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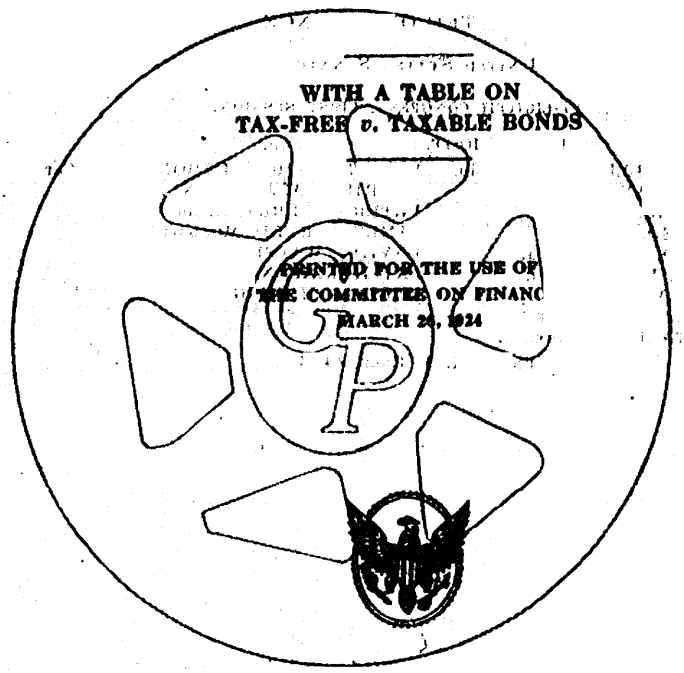
TAX-EXEMPT SECURITIES

LAW ARTICLES, OPINIONS, AND LETTERS IN RESPECT OF THE POWER OF CONGRESS TO TAX INCOME FROM STATE AND MUNICIPAL BONDS

WITH A TABLE ON
TAX-FREE *v.* TAXABLE BONDS



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UNITED STATES SENATE.

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CONSTITUTIONAL TAX EXEMPTION

THE POWER OF CONGRESS TO TAX INCOME FROM STATE AND MUNICIPAL BONDS

BY

EDWARD S. CORWIN

McCormick Professor of Jurisprudence, Princeton University

"What is needed is not further tinkering with the Constitution, but an Act of Congress assertive of its present powers."

SUPPLEMENT TO THE NATIONAL MUNICIPAL REVIEW
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"Aristocracy," wrote Chateaubriand, "has three stages: first, the age of force, from which it degenerates into the age of chivalry, and is finally extinguished in the age of vanity." The fact that there are between thirty and forty billions of privately held public securities in this country which are either partially or totally tax exempt [1] suggests that American aristocracy is rapidly achieving the second stage of its predestined cycle without, perhaps, having altogether left the first stage behind. Some ingenuity has been expended in certain quarters in an effort to show that the immunity of a considerable fraction of the wealth of the country from taxation makes no particular difference to anybody, an argument which, if valid, ought to hold, even though the fraction were increased indefinitely. Certainly, when we learn that the late Mr. William Rockefeller's estate of sixty-seven millions comprised some forty millions of tax-exempt bonds, we conclude that there was a reason; and we also recall the maxim *ex nihilo nihil*. If investors in tax-exempt securities derive a benefit from this type of investment somebody else pays—the question is who?

The actual operation of tax exemption in this country would seem to be somewhat as follows: The national government adopts a system of income taxation by which incomes are taxed at progressively higher rates. In order to escape the upper reaches of the tax, men of large income invest in tax-exempt securities, especially municipal and state bonds, the exemption of which is most nearly absolute. This in turn enables the states and municipalities to float securities on advantageous terms in comparison with private concerns. A saving is thus effected momentarily to the local taxpayer, but at his expense both as taxpayer to the national government and as consumer. For it is apparent that if the national government can not raise adequate revenue by progressive income taxation it must have recourse to other methods which bear more heavily on

[1] This amount includes nearly twenty-three billions of liberty bonds of the five issues, of which the first, of two billions, so far as it has not been converted, remains totally exempt from national taxation. Capital holdings of the succeeding issues, except the Victory Notes, have been exempt from the normal income tax in varying amounts, but not from the surtax; and since the expiration of the two-year period from the ratification of the treaty with Germany even this imperfect immunity has largely lapsed. Such holdings, however, still remain beyond the reach of the taxing power of the states for the most part, but whether this fact merits consideration in this connection would depend on factors which differ with each state.

the average citizen: and it is equally evident that if private producers have to pay higher rates of interest in order to obtain adequate capital, it is the consumer who ultimately foots the bill. Nor does the advantage of the local taxpayer continue indefinitely, since the easy terms upon which they find capital procurable offers an obvious temptation to borrowing on a large scale on the part of states and municipalities. Thus, whereas state and local bonds afloat in 1913 totalled less than four billions, they now total fourteen billions, some of which, it is permissible to hold, represent expenditures, which, if they should have been made at all, should have been made from current funds. So by one and the same system of tax evasion governmental extravagance is promoted, profitable business expansions is put at a disadvantage, the theory of progressive income taxation is undermined, and a tax-exempt aristocracy is created out of the wealthiest part of the community.[2]

Not all tax exemption rests primarily on constitutional grounds. When national securities are exempt from national taxation it is only because congress has so decreed, although once given its promise may possibly constitute a binding contract which may not be repudiated consistently with "due process of law." And the same is the case in a general way with the exemption of state and municipal securities from local taxation. Such exemption rests in the first instance on the will of the local legislature, but once it is accorded it becomes a contract whose obligation may not be impaired.[3] Exemptions which thus originate solely in legislative policy need not be further treated of in this article, our purpose being to investigate those doctrines of constitutional law which have been interpreted to require that exemption from taxation accompany the *issuance* of public securities. Thus it is held that national securities are from the moment of their issuance exempt for the most part from state taxation and that state and municipal securities are likewise exempt from national taxation. The two cases, however, are not, it would appear, in all respects parallel. On the one hand, the exemption rests in both cases on judicial reasoning rather than on any specific clause of the constitution; but, on the other hand, an important difference appears between the considerations which judges have treated as controlling in the two instances. For logical as well as chronological reasons the exemption of national securities from local taxation will be dealt with first.

I.

The judicial doctrine of tax exemption entered our constitutional jurisprudence through the famous decision in *McCulloch* v. *Maryland*,[4] in which in 1819 the supreme court set aside a tax by the state

[2] The market price of tax-exempt securities is such to-day as to tempt people of comparatively low incomes—from twenty to fifty thousand dollars per annum. This signifies, of course, that the very rich get their bonds cheaply, so much so, indeed, that while the income tax law pretends to levy surtaxes ranging as high as 68 per cent, the surtax above 31 per cent is virtually inoperative. See Professor R. M. Haig's article in the *North American Review* for last April. Professor Haig also makes the point that the incomes thus benefited are what Gladstone called "lazy" incomes, which thus seek safe investments, while the risk of developing new enterprises is thrust upon earned incomes. The best thought has always urged that earned incomes should be less heavily taxed than unearned.

[3] Article I, sec 10, par. 1.

[4] 4 Wheat. 316.

of Maryland on certain operations of a local branch of the Bank of the United States. The opinion of the court by Chief Justice Marshall brings forward at least four distinct, even though not clearly distinguished, grounds for the decision. In a phrase often quoted since, the Chief Justice defines the power to tax as involving "the power to destroy."

The inference is that the mere attempt to tax the bank represented a claim on Maryland's part to control or even to wipe out an instrumentality of a government which is supreme within its assigned sphere. But more than that, the opinion continues, while "the sovereignty of a state extends to everything which exists by its own authority or is introduced by its permission," the bank did not fall within this description. So, regardless of the supremacy of the national government, there was "on just theory" a "total failure" of power in the state to reach the bank through taxation. Nevertheless, at the very end of his opinion, Marshall concedes Maryland the right to tax the bank on its "real property . . . in common with other real property within the state," and also "the interest which the citizens of Maryland" held in the institution "in common with other property of the same description throughout the state"; and meantime he has answered an argument drawn by the state's attorneys from the *Federalist* with this observation: "The objections to the constitution which are noticed in these numbers were to the undefined power of the government to tax, not to *the incidental privilege of exempting its own measures from state taxation.*"[5] In other words, the exemption of the bank is thought of at this point as resting on the implied will of congress and therefore to be justified constitutionally as a measure "necessary and proper" for maintaining the full efficiency of the bank as an instrumentality of admitted national powers. In short, while the exemption of the bank from state taxation on its operations was clear, the precise reason for exemption was far from clear. This may have been due to the inherent scope of the taxing power, considered in relation to the supremacy of the national government within its proper field; or it may have been due to the inherent limits of the state's own sovereignty; or it may have been due to the discriminatory nature of the tax attempted in this instance, or finally, to the implied will of congress.

The question arises whether there is a necessary contradiction as between any two of these grounds of decision, or whether they may be considered as together constituting a harmonious whole. The strongest appearance of contradiction emerges from a comparison of the first and third grounds; for if the equal application of a tax to a species of property is guarantee against its abuse, why the proposition that "the power to tax involves the power to destroy"? And why should not any generally imposed tax be valid as to all property within the limits of a state? The answer seems to be that Marshall was trying to draw the line between the *bona fide* taxation by a state of *property* within its limits and an attempt by it to tax an *exercise* of national power within those limits—the former being allowable, the latter not. Yet why not? And here our attention is drawn to the juxtaposition of the first and fourth grounds of decision. Taken together the two grounds spell out the proposition

[5] The italics do not occur in the original.

that congress may always exempt instrumentalities of the national government from local taxation when it is "necessary and proper" for it to do so in order to assure the efficient operation of such instrumentalities. What then of the converse proposition, that where an exemption of national agency from state taxation exists, such exemption is to be deemed as resting in the first instance merely on the will of congress, express or implied, and not on constitutional considerations beyond the reach of congress? The fact is that no clear answer to this question can be gleaned from Marshall's decisions. In *Osborn* v. *the Bank*, he treats the exemption as resting on the will of congress;[6] in *Weston* v. *Charleston*, as implied in the constitution;[7] and subsequent decisions of the court disclose the same uncertainty.[8] Indeed, even when the will of congress is made the basis of exemption, there is still uncertainty as to whether taxation may be permitted in the silence of congress, or the implication of silence should be construed unfavorably to the state's claims.[9] It is submitted, however, that there is no sound reason why these uncertainties should be permitted to continue. With the remedy for any abuse by a state of its power over instrumentalities of the national government securely lodged in congress, there is not the least benefit to be anticipated from the supreme court's troubling itself with the extent of congress's concessions to the states in respect of the taxation of national instrumentalities. Such instrumentalities ought always to be subject to local taxation when they take the form of private property, while any effort of the local taxing power to single them out for special burdens would be void on the face of it. Both of which propositions are fairly implied in *McCulloch* v. *Maryland*.[9a]

II.

We now turn to that branch of the constitutional doctrine of tax exemption which restrains the national taxing power in relation to "means and instruments" of the states. At the outset we note an important difference in the operation of the doctrine in the two fields The principal local taxing power which is caught in the coils

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[6] 9 Wheat. 738. Marshall's language here is as follows: "The court adheres to its decision in the case of *McCulloch* v. *the State of Maryland*, and is of opinion that the act of the state of Ohio, which is certainly much more objectionable than that of the state of Maryland, is repugnant to *a law of the United States made in pursuance of the constitution, and, therefore void.*" (The italics do not appear in the original.)

[7] 2 Pet. 449.

[8] See *Van Allen* v. *Assessors*, 3 Wall. 573, in which was sustained the Act of June 3, 1864 (now ¶5219 of the Revised Statutes), whereby certain powers of taxation with reference to national banks were accorded the states; *Thomson* v. *Union Pacific R. Co.*, 9 Wall. 579; *Union Pacific R. Co.* v. *Peniston*, 18 Wall. 5; *Owensboro National Bank* v. *City of Owensboro*, 173 U. S. 664; *Home Savings Bank* v. *Des Moines*, 205 U. S. 503. In the last case J. Moody, speaking for the court, remarks: "It may well be doubted whether congress has the power to confer upon the state the right to tax obligations of the United States. However this may be, congress has never yet attempted to confer such a right." So the point has never been decided. In *Chaplin* v. *Comm'r*, 12 Com. L. R. 375 (Australia, 1911), the commonwealth was held to have the power to authorize state taxation of federal salaries, although such taxation had been previously held invalid without such authorization. Hall, *Cases on Constitutional Law*, p. 1288 ff. See also note 13 *infra*. If a citizen of one state owns bonds of another state, his own state may levy a tax thereon, as on other personal property the situs of which follows the owner. *Bonaparte* v. *Appeal Tax Court*, 104 U. S. 592. In other words, as between states, privately held public securities of state origin are treated as private property solely.

[9] Notes 6 and 8, *supra*.

[9a] See also the recently decided case of *First National Bank of San Jose* v. *Calif.*, decided June 4, last, and cases there cited, to show that the "dealings of national banks are subject to the operation of general and undiscriminating state laws which do not conflict with the letter or general object or purpose of congressional legislation affecting such banks."

of this doctrine is the power of taxing property directly—in other words, the general property tax, which is thereby disabled in the presence of private property which is viewable from another angle as still discharging a governmental function.

The national government on the other hand is, practically speaking, denied the power of directly taxing property by the unworkable rule of apportionment which the constitution lays down for such taxes.[10] The only kind of national taxation which is affected by the constitutional doctrine under review is consequently income taxation, which, whether it be "direct" or "indirect" in the constitutional sense is to-day relieved by the sixteenth amendment from the rule of apportionment; and the principal operation of the doctrine of tax exemption within the national field has been accordingly to relieve certain categories of *incomes* from national taxation, namely, those derived from state and municipal bonds and state official salaries. By the same token the extension of the doctrine of tax exemption into the field of national taxation incurs difficulties which it does not encounter in the other field. Both on the basis of what has just been said and for other reasons which will be manifest, these may be set down as follows: In the first place, in the case of the average property holder or income taker the burden represented by the general property tax is far greater than the burden of any probable income tax. To illustrate: A tax on income derived from a bond bearing interest at four per cent would have to be twenty-five per cent in order to equal in burden a one per cent property tax on the bond itself; but while the latter is a burden which any citizen may be called upon by the state to meet, the former is one exacted by the national government only of the wealthiest classes and is therefore one evasion of which is rendered possible and profitable only to the wealthy through the operation of the doctrine. In the second place, while it is not so unreasonable to regard a government bond even in the hands of the private purchaser as still an instrumentality of government, since it represents a continuing relationship between the government and the purchaser, to extend the same line of reasoning to income from the bond, the payment and receipt of which is a transaction over and done with once for all, involves a step by no means easy to follow.[11] In the third place, the difference between the national government as the government of all and any particular state as the government of only a section of the people should be taken into account in this connection. As Chief Justice Marshall pointed out in *McCulloch* v. *Maryland*: "The people of all the states and the states themselves are represented in congress," which, therefore, when it taxes a state institution is still taxing only its own constituents, whereas, "when a state taxes the operations of the government of the United States, it acts upon institutions created" by people not represented in the state legislative chambers. Finally, whereas, the principle of national supremacy, to which, as we have seen, the

[10] Article I, sec. 2, par. 3; sec. 9, par. 4.

