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Comments and Casenotes

INTERGOVERNMENTAL TAX IMMUNITY—LIABILITY OF FEDERAL GOVERNMENTAL EMPLOYEES TO STATE INCOME TAX

*Graves v. People of State of New York, ex rel O'Keefe*¹

The State of New York imposed an income tax on the salary of the respondent, a resident of the State employed as an examining attorney by the Home Owners' Loan Corporation, an agency of the United States government. The State Tax Commissioners rejected the respondent's claim for a refund, based on the contention that his salary was constitutionally exempt from State taxation, in that the Home Owners' Loan Corporation was an instrumentality of the United States and that he was necessarily performing an essential governmental function. On the authority of *New York ex rel. Rogers v. Graves*,² this action of the State Tax Commissioners was set aside by the Appellate Division of the New York Supreme Court,³ which was later affirmed by the New York Court of Appeals.⁴ On certiorari, *held* (two justices dissenting): Reversed. A non-discriminatory State income tax on salaries of Federal governmental employees imposes no unconstitutional burden on the performance of governmental functions by the Federal government, in the absence of any contrary intimation by Congress; any effect is the normal incident of our dual system of government and one which the Constitution presupposes.

The decision overrules almost a century of precedent, the tax immunity of governmental employees having been first laid down in 1842 in *Dobbins v. Erie County*⁵ and applied as late as 1937 in *New York ex rel. Rogers v. Graves*⁶ and *Brush v. Commissioner*.⁷ It was rather clearly indi-

¹ 59 S. Ct. 595 (U. S. 1939).

² 299 U. S. 401, 57 S. Ct. 209, 81 L. Ed. 306 (1937). It was held that, where the United States is the sole owner of a railroad carrying private freight and passengers only as an incident to governmental operations, the officers and employees of such railroad were not subject to a State income tax on their salaries.

³ 253 App. Div. 91, 1 N. Y. Supp. (2nd) 195 (1937).

⁴ 278 N. Y. 691, 16 N. E. (2nd) 404 (1938).

⁵ 16 Pet. 435, 10 L. Ed. 1022 (1842).

⁶ *Supra* n. 2.

⁷ 300 U. S. 352, 57 S. Ct. 495, 81 L. Ed. 691 (1937).

cated last year, however, by the decision in *Helvering v. Gerhardt*,⁸ as well as by a line of cases narrowing the field of intergovernmental tax immunity,⁹ that a change in existing doctrine was imminent, although it was possible to speculate as to the nature of such change, in view of the refusal of the Court at that time to over-rule specifically *Collector v. Day*,¹⁰ in which the doctrine of reciprocal tax immunity was first specifically declared. A similar development has occurred in both Canada and Australia, where there existed a constitutional basis for intergovernmental tax immunity similar in broad outline to that under the United States Constitution,¹¹ and this apparently was not without its persuasive effect upon the Court in the instant case.¹²

While the case was immediately concerned only with the question of State taxation of salaries of Federal employees, the decision goes further than this and the opportunity was seized to restate the entire doctrine of intergovernmental tax immunity in an attempt to bring order into the chaos and confusion presented by prior decisions. There can be no doubt that *Collector v. Day* and other cases giving immunity to State employees against Federal taxation have been overruled. No longer will it be necessary to ponder nice questions as to whether a particular individual is a governmental employee or merely an independent contractor. There would seem to be little doubt that a similar fate impends for the line of cases giving tax exemption in sales to both State and Federal governments.¹³

⁸ 304 U. S. 405, 58 S. Ct. 969, 82 L. Ed. 1427 (1938).

⁹ See *James v. Dravo Contracting Company*, 302 U. S. 134, 58 S. Ct. 208, 82 L. Ed. 155 (1937); *Helvering v. Therrell*, 303 U. S. 218, 58 S. Ct. 539, 82 L. Ed. 758 (1938); *Helvering v. Mountain Producers Corporation*, 303 U. S. 376, 58 S. Ct. 623, 82 L. Ed. 907 (1938).

¹⁰ 11 Wall. 113, 20 L. Ed. 122 (U. S. 1870).

