tanks of airplanes, notwithstanding that its ultimate function is to generate power for carrying on interstate commerce.⁴¹⁷ However, a State may not impose a tax upon a foreign corporation for selling in the State in original packages nitrate imported by such corporation from a foreign country.⁴¹⁸ A foreign corporation whose sole business

⁴¹³ *Atlantic Lumber Co. v. Massachusetts* (56 Sup. Ct. 887).

⁴¹⁴ *Cooney v. Mountain States Tel. & Tel. Co.* (294 U. S. 284).

⁴¹⁵ *Pacific Tel. and Tel. Co. v. State of Washington* (297 U. S. 403).

⁴¹⁶ *Bitgaman v. Golden Eagle Western Lines, Inc.* (56 Sup. Ct. 624).

^{416a} *Philadelphia Steamship Co. v. Pennsylvania* (122 U. S. 326).

⁴¹⁷ *Hart Refineries v. Harmon* (278 U. S. 499); *Minn. v. Blasius* (290 U. S. 1); *Gregg Dyeing Co. v. Query* (286 U. S. 472).

⁴¹⁸ *Anglo-Chilean Nitrate Sales Corporation v. Alabama* (288 U. S. 218).

in the State is interstate or foreign commerce cannot be subject to a State tax.^{418a}

While a State may not interfere either directly or indirectly with property in interstate commerce, the Supreme Court has held that it can compel motor vehicles engaged exclusively in interstate commerce to pay a reasonable charge as a contribution to the cost of the highways in the State. This charge must, however, bear a reasonable relationship to the service rendered.⁴¹⁹ A tax on production, measured by sales, has been upheld even though some of such sales were made in interstate commerce.⁴²⁰

In closing this discussion of the commerce clause, it might be well to mention what may be the subject of interstate or foreign commerce. In a very early case, the Supreme Court pointed out that policies of insurance were not commerce within the meaning of this clause.⁴²¹ Neither is the ownership and operation of a bridge, for which tolls are collected from persons who use the bridge, interstate or foreign commerce, as the bridge merely provides an instrumentality which others may use in conducting foreign or interstate commerce.⁴²² However, radio broadcasting constitutes interstate commerce.⁴²³ A Washington State statute levying an occupation tax measured by the gross receipts from radio broadcasting within the State was for this reason held to be an unconstitutional burden upon interstate commerce.⁴²⁴ So is the sending of telegraph or telephone messages across State lines.⁴²⁵ Also, the transportation of oil or gas by pipe lines is interstate commerce.⁴²⁶ Furthermore, contracts bearing a direct relation to interstate commerce are not subject to State taxation.⁴²⁷ It makes no difference whether the commerce is carried on by corporations or individuals; both are protected from State interference under this clause. But the Congress has in some cases removed the restrictions to State control even where the goods are still in unbroken packages and this has been upheld by the Supreme Court. Thus, the Wilson Act, which permitted the State to control the sale of imported liquors, was upheld,⁴²⁸ as was the Webb-Kenyon Act divesting intoxicating liquors of their interstate character in certain cases⁴²⁹ and the Harves-Cooper Act making prison-made goods subject to State law.⁴³⁰ In this last case, the Court made the following comment:

If the power of Congress to remove the impediment to State control presented by the unbroken-package doctrine be limited in any way (a question which we do not now find it necessary to consider), it is clear that the removal of that impediment in the case of prison-made goods must be upheld for reasons akin to those which moved this Court to sustain the validity of the Wilson Act. Even without such action by Congress the unbroken-package doctrine, as applied

^{418a} *Alpha Cement Co. v. Mass.* (268 U. S. 203).

⁴¹⁹ *Aero Mayflower Transit Co. v. Georgia Public Service Comm.* (295 U. S. 285).

⁴²⁰ *Interstate Transit (Inc.) v. Lindsey* (283 U. S. 183); *Am. Mfg. Co. v. St. Louis* (250 U. S. 459).

⁴²¹ *Paul v. Virginia* (8 Wall. 168).

⁴²² *Detroit International Bridge Co. v. Corp. Tax Appeal Board* (294 U. S. 83).

⁴²³ *Federal Radio Commission v. Nelson Bros. Bond and Mortgage Co.* (289 U. S. 266).

⁴²⁴ *Fishers Blend Station, Inc., v. Tax Commission of Washington* (56 Sup. Ct. 608).

⁴²⁵ *Pacific Tel. and Tel. Co. v. Washington* (297 U. S. 403).

⁴²⁶ *E. Ohio Gas Co. v. Ohio* (283 U. S. 465); *Edelman v. Boeing Air Transport* (289 U. S. 249).

⁴²⁷ *Rosenberger v. Pacific Express Co.* (241 U. S. 48).

⁴²⁸ *In re Rohrer* (140 U. S. 545).

⁴²⁹ *McCormack and Co. v. Brown* (286 U. S. 131); *Adams Express Co. v. Kentucky* (238 U. S. 190); *Clark Distillery Co. v. Western Maryland R. Co.* (242 U. S. 311).

⁴³⁰ *Whitfield v. Ohio* (297 U. S. 431).

to interstate commerce, has come to be regarded, generally at least, as more artificial than sound. Indeed, in its relation to that commerce, it was definitely rejected in *Sonneborn Bros. v. Cureton* (262 U. S. 506, 508-509), as affording no immunity from tate taxation. "The interstate transportation", this Court there concluded, "was at an end, and whether in the original package or not, a State tax upon the oil as property or upon its sale in the State, if the State law levied the same tax on all oil or all sales of it, without regard to origin, would be neither a regulation nor a burden of the interstate commerce of which this oil had been the subject."

10. INTERFERENCE WITH FEDERAL FUNCTIONS

(a) DEVELOPMENT OF DOCTRINE OF FEDERAL IMMUNITY

It has already been shown that the Federal Government has no power to tax the governmental functions of a State due to its sovereign character. For the same reason a State has no power to tax the instrumentalities of the Federal Government. Instruments of government include the officers appointed to enact, execute, and expound the laws, and the public buildings erected and occupied for uses of government. When a bank is created as an agency of the United States in the accomplishment of a constitutional purpose, the power of a State to tax such bank, property, or functions can not exist without the consent of Congress. Thus, the States are prohibited from taxing the franchises and intangible property of national banks and Congress may exempt the bonds of national banks from State taxation.^{430a} A State, like the Federal Government, cannot evade this limitation by accomplishing indirectly what it cannot do directly. Thus, a tax on a retail sale of gasoline purchased by the United States for the use of its Coast Guard was held invalid as an interference with a Federal instrumentality.⁴³¹ A State tax upon the storage or withdrawal from storage of gasoline sold to the United States and used by it in performing governmental functions was held invalid by the Supreme Court on the ground that the storing and withdrawal from storage was essential to the sale of gasoline and a tax upon anything so essential amounted to a tax upon the sale itself.⁴³² A law of the State of Maryland penalizing those who operate motor trucks on highways without obtaining licenses based on examination of competency and payment of a fee cannot constitutionally apply to an employee of the Post Office Department while engaged in driving a Government motor truck over a post road in the performance of his official duty.⁴³³ A statute of Massachusetts was held unconstitutional in imposing an excise tax upon all corporations doing business within the State because the measure of the tax was based upon the corporations' incomes from all sources, including Federal securities.