[11] A similar distinction is developed by Marshall in *Weston* v. *Charleston*, *supra*, between state taxation of United States bonds and lands sold by the United States: "When lands are sold, no connection remains between the purchaser and the government. The lands purchased become a part of the mass of property in the country with no implied exemption from common burdens. . . . Lands sold are in the condition of money borrowed and repaid. Its liability to taxation in any form it may then assume is not questioned. The connection between the borrower and the lender is dissolved."

exemption of national means and instruments from state taxation was principally referred by Marshall, is a principle definitely embodied in the written constitution,[12] the theory upon which the doctrine of tax exemption was projected into the national field, rests entirely upon principles external to the written constitution, and, indeed, is logically contradictory of the principle of national supremacy.

The doctrine of tax exemption was first applied in restriction of the national power in 1871, in the case of *Collector* v. *Day*,[13] in which the sole question was whether a general income tax levied uniformly throughout the country could be exacted of a state judge on his official salary. Justice Nelson, speaking for the majority of the court, answered this question in the negative on the following line of reasoning: (1) That a judiciary was a requisite of that "republican form of government" which the United States was pledged by the constitution to maintain in every state; that "the power to tax involved the power to destroy"; (3) that the tax invaded the field reserved to the states by the tenth amendment. Rendered as it was near the close of the Reconstruction Period, during which congress had ridden rough shod over the most sacred pretensions of "State Sovereignty," the decision is easily explicable, especially when we bear in mind the constant solicitation to which the supreme court is always exposed to adopt the rôle of "savior of society"; but these are circumstances which can hardly justify the decision as a rule of law. Would it ever occur to "most people not lawyers"[14] that the republican form of government connotes the elevation of an official class above the common burdens of citizenship? Nor does the maxim that "the power to tax involves the power to destroy" seem particularly applicable to a situation in which its realization would carry with it the destruction of everybody's income. But not only was the court's invocation of the guaranty of a republican form of government extravagantly irrelevant to the actual facts before it, it was also technically unallowable; for the court has said repeatedly that it is not for itself but for congress to say what are the requisites of such a government, that this is "a political question."[15]

Justice Nelson's chief reliance, however, is upon "the reserved rights" of the states, recognized in the tenth amendment; but it does not seem on the whole to be better placed than on the other arguments just reviewed. He contends, in brief, that the right to establish and maintain a judicial department is an "original," "inherent," "reserved" power of a state, "never parted with, and as to which the supremacy" of the national government "does not exist," that "in respect to the reserved powers, the state is as sovereign and independent as the general government." Virginia had made the same argument half a century earlier, and with much better reason, in *Cohens* v. *Virginia*,[16] and had been answered, that as to the purposes of the Union the states are not sovereign but subordinate. Moreover, if the

[12] Article VI, par. 2.
[13] 11 Wall. 113. The decision was preceded by that in *Dobbins* v. *Comm'rs*, 16 Pet. 435, in which the court held the salaries of United States officials to be non-taxable by the states, on the ground that the immunity was *implied by the act of congress fixing such salaries*.
[14] The expression is J. Holmes's. See 252 U. S. 220.
[15] *Luther* v. *Borden*, 7 How. 1; *Pacific States T. and T. Co.* v. *Oregon*, 223 U. S. 118.
[16] 6 Wheat, 264. See also Justice Storey's opinion in *Martin* v. *Hunter's Lessee*, 1 Wheat. 304.

supremacy of the national government does not exist as to the reserved powers of the states, as to what powers does it exist? Modern constitutional law certainly lends Justice Nelson's logic small support. For if the reserved power of a state to establish courts can prevent the incidental operation of an otherwise constitutional tax of the national government, what is to be said of a tax levied upon a privilege granted by the state in the exercise also of powers indubitably reserved to it;[17] or of a direct invasion of the reserved power of a state in the regulation of local transportation?[18] Yet both these assertions of national power have been sustained within recent years. Furthermore, even though it be conceded that the power to maintain a judiciary is a reserved power of so peculiarly sacrosanct a character as to set limits to the operation of otherwise constitutional acts of the national government, yet it would remain to be shown that this reserved power comprised the further power of rendering immune from national taxation the salaries paid the state's judges and already in their pockets. Recent decisions do not tend to support such far-fetched theories of the incidence of taxation[19]—far-fetched and, as Dr. Johnson would have added, "not worth the fetching." For all which reasons the doctrine of *Collector* v. *Day* must to-day be regarded as obsolete; and the same, of course, must also be said of the extension of that doctrine in *Pollock* v. *The Farmers' Loan and Trust Company*[20] to incomes from state and municipal bonds. A special tax on such incomes would fail for vicious classification[21]—perhaps as not a tax at all;[22] but an otherwise constitutional tax cannot in logic or common sense be denied operation upon such incomes; and this would be so even if the sixteenth amendment had never become a part of the constitution.

III

The sixteenth 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.

It is understood that the purpose of this amendment was to overcome in whole or in part the effect of the supreme court's decision in *Pollock* v. *The Farmers' Loan and Trust Co.*,[23] but whether in whole or in part only is disputed. In this case the supreme court ruled, first, that incomes derived from property were "direct taxes" and leviable only by the method of apportion-

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[17] *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, sustaining a tax measured by net profits on the privilege of doing business as a corporation.

[18] The Shreveport Case, 234 U. S. 342; *Railroad Comm'n* v. *Chicago, B. & Q. R. Co.*, 257 U. S. 563.

[19] A tax on income, two-thirds of which was derived from export trade, is valid, notwithstanding the constitutional prohibition of a tax on 'articles exported from any state' (Article I, sec. 9, par. 5), *Peck and Co.* v. *Lowe*, 247 U. S. 165; also, a tax by a state on the profits of a company, though these were derived in large part from interstate commerce, *United States Glue Co.* v. *Oak Creek*, *ibid* 321; also, state and municipal bonds held by a decedent may be validly included in the net value of an estate upon the transfer of which the estate tax imposed by the Act of Sept. 8, 1916, is assessed, *Greiner* v. *Lucellyn*, 258 U. S. 384. Finally, by *New York* v. *Law*, decided Apr. 30, last, a tax on the income from a mortgage is not a tax on the mortgage itself within the sense of *a law exempting the mortgage from taxation*.

[20] 157 U. S. 429; 158 U. S. 601.

[21] See the dicta in *Brushaber* v. *Union Pacific R. Co.*, 240 U. S. 1; *Bell's Gap R. Co.* v. *Penna.*, 134 U. S. 232; *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540; and other cases.

[22] *Bailey* v. *Drexel Furniture Co.*, 259 U. S. 20; *Hill* v. *Wallace*, *ibid.* 44.

[23] See note 20, *supra*.

ment; and, secondly, as we have just noted, that incomes derived from state and municipal bonds were not subject to national taxation at all. The question with which we are concerned, therefore, is this: Does the sixteenth amendment overthrow both branches of this decision or only the first? Or, to put the issue a little more definitely: What is the force and effect of the phrase "from whatever source derived" in this context? Does it permit congress to tax all kinds of income without resort to apportionment, or does it merely permit congress to tax without resort to apportionment such incomes as were previously subject to national taxation?

Anterior to *Evans* v. *Gore*,[24] which was decided four years ago, and which receives special consideration farther along in this paper, the court, or justices speaking for it, had uttered a number of dicta which have been assumed to sustain the narrower view of the amendment. Thus in *Brushaber* v. *Union Pacific R. R. Co.*,[25] which was decided shortly after the amendment was added to the constitution, we find Chief Justice White declaring 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"—a view of the matter which he asserts shortly afterward to have been "settled" by the previous utterance.[26] And to the same effect is the language of Justice Pitney in the Stock Dividend Case.[27] "As repeatedly held, this [the sixteenth amendment] 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." This was the five-to-four decision, but meantime, in *Peck & Co.* v. *Lowe*,[28] Justice Van Devanter, speaking for a unanimous court, had reiterated the same proposition.

But now just what is this proposition? The present writer submits that it is neither more or less than the statement, evident on the face of it, that the sixteenth amendment does not authorize congress to tax without apportionment anything except incomes. Let it be considered what were the precise questions before the court in the two more important of these cases. In the Brushaber Case it was whether an income which had accrued since March 1, 1913, could be reached retroactively by a tax enacted the subsequent August, it being contended that the income had now become capital; while in the Stock Dividend Case the question was whether such a dividend was to be regarded as income in the hands of stockholders or merely as evidence of capital-holding. The former question was answered adversely to the taxpayer concerned, the latter favorably; but in both instances it was obviously proper for the court to clarify its position by stating the self-evident proposition offered above.[29]

On the other hand, interpret the statements above quoted as signifying that the amendment still leaves outstanding certain limitations on congress's power of income taxation, and what results? This, at least: That the supreme court is chargeable with having

[24] 253 U. S. 245.
[25] See note 21, *supra*.
[26] *The Baltic Mining Co.* v. *Stanton*, 240 U. S. 103.
[27] *Eisner* v. *Macomber*, 252 U. S. 189.
[28] Cited in note 19, *supra*.
[29] *The Peck & Co.* v. *Lowe* and *Baltic Mining Co.* v. *Stanton*, as in the Brushaber Case, the exertion of the national taxing power questioned was sustained independently of the sixteenth amendment.

"settled" by the mere process of heaping *obiter dictum* upon *obiter dictum* a most important question of constitutional power, which was not remotely involved in the cases before it, on which, so far as the published briefs of attorneys show, there was no argument worthy of mention, and in justification of its determination of which it condescended to utter not one word of proof, whether of law or of fact. That the supreme court has no authority "to pass abstract opinions upon the constitutionality of acts of congress" has been repeatedly stated by the court itself;[30] that it has no right to anticipate action by congress by affixing to the constitution a reading thereof not required in the determination of any question before it would seem to be even clearer. Respect for the court, if nothing else, forbids our attributing to it the intention of prejudging the interpretation of the sixteenth amendment unnecessarily. Instead, we should recall the maxim stated by Chief Justice Marshall and reiterated many times since: "It is a maxim not to be disregarded that general expressions in every opinion are to be taken in connection with the case in which those expressions are used. If they go beyond the case they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision."[31]

But it is insisted that in *Evans* v. *Gore*,[32] which followed the cases just reviewed, "the very point" here under consideration was presented and decided: is this so? The principal holding of that case was that a United States judge could not, consistently with the provision in article III of the constitution, that judges of the United States shall at stated times receive for their services a compensation "which shall not be diminished during their continuance in office," be subjected to a national income tax in respect of his official salary. Confronted with the argument that the sixteenth amendment must be deemed to have authorized such taxation notwithstanding the language of article III, the majority speaking through Justice Van Devanter said:

> The purpose of the amendment was to eliminate all occasion for such an apportionment because of the source from which the income came,—a change in no wise affecting the power to tax, but only the mode of exercising it. The message of the president recommending the adoption by congress of a joint resolution proposing the amendment, the debates on the resolution by which it was proposed, and the public appeals,—corresponding to those in the Federalist,—made to secure its ratification, leave no doubt on this point. . . .
>
> True, Governor Hughes of New York, in a message laying the amendment before the legislature of that state for ratification or rejection, expressed some apprehension lest it might be construed as extending the taxing power to income not taxable before; but his message promptly brought forth from statesmen who participated in proposing the amendment such convincing expositions of its purpose, as here stated, that the apprehension was effectively dispelled and ratification followed.
>
> 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.

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[30] See J. Sutherland's opinion in *Massachusetts* v. *Mellon*, decided June 4 last, and cases there cited.

[31] *Cohens* v. *Va.*, cited note 16, *supra*.

[32] Cited in note 24, *supra*.

That these words would have been regarded by the court when it uttered them as concluding the question under discussion in this paper may well be believed. Also, it must be said in fairness to the court that the conclusions stated by Justice Van Devanter rest to some extent on a consideration of the question of the scope of the amendment in the light both of fact and of argument. Nevertheless, I venture to challenge the conclusiveness of the facts brought forward by the court and also of the assumption, which I am willing to attribute to it, that the question before it involved the broader question of the status, in relation to the amendment, of incomes from state and municipal bonds and of the salaries of state officials; and let us first take up the question of fact.

IV.

As its citations go to prove, the court's chief reliance is upon arguments which were made by Senators Root and Borah after the amendment had been proposed by congress but before its ratification. On the other side, the court admits the contrary opinion of Mr. Hughes, then governor of New York, whose utterance, however, was but one of several of like tenor, as the following quotations show:

> It is to be borne in mind that this is not a mere statute to be construed in the light of constitutional restrictions, express or implied, but a proposed amendment to the constitution itself which, if ratified, will be in effect a grant to the Federal Government of the power which it defines. The comprehensive words "from whatever source derived," if taken in their natural sense, would include not only incomes from real and personal property, but also incomes derived from state and municipal securities.—Gov. Hughes of New York.
>
> Congress could, therefore, tax incomes from state and municipal bonds, and could exempt incomes so derived. Senators and congressmen being necessarily residents of the states and generally of the municipalities would not pass a law which would destroy through taxation the credit of their own state and their own municipality.—Gov. Gilchrist of Florida.
>
> The objection urged by Governor Hughes does not impress me as being a very substantial or effective one. If it is advisable upon broad grounds of public policy for the national government to subject incomes to taxation, it impresses me as a narrow or technical objection to oppose this amendment for the reason that it does not provide for an exemption of that portion of one' income derived from interest upon state and municipal bonds.—Gov. Hadley of Missouri.
>
> The income tax amendment to the constitution is broad enough to include a tax on incomes derived from the ownership of state and municipal bonds. —Gov. Burke of North Dakota.
>
> The language of the amendment is very broad, and injustice might easily occur unless congress should be careful in the exercise of the authority conferred upon congress by this amendment.—Go. Haskell of Oklahoma.
>
> Indeed it seems to me that if the words "from whatever source derived" would leave the amendment ambiguous as to its power to tax incomes from official salaries and from bonds of states and municipalities, the amendment ought to be opposed by whoever adheres to the democratic maxim of equality of laws, equality of privileges, and equality of burdens. . . . . It is impossible to conceive of any proposition more unfair and more antagonistic to the American idea of equality and the democratic principle of opposition to privilege, than an income tax so levied that it would divide the people of the United States into two classes.—Gov. Dix of New York, in his message to the Speaker urging him to press the amendment.

Here, in short, are six gubernatorial utterances made, some in protest against the amendment, some in its favor, but all to the

same effect, that the amendment would vest congress with the power to tax incomes from state and municipal bonds; while I have encountered but a single utterance from a like source which is clearly to the contrary effect. Yet despite these warnings, following these commendations, the amendment was ratified. And in this connection it should be noted that ratification by the pivotal state of New York followed upon the Dix message, not upon the attempted refutation of Governor Hughes.[33]

But let us consider the evidence which Justice Van Devanter adduces as to the intention of congress itself in proposing the amendment.[34] He first refers to President Taft's message of June 16, 1909, urging an amendment to the constitution which should confer "the power to levy an income tax without apportionment among the states in proportion to population." This clearly shows that the object which was foremost in the president's mind was to get rid of the rule of apportionment in income taxation; but clearly, too, it throws no light on the question of the proper construction of the very differently worded proposal which was finally adopted. In congress the ball was started rolling by Senator Brown of Nebraska, the day following the message. In its original form his proposal gave congress "power to lay and collect direct taxes on incomes without apportionment"; but when it emerged from the senate finance commitee eleven days later, it had assumed the shape of the present amendment. Why the change? It would, perhaps, be difficult to say: but the burden of explaining the change is certainly not on those who contend that it must have had some significance. Nor does the trend of the discussion leading up to the passage of the amendment, in either the senate or the house, strengthen the case for tax exemption. For the most part this dealt with political and historical matter which has no bearing on the present question; but it was interlarded with repeated references to the desirability of clothing the national government with the power to tax incomes effectively, both from the point of view of providing for possible emergencies and also from that of equitable taxation.

