Inter-Governmental Immunities from Taxation

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INTER-GOVERNMENTAL IMMUNITIES FROM TAXATION

The doctrine of inter-governmental immunities from taxation had its origin in 1819 in the decision of *McCullough v. Maryland.* There Chief Justice Marshall not only decided that a discriminatory state tax upon a federal instrumentality was void, but added that a non-discriminatory state tax of the same character would likewise be void, since the state wholly lacked the power to tax a federal instrumentality. The doctrine of *McCullough v. Maryland* was next extended to include a non-discriminatory state tax upon the income of a federal officer or employee in *Dobbins v. Commissioners of Erie County.* Collector v. *Day* established a complete reciprocity of immunities, for it state officers and employees were immune from federal taxation. Collector v. *Day* also recognized the equality of national and state governments in their respective spheres, although this rationale was inconsistent with the basis upon which Chief Justice Marshall put *McCullough v. Maryland,* that the federal government was superior to that of the states. The doctrine of inter-governmental immunities is based on the theory that it is necessary for the protection of the national and state governments in their respective spheres under our constitutional system, and that it is necessary for the maintenance of our dual system of government.

This wholesale withdrawal of subjects from federal taxation was curbed to some extent by the decision in *South Carolina v. United

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1 4 Wheat. (U.S.) 316, 4 L.ed. 579 (1819). A discriminatory tax by the state of Maryland upon national banks for the privilege of issuing bank notes was held unconstitutional, since it impeded the national government in the exercise of its implied constitutional power to maintain a bank.

2 "We find, then, on just theory, a total failure of this original right to tax the means employed by the government of the Union, for the execution of its powers." *McCullough v. Maryland,* 4 Wheat. (U.S.) 316, 430, 4 L.ed. 579, 607 (1819).


4 411 Wall. (U.S.) 113, 29 L.ed. 122 (1871). It was held that Day, a state probate judge, was in the same position as Dobbins in *Dobbins v. Commissioners of Erie County,* 16 Pet. (U.S.) 435, 10 L.ed. 1022 (1842), supra, note 3.

5 Indian Motorcycle Co. v. United States, 283 U.S. 570, 51 Sup. Ct. 601, 75 L.ed. 1277 (1931) held that the federal government was without the power to tax the sale of a motorcycle to a municipal corporation which was to be used by its police force. The salary of counsel for the public service commission of the state was held immune from federal taxation. *Burnet v. Livezey,* 48 F. (2d) 159 (C.C.A. 4th, 1931).

6 The strength of Marshall's contention persisted even until one year before the decision in *Collector v. Day,* 4 Wheat. (U.S.) 316, supra, note 1, in the decision of *Veazie Bank v. Fenno,* 8 Wall. (U.S.) 533, 19 L.ed. 482 (1870).
States, in which it was decided that the immunity of state instrumentalities from national taxation was limited to those functions which were of a "strictly governmental" character, and did not extend to those which were used by the state in carrying on a private business. This decision, therefore, destroyed the immunity of functions carried on by the state governments in their corporate or proprietary capacities, so that the instrumentalities themselves and the incomes derived therefrom by the state officers and employees were no longer immune from national taxation. Whether the converse of the rule in South Carolina v. United States has application, has not been decided. In theory, the rule cannot be extended to federal instrumentalities, since the federal government is one of delegated powers. Therefore, the federal government could constitutionally create only those instrumentalities whose purposes would have to be "essentially governmental." Actually, however, Congress has created instrumentalities which conduct businesses very similar to those conducted by private enterprise. If the court should find that federal proprietary instrumentalities exist, there would seem to be no reason why the instrumentalities themselves and the salaries of the officers and employees thereof should be immune from state taxation under the doctrine of reciprocal immunities.

Although the doctrine of South Carolina v. United States modified to some extent the immunities from national taxation extended to state governmental functions by Collector v. Day, there still remained within the periphery of immunity the essential governmental functions of the states and as a corollary thereto, the income of the officers and employees thereof. The Supreme Court of the United States in Brush v. Commissioner decided that the salary of the chief engineer of the Bureau of Water Supply, City of New York, was immune from fed-