It was shown that the Legislature of Massachusetts was aiming directly at the taxation of Federal securities, for the reason that a prior statute on the same subject had expressly exempted them.⁴³⁴ On the other hand, a New York statute of the same character was upheld on the ground that it was not aimed at the taxation of Federal securi-

^{430a} *McCulloch v. Maryland* (4. Wheat. 316); *Owensboro National Bank v. Owensboro* (173 U. S. 664); *Smith v. Kansas City Title & Trust Co.* (255 U. S. 180).

⁴³¹ *Panhandle Oil Co. v. Mississippi* (277 U. S. 218).

⁴³² *Graves et al. v. The Texas Company* (56 Sup. Ct. 818).

⁴³³ *Johnson v. Maryland* (254 U. S. 51).

⁴³⁴ *Macallen Co. v. Massachusetts* (279 U. S. 620).

ties.⁴³⁵ Furthermore, in *Pacific Company v. Johnson*⁴³⁶ the Supreme Court upheld a California statute levying an excise tax on corporations measured by net income and directing the inclusion of interest on Federal and State securities even though the State constitution had formerly exempted such securities from taxation. This doctrine was extended to Federal officers and employees in 1842 in the case of *Dobbins v. Erie County Commissioners*.⁴³⁷ Chief Justice Marshall was no longer on the bench at the time the opinion was rendered in the *Dobbins case*, having died in 1835. The opinion in that case was rendered by Mr. Justice Wayne. The facts were that Daniel Dobbins, a captain of the United States revenue service, was in command of the United States revenue cutter *Erie* in the Erie station in Pennsylvania. He was rated and assessed as a citizen and resident of Erie County for county taxes upon his office as captain of the United States revenue cutter service. The question before the Court was whether he was liable to be rated and assessed for his office under the United States for county rates and levies. The Supreme Court held that the tax was invalid as it was not competent for the legislature of a State to levy a tax upon the salary or emoluments of an officer of the United States. The decision was placed upon two grounds: (1) The officer was a means or instrumentality employed for carrying into effect some of the legitimate powers of the Government, which could not be interfered with by taxation or otherwise by the States, and that the salary or compensation for the service of the officer was inseparably connected with the office; that if the officer, as such, was exempt, the salary assigned for his support or maintenance while holding the office was also, for like reasons, equally exempt. (2) The compensation of an officer of the United States is fixed by a law made by Congress. Any law of a State taxing such compensation cannot be constitutional because it conflicts with a law of Congress made in pursuance of the Constitution and which makes it the supreme law of the land. It was also pointed out in *Missouri ex rel. Missouri Insurance Company v. Gehner*⁴³⁸ that a State had no right to include Federal securities in the valuation of property in taxing the assets of insurance companies. But this immunity from State taxation does not extend to anything lying outside or beyond the governmental functions and their exertions. By virtue of the sovereignty of the United States and the constitutional power of Congress to dispose of and make all needful rules and regulations respecting the Territories or other property belonging to the United States, no State can tax the property of the United States within its limits.^{438a} This prohibition does not apply where the Government has parted with the equitable title to the property.^{438b} But gasoline sold to an independent contractor performing a Federal function is taxable by a State.^{438c}

(b) EFFECT ON PRIVILEGES GRANTED BY FEDERAL GOVERNMENT

Thus, the Supreme Court has held that the State of New York had the right to tax gross receipts of royalties from copyrights granted by the Federal Government.⁴³⁹ In that case, the Court stated that

⁴³⁵ *Educational Films Corporation of America v. Ward* (282 U. S. 379).

⁴³⁶ 285 U. S. 480.

⁴³⁷ 16 Pet. 435.

⁴³⁸ 281 U. S. 313.

^{438a} *Irwin v. Wright* (258 U. S. 219); *Van Brocklin v. Tenn.* (117 U. S. 151).

^{438b} *Railway Co. v. Prescott* (16 Wall. 603).

^{438c} *Trinity Farm Co. v. Grosjean* (291 U. S. 466).

⁴³⁹ *Fox Film Corporation v. Doyal* (286 U. S. 123).

such a copyright, while granted by the Federal Government, was not a franchise or privilege to be exercised on behalf of the Government or in performing a function of government, for after the copyright was granted it was exercised by the owner for his own personal profit. Furthermore, where a private corporation is granted a privilege or franchise to effect some governmental purpose the property employed by such corporation in the exercise of such privilege is not exempt from State taxation even though the State cannot tax the privilege itself.⁴⁴⁰ Also, the Supreme Court has held that veterans' compensation loses its exemption from taxation by a State when converted into real property.⁴⁴¹ And the pro-rata share of the income of the restricted mineral resources of the Osage Tribe paid to a duly enrolled member of such tribe was held subject to a State income tax because such member was entitled to have the income paid to him and could use it as he saw fit.⁴⁴² The Supreme Court has held that the enjoyment of a privilege conferred by either the National or State Government upon the individual, even though to promote some governmental policy, does not relieve him from taxation by the other of his property or business used or carried on in the enjoyment of the privilege or of the profits derived from it.⁴⁴³ In determining the exemption of a Federal instrumentality from State taxation the courts apply such a practical construction as does not unduly impair the taxing power of the State or the appropriate exercise of the governmental functions of the Federal Government.

(c) BEQUESTS TO FEDERAL GOVERNMENT

Moreover, the Court has upheld the right of a State to levy a succession tax upon a bequest to the United States on the ground that such a tax is not upon the property itself but upon the privilege of transmitting such property.⁴⁴⁴

(d) TAXING SHARES OF NATIONAL BANKS

Thus, in a recent case the Court permitted the Maryland State Tax Commission⁴⁴⁵ to levy a tax upon the shares of a national bank which were held by the Reconstruction Finance Corporation on the ground that Congress had specifically given the States, by section 5219 of the Revised Statutes, the authority to tax shares of national banks, no matter by whom owned.

11. FULL FAITH AND CREDIT CLAUSE

There has been some question as to whether or not the full faith and credit clause⁴⁴⁶ imposes any limitation upon the taxing power of a State. Nothing has developed up to the present time which indicates that this clause is in any way a limitation upon a State's taxing

⁴⁴⁰ *Susquehanna Power Co. v. State Tax Commission* (283 U. S. 291).

⁴⁴¹ *Trotter v. Tennessee* (290 U. S. 354).

⁴⁴² *Leahy v. Oklahoma* (297 U. S. 420).

⁴⁴³ *Federal Compress & Warehouse Company v. McLean* (291 U. S. 17); *Susquehanna Power Company v. State Tax Commission* (283 U. S. 291).

⁴⁴⁴ *United States v. Perkins* (163 U. S. 625).

⁴⁴⁵ *Baltimore National Bank v. State Tax Commission of Maryland* (297 U. S. 209).

⁴⁴⁶ United States Constitution, art. IV, sec. 1.

power. However, judicial proceedings in one State, under which inheritance taxes have been paid and the administration of the estate closed, are denied full faith and credit by the action of a probate court in another State in assuming jurisdiction and assessing inheritance taxes against the beneficiaries where under the law of the former State the order of the probate court barring all creditors who failed to file claims within a certain time was binding upon all.⁴⁴⁷ Nor is a judgment to be denied full faith and credit in State and Federal courts merely because it is for taxes.⁴⁴⁸

12. DOUBLE TAXATION

Nothing in the fourteenth amendment or any other part of the Federal Constitution prevents the States from imposing double taxation, or any other form of unequal taxation, so long as the inequality is not based upon arbitrary distinctions.⁴⁴⁹

13. INTERFERENCE WITH INHERENT RIGHTS OF FEDERAL CITIZENSHIP

Every citizen of the United States has certain fundamental rights guaranteed to him by virtue of his citizenship. These rights cannot be interfered with by State taxation. In holding invalid a statute of Nevada imposing a tax upon passengers for the privilege of leaving the State or passing through it by the ordinary mode of passenger travel, the Court said: ^{449a}

Living as we do under a common government, charged with the great concerns of the whole Union, every citizen of the United States from the most remote States or Territories, is entitled to free access, not only to the principal departments established at Washington, but also to its judicial tribunals and public offices in every State in the Union. For all the great purposes for which the Federal Government was formed we are one people, with one common country. We are citizens of the United States, and as members of the same community must have the right to pass and repass through every part of it without interruption, as freely as in our own States. And a tax imposed by a State, for entering its territories or harbors, is inconsistent with the rights which belong to citizens of other States as members of the Union, and with the objects which that Union was intended to attain. Such a power in the States could produce nothing but discord and mutual irritation, and they very clearly do not possess it.