The resolution of proposal having been passed by the senate by a vote of 77 to 0, then went to the house, where it was voted by an overwhelming majority on July 28, and thereupon went to the states, with the result that congress now lost all control over it. Notwithstanding this, when nearly six months later Governor Hughes sent his message to the New York assembly criticizing the proposal, Senator Borah introduced a resolution asking the senate committee on the judiciary to report on the soundness of the Governor's views;

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[33] Of the foregoing quotations, the first five are taken from the *N. Y. Times* and *N. Y. World* of Jan. 7, 1910. The last is from the *Dix Papers* (1911), p. 533–541. The single hostile utterance referred to was that of Governor Noel of Mississippi, *Times*, Jan. 6. Governor Harmon of Ohio was content to leave the question to congress, whose members would never "pass a law that would cripple or destroy their states." *Ibid.* Governor Weeks of Connecticut, who was opposed to the amendment, congratulated Governor Hughes "upon the tone of his message." *Times*, Jan. 8. Governor Vessey of South Dakota is put down as agreeing with Governor Hughes in the *Literary Digest* of Jan. 15, p. 88. Senator Brown, author of the amendment, declared on the floor of the senate that "Alabama, Ohio, Virginia, New Jersey, and other states have governors who not only favor conferring the power, but favor the proposed amendment, which, if adopted, confers the power." *Congressional Record*, vol. 45, p. 2245. For many of these data I am indebted to Mr. Robert A. Mackay, Proctor Fellow in Politics, Princeton University.

[34] The evidence will be found in the following pages of the *Congressional Record*: vol. 44, pp. 1568–1570, 3384–3385 (President Taft's message), 3377, 3900, 4067, 4105–4121, 4389–4441; vol. 45, pp. 1694–1699 (Mr. Borah's speech) 2245–2247 (Senator Brown's views), 2539–2540 (Senator Root's letter to Mr. Davenport of the New York Senate).

and meantime proceeded to develop his own theory. In brief, his argument was this: It could not be the purpose of the clause "from whatever source derived" to vest congress with additional powers of taxation, since that power was already plenary. The argument is self-contradictory; for if its power of taxation was really plenary, what additional power of the kind was there with which to vest congress? But as an assertion of fact, the statement is merely preposterous, being "so far from the truth"—to borrow an expression of Mr. Chesterton's—"as to be exactly the opposite to it." How, then, is such an absurd statement in the mouth of a reputable public man to be explained? One explanation is to be found in Mr. Borah's quotation of a number of judicial dicta also asserting the plenitude of congress's power in respect of taxation. It does not seem to have occurred to him to notice that these dicta take their rise from a period long antecedent to *Collector* v. *Day* and *Pollock* v. *The Farmers' Loan and Trust Company*, the decisions in which they thus directly impugn.[35] Nor is his invocation of certain principles of "constitutional construction" pertinent unless he means to imply that these are beyond the reach of constitutional amendment, since unlike the original grant of power to congress "to lay and collect taxes," the sixteenth amendment does not employ general terms, but words which are most nicely adjusted to the legal problem to be met—a point which will become clear in a moment.

First and last, of the more than four hundred Members of Congress who voted to propose the sixteenth amendment, I have had brought to my notice utterances of just eight dealing with Governor Hughes's message. Senators Borah, Bailey, and Root dissented from the message, principally on the argument just examined. Senator Brown of Nebraska, the reputed author of the amendment, "agreed" with Mr. Borah, but was "willing to assume the contrary." Pointing out that no proposals had come to congress from any state calling for a modified proposal in consequence of Governor Hughes's message, he said: "It does not follow that the amendment should be rejected; on the contrary, it follows that it should be ratified. Because under that interpretation all the incomes would be treated alike." That "the man whose income arises from investments in state and municipal bonds should be exempt from the income tax," he continued, was "on the face of it" a proposition which did not commend itself. "It does not square with the doctrine of equal rights. It is hateful to every sense of justice. It cannot be defended in principle, nor can it be used successfully, in my judgment, to defeat the amendment." In short, Governor Hughes's view ought to be the correct one, whether it was or not, and was calculated furthermore to promote the ratification of the amendment. The house members referred to are on record only in press interviews. They are Mr. Payne of New York, who, as chairman of the ways and means committee, introduced the amendment into the house; Mr. Underwood of Alabama, leading Democratic member of the same committee, Mr. Walter Smith

[35] The original source of the doctrine of the plenitude of congress's power of taxation is *Hylton* v. *U. S.*, 3 Dall. 171 (1796). See also *Pac. Ins. Co.* v. *Soule*, 7 Wall. 433. The reiteration of the same doctrine in the Pollock Case, which is obviously to be taken in the Pickwickian sense, is to be accounted for by the anxiety of the court to demonstrate that it was not depriving congress of the power of income taxation by its holding that a tax on incomes from property was "direct." See Mr. Hubbard's telling criticism in his article on "The Sixteenth Amendment," in the *Harvard Law Review*, vol. 33, pp. 704–812.

of Iowa, and Mr. Sherley of Kentucky. All of them were inclined to think Mr. Hughes's interpretation the correct one, and that it was probably a good thing that such was the case. Does Justice Van Devanter really think that this evidence supports his conclusions as to the interpretation of the sixteenth amendment?[36]

V.

However, the question is not one of fact alone, but of mixed law and fact, so to say. Thus, it is a maxim which has been frequently applied by the court, that the constitution does not contain useless language.[37] But unless the phrase "from whatever source derived" has the operation which Mr. Hughes claimed for it, what operation does it have? Mr. Root sought to meet this difficulty by urging that the phrase in question was "introduced" in order to make it clear that incomes from property as well as those from personal service were meant to be covered by the amendment. The answer is obvious: the decision in the Pollock Case admits congress's right to tax the latter kind of incomes without apportionment; so Mr. Root's contention boils down to the proposition that notwithstanding its historical relation to the Pollock Case the amendment might have had no effect at all—might have been a work of supererogation—had not the phrase "from whatever source derived" been written into it!

A second suggested purpose of the clause may be disposed of just as summarily. This is to be found in Chief Justice White's opinion in the Brushaber Case and consists in the theory that it was the purpose of the amendment to classify all taxes on incomes as "indirect" by forbidding consideration of the source from which the incomes are derived. Unquestionably the amendment does forbid the consideration of the source of incomes in connection with their taxation; indeed, as we shall note in a moment, this is a fact of first importance in determining the amendment's true operation. But the notion that the amendment classifies all income taxes as "indirect" in the constitutional sense must to-day, in the light of what was said in *Eisner* v. *Macomber*, be abandoned; for it is there clearly implied that taxes on incomes derived from property are still to be considered as "direct," although the necessity for their apportionment is now at an end.[38]

The single application of the phrase that remains is, then, its literal application—the sixteenth amendment says that congress may tax incomes "from whatever source derived," and it means it! The phrase, moreover, was admirably chosen to strike at the very roots of the entire theory of tax exemption, which is that *because of their source* certain incomes ought to be considered not as private property but as instrumentalities of government. Henceforward such

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[36] The *N. Y. World*, Jan. 7, 1910.

[37] See *the Constitution of the U. S Annotated*, George Gordon Payne, Editor; Gov't Printing Office, 1923; at pages 45–46, and in cases there cited. The rule is directly applied in *Calder* v. *Bull*, 3 Dall. 386; and in a number of cases in which the term "due process of law" of the fifth amendment is compared with the same clause of the fourteenth amendment. See *Davidson* v. *N. O.*, 96 U. S. 97; *Hurtado* v. *Calif.*, 110 U. S. 516; etc.

[38] Chief Justice White offers no proof of his singular theory of the purpose of the clause, and his argument for his position involves the admission that the decision in the Pollock Case was usurpation of power by the court.

theories are to be discarded, and congress's power of income taxation is to be defined without regard to the source from which incomes are drawn. In this sense, indeed, the amendment does not *extend* congress's power of income taxation; it restores it to its original dimensions, and not by direct regrant but by levelling to its foundations the whole judicially fabricated structure of tax exemption.

But the case for this reading of the sixteenth amendment is still stronger when it is brought into touch with another acknowledged canon of constitutional interpretation. This is the one wherewith Chief Justice Marshall answered the argument in the Dartmouth College Case[39] that the word "contracts" as used in Article I, section 10 of the constitution was not intended to embrace the charters of private eleemosynary institutions: "It is not enough to say that this particular case was not in the minds of the convention when the article was framed, nor of the American people when it was adopted. It is necessary to go farther and to say that, had this particular case been suggested, the language would have been so varied as to exclude it, or it would have been made a special exception. The case, being within the words of the rule, must be within its literal operation likewise, unless there be something so obviously absurd, or mischievous, or repugnant to the general spirit of the instrument as to justify those who expound the constitution in making it an exception." This maxim has been repeatedly sanctioned by the court, twice in recent cases.[40] Can it be said that there is any such absurdity or repugnancy to the literal rendering of the sixteenth amendment as to exclude it from the rule just stated? It has already been shown on how frail a foundation the doctrine of tax exemption rest especially as applied to income taxation, and also how this doctrine operates to defeat what is universally acknowledged to have been a controlling purpose of the sixteenth amendment, to wit, a more equitable distribution of the burden of taxation.

Yet all this is on the assumption that the intention of those who framed and ratified the sixteenth amendment is a consideration which is material to its interpretation. There is, however, a third maxim of constitutional interpretation which renders this assumption extremely doubtful. The point is that the words "from whatever source derived" are so clear in themselves when not approached with preconceptions drawn from the outside that, in the words of Chief Justice Marshall in a similar case, they "neither require nor admit of elucidation."[41] The court has repeatedly said that "the construction and application of a provision are not restricted by and to the purpose of its adoption";[42] that "it can not be inferred from extrinsic circumstances that a case for which the words provide shall be exempted from its operation";[43] that—with specific reference to the "commerce" clause—"the reasons which may have caused the framers of the constitution to repose this power * * * in congress do not * * * affect or limit the extent of the power itself."[44] In short, the rule would seem to be that when the literal

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[39] 4 Wheat. 518.
[40] *Ozaica* v. *United States*, 260 U. S. 178; *United States* v. *Bhagat Singh Thind*, decided Feb. 19, last.
[41] *Wayman* v. *Southard*, 10 Wheat. 1.
[42] *Constitution of the United States Annotated.* (See note 37, *supra*), p. 42, and cases there cited.
[43] *Op. cit.* p. 45, and cases there cited.
[44] *Addystone Pipe and Steel Co.* v. *United States*, 175 U. S. 211. *See* also *Gibbons* v. *Ogden*, 9 Wheat. 1, and *Chisholm* v. *Georgia*, 2 Dall. 419.

meaning of a constitutional provision is clear, it is not the speculative intention of the authors of the provision but the text itself which governs; and it is submitted that this rule is applicable in the present instance. No more precise wording could have been chosen to convey the power contended for in this paper, while contrariwise it is in the interest of a *restrictive* application of the words of the amendment *only* that the problem of their interpretation has been created, as it were, out of whole cloth. It is truly a case where the interpretative process is resorted to "not to remove an obscurity, but, to import one."[44a]

VI.

We now return to the second point raised above with respect to the decision in *Evans* v. *Gore*,[45] namely, whether it involves the broader question of the status, in relation to the sixteenth amendment, of incomes from state and municipal bonds and the salaries of state officials. The point of view, however, from which this query is put should be made clear. There is no anxiety to preserve the decision in *Evans* v. *Gore*, which fully as much as *Collector* v. *Day*[46] illustrates what curious results the judicial mind can sometimes achieve when it chooses to let itself go. The proposition for which *Evans* v. *Gore* stands is that a certain category of national judges should not be required to pay on their salaries the same taxes to the National Government as other people would on a like income, although they receive the same protection from the Government; that while as to ordinary incomes a payment of taxes is a use thereof, as to certain judicial salaries it is a forced surrender, a confiscation. But if to collect a general income tax on the salary of a judge in office when the tax was enacted is to diminish such salary in the sense forbidden by article III, then to repeal, or even to reduce, an income tax reaching the salary of a president in office would be to increase such salary contrary to article II, and furthermore, to repeal or to reduce the tax as to any part of the income of the president in such a case would be another "emolument from the United States," also forbidden by article II. In other words, as to everybody else in the country an income tax can be repealed or reduced at any time, but as to a president taking office under the act it must be collected to the end of his term, and not only on his salary but on all his income, and at the same rate! Furthermore, in failing to note any distinction between a dis-

[44a] Justice Sutherland, in *Russell Motor Car Co.* v. *U. S.*, decided April 9 last. The opinion cites several cases forbidding resort by a court to legislative debates for extrinsic aid in interpreting a statute: *Lapina* v. *Williams*, 232 U. S. 78, 90; *Omaha & C. B. Street R. Co.* v. *I. C. Com'n*, 230 U. S. 324, 333; *Standard Oil Co.* v. *U. S.*, 221 U. S. 1, 50; *United States* v *Trans-Mo. Frt. Asso.*, 166 U. S. 290, 318. The objections to invoking a supposed "intention" of the legislators as interpretative of the law are admirably stated by Malberg, *Contributions à la Theorie Générale de l'Etat* (1920), I, sec. 237. "In order that the will of the legislator become law, it must take form in an official text adopted in solemn form. * * * That procedure which consists in imputing intentions to the legislator by taking account of the state of mind, the customs, the circumstances which prevailed at the period of the making of the law can furnish interpretation only very vague data. * * * The text alone has the authoritative validity of the law." *Ibid.* The objections against resort to extrinsic aids are, of course, vastly multiplied in the case of an amendment to the constitution of the United States, which becomes law only after proposal by two-thirds of each house of congress and the favorable vote of three-fourths of the state legislatures. To rely upon the views of not more than four men, as Justice Van Devanter does, as expressive of the "intentions" of this far-flung legislative organ would of itself be ridiculous, even if their utterances were not more than offset by contrary evidence, which, however, is clearly the case.

[45] See note 24, *supra*.

[46] Cited in note 13, *supra*.

criminatory and nondiscriminatory taxation of judicial salaries, the decision actually exposes the salaries of future judicial incumbents to special exactions. For while the "judicial independence" of judges in office at any particular time is bulwarked behind this decision, that of judges to be is still left to the mercy of congress and their own fortitude.

But while this decision, for the reasons stated, can hardly claim our applause, it is, nevertheless, until it is set aside by the court, a fact to be reckoned with, and so the question of its scope becomes one of importance. The precise inquiry is, therefore, whether the question decided in *Evans* v. *Gore* can be distinguished logically from the question which would be raised by the application of a national income tax to incomes from state and municipal bonds and to state official salaries? I submit that it can be, for two reasons: In the first place, while the decision in *Evans* v. *Gore* is based on a clause of the written constitution, no such clause can be invoked in behalf of the incomes just mentioned. Be it noted that the court does not claim that national judicial salaries are inherently exempt from national taxation; and indeed, as we have seen, such salaries are subject to an income tax if the tax is in existence when the incumbent takes office. Thus, notwithstanding the importance of the principle of the separation of powers in our system, as well as of the principle of judicial independence, yet neither of these principles, nor both together, were regarded by the framers of the constitution as sufficient to secure the exemption enforced in *Evans* v. *Gore*, but that exemption had on the contrary to be stipulated for in the written instrument itself. The exemption of incomes from state and municipal bonds and of state official salaries from national income taxation is, on the other hand, merely a deduction, and a far-fetched one at that, from theories external to the constitution. The question is surely prompted, why, if implication was insufficient in the one case, should it be supposed to suffice in the other?