¹¹ See, as to Canada, *Leprohon v. City of Ottawa*, 2 Ont. App. 522 (1878); *Abbott v. City of St. John*, 40 Can. Sup. Ct. 597 (1908); *Caron v. The King*, (1924) A. C. 999. As to Australia, see *D'Emden v. Pedder*, 1 C. L. R. 91 (1904); *Deakin v. Webb*, 1 C. L. R. 585 (1905); *Webb v. Outrim*, (1907) A. C. 81; *Amalgamated Society of Engineers v. Adelaide S.S. Co.*, 28 C. L. R. 129 (1920); *West v. Commissioner of Taxation*, 56 C. L. R. 657 (1937).

¹² See the concurring opinion of Mr. Justice Frankfurter, 59 S. Ct. 602, 603.

¹³ As, e. g., *Panhandle Oil Co. v. State of Mississippi, ex rel. Knox*, 277 U. S. 218, 48 S. Ct. 451, 72 L. Ed. 857 (1928); *Indian Motorcycle Co. v. United States*, 283 U. S. 570, 51 S. Ct. 601, 75 L. Ed. 1277 (1931); *Graves v. Texas Company*, 298 U. S. 393, 56 S. Ct. 818, 80 L. Ed. 1236 (1936). In *Helvering v. Gerhardt*, *supra* n. 8, it was intimated strongly that the effect of such taxes on the performance of a governmental function did not differ from the effect of a tax on salaries of government employees.

As restated, the doctrine becomes in all cases a question of economic incidence; with reference to both State and Federal governments, it is made to rest entirely upon whether, in a given case, a substantial burden is imposed upon the ability of either government to perform any function which it has the power to undertake. And, whereas heretofore in certain cases the existence of such a burden has been presupposed,¹⁴ one attacking the applicability of a tax on such grounds must now show affirmatively an actual and substantial burdensome effect upon the performance of governmental functions. For the famous dictum of Chief Justice Marshall in *McCulloch v. Maryland*¹⁵ that "the power to tax involves the power to destroy", there is substituted that of Mr. Justice Holmes in his dissent in the *Panhandle Oil Company* case¹⁶ that "the power to tax is not the power to destroy while this Court sits".¹⁷ Intergovernmental immunity has now become a question of degree in all cases.

Viewed simply from the standpoint of doctrinaire theory, the restatement of the doctrine has followed logical lines. Intergovernmental immunity from taxation necessarily interferes with the ability of both Federal and State governments to exercise—the one a granted, the other a reserved power—necessary to the existence of each. If there is to be implied such a constitutional limitation upon the exercise of the power by either, it can properly be so only because the restriction is also necessary to the existence of each and to the protection of each in its ability to perform the governmental functions allocated to it. It follows that such a limitation should only obtain in cases where the exercise of the taxing power by one government would appreciably and demonstrably interfere with the other's performance of duties imposed upon the latter by our system of government. Little quarrel can be found with the Court's conclusion in the instant case that a non-discriminatory tax on salaries of governmental employees

¹⁴ Cf. *Metcalf and Eddy v. Mitchell*, 269 U. S. 514, 46 S. Ct. 172, 70 L. Ed. 384 (1926). Here Mr. Justice Stone, who also wrote the opinion in the instant case, said: "This court has repeatedly held that those agencies through which either government immediately and directly exercises its sovereign powers, are immune from the taxing power of the other."

¹⁵ 4 Wheat. 316, 4 L. Ed. 579 (U. S. 1819).

¹⁶ *Supra* n. 13.

¹⁷ Quoted with approval by Mr. Justice Frankfurter in his concurring opinion in the instant case, as having "brushed away" the "web of unreality spun from Marshall's famous dictum".

would not appreciably interfere with the activities of the employing government.