C. LIMITATIONS UNDER THE STATE CONSTITUTIONS

As we have said, the taxing power of a State is restricted not only by the Federal Constitution but also by its own State constitution. The taxing authority of each of the States is fixed in their respective legislative bodies by whatever name called, legislature, assembly, or general court as in Massachusetts. The States of Arizona, Arkansas, California, Colorado, Idaho, Maine, Massachusetts, Maryland, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Ohio, Oklahoma, Oregon, South Dakota, Utah, and Washington limit the power of the legislative bodies by the initiative

⁴⁴⁷ *Tilt v. Kelsey* (207 U. S. 43).

⁴⁴⁸ *Milwaukee County v. White Company* (296 U. S. 268).

⁴⁴⁹ *Shaffer v. Carter* (252 U. S. 58); *St. Louis Southwestern Ry. Co. v. Arkansas* (235 U. S. 350).

^{449a} *Crandall v. State of Nevada* (6 Wall. 35).

and referendum. The constitutions of Arkansas, California, Maine, Ohio, Oklahoma, South Dakota, and Utah also extend the powers of initiative and referendum to political subdivisions of the States as to their local affairs. About two-thirds of the State constitutions require that revenue bills shall originate in the house of representatives, though they may be amended in either house. The power to tax belongs to the legislative branch, state or national, and can not be conferred upon the judicial or executive branch.^{449b}

1. EQUALITY AND UNIFORMITY

All State constitutions except those of Connecticut and New York have provisions expressly, or by implication, requiring equality or uniformity in the imposition of taxes. Those of Arkansas, Florida, Indiana, Kansas, Mississippi, Montana, Nevada, New Mexico, South Carolina, South Dakota, Tennessee, Utah, and West Virginia require both equality and uniformity. Florida has the same requirement except as to intangibles. These provisions do not mean that property may not reasonably be divided into classes. A number of the constitutions specifically provide that taxation is to be equal or uniform upon subjects of the same class. Thus, an Oklahoma statute⁴⁵⁰ taxing money, certificates of deposit and other evidence thereof at a higher rate than other personal property does not violate such a provision of the State constitution. Money, as defined in the statute, is a proper subject of classification for purposes of taxation under the constitution.⁴⁵¹ However, an act of Minnesota of 1933 which provided that under certain circumstances delinquent taxes might be satisfied in full by the payment of a fraction of the amount originally assessed was held unconstitutional in that it violated a provision of the Minnesota constitution requiring taxes to be uniform upon the same class of subjects.⁴⁵² The Court stated that the classification of owners of real estate subject to taxation into two classes, those who paid taxes promptly and those who did not, was unreasonable and fanciful in that its practical effect was to prompt taxpayers to allow taxes to become delinquent in order thereafter to be able to satisfy them in full by the payment of a fraction of the amount originally assessed. Likewise, the Ohio sales tax law was held unconstitutional in that by the exemption from its operation of certain sales, as distinguished from others, there was definite discrimination and, therefore, failure of compliance with the uniformity provisions of the State constitution.⁴⁵³ And a tax on bicycles for the construction of bicycle paths, bicycles being within the classes of property subject to general taxation, was held void for inequality.^{453a} In the effort to secure this equality and uniformity, the constitutions of Colorado, Montana, Nebraska, North Dakota, Oklahoma, Texas, Utah, and Wyoming provide for boards of equalization, and a number of the other States have similar boards or commissions of statutory origin.

^{449b} *Heine v. Levee Commissioners* (19 Wall. 655); *Hardenburg v. Kidd* (10 Calif. 402).

⁴⁵⁰ Oklahoma Stat. 1931, secs. 12339-12344.

⁴⁵¹ *In re Diehr, Oklahoma* (50 P. (2nd) 725).

⁴⁵² *Matteson, Trustee, Minnesota, ex rel. v. Luecke, County Auditor, et al.*, Minn. (260 N. W. 206).

⁴⁵³ *State of Ohio v. James Russell* (Ohio Municipal Ct., Summit County, Aug. 9, 1935).

^{453a} *Ellis v. Frazier* (380 Ore. 462).

The States of Rhode Island and Vermont suggest, rather than demand, equality and uniformity: The former says "the burdens of the State ought to be fairly distributed among its citizens", and the latter that every member of society "is bound to contribute his proportion toward the expense" to be protected in the enjoyment of life, liberty, and property. In the bill of rights in the New Hampshire constitution, there is a provision to the effect that as every citizen has a right to be protected in the enjoyment of his property, "he is therefore bound to contribute his share in the expense of such protection."

These requirements as to equality and uniformity in the State constitutions apply, for the most part, to taxes upon "property" as distinguished from taxes on franchises, privileges, occupations, licenses, or local assessments for improvements especially benefited thereby. However, the California constitution specifically includes franchises in its definition of "property", and Nebraska's constitution requires taxes upon franchises to be levied proportionately and by valuation. On the other hand, many State constitutions specifically authorize the laying of taxes upon privileges, franchises, occupations, incomes, inheritances, estates, and successions. Thus, in Arizona, the constitution gives the legislature authority to levy license, franchise, gross revenue, excise, graduated income and death duties, stamp, and other specific taxes. California authorizes the taxation of licenses, railroads, express companies, telegraph companies, insurance companies, and savings and loan associations. In Florida, the legislature is authorized to levy a special capitation tax, limited in its scope, and license taxes. While income taxes are prohibited, the State constitution authorizes the levying of inheritance or estate taxes sufficient to absorb the 80-percent credit allowed under the Federal estate tax. Other States authorizing occupational, franchise, and license taxes include Illinois, Louisiana, Massachusetts, Nebraska, North Carolina, Ohio, Oklahoma, South Dakota, Tennessee, Texas, Utah, Virginia, West Virginia, and Wisconsin.

By reason of the different wording of the equality and uniformity provisions and the definitions of property in some of the State constitutions the decisions are not themselves uniform as to what constitutes a violation of their requirements. It may be said generally that "equality" of taxation is accomplished when a tax burden falls equally and without discrimination upon all persons subject to such tax; and that "uniformity" is accomplished when all taxable property of the same class is subject alike to the tax. While it is true the Supreme Court has said that in the absence of constitutional provisions so requiring, the legislative bodies are not bound to make taxation both equal and uniform, there still remains the "equal protection of the laws" provision of the Federal Constitution requiring taxation of all property in the same class in an equal manner, and it is safe to say that without any constitutional provisions requiring equality and uniformity as to the imposition of taxes on property, any such tax which denies equal protection in the enjoyment of rights to all persons similarly situated would be declared invalid, as would any tax or classification of persons or property so capricious or unreasonable as to be palpably arbitrary in its operation or effect. (For a general discussion of uniformity in taxation, see *Florida C. & P. R. Co. v. Reynolds*.^{453b}

^{453b} 183 U. S. 471.