The second difference between the case decided and the one suggested is even more cogent, though less obvious. It can be put in this way: That whereas the exemption which judicial salaries receive from the constitution has no reference to the *source* of the salary but, on the contrary, is extended to the *recipient* thereof, the exemption which is claimed for incomes from state and municipal bonds—and I should say the same thing of state official salaries—is claimed solely on a consideration of the *source* of such incomes and totally without regard to the deserts or necessities of the *recipients*. Or to put it slightly differently, whereas certain judicial salaries are protected *as such* by article III of the constitution, income derived from state and municipal bonds is sought to be protected *despite its being income* by considering its source. But if the contention of the present writer be accepted, as it must be at this point at least for the purpose of argument, consideration of source is precisely what the sixteenth amendment forbids in the determination of the scope of congress's power in taxing incomes. So, conceding the point decided in *Evans* v. *Gore* to have been correctly decided, namely, that the tax there involved was a diminution of judicial salaries in the sense of article III, the sixteenth amendment had absolutely no bearing on the case; not, however,

because the amendment does not purport to enlarge congress's power of taxing income, but *because the criterion which had previously restricted this power and which is now repealed by the amendment, does not appear in article III.* It follows of necessity that what was said in *Evans* v. *Gore* about the sixteenth amendment was pure *obiter dictum* and without any legal weight whatsoever.

To summarize: (1) Congress has the power to permit state taxation of national securities by nondiscriminatory taxes. (2) On correct theory, it has always had the power to tax incomes from state and municipal securities by a general income tax. (3) The sixteenth amendment restores that power by striking down the judicial theory whereby such incomes came to be exempted. Congress may tax incomes from whatever source derived. The words of the amendment are perfectly explicit and the sense of them could not be made clearer by a dozen constitutional amendments. What is needed, therefore, is not further tinkering with the constitution but an act of congress assertive of its present powers. Nor is there any judicial decision interpretative of the sixteenth amendment which stands in the way of such an assertion of power. Yet even if it were otherwise, that should not deter congress from taking the proper steps to secure a reconsideration of so important a question. In the words of the historian of the constitution: "It is the constitution which is the law, and not even the past decisions of the court upon it. . . . To the decision of an underlying question of constitutional law no . . . finality attaches. To endure it must be right."[47]

It only remains to indicate briefly the form that congress's action should take. This action would be based on the fundamental premise that public securities in the hands of private persons are private property and that the income from such securities is private income. On the one hand, therefore, congress should subject all future issues of national securities, as well as the incomes therefrom, to the unimpeded operation of the general nondiscriminatory tax laws of the states, and, on the other hand, claim a like operation for the national income tax upon the incomes from all future state and municipal issues. That is to say, the act should be reciprocal as between the national government and the states, and it should respect existing vested rights and moral obligations. To be sure, it may be argued that expectations growing out of an attempt to evade taxation are not entitled to much respect, yet the answer is plain: the evasion was one which the law itself allowed, and indeed promoted; wherefore it would be most imprudent to ask the court to disappoint such expectations. And, anyway, there is no need to cry over spilt milk if only we can make sure that no more milk will be spilt.[48]

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[47] Bancroft, *Works*, IV, 540, as quoted by F. J. Stimson, the *American Constitution*, etc., p. 29. See also to the same effect Bancroft's *History* (Author's last revision), VI, 350. See further to the same effect George Ticknor Curtis, *Constitutional History of the United States* (N. Y., 1897), II, 69–70; also Chief Justice Taney's words in *The Genesee Chief*, 12 How. 443, overruling *The Thomas Jefferson*, 10 Wheat. 448: "We are convinced that if we follow it we follow an erroneous decision, and the great importance of the question could not have been foreseen."

[48] An additional difficulty in the way of maintaining *Collector* v. *Day* to-day should have been noticed under section II *supra*. *Green* v. *Frazier*, 253 U. S. 233, makes it clear that States may to-day borrow money to an almost unlimited extent for purposes which were nongovernmental in 1789. Yet by *South Carolina* v. *U. S.*, 199 U. S. 437, *a state is not entitled to claim exemption from national taxation in the discharge of such functions.* On this ground alone the right of holders of state and municipal bonds to be exempt as to such holdings from the national income tax becomes most questionable in many cases. And generally speaking, it seems clear that the court can not profess to uphold both *Collector* v. *Day* and *South Carolina* v. *U. S.* indefinitely.

THE PROBLEM OF TAX-EXEMPT SECURITIES

BY

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THE PROBLEM OF TAX-EXEMPT SECURITIES.

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THE DOCTRINE OF TAX EXEMPTION.

Prior to the adoption of the income tax amendment in 1913, Congress was forbidden to tax municipal securities either directly or indirectly under the guise of an income tax.[1] The decisions which led up to this conclusion of the courts are among the most important to be found in the reports. Whether they are right or wrong, these decisions follow such an undeviating course that the conclusion which they reach must be accepted as settled law unless it has been overruled by the sixteenth amendment.

They begin with the case of *McCulloch* v. *Maryland*,[2] decided over a century ago, and continue down through the income tax decisions of 1895 even into our own day. In the *McCulloch Case* it was decided, among other things, that a state may not tax a bank chartered as an instrumentality of the Federal Government. This decision, which has been reaffirmed in other similar cases, was followed by others in which it was held that the state governments and their municipal subdivisions may not tax the securities of the United States, or the property or revenue of the United States, or the emoluments of federal officers.[3] These decisions and numerous dicta simply carry out the general theory that the state governments are totally lacking in the power to control federal instrumentalities, and that the only way in which such control can be prevented is by the complete denial of the state's power to tax or otherwise interfere with such instrumentalities.

"The sovereignty of a state extends," says Marshall, "to everything which exists by its own authority, or is introduced by its permission; but does it extend to those means which are employed by Congress to carry into execution powers conferred on that body by the people of the United States? We think it demonstrable that it does not."[4]

At a later date, when the danger was no longer that the states would destroy the union, but rather that the states themselves would be totally submerged and wiped out of existence by the torrential flow of federal power, the court was compelled to develop

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[1] "Municipal securities" will be understood to include all securities whether in the form of bonds, certificates of indebtedness, or some other form, issued by the State governments or their municipal subdivisions.

[2] (1819) 4 Wheat. (U. S.) 316, 4 L. Ed. 579.

[3] *Osborn* v. *Bank of the United States* (1824), 9 Wheat. (U. S.) 738, 6 L. Ed. 204; *Weston* v. *Charleston* (1829), 2 Pet. (U. S.) 449, 7 L. Ed. 481; *People ex rel. Bank of Commerce* v. *City and County of New York* (1862), 2 Black (U. S.) 620, 17 L. Ed. 451; *Van Brocklin* v. *State of Tennessee* (1886), 117 U. S. 151; 29 L. Ed. 845, 6 S. C. R. 670; *Lobbins* v. *Commissioners of Erie County* (1824), 16 Pet. (U. S.) 435, 10 L. Ed. 1022.

[4] *McCulloch* v. *Maryland* (1819), 4 Wheat. (U. S.) 316, 429, 4 L. Ed. 579.

the converse of this proposition, namely, that the federal government is without the power to tax the governmental instrumentalities of the states. It was necessary, indeed, for the court to call attention once more to the separate and independent powers of the states.

"Not only," said the court in a dictum, "can there be no loss of separate and independent autonomy to the states, through their union under the constitution, but it may be not unreasonably said that the preservation of the states, and the maintenance of their governments, are as much within the design and care of the constitution as the preservation of the union and the maintenance of the national government. The constitution, in all its provisions, looks to an indestructible union, composed of indestructible states."[5]

In the case of *The Collector* v. *Day*[6] it was held that Congress has no power to tax the salary paid by a state to one of its officers. Following this case it was held that the federal government has no power to levy a tax even indirectly upon the property and revenues of a municipal corporation which is acting as an agent of the state and is carrying out public purposes.[7] Finally in the *Pollock Case*,[8] the famous income tax case of 1895, although the judges disagreed most sharply upon the other points involved, they were unanimous in holding that Congress is without power to levy a tax upon the income derived from municipal bonds. The basis of the latter decision was simply this, that such a levy "is a tax on the power of the states and their instrumentalities to borrow money, and consequently repugnant to the constitution."

Because of the obvious fact that the states and municipalities sometimes go into business of a private nature, there has developed one exception to the rule of non-taxability of state instrumentalities. The exception, which is justified on the ground that it prevents the states from seriously impairing the sources of federal revenue, but which at the same time really adds strength and precision to the exemption from federal taxation enjoyed by the states, is illustrated by the South Carolina case involving public liquor dispensaries.[9] The state government, having monopolized in order to control the traffic in intoxicating liquors, objected to paying the federal internal revenue taxes. This objection was overruled by the Supreme Court on the ground that it is only truly governmental instrumentalities which are entitled to the exemption. Otherwise a state might, by monopolizing all lines of private business within the state, exclude the federal taxing power entirely.

The unanimous decision of the judges in the income tax case that the federal government may not tax the income of municipal bonds brought to completion the development of a principle which had been in the making since the days of Marshall. The principle is, in brief, that the states may not tax federal instrumentalities as such, and that the federal government may not tax the proper govern-

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[5] *Texas* v. *White* (1869), 7 Wall. (U. S.) 700, 19 L. Ed. 227. See also the remarks in *People ex rel. Bank of Commerce* v. *City and County of New York* (1862), 2 Black (U. S.) 620, 635, 17 L. Ed. 451, 17 L. Ed. 459; and in *Lane County* v. *Oregon* (1869), 7 Wall. (U. S.) 71, 19 L. Ed. 101.

[6] (1870) 11 Wall. (U. S.) 113, 20 L. Ed. 122.

[7] *United States* v. *Railroad Company* (1873), 17 Wall. (U. S.) 322, 21 L. Ed. 597.

[8] *Pollock* v. *Farmers' Loan and Trust Co.* (1895), 157 U. S. 429, 39 L. Ed. 759, 15 S. C. R. 673.

[9] *South Carolina* v. *United States* (1905), 199 U. S. 437, 50 L. Ed. 261, 26 S. C. R. in continuing to uphold both the rule in this case and that in *The Collector* v. *Day*. Corwin, Constitutional tax exemption, suppl. 13 Nat. Mun. Rev. 67, note.

mental instrumentalities of the states and their municipalities. The principle is nowhere stated in the constitution in so many words, but in the words of Marshall the first part of it "so entirely pervades the constitution, is so intermixed with the materials which compose it, so interwoven with its web, so blended with its texture, as to be incapable of being separated from it, without rending it into shreds,"[10] whereas the second part of it has been developed by the judges since the Civil War as a necessary corollary of the first. The whole rule has, in fact, become an established maxim of American constitutional law.

THE INCOME-TAX DECISIONS OF 1895.

The principle which we have just been discussing has never given rise to any important controversy until very recent years. The public at large have thought little of it, and no political party has demanded its modification. It has been accepted almost universally and without serious question that the state and federal governments should not tax each other. Entirely different was the reception accorded to the income-tax decision of 1895 as to the taxation of incomes generally.

During the Civil War and for some years thereafter the government levied an income tax and derived a considerable revenue therefrom. No one questioned the power of the government to levy such a tax, but a number of years after the war question was raised whether an income tax is not a direct tax which, under the constitution, must be apportioned among the states according to population.[11] The constitution provides that "representatives and direct taxes shall be apportioned among the several states . . . according to their respective numbers" as determined by the census; that "no capitation or other direct tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken:" and that "all duties, imposts, and excises shall be uniform throughout the United States."[12] Since the income tax at that time was being levied uniformly, the litigant hoped to prove the act invalid by demonstrating that it was a direct tax which should have been apportioned. The Supreme Court refused to take this view. It held that there were only two types of direct taxes, namely capitation taxes and taxes on real estate. An income tax was held to be an excise or duty which it was proper to levy uniformly throughout the United States.

After the country had gone some years without an income tax, Congress in 1894 again passed an act for the imposition of such a tax, and again by the rule of uniformity. This act was immediately attacked by most able counsel on behalf of a loan and trust company.[13] The chief contention of the plaintiff was that the tax upon the income from real and personal property was a direct tax just as much as if the tax had been laid upon the real estate or personal property directly. While it was agreed among the judges that a tax upon salaries and business profits would be an indirect tax,

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[10] *McCulloch* v. *Maryland* (1819), 4 Wheat. (U. S.) 316, 424, 4 L. Ed. 579.
[11] *Springer* v. *United States* (1881), 102 U. S. 586, 26 L. Ed. 253.
[12] Constitution, art. 1, sec. 2, par. 3; sec. 9, par. 4; and sec. 8, par. 1.
[13] *Polock* v. *Farmers' Loan and Trust Co.* (1895), 157 U. S. 429, 39 L. Ed. 759, 15 S. C. R. 673, 158 U. S. 601, 39 L. Ed. 1103, 15 S. C. R. 912.

subject to the rule of uniformity, it was finally held upon the second hearing of the case, five judges concurring against four dissenting, that a tax upon income from property is a direct tax which must be apportioned according to population. This decision, which was a reversal of the earlier ruling of the court, invalidated certain essential portions of the income-tax law and made the whole act inoperative. One consequence of this reversal of position was the arousing of a great deal of adverse criticism of the court throughout the country.

It should be noted here that the court did not declare that Congress had no power whatever to levy an income tax. On the contrary the possession of this power by Congress was asserted. What the court did say was that a tax upon the income from property, if levied at all, must be apportioned among the States according to population. The court, in other words, traced the income to its source, and held that if a tax upon the source would constitute a direct tax, so also would a tax upon the income from that source.

Practically speaking, however, the decision of 1895 made a federal income tax unworkable. In the first place a tax upon the income, "gains or profits from business, privileges, or employments," would have to be levied uniformly, while a tax upon the income derived from property would have to be apportioned according to population. In the second place, to have apportioned the latter tax among the States would have been to reduce it to an absurdity and to have made its administration almost impossible. To apportion a tax Congress must first decide how much revenue it desires from the tax. Suppose that it decides to raise $500,000,000 in a population of approximately 100,000,000 people. This would amount to five dollars per capita. New York state, with ten million inhabitants, would pay $50,000,000. Minnesota, with two and a third million, would pay about $11,500,000, and so on through the states. Because of differences in total income and in the distribution of incomes according to size, there would have to be a different income tax rate schedule for each one of the forty-eight states. The rate would be relatively high in Minnesota and very low in New York. Under a uniform income tax the people of New York state paid income and profits taxes in 1921–22 of over $525,000,000. The people of Minnesota paid a little over $30,000,000, or about one seventeenth as much. Under an apportioned tax New Yorkers would have paid only four times as much total as the citizens of Minnesota instead of seventeen times as much. The result of such a law, aside from its gross inequalities, would probably be to make residence in New York more than ever attractive to the wealthy people of the country.