11 In Baltimore National Bank v. State Tax Commission, 297 U.S. 209, 80 L.ed. 586, 56 Sup. Ct. 125 (1936), the question was presented but the case was decided on other grounds.
12 The T. V. A., although it bases its constitutionality upon the federal power over navigation and conservation, and theoretically, at least, is not in the business of manufacturing and distributing power, is in fact as much of a trader as was the state of South Carolina in South Carolina v. United States, 199 U.S. 437, 50 L.ed. 261, 26 Sup. Ct. 110 (1905).
13 T. V. A., Federal Loan Banks, and Home Loan Banks conduct, more or less, private businesses.
14 300 U.S. 352, 81 L.ed. 691, 57 Sup. Ct. 495 (1937).
eral taxation because the water system conducted by the city is an “essential governmental”\(^{15}\) function. This decision is noteworthy because in two previous cases decided by the Supreme Court it was declared by way of illustration that the operation of a water system was a proprietary function.\(^{16}\) In *Brush v. Commissioner* the court refused to apply the tort rule for the determination of whether a function was essentially governmental or proprietary in taxation cases, because the objective of the tort rule was not the same as the objective in taxation cases.\(^{17}\) Whether the function was to be considered governmental or proprietary for taxation purposes was to be determined on the facts presented in each case by judicial “inclusion and exclusion.”\(^{18}\)

What functions the court considered essentially governmental can best be stated in their own words: “Certainly, the maintenance of schools, of a fire department, a system of sewers, parks, public buildings—to say nothing of other facilities and uses calls for the exercise of governmental functions.”\(^{19}\) *Brush v. Commissioner* and other cases\(^{20}\) decided about the same time demonstrate that the interpretation by the Court of “essential governmental functions” conferred immunity from federal taxation upon many subjects, which if taxed, would not burden the state in the exercise of its sovereign powers. That there was a need for revision, and that the Supreme Court of the United States was ready upon proper submission of the question to revise the doctrine of implied immunities was judicially hinted by Justices Stone and Cardozo in *Brush v. Commissioner*.\(^{21}\) In that case, although they voted with the majority, they did so only upon the ground that the taxpayer had brought himself within the terms of the exemption prescribed by the Treasury Department.\(^{22}\) Since the validity of the regulation making such exemption was not challenged by the government, no opinion was

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\(^{15}\) The Court declared that it was immaterial whether the function be denominated “usual governmental,” “essential governmental,” or “strictly governmental.” See supra note 9.


\(^{17}\) The rule adopted in tort cases was obviously formulated with the intent of preventing injustice by the recognition of a technical defense.


\(^{21}\) Brush v. Commissioner, 300 U.S. 352, 374, 81 L.Ed. 691, 701, 57 Sup.Ct. 495, 505 (1937).

\(^{22}\) The regulation exempted from the federal income tax the compensation of state employees received for services rendered in connection with the exercise of an essential governmental function.
expressed as to the need for the revision of the doctrine of implied immunities as declared in earlier decisions. Heeding the intimation, the Treasury Department amended the regulation so as to open the way for the government to argue the revision of the doctrine. An opportunity presented itself in the case of Helvering v. Gerhardt. Unfortunately, the facts of the case did not present the issue squarely, because the case may be restricted to the holding that the taxpayers involved were not considered to be officers or employees of the state. The instrumentality involved in Helvering v. Gerhardt was the Port Authority, a bi-state corporation created by compact between New York and New Jersey and approved by Congress; it was organized to coordinate transportation facilities and to reduce traffic congestion. The Court said that the functions of this instrumentality were not necessary to the preservation of the state government. The language of the case is strong enough to indicate that a contrary result would be reached if the Brush case were to be litigated again. The indication is that a tax laid on the income of an officer or an employee of an essential governmental function is not immune when the burden upon the state because of the tax is merely speculative, and the tax will in all probability, substantially or entirely, be absorbed by private persons. The language and rationale of the decision is such as to suggest that constitutional immunity from federal taxation of incomes now only extends to those derived from functions necessary to the preservation of the state government as such. This is tantamount to saying that the implied constitutional immunity now exists only as to income derived from exclusively governmental functions, viz. the maintenance of its executive, legislative, and judicial branches.

The court in Helvering v. Gerhardt was very careful in recognizing the distinction between the immunity of the states and the immunity of the national government, so that there is no reason to believe that the doctrine of the immunity of federal instrumentalities from state taxation as laid down in McCullough v. Maryland will be abrogated. It is interesting to note in concluding that while the doctrine of McCullough v. Maryland has been challenged it still stands as potent as ever; while the doctrine of Collector v. Day, its reciprocal in the doctrine of inter-governmental immunities, has been narrowly limited to the very point it decided, viz. the immunity of the salary of a state judicial officer from federal taxation.

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23 The regulation was changed so as to give exemption only to the compensation received by state employees which was immune from taxation under the constitution of the United States.

24 58 Sup. Ct. 969 (1938).

25 Ibid.

26 Supra note 1.

27 Supra note 4.