2. VALUATION

The constitutions of the majority of the States have provisions that the assessment of taxes must bear some relation to the value of the property upon which the tax is imposed.

For instance, Alabama requires that the assessment must be in exact proportion to value; Colorado at full cash value; Kentucky at fair cash value, estimated at the price it would bring at a voluntary sale; Michigan at cash value; Mississippi and New Jersey at true value; Oklahoma and Oregon at fair cash value; North Carolina and Ohio at true value in money; and Utah according to its value in money; South Carolina at actual value; Virginia at fair market value; Louisiana at not more than actual cash value and real estate at actual value; and North Dakota at 50 percent of full and true value. The constitutions of a number of the States require that the assessment shall be at a "just value", and others that it shall be in proportion to, or according to, value.

Some States provide in their constitutions that periodical valuation shall be made of the property within the State. Connecticut is one of these, showing that the framers of the constitution had then in mind that taxation was to be in proportion to value. Other States having similar provisions are Maine, Massachusetts, and New Hampshire. The constitution of Michigan requires the annual assessments which are made by township officers to be equalized by a State board, which reviews them periodically for that purpose; and the constitution of Rhode Island requires the legislature "from time to time" to provide for new valuations of property for the assessment of taxes in such manner as they may deem best. Likewise, in certain other State constitutions, while there are no provisions on this subject the necessity for valuation is nevertheless implied, though the mode of making it, and the period at which it shall be made, are left to the legislative discretion. Moreover, different systems as to the valuation of different kinds of property are permitted.^{453c}

The following quotation from Cooley, *Constitutional Limitations*, eighth edition, volume 2, page 1047, is of interest:

As to all taxation apportioned upon property, there must be taxing districts, and within these districts the rule of absolute uniformity must be applicable. A State tax is to be apportioned through the State, a county tax through the county, a city tax through the city; while in the case of local improvements, benefiting in a special and peculiar manner some portion of the State or of a county or city, it is competent to arrange a special taxing district, within which the expense shall be apportioned. School districts and road districts are also taxing districts for the peculiar purposes for which they exist, and villages may have special powers of taxation distinct from the townships of which they form a part * * *.

As we have suggested, the provisions as to uniformity and equality, as do those as to valuation, in the several constitutions, apply generally to what is commonly known as "property taxes." The definition of "property", however, in some of the constitutions gives a broader meaning than that usually understood.

The California constitution, for instance, defines "property" to include "moneys, credits, bonds, stocks, dues, franchises, and all other matters and things, real, personal, and mixed, capable of private own-

^{453c} *Tappan v. Merchants' Nat. Bank* (19 Wall. 490).

ership." Montana has a similar provision. Idaho requires that "the definition of property shall be fixed and classified by law." Washington, "Property * * * shall include everything, whether tangible or intangible, subject to private ownership." Such definitions and different interpretations of the State courts as to what constitutes property naturally affect the imposition of income taxes by the States, and in those States where income is defined as, or held to be, property, a stumbling block has been found when an attempt was made to lighten the burden on property by the imposition of graduated income taxes. The question as to whether income is property under the State courts does not present a Federal question, and rests finally with the highest court of the State.⁴⁵⁴ The Illinois income-tax law was held to be unconstitutional because "income" was defined as "property" under the Illinois constitution. In holding the statute to be invalid, the Illinois Supreme Court made the following comment:⁴⁵⁵

The word "property" as used in our constitution includes income, and income is property. Therefore, it necessarily follows that under the constitution of the State all taxes must be levied by valuation so that every person and corporation shall pay a tax in proportion to the valuation of his or its property.

Pointing to the fact that the income tax provides for a graduated scale, the court concluded that "graduation" was not "valuation", and was not "uniform" as required by the constitution.

The constitution of Tennessee authorizes "a tax upon incomes derived from stocks and bonds that are not taxed ad valorem", and such tax is now imposed. The former income tax was held unconstitutional in that it was a property tax and as such subject to the constitutional requirements as to valuation and uniformity. For similar reasons the income-tax law of 1932 imposed by the State of Washington was declared invalid.⁴⁵⁶ An amendment to the Washington constitution (1930) defines property "to mean and include everything, whether tangible or intangible, subject to ownership", this same amendment requiring "all taxes shall be uniform upon the same class of property." A graduated income tax was enacted under this amendment and declared invalid by the supreme court of the State in September 1933, the court saying:

Our fourteenth amendment prescribes that all taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax, etc. It needs no argument to demonstrate that the income taxes here levied are wholly lacking in uniformity.

The State legislature then endeavored to circumvent this decision by imposing in 1935 a tax on "the privilege of receiving income", but this also was held subject to the fourteenth amendment of the State constitution,⁴⁵⁷ and as such in violation of the uniformity rule. The act clearly showed that the legislature was concerned with the income upon which the amount of the tax was to be levied, not with the mere privilege of the individual to receive the income. The court said:

The right to receive property (income in this instance) is but a necessary element of ownership, and, without such right to receive, the ownership is

⁴⁵⁴ *Guarantee Trust Company v. Blodgett* (287 U. S. 509).

⁴⁵⁵ *Bachrach v. Nelson* (349 Ill. 579).

⁴⁵⁶ *Culliton v. Chase* (174 Wash. 363, 25 P. (2d) 81).

⁴⁵⁷ *Jensen v. Henneford*; *Bronson v. Same* (Washington, 53 P. (2d) 607).

but an empty thing and of no value whatever. * * * The mere potential privilege of receiving earned income amounts to nothing unless and until the income is received. The right to receive, the reception, and the right to hold, are progressive incidents of ownership and indispensable thereto. To tax any one of these elements is to tax their sum total, namely, ownership, and therefore, the property (income) itself.

And on the same grounds the Washington corporate net income tax has been declared unconstitutional for lack of uniformity,⁴⁵⁸ the property of a corporation not being subject to a tax not imposed upon property of co-partners and individuals. However, a tax on the privilege of engaging in business activities has been held not to violate the constitution of the State of Washington;⁴⁵⁹ nor does a State sales tax;⁴⁶⁰ or a compensating tax.⁴⁶¹ In Pennsylvania a graduated tax imposed in 1935⁴⁶² on income derived from property or business was also held by the supreme court of that State to be violative of the Constitution of Pennsylvania which provides that "all taxes shall be uniform upon the same class of subjects". The court stated that the tax on the income from real estate, securities, and other tangible objects in the hands of the owner was purely a "property tax" and as such not meeting the requirements as to uniformity, and that while the tax on the income from professions was an excise tax and perhaps valid in some instances, it too must nevertheless fall because, despite a separability clause in the act to the contrary, it was convinced that "this bill would never have been passed by the legislature if its only effect was to impose a tax upon the income derived from occupations and professions".⁴⁶³ A tax on income was also held to be a tax on property under the Alabama Constitution.⁴⁶⁴

Some States have provided for such a situation by granting the legislature express authority in their constitutions to levy both flat and graduated income taxes. This is true in Arizona, California, Kansas, Oklahoma, South Dakota, Utah, and Wisconsin; in Massachusetts which permits taxing income from property at a higher rate than unearned income; in North Carolina, if the rate of tax does not exceed 6 percent, exemptions to be not less than \$2,000 for married persons or heads of families, or \$1,000 for single persons, and no deductions for living expenses allowed; and in Virginia on incomes in excess of \$600. During the year 1933, amendments to the Constitutions of Alabama and West Virginia authorizing the imposition of graduated income taxes were adopted. An amendment proposed by Minnesota was rejected.