From the standpoint of practical administration of government, however, the substitution of such an elastic standard seems likely to present serious difficulties of application, with which it may be doubted whether the Courts are equipped to deal satisfactorily. It seems to be implicit in the opinion that a discriminatory tax would be unconstitutional; but whether a non-discriminatory tax could yet be so burdensome as to make it inapplicable to governmental agencies, and if so, how to test the degree of burden, are questions which remain unanswered. It by no means follows necessarily from the present decision, for example, that governmental securities and interest received therefrom are no longer entitled to the immunity to which they have been heretofore held entitled.¹⁸ This and other such questions will depend for their answer upon the extent to which in any given case the Supreme Court will regard a tax as impeding unduly the exercise of governmental powers. As to this, there may well be present validity in Marshall's words in *McCulloch v. Maryland*,¹⁹ where he speaks of the "perplexing inquiry, so unfit for the judicial department, what degree of taxation is the legitimate use and what degree may amount to the abuse of the power".

The decision recognizes that Congress, at least, may, as incidental to the power to create Federal governmental agencies, by express language grant them immunity from State taxation, to an extent which the Court declares it unnecessary at present to state. This was also suggested in *James v. Dravo Contracting Company*.²⁰ The question at once arises as to whether any limitations exist on this power, or whether the determination of Congress, that such immunity is necessary to the proper functioning of the agency, would bind the Courts, as presenting a political rather than a judicial question.²¹ Only recently, a grant of such immunity by Congress has been held effectual to prevent subjection of a Federal agency to the Maryland recording tax.^{21a} Though it was not specifically stated

¹⁸ *Weston v. City Council of Charleston*, 2 Pet. 449, 7 L. Ed. 481 (1829); *Pollock v. Farmers' Loan & Trust Company*, 158 U. S. 601, 15 S. Ct. 912, 39 L. Ed. 1108 (1895).

¹⁹ *Supra* n. 15.

²⁰ 302 U. S. 134, 58 S. Ct. 208, 82 L. Ed. 155 (1937).

²¹ Cf. the reasoning in *Coleman v. Miller*, 59 S. Ct. 972 (U. S. 1939), which would seem quite applicable.

^{21a} *Pittman v. Home Owners' Loan Corporation* (decided Nov. 6, 1939) 7 U. S. Law Wk. 503.

that Congress could grant an immunity greater in extent than the Constitutional immunity, this nevertheless seems the result of the decision; the tax involved was non-discriminatory, and in itself, apart from the Congressional declaration, would not have seemed unduly or even appreciably burdensome with respect to the functioning of the Federal governmental agent.

Of possibly equal significance with the actual result in the instant case, is the refusal of the Court to reach it through the reasoning urged by the New York Tax Commissioners. The latter had argued that the rule refusing immunity to State agencies performing non-governmental functions²² should be extended to the Federal government and that such agencies as the HOLC should be regarded as non-governmental in character. While it has been urged by a few authorities, including the Maryland Court of Appeals,²³ that the rule was applicable to both State and Federal governments, the question has never before been directly discussed by the Supreme Court. In the present case, it is stated flatly that, since the Federal government is one of delegated powers, "its every action within its constitutional power is governmental action" and that all activities constitutionally authorized by Congress must stand on a parity with respect to their constitutional immunity from taxation.

It is at least possible that this may presage eventual abandonment of the "governmental function" test as applied to the State governments also, and that the entire question may become one of the degree of interference with governmental performance of any activity. Cases refusing immunity to State agencies on the ground of non-governmental functioning, can readily be fitted into the broader rule; and in fact the most recent of these seems to be in part so reasoned.²⁴ The confusion and illogicality resulting from the attempt to distinguish between governmental and proprietary activities would be thus avoided.

²² See *South Carolina v. United States*, 199 U. S. 437, 26 S. Ct. 110, 50 L. Ed. 261 (1905); *Helvering v. Powers*, 293 U. S. 214, 55 S. Ct. 171, 79 L. Ed. 291 (1934).

²³ *State Tax Commission v. Baltimore National Bank*, 169 Md. 65, 180 A. 260 (1935), affirmed on other grounds, 297 U. S. 209, 56 S. Ct. 417, 80 L. Ed. 586 (1936).

²⁴ *Allen v. Regents of University System of Georgia*, 304 U. S. 439, 58 S. Ct. 980, 82 L. Ed. 1448 (1938).