

Constitutional Law - Federal Unemployment Insurance - Social Security Act

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CONSTITUTIONAL LAW—FEDERAL UNEMPLOYMENT INSURANCE—SOCIAL SECURITY ACT.—Within forty years the population of the United States has changed from one largely rural to one chiefly urban. This change has been accompanied by a tremendous growth in industrial activity. All population groups, urban and rural, have felt the effects of insecurity attendant to industrial changes and ills. The average man's position in society has become less secure. The family is no longer a self-sufficing unit. Individuals must live in the present and either do not or can not plan for the future. Local groups have been unable to respond to the demands of the indigent, the unfit and the aged. Single states have been generally unwilling to jeopardize their own industrial units by subjecting them to social burdens which their competitors in other states do not have to bear. The Social Security Act passed by Congress, and signed by the President on August 14, 1935,¹ was enacted to bring about nationwide, cooperative efforts among the states to meet these problems of economic insecurity. That part of the Act providing an incentive for state unemployment insurance laws will be discussed in this note.

The federal plan for unemployment insurance is contained in Titles III and IX of the Social Security Act. Title III provides for an annual appropriation of \$49,000,000 after June 30, 1936,² to be distributed in such amounts as the Social Security Board sees fit to states having unemployment insurance plans approved by the Board.³ Title IX levies on every employer of eight or more persons an excise tax equal to one per cent of his payroll during the year 1936, two per cent during the year 1937, and three per cent for the year 1938 and each year thereafter.⁴ However, an employer paying into an approved⁵ state plan may

¹ P.L. No. 271, 74th Congr., 1st Sess. (1935).

² Section 301.

³ Section 303 allows the Board to approve a state plan if it includes the following provisions: (1) such methods of administration as are found by the Board to be reasonably calculated to insure full payment of unemployment compensation when due; (2) payment of compensation solely through public employment offices in the state or such other agencies as the Board may approve; (3) opportunity for a fair hearing for all individuals whose claims for unemployment compensation are denied; (4) the payment of all money received in the unemployment fund of such state, immediately upon such receipt, to the Secretary of the Treasury and to the credit of the Unemployment Trust Fund established by Section 904; (5) expenditure of all money requisitioned by the state agency from the Unemployment Trust Fund, in the payment of unemployment compensation, exclusive of expenses of administration; (6) the making of such reports as the Board from time to time may require; and (7) making available upon request to any agency of the United States the name, address, etc., of each recipient of unemployment compensation.

⁴ Section 901.

⁵ It is interesting to note that the requirements under Section 903 differ from those set up by Section 303, thus lending an air of independence to each. Section 903 provides for approval if, (1) all compensation is paid through a state agency, (2) no compensation is payable until two years after contributions are required, (3) all money received is immediately paid over to the Unemployment Trust Fund, (4) compensation is not denied an otherwise eligible individual for refusing work under any of the following conditions: (a) if the position offered is vacant because of a labor dispute, (b) if the wages, hours, or other conditions of the work offered are substantially less favorable to the individual than those prevailing for similar work in the locality, (c) if, as a condition of employment, the individual would be required to join a company union or to resign from or refrain from joining any bona fide labor

credit his state payments against ninety per cent of his federal payroll tax. One of the requirements for approval of a state plan under Title IX is the payment by the state into the national treasury of all state taxes collected. The treasury will hold these funds in trust for withdrawal by the state to meet unemployment claims. It is thus to be noted that the federal government is not expected to distribute the unemployment benefits, but merely to award grants to states to aid them in the administration of their approved plans. The divorce of the appropriating and tax levying sections of the Act into separate titles and the treatment of each as though unrelated is an obvious legislative device to catalog each section under an undisputed federal power. Until the AAA decision⁶ the effectiveness of this subterfuge was a controversial question. The Agricultural Adjustment Act⁷ contained a similar division between tax and appropriation titles, and while the court looks to the intent of the whole, and does not consider the individual titles as parts of an omnibus bill, the condemnation of that Act was based on the fact that the tax was not a tax, but a part of a scheme to regulate agriculture, a purely local activity.⁸ The purpose of the unemployment insurance titles of the Social Security Act is not to regulate unemployment, but to guard the national treasury against the demands created by it. Therefore, the tax and the appropriation titles of the Act may be considered separately. The wide power of appropriation enjoyed by Congress is admitted.⁹ That Congress may have a double purpose in levying a tax does not make that tax invalid.¹⁰ And finally, it has been held that the set-off device allowing for deductions from federal assessments to the extent of state taxes paid is valid.¹¹ However, the controversies prompting most of these decisions can be fundamentally distinguished from the attacks on the Social Security Act.