THE SIXTEENTH AMENDMENT.

In the popular discussion which followed upon the decision in the income tax case, almost the entire emphasis was placed upon the rule of apportionment for direct taxes. The other phase of the decision, relative to the taxation of the income of municipal bonds, was then relatively unimportant and seems to have been generally ignored. The Democratic party became the chief exponent of an income tax. Its platforms and its speakers dwelt upon the need of

such a tax as a means of making the wealthy pay their proportionate share of the national taxation, but at first little progress was made.

In 1907 a business panic was followed by depression. With the diminution of business, the tariff revenues declined. When President Taft took office in 1909 the treasury faced a deficit of approximately one hundred million dollars. The president therefore called Congress in special session in March to revise the tariff and to provide revenue to cover the deficit. In his first address he recommended the imposition of an inheritance tax as a source of additional revenue.[14] Democratic and insurgent Republican members of Congress were not content with these measures. They proceeded to add to the tariff bill an amendment to provide for a uniform income tax. It was their expectation that the measure would be attacked as unconstitutional, but with the changed membership of the supreme court, they hoped for a reversal of the decision of 1895.

Under these circumstances the president delivered a special message to Congress.[15] For immediate revenue purposes he now urged the imposition of an excise tax on corporations. As to the income tax he said:

> Although I have not considered a constitutional amendment as necessary to the exercise of certain phases of this power, a mature consideration has satisfied me that an amendment is the only proper course for its establishment to its full extent. I therefore recommend to the Congress that both houses, by a two-thirds vote, shall propose an amendment to the constitution conferring the power to levy an income tax upon the national government without apportionment among the states in proportion to population.

He urged Congress not to reënact the income tax law previously declared unconstitutional.

> For the Congress to assume that the court will reverse itself, and to enact legislation on such an assumption, will not strengthen popular confidence in the stability of judicial construction of the constitution.

Previous to President Taft's special message, Senator Brown of Nebraska had offered a resolution for a constitutional amendment to the effect that "The Congress shall have power to lay and collect taxes on incomes and inheritances." Upon being informed in debate that Congress already had both of the powers in question, and that is was only the rule of apportionment which stood in the way of federal income taxation, he offered, a few days later, a second resolution which read that "The Congress shall have power to lay and collect direct taxes on incomes without apportionment among the several states according to population."[16] Not long afterwards there emerged from the Senate committee on finance, of which Senator Aldrich of Rhode Island was chairman, a resolution for a constitutional amendment, reading:[17]

> 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.

In this form the amendment passed both houses and was submitted to the states. The action of Congress upon it was indeed a

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[14] 44 Cong. Rec., March 4, 1909, p. 3.
[15] 44 Cong. Rec., June 16, 1909, p. 3844.
[16] 44 Cong. Rec., pp. 1548, 1568, 3377.
[17] 44 Cong. Rec., p. 3900.

curious proceeding.[18] Here was a proposed constitutional amendment, destined as it proved to be the first one adopted in over forty years. The chief proponents of the measure were men who had never espoused the cause of income taxation. The resolution was discussed on only one day in the Senate and one in the House. There was no critical analysis of the wording of the amendment, no attempt made to explain its meaning in detail. One member said:

> The resolution is simple in construction and covers but one subject and one purpose. It is formulated in clear and unambiguous terms, leaving no possibility for doubtful construction.

Another averred that it was "very defectively drawn," but neglected to point out the defects. One thing only is clear, and that is that the members who discussed it expected it to overrule the decision of 1895 as to the apportionment of income taxes among the states. There was no word of discussion of the problem of tax-exempt securities, or of the taxation of incomes derived from state and municipal salaries. The printed debates discover no intention whatever upon the part of the members of Congress to enlarge the power of taxation already possessed by the federal government, or of bringing the income from municipal securities under federal income taxation. Since the evidence of the debates upon this point is entirely negative, however, it is, of course, not correct to say upon the basis of this evidence alone that Congress had no intention of the sort.

No sooner had the proposed amendment been submitted to the states than questions began to be raised as to its meaning. Governor Hughes' message to the New York legislature early in 1910 raised serious doubts as to what effect the amendment would have if adopted.[19] He said:

> The comprehensive words "from whatever source derived," if taken in their natural sense, would include not only incomes from real and personal property, but also incomes derived from state and municipal securities.

Several other governors expressed similar misgivings.[20] It would be far more to the purpose to have the opinions of the members of the state legislatures which adopted the amendment, but such evidence is now impossible to obtain.

Senator Borah found early opportunity to address the Senate in reply to Governor Hughes.[21] He came to the conclusion that the proposed amendment added nothing to the taxing power of Congress, which was "complete, unfettered, plenary before;" that it dealt, and purported to deal, only with the manner of exercising the power; and that

> to construe the proposed amendment so as to enable us to tax the instrumentalities of the state would do violence to the rules laid down by the supreme court for a hundred years, wrench the whole constitution from its harmonious proportions and destroy the object and purpose for which the whole instrument was framed.

But the most cogent reply to Governor Hughes was contained in a letter written by Mr. Root to Mr. F. M. Davenport of the New York

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[18] 44 Con. Rec., pp. 1568-70, 4007-08, 4105-21, 4304, 4390, 4441, 4493, 4495, 4620, Appendix pp. 70-71, 75-79, 103-114, 117-128, 131-132.
[19] Message of Jan. 5, 1910; *Evans* v. *Gore* (1920), 253 U.S. 245, 261, 64 L.Ed. 837, 40, S.C.R. 550; quoted in Corwin, Constitutional Tax Exception, suppl. 13 Nat. Mun. Rev. 60.
[20] Corwin Constitutional Tax Exemption, suppl. 13 Nat. Mun. Rev. 60.
[21] 45 Cong. Rec., Feb. 10, 1910, pp. 1694-99. See also remarks of Senator Brown, pp. 2245-47.

state legislature.[22] It was his conclusion that the amendment would not "in any degree whatever * * * enlarge the taxing power of the national government" or "have any effect except to relieve the exercise of that taxing power from the requirement that the tax shall be apportioned among the several states. The effect of the amendment will be, in my view, the same as if it said, 'The United States may levy a tax on incomes without apportioning the tax, and this shall be applicable whatever the source of the income subjected to the tax,' leaving the question 'What incomes are subject to national taxation?' to be determined by the same principles and rules which are now applicable to the determination of that question." No one arose in either house to dispute this view, although Mr. Borah spoke at length in the Senate, and the letter written by Mr. Root was spread at large upon the Record. When we couple this fact with the negative testimony of the debates at the time of the proposal of the amendment, we have not complete proof of the intention of Congress in proposing the amendment, but at least very good grounds for a controlling presumption.

VIEWS OF THE BROAD CONSTRUCTIONISTS.

In the interpretation of the sixteenth amendment there are two outstanding difficulties. One is that the amendment takes the form of a substantive grant of power to Congress. The second is embodied in the words "from whatever source derived." The amendment seems, in other words, to grant to Congress a power not previously possessed, to tax incomes, and to tax them from whatever source they may be derived. This plausible view is rendered the more natural when we recall that the income tax case of 1895 raised both the question of apportionment of the tax and the question of the power of Congress to tax the income from municipal bonds. It may be reasoned, therefore, that the amendment was designed to surmount at one stride both the supposed obstacles to income taxation discussed in that case.

The latter view is ably presented in an article by Professor Henry Rottschaefer in the Minnesota Law Review.[23] The bases upon which his argument rests are as follows: *First.* Prior to 1913 there was a double defect in the federal power to levy income taxes. On the one hand Congress had no power to tax the income of municipal bonds, and on the other hand it was required to follow the rule of apportionment instead of the rule of uniformity in taxing the income derived from property. *Second.* Unlike other federal amendments, the income tax provision takes the form of a grant of power to Congress. *Third.* Literally construed the amendment grants Congress the power to levy taxes upon incomes from whatever source derived, and to levy them without apportionment among the states according to population. It serves thus to overcome both of the previous defects in the power of Congress to tax incomes. *Fourth.* Where the literal meaning is so obvious, and where the language serves so well to remedy a preëxisting evil, it is unnecessary and improper to study other evidences as to the motives and intent of the

[22] 45 Cong. Rec., March 1, 1910, pp. 2539-40.
[23] 8 Minnesota Law Review 112-126.

framers of the amendment. *Fifth.* In any case the intent of the members of Congress is of little moment, since it was the state legislatures which actually adopted the amendment. The conclusion reached is that the amendment may properly be construed to authorize federal taxation of the income of municipal bonds.

In his two articles on the subject, Professor E. S. Corwin pursues a somewhat different course of reasoning, but comes to substantially the same conclusion.[24]

"Approached without preconceptions," he says, "the sixteenth amendment clearly gives the power to tax incomes from municipal and state bonds, as well as the salaries of state officials, by a general income tax."

The amendment must be taken as meaning what it literally says, or seems to say. "On correct theory" Congress "has always had the power to tax incomes from state and municipal securities by a general income tax." This power was effectually taken away by the decision in the *Pollock Case*, but "the sixteenth amendment restores that power by striking down the judicial theory whereby such incomes came to be exempted. Congress may tax incomes from whatever source derived. The words of the amendment are perfectly explicit and the sense of them could not be made clearer by a dozen constitutional amendments." But it is impossible here to show with what a wealth of information and dialectic power this author proceeds to demonstrate his views.

In a dissenting opinion in the case of *Evans* v. *Gore*,[25] Justice Holmes has suggested but has not fully expounded an interpretation which comes to the same conclusion. He also looks upon the amendment as a grant of power to Congress to tax incomes "from whatever source derived." It is true, he says, that the amendment goes on to provide for the levy of such taxes "without apportionment among the several states, and without regard to any census or enumeration," and this, he says, "shows the particular difficulty that led to it. But the only cause of that difficulty was an attempt to trace income to its source, and it seems to me that the amendment was intended to put an end to the cause and not merely to obviate a single result. I do not see how judges can claim an abatement of their income tax on the ground that an item in their gross income is salary, when the power is given expressly to tax incomes from whatever source derived." While the case here under discussion involved the taxation of the salary of a federal judge, the reasoning is broad enough to cover the case of municipal bond interest. What Justice Holmes asserts is that the amendment rules out and makes inadmissible all discussion of the source from which income is derived. No one, he thinks, may now be heard to claim exemption from income taxes on the ground that his income is derived from this or that supposedly exempt source.

The writer has found only one other line of argument put forward to justify federal taxation of the income of municipal bonds. During the debates upon the War Revenue Act in the Senate in 1917–18 Senator Knox argued that the war power was broad enough to

[24] Tax-exempt Securities, 33 New Republic, 248–45; Constitutional Tax Exemption, suppl. 13 Nat. Mun. Rev. 49–67.

[25] (1920) 253 U. S. 245, 264–67, 64 L. Ed. 887, 40 S. C. R. 550.

authorize the tax.[26] He argued from some language found in the case of *The Collector* v. *Day* that the exemption of state instrumentalities from federal taxation was founded upon the principle of self-preservation. When the life of the nation was in danger, when lives and wealth were being conscripted to protect the entire people, he thought the doctrine of self-preservation required that the federal government should have the power to tax the incomes of all the people. Since this line of argument has nothing to do with the sixteenth amendment it will be unnecessary to refer to it again.

THE OFFICIAL VIEW.

Giving all due consideration to the eminent authorities who assert the present power of Congress to tax the income of municipal bonds, it must be said that the weight of opinion is against them. Congress itself has from the first seemed to assume that its power does not extend so far.[27] Even during the war when, if ever, the national government stood in dire need of a copious revenue, and when one revenue act was actually drawn to subject such incomes to taxation, so great was the doubt upon this point that this provision was finally omitted.[28] The misgivings as to the possession of this power have been expressed both in debate and in committee reports, and more recently by the proposal, which passed one house of Congress in 1923 and is now again before that body, of a resolution for a constitutional amendment to authorize the taxation in question.[29] President Harding also held the view that a new amendment is needed, and President Coolidge holds the same position.[30] It is unnecessary, perhaps, to call attention to the attitude of the treasury department.[31] This practical construction of the constitution may not be ignored.[32] It began with the first Congress and the first administration which took office after the adoption of the amendment and has continued without change down to the present time.

Because Congress, doubting its own power, has failed to enact a law to make municipal-bond interest taxable as income, it has been impossible for the Supreme Court to pass directly upon the question. We are not, however, without clues as to the probable attitude of the judges. In a number of decisions, where it has been called upon to interpret and to apply the income tax amendment, the Supreme Court has asserted in dicta that it was not the intention of the amendment to enlarge the scope of the federal taxing power or to extend that power to subjects formerly exempt from taxation, but that its purpose was merely to change

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[26] 56 Cong. Rec., Sept. 30, 1918, pp. 10933-41.

[27] 38 Stat. at L., p. 168 (1913); 39 Stat. at L., pp. 758-59 (1916); 40 Stat. at L., pp. 320-30 (1917); ibid. pp. 1065-66 (1918); 42 Stat. at L., p. 288 (1921). In the acts of 1918 and 1921, no express provision is made for exempting the salaries of state and municipal officers and employees, but it has been ruled that the exemption still exists on constitutional grounds.

[28] House Report No. 767, 65th Cong., 2nd Sess., p. 9; Senate Report No. 617, 65th Cong. 3rd Sess., p. 6; 56 Cong. Rec., pp. 10933-41, 10628-33; 11181-87; 40 Stat. at L., p. 1065-66.

[29] House Report No. 969, 67th Cong., 2nd Sess.; H. J. Res. 314, 67th Cong., 2nd Sess. The proposed amendment is given in note 48, infra.

[30] Message, President Harding, Dec. 6, 1921; 62 Cong. Rec., p. 39; ibid., Dec. 8, 1922, 64 Cong. Rec., p. 215; message of President Coolidge, Dec. 6, 1923, 65th Cong. Rec., p. 98.

[31] See the N. Y. Times, especially under dates of Jan. 9 and 12, 1924.

[32] "Contemporaneous or practical construction of an ambiguous provision of a constitution by the legislative or executive departments of the government is always important, and is frequently of controlling influence in determining its meaning." 12 C. J. 712, (Const. Law §65) and cases there cited.

the law as to the apportionment of income taxes. In the leading case upon the amendment Chief Justice White said:

It is clear on the face of its 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."

In another decision handed down at the same term of court the Chief Justice said that:

by the previous ruling [quoted above] 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."

There are similar dicta in other cases, particularly in that of *Evans* v. *Gore*,[33] which involved the power of Congress to tax the income derived by a federal judge from his official salary. This case involved a question not unlike that which is discussed in this paper. The decision, which the writer does not attempt to justify, simply was that the income-tax amendment does not change or overrule that provision in article 3, section 1, of the constitution, which provides that the compensation of federal judges "shall not be diminished during their continuance in office." The court refused to tolerate a diminution even in the form of an income tax. In this decision the history of the sixteenth amendment was carefully reviewed in the light of the information then available in order to ascertain its purpose. The conclusion was stated as follows:

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.

THE CASE FOR STRICT CONSTRUCTION.

Inconstruing the words of the amendment the most important question is whether they are to be construed as a grant of power. To the author it would seem that they do not constitute a grant of power in a substantive sense, but only in an adjective sense. Congress has always had the substance, namely, the power to tax incomes. This power was conferred by the original constitution, article 1, section 8.

