

1947

Taxation: Scope of Exemption in Railroad Charter

Gordon Samuelson

Follow this and additional works at: <https://scholarship.law.marquette.edu/mulr>



Part of the [Law Commons](#)

Repository Citation

Gordon Samuelson, *Taxation: Scope of Exemption in Railroad Charter*, 31 Marq. L. Rev. 186 (1947).
Available at: <https://scholarship.law.marquette.edu/mulr/vol31/iss2/13>

This Article is brought to you for free and open access by the Journals at Marquette Law Scholarly Commons. It has been accepted for inclusion in Marquette Law Review by an authorized editor of Marquette Law Scholarly Commons. For more information, please contact megan.obrien@marquette.edu.

Taxation—Scope of Exemption in Railroad Charter—To encourage railroad building, the State of Georgia in 1833 chartered a corporation (now the Georgia Railroad and Banking Company), granting the railroad partial immunity from taxation. The exemption provision in the charter read: "The stock of said company and its branches . . . shall be subject to a tax not exceeding one half per cent per annum on the net proceeds of their investments".¹ A state tax of 5½ per cent on the net income of all domestic and foreign corporations was imposed in 1931. Not until the years 1941, 1942, and 1943, did the State Revenue Commissioner assess deficiency taxes at the 5½ per cent rate against the Atlantic Coast Line Railroad Company, the corporation's lessee. It resisted on the ground that this income tax impaired the obligation of the contract arising by reason of the exemption in the charter. *Held*: The partial exemption, although measured by the income from the railroad property, extended only to a tax on the property; and had no application to what is today known as a corporate net income tax, so that the 1833 legislature had not bargained away the state's power to impose an income tax. *Atlantic Coast Line Railroad Company v. Phillips*, 67 S. Ct. 1584 (1947).

This holding of the Supreme Court of the United States affirmed the decision of the Supreme Court of Georgia.² The judicial history of the charter tax exemption here involved is a lengthy one, reaching back about seventy-five years. Confirmation of its validity and that of similar special exemptions to railroads has been made repeatedly by the courts.³

Conceding that the state court's ruling that the income tax is valid was not conclusive where it is claimed the Federal Constitution is violated, the Court declared that it would not set aside the state court's interpretation unless it was "manifestly wrong." This principle may well be considered as decisive, being the legal tenet upon which the Court prefers to place the onus of its judgment. In a few of the numerous unsuccessful attacks upon the exemption by the state in its search for added revenue, the federal courts took occasion to construe the tax as one upon net income.⁴ These cases are distinguishable from the present dispute because the reference to "income" in them was incidental, property taxes being the subject of discussion. The concluding words of the instant opinion reiterate, "In any event, these phrases leave untouched our duty to respect the judgment of a state court as to the fair intentment of an exemption." So the rule

¹ Section 15, Act of December 21, 1833, Acts 1833 p. 256, 263-264.

² *Thompson v. Atlantic Coast Line R. Co.*, 200 Ga. 856, 38 S.E. 2d 774 (1946).

³ 64 A.L.R. 1218n. (1930).

⁴ *Wright v. Georgia R. & Banking Co.*, 216 U.S. 420, 30 S.Ct. 242, 54 L. Ed. 544 (1910); *Wright v. Louisville and Nashville R. Co.*, 236 U.S. 687, 35 S. Ct. 675, 59 L. Ed. 788 (1915); *Georgia R. & Banking Co. v. Wright*, 132 F. 912 (1904).

may safely be put that the Supreme Court will follow the state court's construction of a tax exemption contract if its decision is reasonable and does not conflict with the plain language of the act granting immunity. Reason proclaims the state court as best able to construe the legislation of its own state.

In arguing that the contract clause of the United States Constitution had been violated, the Atlantic Coast Line Railroad Company relied upon sound stratagem. The Georgia court was compelled to admit the existence of a binding contract. The charter was granted before constitutional restrictions had been imposed upon the power of the state legislature to grant tax exemptions. No power had been reserved to alter or repeal general laws or special acts of the legislature relating to corporations. The State Revenue Commissioner contended that the 1833 legislature could not make a valid contract of the kind here involved, since it lacked authority to bargain away the sovereign power of the state.

“But it is now well established that whenever the legislature of a state has power to grant an exemption from taxation it may enter into a binding contract that the property shall be exempt from taxation forever or for a definite term and that a grant of exemption made for a valuable consideration is a contract within the provision of the Federal Constitution forbidding the enactment by any state of any law impairing the obligation of contracts”.⁵

Acceptance of the charter by the railroad and the assumption by it of the obligation to perform public service as specified in the charter is sufficient consideration to support the contract.⁶

After admitting a valid contract existed, the Georgia Supreme Court applied two basic canons of construction to it in deciding that the only taxes barred were further levies on the railroad property. The Supreme Court now certifies its approval of the logic and conclusions of the local court. First, the exemption is to be given a “meaning that at a particular time and place and in the setting of a particular statute might reasonably have acceptance by men of common understanding”.⁷ Collection of an income tax couldn't result in an impairment of the railroad's contract because Georgia had no general income tax law when the exemption was granted.⁸ And since income taxes were then unheard of, the 1833 legislature couldn't have intended the one half of one per cent tax to be assessed as an income tax. The charter provision therefore could not bar an assessment

⁵ 26 R.C.L. 264, p. 300 (1920).

⁶ 60 L.R.A. 53n. (1903).

⁷ *Hale v. Iowa State Board of Assessment and Review*, 302 U.S. 95, 58 S.Ct. 102, 82 L.Ed. 72 (1937).

⁸ Kennan, *Income Taxation* pp. 209, 210 (1910).

under an income tax law passed a century later. Especially not, when it is realized that the practice of assessing property by its earning power rather than by its exchange value was sometimes done both before and after the time when the charter here was granted.⁹ Secondly, a legislative grant of exemption from taxation will be strictly construed by the courts.¹⁰ A contract restraining the taxing power must be subjected to the most rigid scrutiny and will not be permitted to stand either in scope or duration beyond what the terms of the exemption clearly demand. Nor does the failure of the State Revenue Commissioner to assess deficiency taxes against the railroad until ten years after the income tax statute was passed raise an inference that an exemption from such tax was recognized or intended.¹¹ There can be no presumption that a broad exemption was intended. As the Court here says, "The potential needs of all governmental powers, and fairness in the distribution of burdens or in the enjoyment of privileges precludes such an assumption." It is pointed out that the state may go far in restricting its own power to tax without actually granting tax immunity, just as the taxpayer has a correlative right of tax avoidance to a limit short of breach of the law.

This case appears to be the culmination of a prolonged struggle by the state to preserve its right to tax an exempt corporation by one means or another. When ambiguity is found in the grant of certain exemption from taxation, the contract will be given the "narrowest rational reading" by the state court and its decision will be upheld on appeal to the Supreme Court of the United States if no manifest wrong will result. The power of a state government to tax will be jealously protected since such power is essential to the promotion of the public good.

GORDON SAMUELSEN

⁹ Seligman, *The Income Tax* (2d Ed.) pp. 382, 383.

¹⁰ 61 C.J. 396, pp. 392-397; *West Wisconsin R. Co. v. Board of Sup'rs Trempealeau County*, 93 U.S. 595, 23 L.Ed. 814 (1876), affirming 35 Wis. 257 (1874).

¹¹ *Bailey v. Magwire*, 22 Wall. 215, 89 U.S. 215, 22 L.Ed. 850 (1874); *Vicksburg, etc. R. Co. v. Dennis*, 116 U.S. 665, 6 S.Ct. 625, 29 L.Ed. 770 (1886).