3. LIMITATIONS AS TO RATE

Some constitutions place a limit upon the rate at which property may be taxed: For example, Alabama prohibits a levy in any one year of a greater rate of taxation than sixty-five one hundredths of 1 percent of the value of the taxable property within the State for

⁴⁵⁸ *Petroleum Navigation Co. v. Henneford*, Washington (55 P. (2d) 1056).

⁴⁵⁹ *State ex rel. Stiner v. Yelle* (174 Wash. 402, 25 P. (2d) 91).

⁴⁶⁰ *Morrow v. Henneford* (47 P. (2d) 1016).

⁴⁶¹ *Vancouver Oil Co. v. Henneford* (49 P. (2d) 14).

⁴⁶² Act of Assembly of Pennsylvania of July 12, 1935.

⁴⁶³ *Kelley et al. v. Kalodner*, Pennsylvania (181 A. 598).

⁴⁶⁴ *Eliasberg Bros. Mercantile Co. v. Gunes* (204 Ala. 492).

State purposes and limits the rates which may be imposed by the counties and towns; Georgia requires that the levy for any one year, for all purposes, shall not exceed 5 mills of the value of the property in the State; Idaho, that it shall not exceed 10 mills on the dollar of assessed valuation for State purposes. Arizona, Arkansas, Colorado, Idaho, Louisiana, Michigan, Missouri, Montana, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, South Dakota, Texas, Tennessee, Utah, West Virginia and Wyoming all have some such limitations.

4. LIMITATIONS AS TO DEBT

In a number of the State constitutions a limitation is placed upon the amount of the State indebtedness, except for purposes of public defense. Nebraska has a rigid provision of this nature. More frequently such limitation is fixed as to counties and municipalities, or the legislative bodies are required to restrict their power to contract debts. There are, however, so many exceptions as to the latter provisions that their practical effect is somewhat doubtful.

5. EXEMPTIONS

Most of the State constitutions provide that certain property shall be exempt from taxation, or that the respective legislative bodies are authorized to make such exemptions. The exemptions provided for generally extend to religious, eleemosynary, and educational institutions, and to property and evidences of indebtedness of the United States, the State, and its subdivisions. Various exemptions are also provided as to homesteads and property limited to stated amounts in value.

The Constitutions of Arizona, Arkansas, Kentucky, Texas, and Virginia prohibit all exemptions other than those specifically named therein. In Minnesota it has been held that if provision for certain exemptions is made by the constitution, no others are valid.⁴⁶⁵ And in some of the States it has been decided that the particular provisions inserted in their constitutions to insure uniformity are so worded as to forbid exemptions. Thus, under the provision in the Constitution of Ohio⁴⁶⁶ that "laws shall be passed taxing by a uniform rule all moneys, credits, investments in bonds, stocks, joint-stock companies, or otherwise; and also all real and personal property, according to its true value in money", it was held unconstitutional for the legislature to provide that lands within the limits of a city should not be taxed for any city purpose, except roads, unless the same were laid off into town lots and recorded as such, or into out-lots not exceeding 5 acres each.⁴⁶⁷ The Constitution of California provides that "all property in the State shall be taxed in proportion to its value"; and this is held to preclude all exemptions of private property when taxes are laid for either general or local purposes.⁴⁶⁸ In Nebraska, for instance, an act permitting taxpayers, who had paid 1935 taxes prior to a certain date, to pay delinquent

⁴⁶⁵ *Le Duc v. Hastings* (39 Minn. 110, 38 N. W. 803).

⁴⁶⁶ Art. 12, sec. 2, Constitution of Ohio.

⁴⁶⁷ *Zanesville v. Auditor of Muskingum County* (5 Ohio St. 589).

⁴⁶⁸ *People v. McCreery* (34 Cal. 432); *Crosby v. Lyon* (37 Cal. 242).

taxes for previous years without interest, penalties, or costs, either in cash or installments, was held unconstitutional ⁴⁶⁹ in that it violated that part of section 4 of article VIII of the Constitution of Nebraska providing that "the legislature shall have no power to release or discharge any county, city, township, town or district whatever, or the inhabitants thereof, or any corporation, or the property therein, from their or its proportionate share of taxes to be levied for State purposes, or due any municipal corporation." In determining the act to be unconstitutional, the court said:

It must be conceded that if the legislature has the power to extend the time in which taxes must be paid, as was done in the instant case, it could repeat the extensions or extend them for such a duration of time that it would amount to a remission of the tax.

However, the legislature was not prevented from waiving or remitting the interest, penalties, and costs since they were not part of the taxes within the meaning of this provision of the constitution.

By recent constitutional amendments in Florida, exemption is granted to motion-picture studios and homesteads up to \$5,000 in value. Louisiana and Texas also adopted amendments providing for homestead exemptions.

Minnesota by amendment has authorized the legislature to exempt household goods and farm machinery from taxation, "as it may determine."

It seems, however, that in spite of constitutional provisions regarding exemptions, the legislatures of the various States may exempt lands received from the Federal Government in trust to aid in the building of railways. ⁴⁷⁰

6. ENACTMENT OF SPECIAL LAWS

In a majority of the State constitutions the enactment of special laws is prohibited as to the assessment and collection of taxes, and as to exemption of property from taxation. Thus, an Illinois statute (Laws 1935, p. 1168) providing for the payment of delinquent taxes on real estate "in counties containing 500,000 or more inhabitants" differently than in those counties with smaller populations was held void ⁴⁷¹ under a provision of the State constitution prohibiting the enactment of local or special laws, for the reason that only one county met this requirement as to population, no other even approximating it. The act was, therefore, special and local, and not general. So, too, an act permitting the issuance of bonds for the erection of a courthouse in counties of over a certain population was also held invalid as being special, only one county obviously being intended. ⁴⁷² In the case contesting the constitutionality of this latter act, the court said:

Designating counties as a class according to a minimum population, which makes it absolutely certain but one county in the State can avail of the benefits of a law applicable to such class, cannot but be regarded as a mere device to evade the constitutional provisions forbidding special legislation.

⁴⁶⁹ *Steinacher v. Swanson* (Nebraska Sup. Ct., No. 29829, July 8, 1936).

⁴⁷⁰ *Stearns v. Minnesota ex rel. Marr* (179 U. S. 223); *Duluth & I. R. R. Co. v. St. Louis Co.* (179 U. S. 302).

⁴⁷¹ *Clarke, People, ex rel. v. Jarecki*, Ill. (1 N. E. (2d) 855).

⁴⁷² *Devine v. Cook County Comrs.* (84 Ill. 590).

For the same reason, a statute attempting to place certain limits on the taxing power of municipalities in counties of more than a certain population was held violative of the Illinois State Constitution.⁴⁷³ Likewise, a Michigan statute⁴⁷⁴ which purported to abolish township boards of review in only one county, leaving unchanged the law applicable to the other counties, was void because it was a local act in a case in which a general act could be made applicable, in violation of a provision of the State constitution prohibiting the enactment of such a local act.⁴⁷⁵

7. FOR RELIGIOUS PURPOSES

It is interesting to note that the imposition of taxes for religious purposes is prohibited in the constitutions of Alabama, Arizona, Connecticut, Idaho, Illinois, Indiana, Iowa, Michigan, New Hampshire, New Jersey, Rhode Island, Tennessee, Vermont, Virginia, and West Virginia.