The Congress shall have power: 1. 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.

This provision is still in effect. It has been supported by numerous judicial decisions and by the most far-reaching judicial dicta as to the extent of the taxing power.[34] The power to tax incomes

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[33] *Brushaber* v. *Union Pacific Railroad Co.* (1916), 240 U. S. 1, 36 S. C. R. 236, 60 L. Ed. 493.

[34] *Stanton* v. *Baltic Mining Co.* (1916), 240 U. S. 103, 36 S. C. R. 278, 60 L. Ed. 546. (1920 253 U. S. 245, 64 L. Ed. 887, 40 S. C. R. 550. See also *Peck and Co.* v. *Lowe* (1918), 247 U. S. 165, 62 L. Ed. 1049, 38 S. C. R. 432 *Eisner* v. *Macomber* (1920), 252 U. S. 189, 64 L. Ed. 521, 40 S. C. R. 189.

[35] *License Tax Cases* (1867), 5 Wall. (U. S.) 462, 18 L. Ed. 497; *Veazie Bank* v. *Fenno* (1870), 8 Wall. (U. S.) 533, 540, 19 L. Ed. 482; *Knowlton* v. *Moore* (1900), 178 U. S. 41, 44 L. Ed. 969, 20 S. C. R. 747.

is traceable to this source and not to the sixteenth amendment. The two must be read together, the one as conferring the power and the other as determining the manner in which the power may be exercised. But the substantive power to tax incomes as well as the power to tax other subjects has for many years by an unbroken line of decisions been held to be subject to the limitation that the federal Government may not tax the instrumentalities of the states. A tax upon the income derived from government bonds has been held with unimpeachable logic to be equivalent to a tax upon the government directly."

What the income tax amendment does, and does very effectively, as all agree who have studied the question, is to abolish the requirement created by the decision in the *Pollock Case* of apportioning the tax upon income derived from property among the states according to population. The gist of the amendment is this:

> The Congress shall have power to lay and collect taxes on incomes . . . without apportionment among the several states, and without regard to any census or enumeration.

The form of the amendment clearly indicates that this is the essence of the whole proposition.

But the question still remains, Does not the amendment do more than this? This brings us to the second difficulty, namely the meaning of the elliptical clause, "from whatever source derived," which is inserted parenthetically in the middle of the sentence. It should be noted that the sentence is entirely complete without it. Indeed, as originally drafted the amendment contained no such phraseology. The words in question were inserted, as explained by one who had reason to know, to make assurance doubly sure that all legal income taxes might be levied by the rule of uniformity.[38] After the *Pollock Case* decision the law seemed to require that taxes upon the income from salaries, business profits, and other income not arising from property, should be levied uniformly, whereas taxes upon the income from property would have to be levied according to the rule of apportionment. To the writer it would seem that the words in question might well have been omitted, that they are a mere work of superogation. Or, if it was deemed necessary to put them in, it might have been better to have said, "from whatever *legally taxable* source derived," for this, according to Mr. Root, was the intention. In other words, the term "whatever" has reference only to those sources of income which were formerly taxable by the federal government.

It is our purpose, however, not to show how the amendment might have been more clearly drafted, but to try find its meaning as it is. Do the four words, "from whatever source derived," empower Congress to tax the income of municipal bonds? The exemption of federal instrumentalities from state taxation, and of state instrumentali-

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[37] *Weston* v. *Charleston* (1820), 2 Pet. (U. S.) 449, 7 L. Ed. 481. "The right to tax the contract to any extent, when made, must operate upon the power to borrow, before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government; to any extent, however inconsiderable, it is a burden on the operations of government. It may be carried to an extent which shall arrest them entirely." p. 468. See also *People ex rel. Bank of Commerce* v. *City and County of New York* (1862), 2 Black (U. S.) 620, 17 L. Ed. 451; *Farmers and Mechanics Savings Bank* v. *State of Minnesota* (1914), 232 U. S. 516, 58 L. Ed. 706, 34 S. C. R. 354. In the arguments for abolishing tax exemption it is admitted that state and local governments will have to pay a higher rate of interest if the exemption is abolished.

[38] See Senator Root's letter in 45 Cong. Rec., March 1, 1910, pp. 2539–40.

ties from federal taxation, is a rule which lies at the very foundation of our federal system. Perhaps we should have had an equally good system of government if the judges had never insisted upon this complete separation between the two authorities, but the fact is that our law has developed in this way. The importance of this separation has been stressed by the Supreme Court time and again, from Marshall's day to the present. Are we to suppose that the Congress, without discussion of the question, by the clumsy use of four words in the middle of an amendment designed apparently for a different purpose, intended to introduce a change of so tremendous significance?

By the ordinary principles of legal draftsmanship a change so important would seem to require at least a separate sentence, and some separate consideration. It could hardly be effected by mere inadvertence. New and fundamental powers are not usually conferred by a single phrase found in provision having a different purpose. A single simple sentence usually accomplishes only one object. It is interesting in this connection to note that those who assert that this one-sentence amendment accomplishes two objects, usually construe it as if it were two sentences, or two practically coördinate clauses, reading substantially as follows: "The Congress shall have power to lay and collect taxes on incomes from whatever source derived. Such taxes may be laid without apportionment among the several states, and without regard to any census or enumeration." They omit even to note the parenthetical position of the words "from whatever source derived," which in the amendment are entirely set off by commas.

Another objection to the broad interpretation is that, once accepted, it may be extended almost indefinitely. It can be made to apply not only to income from municipal securities, but to all income from salaries and wages paid by state and local governments to their officers and employees. It can be made to apply to pensions, to bonuses, and to all other forms of payment by state and local governments to individuals. It need hardly stop there. The principle of taxation at the source may be applied, the federal government ordering the states and municipalities to withhold a portion of the salaries and wages, and possibly even of contractual interest payments, and to pay these sums directly to the federal government. Indeed it might be suggested that if the intention of Congress in proposing the amendment and of the states in adopting it is to be ignored, and if we are not to seek in history the meaning of the provision, the very "incomes" or revenues of the state and municipal governments as such might, under a broad interpretation, become directly taxable by the federal government. The sixteenth amendment does not specify "personal incomes" as being alone taxable, and there have been cases where a federal tax has impinged with substantial directness upon municipal revenues.[39]

The power to tax is still the power to destroy. If Congress has the power to tax the income from municipal bonds and the salaries of state and municipal employees, it might, by classifying incomes into "earned" and "unearned," by raising some rates and lowering others, by the addition of surtaxes, and by other devices, put direct burdens upon the operations of State and local governments. The

[39] *United States* v. *Railroad Co.* (1873), 17 Wall. (U.S.) 322, 21 L.Ed. 597.

argument that this will not be done in fact is one which the court refused to consider in the case of *McCulloch* v. *Maryland* as well as in subsequent cases.[40] It is the existence of the power which is obnoxious to the constitution, and not a particular method of exercising the power.

There are still other objections to a broad construction of the amendment. If taken broadly and literally, it would seem to authorize the impairment of the obligation of contracts. All municipal bonds sold after the income-tax decisions of 1895 certainly could have been taken by the purchasers on the faith that the income therefrom was exempt from federal taxation. The state and municipal governments had the legal right to certify that tax exemption was one of the privileges attaching to their securities. The taxation of bonds under such circumstances, it has been held, operates directly upon the contract.[41] The buyer of a tax-exempt bond pays something for the exemption privilege in the form of lessened interest, or interest foregone. Surely Congress and the state legislatures did not connive at the passing of an amendment to the constitution to impair existing contractual obligations! This, it has been held in a similar situation, would be "so inconsistent with the honor and dignity of the United States that such an intent should not be presumed without the clearest legislative language requiring it."[42] But there are no words in the amendment which in any way recognize such contractual rights or guarantee against the taxation of the interest income of such previous buyers in good faith. The presumption must be that the taxation of such income was not intended. It is interesting to note in this connection how careful the framers of the proposed new amendment have been to protect the constractual rights of those who buy municipal bonds before the amendment takes effect.[43]

Another consideration is perhaps not unworthy of mention. What the amendment authorizes Congress to do is to lay and collect "taxes" on incomes in a certain manner. What are taxes? Is it too far-fetched to suggest that if the federal government should attempt to levy a charge directly upon the state and municipal governments as such, it would not be a tax at all, but a forced contribution of wholly arbitrary character? Is it not proper to construe the decisions upon this point from *McCulloch* v. *Maryland* down to date as holding in effect that such levies do not come under the designation of taxes?[44] This does not seem to have been said in so many words, yet this is the result, for in all the cases the courts assert the complete and "plenary" power of "taxation" of both the state and federal governments, but at the same time deny the power to levy

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[40] *People ex rel. Bank of Commerce* v. *City and County of New York*, (1862) 2 Black (U.S.) 620, 620–35, 17 L.Ed. 451, 17 L.Ed. 459.

[41] *Weston* v. *Charleston*, (1829) 2 Pet. (S.U.) 449, 7 L.Ed. 481; and other cases cited in note 36, supra.

[42] *Farmers and Mechanics Savings Bank* v. *State of Minnesota*, (1914) 232 U.S. 516, 58 L.Ed. 706, 34 S.C.R. 354.

[43] See note 48 for the proposed amendment. Of course the federal government itself is not forbidden by express language of the constitution to impair the obligation of contracts, but at the same time it is not to be presumed that an act of Congress or even a constitutional amendment is intended to bring about an impairment. If possible a construction should be given to the language used which will avoid such a result.

[44] The definitions of taxation do not include the idea of one government "taxing" another. Taxes impinge upon natural persons and private corporations, upon property and business, upon privileges or franchises and income, but not upon governments as such.

the contributions in question. If this be so as to a direct levy, it is almost as true of a charge upon incomes derived from either the state or federal government, for such a charge would react directly upon the paying authority.

There is, finally, a very real objection to the position of the broad constructionists in their refusal to consider the intent of the framers of the amendment, and of those who adopted it, as having any bearing upon the question. They take the view that the meaning of the amendment is so entirely clear upon the face of it that it is improper to resort to the evidences as to intent. When all three branches of the federal government seem to be united in holding a narrow view of the powers conferred by the amendment, it is a little difficult to understand how it can be said that the opposite construction is so clearly the right one that it could not be made clearer. In fact, there is actual doubt as to the meaning of the words, although the official view is that of narrow construction.

But it is suggested that we should approach the question without preconceptions. It may be true that a man from Mars, or an average uninformed citizen, knowing nothing about the constitutional history of the country, or about the other provisions of the constitution, upon being handed a slip of paper containing only the sixteenth amendment, would probably say that it constituted a grant of power to Congress to tax incomes, and that the words "from whatever source derived" would seem to authorize the taxation of all sorts of incomes, including an income from municipal bonds. Likewise, it has been the experience of the writer with beginning classes in American government that they always assert, and with almost perfect assurance, that the fifth amendment prohibits the states from dispensing with the grand jury in criminal cases; that the term "ex post facto law" in article I, section 9, means any law passed with reference to an act previously committed; and that the two-thirds vote required by article V for the submission of constitutional amendments means two-thirds of all the members of each house.

It is, of course, entirely improper to pick out a single provision of a constitution and to construe it by itself without reference to other parts of the document. It is equally unjustifiable to take the bare words and to construe them with an uncompromising literality. To do so is to make language not the servant but the master of the will. It ceases to be the tool and becomes the workman. When the letter is the law the people become the victims of the unskilled draftsman and the careless copyist. We do not put mere grammarians and lexicographers upon the bench any more than we submit questions of constitutional construction to the uninformed. Constitutional questions are submitted to courts consisting of judges who are supposed to know something of law and history, not excluding the history of the constitution. The more learned they are, the more previous knowledge they have, the greater is our confidence in them. Indeed, in the long run under our system of government, it is the judges who are the ministers of the constitution, "not of the letter but of the spirit; for the letter killeth, but the spirit giveth life." They are supposed to know the intent of the framers and the spirit of the document as a whole and to apply this knowledge in interpreting the meaning of the words.

There is, then, a doubt as to the meaning, not perhaps of this amendment taken by itself without regard to other provisions, but of this provision when read, as it should be, in connection with the rest of the constitution, and as to the interpretation to be placed upon the instrument as a whole, including this amendment. The instrument must be construed as a whole, and it must be given a practical construction which will give due weight to all its parts.

Little is gained by the citation of rules of constitutional construction. It would be impossible to harmonize all the different dicta of the court upon this point. We know that in practice the judges do study the history of the constituion, the reasons for its adoption, the debates at the time of its adoption, and even the opinions of contemporaries as to its meaning and purpose. Not only is this done in practice but the judges assert that it is proper to follow this course.[45] Perhaps a leading digest of the law is not far wrong when it summarizes the rules upon this point as follows:

> The fundamental purpose in construing a constitutional provision is to ascertain and give effect to the intent of the framers and of the people who adopted it. The court, therefore, should constantly keep in mind the object sought to be accomplished by its adoption and the evils, if any, sought to be prevented or remedied.[46]

This rule, if it be sound, probably applies as much to amendments as to the original document and is particularly applicable where there is doubt as to the meaning of one provision when construed in conjunction with another. The opportunity has not yet arisen for the court to pass directly upon the question discussed in this paper, but other questions touching upon the sixteenth amendment have arisen. In deciding these questions the judges have resorted, and that very properly, to the history of the amendment, to the necessities which gave it birth, and to the records which exist as to the purpose of the framers and of those who adopted it. Let it not be thought that they have read merely the printed page in this connection, nor that they are required to restrict themselves to that sort of evidence. The judges who have rendered the decisions thus far upon this amendment are men who lived through the period of agitation for it and of its adoption. Not improperly perhaps, they have called upon their own knowledge of what took place and of the reasons why it took place. No doubt they have agreed with Mr. Root that the question of tax-exempt securities was not a serious evil at the time the amendment was proposed, and that it was not intended to change the law upon that point. Perhaps they have been mistaken as to the facts. That may very well be, but the evidence adduced up to the present time to prove that Congress and the state legislatures intended to make the income from municipal bonds taxable by the federal government is very meager.[47]

From what has been said it must follow that we can not speak with absolute assurance and finality upon the question at issue. At

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[45] "If, from the imperfection of human language, there should be serious doubts respecting the extent of any given power, it is a well-settled rule that the objects for which it was given, especially when those objects are expressed in the instrument itself, should have great influence in the construction." Marshall, C. J., in *Gibbons* v. *Ogden* (1824), 9 Wheat. (U. S.) 1, 6 L. Ed. 23. See also *Evans* v. *Gore* (1920), 253 U. S. 245, 65 L. Ed. 887, 40 S. C. R. 550.

[46] 12 C. J. 700 (Const. Law § 43). See also the cases there cited.

[47] The best collections of evidences on this point will be found in Evans v. Gore, (1920), 253 U. S. 245, 64 L. Ed. 887, 40 S. C. R. 550; and in Corwin, Constitutional Tax exemption, suppl. 13 Nat. Mun. Rev. 59–62.

the same time the official or strict construction of the sixteenth amendment appears to be the sound one. It is preferable to the other view because it considers the constitution as a whole, it is not misled by the mere form of the amendment into a disregard of its substance, it conforms to the generally held opinion as to the intention of those who framed the provision, it does not open the door to such obnoxious results as the impairment of the obligation of contracts, and it preserves the fundamental rule of our constitutional jurisprudence that the federal government may not tax the governmental instrumentalities of the states. This view is, therefore, adequately supported by reason. It is also buttressed by the weight of opinion and by a long-continued practical construction. To change the accepted interpretation [48] at this late date would seem to require a new constitutional amendment dealing expressly with the subject.