In *Massachusetts v. Mellon*,¹² generally regarded as the leading case on the immunity of Congressional appropriations from judicial review, the appropriation in question was that authorized by the Sixty-seventh Congress in the popularly described Maternity Act.¹³ The Act provided for annual appropriations for five years to be divided by the Board set up by the Act among states which should submit an approved plan for spending the money. The characteristics of the Maternity Act were, first, a temporary underwriting by the federal government of state efforts to promote maternity welfare, and secondly, no direct loss to any particular state which should submit no plan for spending the proposed appropriation. On the other hand, the Social Security Act contemplates (1) perpetual grants, (2) a permanent federal controlling

organization, and (5) all the rights, privileges or immunities conferred by such law or by acts done pursuant thereto shall exist subject to the power of the legislature to amend or repeal such law at any time.

⁶ *United States v. Butler*, 56 Sup. Ct. 312, 80 L.ed. 287 (1936).

⁷ 48 STAT. 31 (1933), 7 U.S.C.A. 601 et seq. (1935).

⁸ *United States v. Butler*, 56 Sup. Ct. 312, 320, 80 L.ed. 287, 296 (1936).

⁹ *Field v. Clark*, 143 U.S. 649, 12 Sup. Ct. 495, 36 L.ed. 294 (1892); *United States v. Realty Company*, 164 U.S. 427, 16 Sup. Ct. 1120, 41 L.ed. 215 (1896); *Massachusetts v. Mellon*, 262 U.S. 447, 43 Sup. Ct. 597, 67 L.ed. 1078, (1923).

¹⁰ *United States v. Doremus*, 249 U.S. 86, 39 Sup. Ct. 214, 63 L.ed. 493 (1919).

¹¹ *Florida v. Mellon*, 273 U.S. 12, 47 Sup. Ct. 265, 71 L.ed. 511 (1927).

¹² *Massachusetts v. Mellon*, 262 U.S. 447, 43 Sup. Ct. 597, 67 L.ed. 1078 (1923).

¹³ 42 STAT. 224 (1921).

board, and (3) a forfeiture by the state of ninety per cent of the federal tax levied on its own citizens if no state plan is established.¹⁴ Thus it is not inconceivable that the Supreme Court should find that *Massachusetts v. Mellon* does not control it, and for this reason the Justices are free, for all practical purposes, to decide this feature of the Act according to their individual sociologic-economic philosophies.

It has been contended that the decisions of the Supreme Court in the *Child Labor Tax Case* and the Florida inheritance tax case set the standards to which the scheme of Title IX must conform. After making an unsuccessful attempt to bar the products of child labor from interstate commerce,¹⁵ Congress levied an excise tax on employers knowingly employing child labor.¹⁶ This was held invalid on the ground that it was in fact a penalty¹⁷ and not a regulatory measure. However, the inference is most apparent that even if the tax had not been based on *scienter*, the measure would have been held invalid as an invasion of the functions of the state.¹⁸ Congressional power over commerce is for the purpose of regulation only. It is to be noted that both attempts on the part of Congress to regulate child labor were held invalid because Congress could not bring them under the commerce clause, and there was no other means of assuming jurisdiction. In the second child labor case the Supreme Court distinguishes the tax from a justifiable one, the latter being within the jurisdiction of Congress both as to the *res* and the regulation of the *res*.¹⁹ The question that logically follows is whether unemployment insurance can be classified under a Congressional power extending both to the *res* and the regulation thereof, for example, the credit of the federal government. Should the answer be in the affirmative we can already hear the court refusing to go behind

¹⁴ How then can the following language used in the Mellon Case be quoted with any semblance of finality: "If Congress enacted it (the Maternity Act) with the ulterior purpose of tempting them (the states) to yield, that purpose may be frustrated by the simple expedient of not yielding"? *Massachusetts v. Mellon*, 262 U.S. 447, 482, 43 Sup. Ct. 596, 67 L.ed. 1078 (1923).

¹⁵ *Hawner v. Dagenhart*, 247 U.S. 251, 38 Sup. Ct. 529, 62 L.ed. 1101 (1918).

¹⁶ 40 STAT. 1057 (1919).

¹⁷ *Child Labor Tax Case*, 259 U.S. 20, 42 Sup. Ct. 449, 66 L.ed. 817 (1922), in which the court said, after analyzing the provisions of the Act, "In the light of these features of the act, a court must be blind not to see that the so-called tax is imposed to stop the employment of children within the age limits prescribed. Its prohibitory and regulatory effect and purpose are palpable."

¹⁸ *Child Labor Tax Case*, *supra*, note 17, at page 39, "The analogy to 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 the 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."