8. WIFE'S SEPARATE ESTATE

It is of some interest and value to know that provision is made for the recognition of the wife's separate estate in the constitutions or statutes of the following States: Arizona, Arkansas, California, Florida, Georgia, Idaho, Kansas, Louisiana, Maine, Maryland, Michigan, Mississippi, Nebraska, Nevada, New Mexico, North Carolina, Oregon, South Carolina, South Dakota, Tennessee, Texas, Utah, Washington, and West Virginia.

As a matter of statutory law, community property rights are recognized in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, and Washington, and in the Constitution of Texas.

Many State constitutions provide that the power to tax shall not be surrendered or contracted away by the legislature. This is especially the rule in the case of the taxation of corporations. Very recently the cigarette tax law of Utah, insofar as it empowered the State tax commission to fix the amount of the penalty for failure properly to affix and cancel stamps to cigarettes, was held unconstitutional as being a delegation of legislative power.⁴⁷⁶ In a few instances, the State constitutions contain provisions similar to those contained in the Federal Constitution, such as the provision prohibiting the impairment of contracts, the due process clause, and the equal protection of the laws provision.

9. DOUBLE TAXATION

As heretofore pointed out, double taxation is not prohibited by the Federal Constitution, and where not forbidden by the State constitution, it is generally held to be within the power of the State. One or two State constitutions expressly prohibit double taxation. Others, because of their equality and uniformity provisions, render double taxation invalid. In a recent case, it was held by a Kentucky court that to constitute double taxation, two or more taxes must be

⁴⁷³ *People v. Knopf* (183 Ill. 410).

⁴⁷⁴ Public Acts, first extra session 1934, no. 33.

⁴⁷⁵ *Great Lakes Steel Corp. v. Lafferty*, Mich. (12 F. Supp. 55).

⁴⁷⁶ *Tite et al. v. State Tax Commission of Utah* (57 P. (2d) 734).

imposed on the same property, by the same government, during the same taxing period, and for the same purpose. This is also the rule applied in the majority of the States.

D. SUMMARY OF LIMITATIONS ON STATE TAXING POWER

The limitations upon the power of State governments to levy taxes, as set forth above, may be briefly summarized as follows:

1. INHERENT LIMITATIONS

(1) No State has any authority to tax real property or tangible personal property located outside of its borders. In the case of intangible property, the rule generally applied is that the State of domicile is the only State which has authority to levy the tax. This last rule is subject to certain exceptions. For instance, there are certain cases in which intangible property may acquire a business situs in a State other than that of the domicile of the owner. In such a case it may be possible for the State in which such property is located to impose the tax.

(2) A State has no authority to impose a tax except for a public purpose.

2. LIMITATIONS UNDER THE FEDERAL CONSTITUTION

The limitations on the taxing power of the States under the Federal Constitution may be summarized as follows:

(1) A State has no power to levy a tax in conflict with the Constitution of the United States, the laws of the United States, or treaties entered into by the United States.

(2) Bonds or other securities of the United States may not be taxed by State authorities, for to do so would be an interference with the express power given Congress in the Federal Constitution to borrow money.

(3) No State has any authority to levy a duty of tonnage. A duty of tonnage, within the meaning of the Federal Constitution, is a charge upon a vessel, according to its size or capacity, for the privilege of navigating the public waters of the country or of entering or leaving a port therein.

(4) No State has any authority to impair the obligations of a contract. For instance, a State might issue bonds provided that they should be exempt from the payment of certain taxes. It would thereafter have no authority to require such bonds to be subject to such taxes. This last statement must be modified to the extent that the State constitution prohibits the State from contracting away the right to impose taxes.

(5) No State has any power by taxation to discriminate against the citizens of other States. For example, a State has no authority to tax citizens of other States who own property or carry on business within its territorial limits at a higher rate than its own citizens are taxed under similar conditions.

(6) No State has any authority to levy taxes on articles imported from, or exported to, foreign countries.

(7) No State has authority by taxation to deprive a taxpayer of property without due process of law. The purpose of such a prohibition is to extend to citizens and residents of the State the same protection against arbitrary State action as is afforded them against arbitrary Federal action by the fifth amendment.

(8) No State has any power to levy any tax which denies to any person within its jurisdiction the equal protection of the laws. Equal protection of the laws is accomplished if the classification for taxation is a reasonable one; that is, not based upon arbitrary distinctions, and there is equality within the classification itself.

(9) No State has any power to interfere by taxation with interstate or foreign commerce. This prohibition applies not only to a tax laid on the transportation of the article of commerce but also to the receipts derived from such transportation or the business or occupation of carrying it on. The moment of time when the State's power of taxation ceases is when the article to be taxed commences its final movement for transportation from the State of its origin to that of its destination.

(10) A State has no power to tax the property of the Federal Government or to interfere by taxation with the exercise of Federal functions.

3. LIMITATIONS UNDER STATE CONSTITUTIONS

The limitations imposed on the State legislators by the constitutions of their respective States may be summed up as follows:

(1) The constitutions of many of the States contain provisions requiring equality and uniformity in taxation. Some require that the taxation shall be equal and uniform, some that property shall be taxed in proportion to its value, others that all taxes shall be uniform upon the same class of objects within the territorial limits of the authority levying the tax, and still others that the legislature shall provide for an equal and uniform rate of assessment and taxation. Due to the different wording of the above provisions, the decisions are not altogether uniform as to what constitutes a violation of their requirements. In general, equality of taxation is accomplished when the burden of the tax falls equally or impartially upon all persons subject to it; and uniformity, when all taxable property is, alike, subject to the tax. As a general rule, the equality and uniformity restrictions apply only to property taxes, as distinguished from taxes upon occupations, licenses, etc.

(2) Many State constitutions specifically provide the property which shall be exempt from taxation and require the taxation of all other property. Many State constitutions fix the maximum rate of the property tax. Some, like North Carolina and Virginia, fix the rate for income-tax purposes and, in a few instances, for estate-tax purposes.

PART III. POWERS OF COUNTIES, MUNICIPALITIES, AND SUBDIVISIONS

A claim has been advanced that counties, cities, towns, and other political subdivisions have inherent or sovereign powers of taxation. This is on the theory that Magna Charta recognized such rights, particularly to cities and towns, prior to the establishment of the American Colonies, and that these rights were brought over with the colonists and were a part of the existing rights in the colonial governments at the time of the formation of our National Government, and at the time of the adoption of our Federal Constitution. These inherent rights have been recognized in a few instances, but in a vast majority of the States the right of the people of a municipality to control its affairs is not considered or recognized as an inherent right in the people but is dependent upon either State constitutions or legislative authority. Furthermore, the power of taxation on the part of a municipal corporation is not private property, or a vested right of property in its hands. The conferring of such power is an exercise by the legislature of a public and governmental power, which cannot be imparted in perpetuity, and is always subject to revocation, modification, and control, and is not the subject of contract.^{470a}

The Constitution of Connecticut would seem to go far to recognize such inherent rights in the people of the counties but even in that State the courts have held that the entire legislative power is in the hands of the general assembly and that the legislature may exercise the taxing power for lawful purposes at its discretion, provided, however, the taxing power may be delegated to municipal corporations or municipal boards. It may be said, therefore, that it is generally true that every political subdivision levying taxes must rely upon some constitutional or legislative authority to support the tax imposed by it. It is equally true that the principle of home rule (the right of the people to control their local affairs) is so firmly imbedded in our republican form of government that it cannot be shaken, and, as we have shown, seven of the State constitutions specifically reserve the power of the initiative and referendum to the subdivisions as to their local affairs.