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[48] Such an amendment was submitted to the last Congress. It passed the lower house with the requisite two-thirds majority and was recommended for passage in the Senate, but the latter body was unable to reach a vote upon it. The same amendment is now again before Congress, but has failed by a small margin to pass the House of Representatives. It reads as follows:

"Section 1. The United States shall have power to lay and collect taxes on income derived from securities issued, after the ratification of this article, by or under the authority of any state, but without discrimination against income derived from such securities and in favor of income derived from securities after the ratification of this article, by or under the authority of the United States or any other states.

"Section 2. Each state shall have power to lay and collect taxes on income derived by its residents from securities issued, after the ratification of this article, by or under the authority of the United States; but without discrimination against income derived from such securities and in favor of income derived from securities issued, after the ratification of this article, by or under the authority of such state." H. J. Res. 314, 67th Cong., 4th Sess., 1923; H. J. Res. 1 and 186, 68th Cong., 1st Sess., 1923.

THE SIXTEENTH AMENDMENT AND INCOME FROM STATE SECURITIES

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Many laymen and not a few lawyers are finding it hard to believe that the sixteenth amendment does not vest in the Federal Government power to tax income from State and municipal bonds. Certainly there is no exclusion of such income in the comprehensive words: "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." What could be broader than the description "Income from whatever source derived?" Yet the Supreme Court has held that income from certain sources is not taxable by the Federal Government. It has given the plainest intimation that such exempt income includes interest from State and municipal bonds. Apparently, therefore, in the mind of the Supreme Court the sixteenth amendment does not mean what it says. It says that Congress may tax income from whatever source derived, but it does not mean this. The phrase "from whatever source" relates not to the power to tax, but to the requirement that certain Federal taxes must be apportioned among the States according to their respective populations. The amendment, therefore, means merely that a tax on income from whatever source derived is immune from the requirement of apportionment. This still leaves the question whether income from any given source is taxable at all—a question which depends for its answer on considerations wholly dehors the sixteenth amendment.

The case in which this interpretation of the sixteenth amendment stands as a square decision of the court is Evans *v.* Gore (1920), 253 U. S. 245. This holds that the salary of a Federal judge is "diminished" by forced inclusion in his income-tax return and that therefore such inclusion is inhibited by the constitutional provision that the judges shall "receive for their services, a compensation, which shall not be diminished during their continuance in office." This decision that taxation is diminution of compensation is open to serious question. It might reasonably be so regarded if judicial compensation were taxed more heavily than other income, but it seems sensible to say that a tax burden imposed on all earnings without discrimination is not a reduction of them but a burden based merely on ability to pay. Be this as it may, it does not concern us here. Our present interest is confined to the further holding in Evans *v.* Gore that this inhibition against diminution by taxation, extracted by inference from the clause in the original

Constitution, is in no way relaxed or modified by the apparent grant in the sixteenth amendment of power to levy a tax on incomes from whatever source derived. This further holding was essential to the decision reached by the court, once it had made up its mind that taxation is diminution. The holding, therefore, can not be dismissed as obiter dictum as may the declarations to the same effect in earlier Supreme Court opinions.

THE FIRST INTERPRETATION.

These earlier declarations are quoted at length in Mr. Justice Van Devanter's opinion in Evans *v.* Gore. They begin with the one of Chief Justice White in Brushaber *v.* Union Pacific R. Co. (1916), 240 U. S. 1. This was the first case involving the scope and meaning of the sixteenth amendment. To understand its lucubrations on this topic, we must first note its interpretation of Pollock *v.* Farmers Loan & Trust Co. (1895), 157 U. S. 429, 158 U. S. 601. This was the great case that subjected an income tax to the requirement that direct taxes be apportioned among the States. It declared that a tax on income is in substance a tax on the source from which the income is derived. From this followed the corollary that a tax on income is a direct or an indirect tax according as a tax on the source thereof would be direct or indirect. Then came the conclusion that since a tax on real or personal property is a direct tax, a tax on income from real or personal property is a direct tax and therefore one that can be levied by the Federal Government only upon compliance with the constitutional prescription of apportionment. Since the income tax in question was not an apportioned tax, it was held invalid to the extent that it laid hold of income derived from property. The tax on income from business or labor was found to be inseparable from that on income from property. Without deciding whether the former tax was direct or not, the court held that it failed with the failure of the rest from which it was inseparable.

Such was the theory and such the result of the Pollock case. In stating them in the Brushaber case Chief Justice White paraphrases and elaborates and embroiders as follows:

> 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 the 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 to prevent. As this conclusion but enforced a regulation as to the mode of exercising power under particular circumstances, it did not in any way dispute the all-embracing taxing authority possessed by Congress, including necessarily therein the power to impose income taxes if only they conformed to the constitutional regulations which were applicable to them.
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> 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.

This interpretation, being interpreted, means that the theory of the Pollock case was that, although formally and generically all income taxes are excises and therefore indirect taxes, nevertheless substantially they are direct taxes whenever they amount to the same thing as taxes on property because of its ownership. Thus the substantial character of an income tax is made to depend upon the character of the source from which the income is derived. Hence whether an income tax must be apportioned is likewise made to depend upon the source from which the income is derived.

Lagging along after the Pollock case came the sixteenth amendment saying that Congress may tax incomes, from whatever source derived, without apportionment among the States. The meaning of these words, as discovered by Chief Justice White in the Brushaber case and as accepted through approving quotation by Mr. Justice Van Devanter in Evans *v.* Gore, is as follows:

> It is clear on the face of this text that it does not purport to confer power to levy income taxes in a general 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 on the taxed income on 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.

Put somewhat more briefly, this is to say that the sixteenth amendment did not grant to Congress a power to tax income from whatever source derived, but merely removed any requirement of apportioning among the States a tax on income, whatever the source from which the income might be derived. Thus in effect the amendment forbade the Supreme Court to look at the source of income in order to determine the substantial character of an income tax. This permitted all income taxes to retain their formal and generic character of indirect taxes by rendering their substantial character no longer important, since no longer was a tax on income from any source whatever to be subject to the requirement of apportionment.

The intricate ingenuity of these intellectual involutions is highly characteristic of the late Chief Justice. In its own peculiar field it takes high rank. We may admire its gymnastic supremacy without precluding ourselves from pointing out the simple non sequitur of which it is guilty. The sixteenth amendment may do exactly what the Chief Justice says that it does, and still do also what he implies that it does not. It may remove the requirement of apportionment from an already possessed power to levy an apportioned tax on income, and it may in addition grant a substantive power to tax income from whatever source derived, as it verbally professes to do. It may nullify the whole of the Pollock case and not merely a part of it. It may nullify the Pollock ruling that a tax on income from certain sources must be apportioned and nullify also the further Pollock ruling that a Federal tax on income from State and municipal bonds

is an unconstitutional interference with the independence of the States. The Chief Justice points to nothing in the congressional debates to indicate that the sixteenth amendment was aimed exclusively at one-half of the Pollock case. On the other hand, in 25 Harvard Law Review, 794, and in 6 American Bar Association Journal, 202, Mr. Harry Hubbard goes to the debates and finds not a little evidence here and there that the amendment was aimed to kill the whole of the Pollock case. Its language contains not the slightest intimation to the contrary. Clearly the narrow interpretation of the Chief Justice and his colleagues in the Brushaber case was dictated not by necessity but by preference.

NO NEED FOR DECISION.

This lack of necessity was twofold. There was no need to give the narrow interpretation put forth. There was no need to pass on the issue at all. Chief Justice White had to work hard to find reason for saying that the amendment conferred no new power to tax. The fact that he chose to do so makes his dictum psychologically as significant as if it were explicit decision. It shows that the court went out of its way to settle a question that had been much mooted. While the sixteenth amendment was before the New York Legislature for ratification, Governor Hughes and others opposed ratification on the ground that the result of ratifying would be to subject the income of State bonds to Federal taxation. Senator Root and Professor Seligman put forward a contrary interpretation. After the amendment had become part of the Constitution, the question of its meaning was still an open one. There can be no doubt that the roundabout opinion of the Chief Justice in the Brushaber case was designed to close the debate and to announce positively, if not clearly, that the amendment in no way affects exemptions previously obtaining by reason of the judicial doctrine that neither the States nor the United States may tax the governmental instrumentalities of the other. Confirmation of this guess from the Brushaber opinion appeared a month later in Stanton *v.* Baltic Mining Co. (1916, 240 U. S. 103), in which the Chief Justice put forth the caveat:

> Mark, of course, in saying this we are not here considering a tax not within the provisions of the sixteenth 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.

This must refer to income taxes, since only income taxes could be thought to be within the sixteenth amendment. The warning that some income taxes gained no sanction from the sixteenth amendment must, in view of the debate on the question of State securities, be taken to have been uttered with reference to that question.

EARLY DECISIONS UNANIMOUS.

The interpretations thus early put upon the sixteenth amendment were reached without dissent. The issue was raised collaterally two years later in Peck & Co. *v.* Lowe (1918), 247 U. S. 165, which held that a Federal tax on the net income from an exporting business is

not a tax on exports. In the course of the opinion for an again unanimous court Mr. Justice Van Devanter observed:

> The sixteenth amendment, although referred to in argument, has no real bearing and may be put out of view. As pointed out in recent decisions, it does not extend the taxing power to new or excepted subjects, but merely removes all occasion, which otherwise might exist, for an apportionment among the States of taxes laid on income, whether it be derived from one source or another.

This again was dictum. The statement was, however, later quoted or paraphrased in Eisner *v.* Macomber (1920), 252 U. S. 189, and in Evans *v.* Gore, prefaced by such introductions as "we have so held," "we again held," and "as repeatedly held." In the latter case Mr. Justice Van Devanter announced that "after further consideration, we adhere to that view, and accordingly hold that the sixteenth amendment does not authorize or support the tax in question." This, as already pointed out, was square decision, since it was necessary to the result reached in declaring the statute unconstitutional, and since the opposite attitude toward the effect of the amendment would have led to the opposite result of sustaining the tax.

Now for the first time we find judicial dissent from this uniform and previously unanimous attitude toward the amendment. While Justices Holmes and Brandeis thought it perfectly proper to tax the salaries of the judges, even without any aid from the sixteenth amendment, they added that they thought also that the amendment set the matter at rest. As Mr. Justice Holmes puts it:

> A second and independent reason why this tax appears to me valid is that, even if I am wrong as to the scope of the original document, the sixteenth amendment justifies the tax, whatever would have been the law before it was applied. By that amendment Congress is given power to "collect taxes on incomes from whatever source derived." It is true that it goes on "without apportionment among the several States, and without regard to any census or enumeration," and this shows the particular difficulty that led to it. But the only cause of that difficulty was an attempt to trace income to its source, and it seems to me that the amendment was intended to put an end to the cause, and not merely to obviate a single result. I do not see how judges can claim an abatement of their income tax on the ground that an item in their gross income is salary, when the power is given expressly to tax incomes from whatever source derived.

This inability to see that words do not mean what they say seems somewhat belated. The two dissentients had sat in the Peck case without any announced disapproval of the shackles therein placed on the sixteenth amendment. From first to last we have an unbroken series of warnings that the Supreme Court would not let Congress, after the amendment, tax any income that was wholly exempt before.

In the face of this overwhelming evidence, it seems strange that anyone should have the temerity to advise Congress to go ahead and tax the income from State securities without waiting for any new constitutional authorization. In the New Republic for January 31, 1923, Professor Corwin, of Princeton, argues ably that the court ought not to have restricted the scope of the sixteenth amendment and he gives good reasons why income from State bonds should never have been held exempt from Federal taxation. His constitutional law is excellent, except in the single respect that it is not the constitutional law of the Supreme Court of the United States. Law, as Mr. Justice Holmes has told us, is a "prophecy of what courts will do in fact." That this prophecy was in its earlier stages uttered

obiter is no longer material now that dictum has become decision. Nor can the decision on the salary of a Federal judge be denied application to the income from State securities, as Mr. Corwin seeks to do. The fact that the two exemptions came originally from different constitutional premises gives no warrant for faith that the Supreme Court will either reverse previously well-settled law or make the sixteenth amendment mean a grant of power in one case and not in another.

The doctrine that neither the States nor the United States can tax the instrumentalities of the other is one of the earliest in our constitutional law and one that never has been disputed. Where there has been disagreement it has been confined to the issue whether the tax in question is or is not a tax on an instrumentality of government. It was in the Pollock case that the Supreme Court squarely held that the Federal Government can not tax the interest paid on State and municipal bonds. Here Chief Justice Fuller observed:

> It is contended that although the property or revenues of the States or their instrumentalities can not 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 the tax on the income from their securities, and for the same reason, and that reason is given by Chief Justice Marshall in Weston *v.* Charleston, 2 Pet. 449, 468, where he said: "The right to tax the contract to any extent, when made, must operate upon the power to borrow before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burden on the operations of government. It may be carried to such an extent as to arrest them entirely. * * * The tax on Government stock is thought by this court to be a tax on the contract, a tax on the power to borrow money on the credit of the United States, and consequently to be repugnant to the Constitution." Applying this language to these municipal securities, 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 taxation in question is a tax on the power of the States and their instrumentalities, and consequently repugnant to the Constitution.

This may be criticized as bad economics or bad politics, but it still stands as law. Income from State securities was exempt from Federal taxation prior to the sixteenth amendment, and the sixteenth amendment "does not extend the taxing power to new or excepted subjects." Those who desire a change in the situation will do well to waste no time on any minor operation. The first step is to get a new constitutional amendment saying that the sixteenth amendment means what it says.

This is not to say that there are no devious ways in which here and there by indirection the interest from State and municipal bonds may be made to contribute somewhat to the Federal fisc. An excise tax on doing business in corporate form or on doing business generally might be measured by income from all sources. Exemptions and deductions might possibly be restricted in the case of taxpayers who have untaxed income from State securities. It is doubtful, however, whether such indirect methods are worth trying. They would usually fail to reach the particular sore spot in the exemptions enjoyed by individual recipients of large incomes. They would throw the Federal taxing system into even worse confusion than that which it now enjoys. What is needed to defeat the defeat of the progressive feature of income taxation is a constitutional amendment explicitly sanctioning the inclusion of income from

State securities in the returns for the Federal income tax. The wisdom of such an amendment can be supported by exposing the large elements of unwisdom in the existing constitutional law which makes an amendment necessary. This unwisdom is due in part to the fact that our law has had to be made piecemeal, in part to the fact that income taxes were late in arriving, in part to overemphasis on political values to the neglect or the distortion of economic values, in part perhaps to judicial frailty. The time has now arrived for a comprehensive treatment of the problem and for the establishment of the fiscal interrelations of State and Nation on a new basis.

AMENDMENT NECESSARY.