¹⁹ *Child Labor Tax Case*, *supra* note 17, at page 41, in speaking of *Veazie Bank v. Fenno*, 8 Wall. 533, 19 L.ed. 482 (1869), says, "It will be observed that the sole objection to the tax here was its excessive character. Nothing else appeared on the face of the act. *It was an increase of a tax admittedly legal to a higher rate and that was all.*" (Italics author's.)

the tax measure to determine whether or not regulation is the primary purpose of the Act.²⁰

Proponents of Title IX quite evidently had in mind the Florida inheritance tax case,²¹ for the Senate Report says that the tax offset device is modelled after the provision in the federal estate tax law under which a credit is allowed up to eighty per cent of the federal tax for amounts paid under state inheritance tax laws. However, the Florida case is distinguishable upon two grounds. In the first place, the offset provision of the federal estate tax law is not conditional upon the presence in the state inheritance tax law of certain federal requirements, whereas Title IX of the Social Security Act sets up criteria for state unemployment compensation laws.²² But in this regard the only necessary criterion for an inheritance tax offset is the amount of the state assessment, and that criterion was automatically taken care of by the eighty per cent offset provision in the federal act, whereas there must of necessity be at least some criteria set up in addition to the amount of contributions in order that a state plan actually be what it purports to be. In the second place, the Florida decision was apparently predicated upon the lack of ulterior motive in the federal estate tax in spite of the charge made in the brief for the State of Florida²³ that the tax was not passed for the purpose of raising revenue, but was directed primarily at the State of Florida. Such direction, however, did not appear on the fact of the Act, while the ulterior purpose of Title IX is clearly shown on its face. However, will the Supreme Court reject a measure (Title IX) productive of great revenue because it is frank in expressing that it has an additional purpose, namely, to encourage local legislation, after having sustained an arrant subterfuge (the federal estate tax) productive of practically no revenue, merely because it purported on its fact to be a revenue measure? The argument that Title IX creates no revenue for the support of the government ought not be given too much weight, literally, because proceeds from the general fund may very probably be available on "constitutional" grounds, and certainly on moral principles, for the relief of the unemployed. And, after all, is it not plausible that the offset provisions of the estate tax, as sustained in the Florida case, and Title IX of the Social Security Act be justified as attempts to avoid double taxation?

Speculation as to the Court's reaction to the scheme of Title IX has been stimulated by the recent decision in the "Triple A" case. There

²⁰ *United States v. Doremus*, 249 U.S. 86, 39 Sup. Ct. 214, 63 L.ed. 493 (1919).

But the real ground of distinction between the child labor tax and that levied under Title IX appears to be that the child labor tax was an obvious attempt by the Congress to legislate directly on a matter on which only the state can legislate constitutionally, whereas Title IX is merely an attempt by the Congress to make it worth the while of each state to enact effective legislation in a certain field, the details being left to the state. Or, it may be said that Title IX rewards states that adopt a genuine unemployment benefit plan by correspondingly decreasing the levies of the taxpayers of such states.

²¹ *Florida v. Mellon*, 273 U.S. 12, 47 Sup. Ct. 265, 71 L.ed. 511 (1927).

²² Section 903.

²³ *Florida v. Mellon*, *supra*, note 21, the court quotes (p. 14) this charge but failed to answer it. However the rule that an act cannot be declared invalid just because another motive than taxation, not shown on the face of the act, might have contributed to its passage, can be taken to overrule the charge by the State of Florida.

is language in the opinion which may well be taken to limit the decision to the facts of the case and to reserve the questions that will undoubtedly be raised under the unemployment insurance titles of the Social Security Act.²⁴ After criticizing the Agricultural Adjustment Act as a measure robbing Peter to pay Paul, the court concedes that such an 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.²⁵ Such language brings the Social Security Act squarely under the general welfare clause of the United States Constitution.²⁶ On the ground that the Agricultural Adjustment Act invades the powers of the states, the court in the *Butler* case avoids the issue of general welfare directly raised by the government. However, before leaving the subject, the court quotes from Mr. Justice Story's exposition on the Constitution to show that the powers of taxation and appropriation extend only to matters of national, as distinguished from local, welfare.²⁷ In the past few years, all the states have looked to Washington for aid in the handling of their staggering relief load. The national treasury has undergone an enormous strain in handling these demands. Can it, under these circumstances, be said that the providing for such relief is not identified with the national welfare? Is not the protection of the national credit from onslaughts of this type in furtherance of the general welfare? In the determination of this problem in the future, cannot the court take judicial notice of the extent of a "depression," whether it is localized or national, and thus protect the nation from any ill effect that might arise in the form of precedent if the Act under consideration is upheld?