In many cases, the State constitutions directly provide for assessment and collection of taxes by the counties and subdivisions, but frequently, even in so doing, limit the purpose and extent of this delegated power. In some cases, the legislatures are authorized to confer such powers upon local authorities. In others they are required to impose restrictions upon these powers. Even in cases where constitutional authority is given to subdivisions to determine and control their local affairs, the rate or amount of indebtedness is often

^{470a} *Williamson v. New Jersey* (130 U. S. 189).

limited. Many of the constitutions restrict the legislatures from passing local or special laws regulating county affairs or those of other subdivisions, thus prohibiting the State legislature from levying taxes for local purposes as distinguished from State purposes. In such cases, the constitutions give the local governments the power to impose local taxes under a general authorization of the legislature. However, it is not always easy to determine whether a tax is for a local purpose or for a State purpose. For instance, a local government would not have the authority to protest against the levying of a tax to provide revenue for police protection, as one of the highest duties of the State is to preserve the public peace. It is also true that the legislature may impose taxes to provide for the public health, the public highways, and many other matters which affect the State as a whole. Thus, while the act of the Assembly of Pennsylvania of July 12, 1935, imposing a graduated income tax for school purposes was declared unconstitutional on other grounds,⁴⁷⁷ it did not contravene section 7 of article III of the Constitution of Pennsylvania which forbids the general assembly from passing any local or special law regulating the affairs of school districts or the management of public schools, and the raising of money for such purposes, since the Act applied to all school districts and could not for that reason be local or special legislation. On the other hand, local improvements, etc., would appear to be entirely within the control of the local governments. In levying taxes for local purposes, it is well settled that the local government has no authority to extend its taxation provisions to property located outside of its district. It must confine its taxation to property located within the district and the tax must operate uniformly within such district.

As we have stated before, the constitutions in many instances limit the rate of taxation of counties and municipalities, and the power to contract debts, or else direct the legislature so to do.

It is impossible to enumerate all of the various taxes imposed under authority of the county and local subdivisions or their legal restrictions. It should not be overlooked, however, that counties, cities, and local subdivisions impose a heavier burden of taxation than either the Federal or State Governments. For example, the taxes collected by the Federal, State, and local subdivisions for 1932 amounted to the following:

Federal -----	\$1, 558, 000, 000
State -----	1, 642, 000, 000
Counties, cities, and local subdivisions-----	4, 715, 000, 000

Out of the \$4,715,000,000 collected by the counties, cities, and local subdivisions, \$4,360,000,000—or about 92 percent—came from general property taxes. The States collected only \$323,000,000 from the general property taxes. It is evident, therefore, that the general property tax is the most important tax to be considered in connection with the counties, municipalities, and local subdivisions. As already pointed out, most of the State constitutions contain provisions requiring the assessment of property taxes to be in proportion to value. As a general rule, in determining the value of property a great deal of discretion is necessarily reposed in the assessing

⁴⁷⁷ See note 463.

officers. However, the values may not be discriminatory as to the taxpayers in the same class. Some taxpayers cannot be assessed at 100 percent of the value of their property pursuant to statutory authority and others in the same class at a lower percentage. This was brought out by the decision of the Supreme Court in *Sioux City Bridge Company v. South Dakota*,⁴⁷⁸ in which the Court said:

This Court holds that the right of the taxpayer whose property alone is taxed at 100 percent of its true value is to have his assessment reduced to the percentage of that value at which others are taxed even though this is a departure from the requirements of the statute. The conclusion is based upon the principle that where it is impossible to secure both the standard of the true value and the uniformity and equality required by law, the latter requirement is to be preferred as the just and ultimate purpose of the law.

Nor can the values be excessive or arbitrary. Thus, where the assessment of railroad properties was the same for 1933 as for 1932, which was only slightly below the 1929 assessment, the Court held the 1933 valuation to be excessive because it did not take into account the diminution or shrinkage in value caused by the depression.⁴⁷⁹

In ascertaining the value of property the recent cases indicate that the income or rental value of the property is a factor to be considered. In *Sanitary District of Chicago v. Young*⁴⁸⁰ the Court said with reference to ascertaining the value of channel and improvement of the Sanitary District of Chicago:

It must be conceded, generally speaking, that the fair cash market value of property depends upon the amount of earnings that property will net for its owner when employed to its capacity or to the capacity that its patronage will insure. Other factors may enter into the calculation of value, but we have no hesitation in saying that the evidence in this record does not show overvaluation of appellant's property, as charged in its bill.

And in *Somers v. City of Meridan*⁴⁸¹ the Connecticut Supreme Court of Errors held that capitalization of the average annual rentals for the past three years at the rate of 10 percent was a proper method for arriving at the valuation of property on a long-term lease, where there was no ready market for the property.

In many other States the courts have held that income or rental value of the property is a proper factor to be considered as a basis for the valuation of property.⁴⁸²

⁴⁷⁸ 260 U. S. 446.

⁴⁷⁹ *Great Northwestern Railway Company v. Weeks* (297 U. S. 135).

⁴⁸⁰ 285 Ill. 360.

⁴⁸¹ 174 Atl. 184.

⁴⁸² *Meekings, Packard & Weeks, Inc., v. Board of Assessors of the City of Springfield* (Sept. 20, 1934, B. T. A., Adv. Sh. 135); *Potlatch Timber Co., in re Delinquent Taxes* (160 Minn. 309); *Szerlip v. Goldfogle* (192 N. Y. Sup. 210); *Sebring v. Dowd* (200 N. Y. Sup. 3); *Adams Express Co. v. Ohio State Auditor* (165 U. S. 225); *Northern Pacific Railway Co. v. Benton Co.* (89 Wash. 534).

SUPPLEMENT

POWERS OF THE STATE GOVERNMENT

LIMITATIONS UNDER THE FEDERAL CONSTITUTION

EQUAL PROTECTION OF THE LAWS

(1) *Taxing importation of intoxicating liquor.*—A California State fee for the privilege of importing beer was held not to violate the equal protection clause of the fourteenth amendment. In this connection the Court said:¹

* * * A classification recognized by the twenty-first amendment cannot be deemed forbidden by the fourteenth. Moreover, the classification in taxation made by California rests on conditions requiring difference in treatment. Beer sold within the State comes from two sources. The brewer of the domestic article may be required to pay a license fee for the privilege of manufacturing it; and under the California statute is obliged to pay \$750 a year. Compare *Brown-Forman Co. v. Kentucky*, 217 U. S. 563. The brewer of the foreign article cannot be so taxed; only the importer can be reached. He is subjected to a license fee of \$500. Compare *Kidd v. Alabama*, 188 U. S. 730, 732.

(2) *Taxing chain stores.*—But section 4 (b) of the Chain Store Tax Act of 1935 of the State of Iowa, imposing a tax on gross receipts from sales according to an accumulated graduated scale, was held to violate the equal protection clause as creating an arbitrary discrimination in *Iowa v. The Great Atlantic & Pacific Tea Company*,² the court affirming the district court on direct appeal upon the authority of *Stewart Dry Goods Co. v. Lewis*.³ The reasoning of the district court is set forth below:

Recent decisions of the Supreme Court of the United States with reference to the power of States to tax chain stores, or stores with one or more units, aids in limiting the questions here to be determined.