It is therefore safe to say that: (1) Congressional action to protect the national treasury against the strain created by unemployment relief demands may come within the scope of the general welfare clause; (2) the grant-in-aid (Title III) and the conditions thereto attached are valid; and (3) the off-set provision is, in itself, defensible. The Act, as far as it goes, is constitutional, but it does not go far enough. As has been previously pointed out, unless a state inaugurates a plan for unemployment insurance that meets the conditions set forth in Titles III and IX, the entire federal tax paid by its citizens becomes part of the general fund of the federal government and there is no assurance that such tax will revert to the state in the form of relief as does that of the state which passes an approved plan. Furthermore, if a state adopts a plan that does not meet with the approval of the Social Security Board, the ninety percent set-off is forfeited even though the

²⁴ *United States v. Butler*, 56 Sup. Ct. 312, 322, 80 L.ed. 287, 299 (1936): "We are not here concerned with a conditional appropriation of money, nor with a provision that if certain conditions are not complied with the appropriation shall no longer be available. By the Agricultural Adjustment Act the amount of the tax is appropriated to be expended only in payment under contracts whereby the parties bind themselves to regulation by the federal government. There is an obvious difference between a statute stating the conditions upon which moneys shall be expended and one effective only upon the assumption of a contractual obligation to submit to a regulation which otherwise could not be enforced."

²⁵ *United States v. Butler*, 56 Sup. Ct. 312, 317, 80 L.ed. 287, 292 (1936).

²⁶ U.S. CONST. Art. I, § 8.

²⁷ I STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES (5th ed.) 673.

plan may adequately satisfy the needs of the state. The net result is that every state is compelled to adopt a plan modelled along the lines set forth in Titles III and IX and Congress is in effect legislating by remote control. It is suggested, however, that an amendment providing for the earmarking of the tax collected in states having no approved plan for general relief of unemployment hardships in those states be added to the Act. The grant-in-aid title would still be an effective inducement for state plans of the type desired and no state could protest on the ground of discrimination or compulsion.

JOHN L. WADDLETON.

CORPORATIONS—COMPENSATION OF PROMOTERS—FRAUD.—The problem of promoters is one which has long perplexed the courts of this country. There has been little uniformity of opinion on the matter, as is illustrated by the contrary decisions prevalent among the many existing cases. The controversy embraces a wide field of promotional and corporate problems, and though the issue can seldom be determined concerning a specific case without first reviewing the particular circumstances of the case in question, several broad principles have evolved which may serve to enlighten somewhat a consideration of the numerous difficulties which involve this problem.

It is now undisputed that the promoter performs a valuable service in the field of corporate finance. Possessed of a peculiar knowledge of industrial affairs he is able to judge with a fair degree of accuracy the potential possibilities of a proposed venture. He is acquainted with the materials required and their relative value. He is aware of the proper ratio which operating capital must bear to total assets. In these and numerous other matters he supplies the expert advice necessary to the organization of a well planned corporation.¹ That he is entitled to a fair compensation for this service is beyond dispute.² The problem is—How may this compensation be made legally? Under what plan may he be compensated, and what assurance is there that the selected arrangement will not be upset by the courts? If the compensation were a cash payment of an amount fairly estimated as the reasonable value of his services, there could be no question concerning its legality.³ But, as the newly formed corporation seldom has adequate cash resources to meet other than the urgent requirements of the business, the problem is rarely settled in so simple a manner. The device generally adopted has been one of awarding compensation by giving the promoter an interest in the corporation, either by way of par value stock, no par value stock, or stock purchase warrants. And this is where the parties run afoul of the law.⁴

¹ GERSTENBERG, FINANCIAL ORGANIZATION AND MANAGEMENT (1924) 415; LOUGH, CORPORATION FINANCE (1909) 156.

² *Mason v. Carrothers*, 105 Me. 392, 74 Atl. 1030 (1909); *Fitzpatrick v. O'Neil*, 43 Mont. 552, 118 Pac. 273 (1911); *United German Silver Co. v. Bronson*, 92 Conn. 266, 102 Atl. 647 (1917).

³ *Southern Hardwood Lumber Co. v. Scott*, 46 Ill. App. 285 (1892).

⁴ *Hebgen v. Koeffler*, 97 Wis. 313, 72 N. W. 745 (1897); *Franey v. Wauwatosa Park Co.*, 99 Wis. 40, 74 N.W. 548 (1898); *Pietsch v. Milbrath*, 123 Wis. 647, 101 N.W. 338 (1904); *Richland Oil Co. v. Morriss*, 108 Va. 288, 61 S.E. 762 (1908); *Mason v. Carrothers*, 105 Me. 392, 74 Atl. 1030 (1909).