A classification of chain stores as such for the purpose of imposition of a license or occupation tax is proper. *Tax Commissioners v. Jackson* (Indiana) (283 U. S. 527); *Liggett Co. v. Lee* (Florida) (288 U. S. 517); *Fox v. Standard Oil Co.* (West Virginia) (294 U. S. 87); *Stewart Dry Goods Company v. Lewis* (Kentucky) (294 U. S. 550). In *Tax Commissioner v. Jackson*, *supra* (p. 537), it is said:

"A very wide discretion must be conceded to the legislative power of the State in the classification of trades, callings, business, or occupations which may be subjected to special forms of regulation or taxation through an excise or license tax. If the selection or classification is neither capricious nor arbitrary and rests upon some reasonable consideration of difference or policy, there is no denial of the equal protection of the law."

¹ *State Board of Equalization of California et al., v. Young's Market Co. et al.*, decided by the Supreme Court on Nov. 9, 1936.

² Decided by the Supreme Court, per curiam, on Nov. 9, 1936.

³ 294 U. S. 550.

The defendants claim that under these decisions the classification is proper and the taxes sought to be exacted are occupational taxes upon a method of conducting business and that the power of the State of Iowa to impose such taxes is absolute and that this tax being an occupational tax on conducting a business by a system of chain stores is within that power and violative of none of the provisions of the Constitution of the United States. Complainants insist that the tax and especially that provided by section 4 (b) is not an occupation tax but a gross sales tax and comes within the limitation of the power of the legislature by the fourteenth amendment as being discriminatory, arbitrary, and capricious, and condemned by the Supreme Court of the United States in the *Stewart case*, supra.

While the Iowa chain-store tax law, here under consideration, is in some particulars different from the Kentucky statute under consideration by the Supreme Court in the *Stewart case*, supra, we are of the opinion that as we find and have found that there are similar controlling facts in the two cases, that this case is governed by the pronouncements in the *Stewart case*.

The classifications are different, as in the case at bar the tax under consideration is only imposed upon retail stores having more than one separate unit while under the Kentucky statute the classification included all retail stores. Under the Kentucky act the maximum exaction upon gross sales of the retailer was limited to 1 percent, while here the maximum exaction which under the act is applicable to some of the litigants in these cases amounts to 10 percent on the gross receipts from sales. Another difference is that the Kentucky statute provided for a percentage tax on each graduated classification of gross sales while under the Iowa law the tax is a flat amount on each such graduated classification.

In these particulars the cases are different, but we are unable to say that such differences permit the escape of a similar condemnation as being arbitrary and discriminatory under the pronouncements in the *Stewart case*. The additional and higher brackets with corresponding increase in the gross sales tax in the Iowa statute make the discrimination more apparent. The limitation in the classification to the taxation of chain stores only, could not change the nature of the tax, and this would be true giving consideration to the distinctive business species of the chain stores and all economic and welfare questions which are brought about by their advantages in making sales. Such questions might well bear on the propriety of the classification but not on what constitutes the form or nature of a tax.

Nor are we able to find any legal or rational difference between an assessment on a graduated classification of gross sales on a percentage basis as against such an assessment in a flat amount, where the question is whether it is a tax on the person or sale. *Telegraph Co. v. Texas*, 105 U. S. 460, 465; *Quaker City Cab Co. v. Penna.*, 277 U. S. 389; *Indian Motorcycle Co. v. United States*, 283 U. S. 570; *Stewart Dry Goods Co. v. Lewis*, 294 U. S. 587. As said by the Supreme Court of Wisconsin in the case of *Ed. Schuster & Co., Inc., v. Henry*, 261 N. W. 20, in considering a Wisconsin chain store statute similar to that of Iowa, they are the same "in substance and legal effect."

We think it is fairly established by the opinions of the Supreme Court of the United States that a separate tax may be imposed upon chain stores as a class if it be in the form of an income tax, or upon a flat tax on a number of stores or on the amount of sales, but such cases are clearly distinguished in the *Stewart case* when the differences are as there pointed out in discussing the case of *Clark v. Titusville*, on page 564 (294 U. S.) as follows:

"The purpose (in the *Titusville case*) was to charge a larger license fee to a larger business. Any tax measured by a fixed and uniform percentage of gross sales would impose a heavier burden on the taxpayer having the greater volume of sales. The excise here involved is not of that sort, the sum exacted from the merchant doing the larger business being not only greater in gross amount but larger in proportion to sales, than that demanded of his smaller competitor."

In the Iowa statute we find the tax determined on a basis of the amount of gross sales of merchandise on an accumulative graduated scale and at a fixed rate on each such classification. It thereby becomes indirectly a tax upon each sale and results in an exaction of taxes in the larger graduated class in a greater amount and proportion than those exacted from a business doing the same thing where the amount of the gross sales is smaller. For instance, a merchant in the first class under section 4 (b) doing a business of \$50,000 a year would pay a tax of 1/20ths of 1 percent on each dollar of goods sold: the eighth class chain store doing a business of \$500,000 would pay a tax of 14/20ths

of 1 percent on each dollar; the chain store in the last class doing a business of more than \$9,000,000 would pay a tax of 200/20ths of 1 percent, or 10 percent, on each dollar of goods sold, and 200 times the rate provided for the gross sales in the smallest classification.

All the cases decided since the decision in the *Stewart case* when the tax is based on graduated gross sales have held the tax arbitrary and in violation of the equal-protection clause of the Constitution. They are: A nisi prius decision by a State (Florida) court and a three-judge court construing a chain-store tax in Florida, *Lane Drug Stores v. Lee*, 11 Fed. Sup. 672; *The Great Atlantic & Pacific Tea Co. v. Harvey* (Vt.), 177 At. 423. The statutes construed by those courts provided for a percentage taxation on separate graduated classification of gross sales.

The Supreme Court of Wisconsin, in the case of *Ed. Schuster & Co., Inc., v. Henry*, 261 N. W. 20 (certiorari to the Supreme Court of the United States denied on or about Oct. 22, 1935), and the Supreme Court of New Mexico in the case of *Safeway Stores, Inc., v. Vigil*, not yet officially reported, considered identical statutes as here under consideration and found them unconstitutional under the authority of the *Stewart case*. It will not aid to reiterate the reasoning therein found to support our conclusion. That part of the Iowa statute known as section 4 (b) will have to be held unconstitutional under the reasoning in the *Stewart case*, the last paragraph of which is as follows (294 U. S. 566):

"The law arbitrarily classifies these vendors for the imposition of a varying rate of taxation, solely by reference to the volume of their transactions, disregarding the absence of any reasonable relation between the chosen criterion of classification and the privilege the enjoyment of which is said to be the subject taxed. It exacts from two persons different amounts for the privilege of doing exactly similar acts because the one has performed the act oftener than the other. We hold the act unconstitutional and reverse the judgment."

INTERFERENCE WITH INTERSTATE AND FOREIGN COMMERCE

Taxing importation of intoxicating liquor.—In the case of *State Board of Equalization of California et al. v. Young's Market Company et al.*,⁴ the Supreme Court upheld a statute of California imposing a license fee of \$500 for the privilege of importing beer to any place within its borders. The Court pointed out that prior to the twenty-first amendment such a fee would have been unconstitutional because it would be a direct burden on interstate commerce. However, the Court concludes that the twenty-first amendment which prohibited the transportation or importation of intoxicating liquors into any State in violation of the laws thereof abrogated the right to import free, so far as concerns intoxicating liquors, and gave the State the right to levy a fee upon the importation of intoxicating liquors.

⁴Decided on Nov. 9, 1936.

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