Any comprehensive survey will discover at once that the unwisdom in the immunity of State securities from Federal taxation is part and parcel of the wisdom or unwisdom of the immunity of Federal securities from State taxation. It will doubtless be well, therefore, to make the cure as comprehensive as the malady and not to confine it to the Federal income tax. It may be unfair to ask the States to give up the bounty which they now enjoy unless they in turn receive some secure guaranty that the Federal Government will also yield its reciprocal bounty. Such a guaranty, even if not demanded by fairness, may very likely be demanded by selfishness. The States may well ask what they are to get in return for what they are to lose. They may prefer to have the question answered by the very constitutional amendment which they will be asked to accept, so that they will not be dependent on future congressional declarations subjecting new issues of Federal securities to State taxation. Indeed, there is some doubt as to whether Congress has power to provide that Federal securities may be subjected to State taxation. Their exemption has been predicated on the Constitution, and Congress can not change the Constitution. Such is the argument. A common-sense answer is that Congress is the best judge of whether its borrowing power needs the bounty which it now enjoys and that it can therefore tinker with the immunity of Federal securities as it has tinkered with the immunity of national banks. Yet, even if it were certain that Congress can give to the States the counterpart of what the Federal Government can get from the States only by constitutional amendment, no single Congress can give to the States the firm assurance that they would find in a constitutional amendment.

The exemption of Federal securities from State property and income taxes compels the States to give a bounty to the Federal borrowing power. The only justification for this bounty is the reciprocal bounty which the State borrowing power enjoys in the exemption of State securities from Federal taxation. Had the sixteenth amendment been interpreted as it seems to read, the States would have lost their bounty and would still be required to confer a bounty on the Nation. A court might well pause before sanctioning such a result. The official interpretation of the sixteenth amendment may be subject to literary and logical criticism and still have in its favor a preponderance of substantial statesmanship. It retains a balance which a contrary interpretation would have overthrown. If the situation is unhappy we can remedy it by constitutional amendment. Such an amendment, however, should emulate the Supreme Court in still preserving a proper balance between the Nation and the States.

LETTER FROM THE SECRETARY OF COMMERCE TO THE HON. REED SMOOT

TRANSMITTING

A MEMORANDUM OPINION

BY

JUDGE STEPHEN B. DAVIS

LETTER FROM THE SECRETARY OF COMMERCE TO THE HON. REED SMOOT, TRANSMITTING A MEMORANDUM OPINION.

By Judge Stephen B. Davis.

Department of Commerce,
Office of the Secretary,
Washington, November 2, 1923.

Hon. Reed Smoot,
United States Senate.

My Dear Mr. Senator: In accordance with your request I inclose herewith a memorandum opinion by Judge Stephen B. Davis on the power of Congress to impose a special or additional estate tax upon the succession to the portion of an estate which consists of Federal, State, or municipal bonds, the income from which is exempt from Federal income tax. You will see that Judge Davis believes Congress has constitutional power to levy such a tax, subject, perhaps, to the condition that the differentiation in rates of levy be not arbitrary but have some reasonable basis. By such a tax rates can be so adjusted as to effect, through the difference in the amounts which would be exacted from the corpus of the estate, an ultimate approximate equalization between the burdens currently borne by incomes subject to surtaxes and incomes which are not so subject because of investment in securities of a legally privileged nature. Such an ultimate equalization would tend to do away with a great amount of the present successful avoidance of the burdens of Federal taxation.

This plan, might, on consideration, develop weaknesses that are not now apparent, but I would like to make some comment on this whole question of tax-exempt securities from the point of view of industry and commerce in support of Secretary Mellon's recommendations.

Secretary Mellon has stated that eleven billions of State and municipal securities are in circulation free of income tax. It is generally believed that these securities are sought after by persons subject to the higher percentages of income tax. Therefore the very persons best able to bear the burden of taxation are escaping it.

Nor is direct tax exemption of these securities the whole story, for they furnish a wide basis for further avoidance of taxation. For instance, a man may borrow 70 per cent on his house (if his other credit is good); he may invest this borrowed sum in tax-exempt securities; under our present income-tax laws he may deduct the interest which he pays on his mortgage from his income and does not have to account for the sum he receives on tax-exempt securities. There appears to have definitely grown up not only this form of avoidance but other forms based on various kinds of interlocking transactions which carry avoidance a great deal further than the actual sum otherwise collectible on tax-exempt securities.

This question has many bearings on productive industry and commerce and many economic as well as social implications.

1. It must be obvious that we are thus thrusting the burden of income taxes upon productive industry and personal effort.

2. Most other countries in the world give special relief in income taxes to business and professional incomes as distinguished from rent and interest as being necessary to maintain the initiative and enterprise of the people. We not only do not give this relief but the effect of the tax-exempt security as shown above is to thrust even a much larger burden upon earned income from business and professions and to offer larger opportunity for avoidance of taxes on so-called property incomes.

3. Aside from the uneconomic thrust of taxes onto productive activities, there is an inherent injustice in this distribution of the burden from the fact that holders of professional and business incomes must set aside a portion of these incomes to provide for their dependents, whereas persons possessed of rent or interest incomes have by the nature of things already made such provision. Other countries allow a large deduction of amounts paid for insurance premiums. We allow none.

4. Under the tax-exempt provisions, States and municipalities are able to borrow money with even lower margins of interest over manufacture and business. The net effect is to increase interest rates in industry and commerce and this misdirection in the flow of capital tends to increase the prices of every commodity.

5. The collection of estate taxes upon exempt securities does not present the difficulties in payment presented by such taxes upon going business, for these securities are readily marketable. Such a tax increase will also result in a better distribution of estates representing unduly large accumulation.

6. Even though the States be disposed to accept a constitutional amendment on tax exempt securities it will take time, and in the meantime further securities will be piling up.

7. What additional tax should be placed upon the portion of the estate composed of exempt securities in order to compensate for the loss of income tax upon them needs careful study. It will probably have to be an empirical figure in any event.

It is an extraordinary thing for a commercial nation like ours to have developed a form of taxation which puts a premium on non-productivity and a blight on productivity itself.

Yours faithfully,

HERBERT HOOVER.

MEMORANDUM OPINION BY JUDGE STEPHEN B. DAVIS.

OCTOBER 19, 1923.

Neither the principal nor interest of bonds and other evidences of indebtedness issued by States or their municipalities is subject to taxation by the Federal Government, nor are such bonds of the Federal Government taxable by the States.

State bonds: Mercantile Bank *v.* New York, 121 U. S. 138; Pollock *v.* Farmer's Loan & Trust Co., 157 U. S. 429; South Carolina *v.* United States, 199 U. S. 437, 467.

United States bonds: Bank Tax cases, 2 Wall. 200; McCullough *v.* Maryland, 4 Wheat. 316, 421; Hibernia Savings Society *v.* San Francisco, 200 U. S. 310, 313; Home Savings Bank *v.* Des Moines, 205 U. S. 503, 513.

But an inheritance or estate tax levied upon the right of succession to property after death is not a tax upon the property bequeathed or inherited, and such a tax is valid, although the estate upon which it is levied consists in whole or in part of "tax-free" securities. Plummer *v.* Coler, 178 U. S. 115; U. S. *v.* Perkins, 163 U. S. 625; Home Savings Bank *v.* Des Moines, 205 U. S. 503.

The present Federal estates tax is measured by the entire estate, including municipal bonds, and has been held valid in this respect by the Supreme Court of the United States in Greiner *v.* Lewellyn, 258 U. S. 384, an opinion by Justice Brandeis, in which he said:

> That the Federal Government has power to tax the transmission of legacies was settled by Knowlton *v.* Moore, 178 U. S. 41; and that it has the power to tax the transfer of the net assets of a decedent's estate was settled by New York Trust Co. *v.* Eisner, 256 U. S. 345. The latter case has established also that the estate tax imposed by the act of 1916, like the earlier legacy or succession tax, is a duty or excise, and not a direct tax like that on income from municipal bonds. Pollock *v.* Farmers' Loan & Trust Co., supra. A State may impose a legacy tax on a bequest to the United States, United States *v.* Perkins, 163 U. S. 625, or on a bequest which consists wholly of United States bonds, Plummer *v.* Coler, 178 U. S. 115; Orr *v.* Gilman, 183 U. S. 278. Likewise the Federal Government may impose a succession tax upon a bequest to a municipal corporation of a State, Snyder *v.* Bettman, 190 U. S. 249, or may, in determining the amount for which the estate tax is assessable, under the act of 1916, include sums required to be paid to a State as inheritance tax, for the estate tax is the antithesis of a direct tax, New York Trust Co. *v.* Eisner, supra. Municipal bonds of a State stand in this respect in no different position from money payable to it. The transfer upon death is taxable, whatsoever the character of the property transferred and to whomsoever the transfer is made. It follows that in determining the amount of decedent's net estate municipal bonds were properly included.

Property may be classified for purposes of taxation and the rate varied among the different classes, so long as there is some reasonable basis for the classification and it is not merely arbitrary. Magoun *v.* Illinois Trust & Savings Bank, 170 U. S. 283; Watson *v.* State Comptroller, 254 U. S. 122.

The provision of the Constitution of the United States, Article I, section 8, that "duties, imposts, and excises shall be uniform throughout the United States" requires only geographical uniformity, not uniformity between classes. Patton *v.* Brady, 184 U. S. 608.

A classification of securities according to whether or not they have through taxation paid their proportion of the expense of government during the life of the owner would seem a reasonable classification, and there would be no constitutional objection to the imposition of an additional rate by way of estate tax upon the succession to that portion of the estate which has escaped such taxation, to the end that the tax burden might so far as possible be equalized.

In Plummer *v.* Coler, 178 U. S. 115, the Supreme Court said:

> After all, what is an inheritance tax but a debt exacted by the State for protection afforded during the lifetime of the decedent? It is often impracticable to secure from living persons their fair share of contribution to maintain the administration of the State, and such laws seem intended to enable the State to secure payment from the estate of the citizen when his final account is settled with the State. Nor can it be readily supposed that such obligations can be evaded or defeated by the particular form in which the property of the decedent was invested.

Several of the States have enacted statutes imposing inheritance taxes upon securities on which for one reason or another no taxes were paid during the life of the owner. In New York an additional tax of 5 per cent is levied "on all investments which have not paid the stamp tax or the personal property tax during the lifetime of the decedent." An interesting discussion of such a tax is found in the opinion of the Court of Appeals of New York in In re Watson's Estate, 226 N. Y. 384, 398–400, as follows:

Assuming without deciding that the discretion to classify personal property which must pay an inheritance tax before passing by will or inheritance is limited to a classification which is based upon some reason and not the mere caprice of the legislature, this present law under discussion comes within such a rule.

Holding up the section under discussion for comparison with these authorities as a pattern, does it fall within or without the line of constitutional limitation? In the first place, we may consider this tax as though it were the first and only tax placed upon transfers. The fact that it is an additional tax does not change the principle involved. The tax is then, one placed upon the transfer of property at the time of death which has not theretofore paid any tax, local or State.

The objection can not be pressed, that the beneficiary under the will is punished for the misdeeds of the ancestor in not paying a local or State tax. The beneficiary has no claim to the property of an ancestor except as given by law, and, if the State has a right to impose a tax at all upon the passing of property, the transferee takes only what is left after the tax is paid. The State, therefore, having the power to place an inheritance tax upon property which has escaped taxation during the lifetime of the testator, it is no valid objection that the legatee may deem himself punished by the circumstance. Neither is there foundation in the authorities for the assertion or implication that the inheritance tax laws must look with indifferent eye upon the kind of property transferred and can not single out personalty as distinguished from realty and the like. * * * Slight inequalities or injustices which may follow from the application of this law as it is applied by the taxing authorities are not in and of themselves constitutional objections (Matter of White, 208 N. Y. 64), unless they become so great as to violate the principles stated. It has been said that this is not classification but a mere arbitrary tax upon the right to transfer investments. Is there not, at least, a semblance of reason in seeking to tax upon inheritance property which has not been taxed locally or for State purposes, when such fact can only be discovered upon the death of the owner? The matter at least permits of argument and is not so capricious and whimsical as to be purely arbitrary. It has in it at least an effort for the equalization of taxation and the adjustment of the burdens of government.

This decision was affirmed by the Supreme Court of the United States (Watson *v.* State Comptroller, 254 U. S. 122), the court saying:

The occasion and the purpose of the statute are shown by the Court of Appeals. An owner of investments is not required either to list them for assessment locally under the general property-tax law or to present them for stamping under the investment-tax law. Whether the investments of a resident are taxed during his life depends either upon his own will or upon the vigilance and discretion of the local assessors. This condition led to loss of revenue by the State and to inequality in taxation among its citizens. To remedy both evils this additional transfer tax was imposed upon investments of a decedent which had wholly escaped taxation. It is insisted that the tax is discriminatory because under it other property of the same kind bequeathed to persons standing in the same relationship to the decedent will not be taxed. But the power to classify for purposes of taxation is fully established. The executors admit, as they must, that a classification is reasonable if made with respect to the kind of property transferred; or, to the amount or value of property transferred, or to the relationship of the transferees; or to the character of the transferee, for instance as engaged in charity. Magoun *v.* Illinois Trust & Savings Bank, 170 U. S. 283, 300; Billings *v.* Illinois, 188 U. S. 97; Campbell *v.* California, 200 U. S. 87. But their list does not exhaust the possibilities of legal classification. See Beers *v.* Glynn, 211 U. S. 477, 484; Keeney *v.* New York, 222 U. S. 525; Maxwell *v.*

Bugbee, 250 U. S. 525; compare Hatch *v.* Reardon, 204 U. S. 152. Any classification is permissible which has a reasonable relation to some permitted end of governmental action. It is not necessary, as the plaintiff in error seems to contend, that the basis of the classification must be deducible from the nature of the things classified—here the right to receive property by devolution. It is enough, for instance, if the classification is reasonably founded in 'the purpose and policy of taxation.' Pacific Express Co. *v.* Siebert, 142 U. S. 339, 354; Kidd *v.* Alabama, 188 U. S. 730, 732; Clement National Bank *v.* Vermont, 231 U. S. 120, 136–137; Farmers Bank *v.* Minnesota, 232 U. S. 516, 529–530. And what classification could be more reasonable than to distinguish, in imposing an inheritance or transfer tax, between property which had during the decedent's life borne its fair share of the tax burden and that which had not?

It does not follow, as is also argued, that the act in question imposes a property tax, merely because its existence may induce owners of investments to present them for taxation under the investment tax law. Nor is it to be deemed a law imposing a penalty merely because the decedent's estate may under it be required to pay more in taxes than the deceased would have paid if he had presented his property for taxation under the investment tax law. Whether this additional transfer tax would be obnoxious to the fourteenth amendment if it could be deemed a property tax or a penalty, we have no occasion to consider.

The judgment of the surrogate court entered on the remittitur from the Court of Appeals of New York is affirmed.

A statute of the State of Connecticut provides:

All taxable property of any estate upon which no town or city tax has been assessed * * * or upon which no tax has been paid to the State during the year preceding the date of the death of the decedent, shall be liable to a tax of 2 per cent per annum on the appraised inventory value of such property for the five years next preceding the date of the death of such decedent.

While this statute can not perhaps be considered strictly as imposing a succession or inheritance tax, since it operates directly upon the body of the estate rather than upon the right of succession to it, the attitude of the courts toward it is of interest. It is based upon the evasion of taxes by the owner rather than upon the mere fact that the property did not contribute its fair share of taxes, and is therefore in the nature of a penalty. The Supreme Court of Errors of Connecticut (Bankers Trust Co. *v.* State of Connecticut, 114 Atl. 104), referred to it as a law "to compel estates to pay to the State a sum which shall approximately equal the taxes which the property of the estate has escaped paying while in the hands of the decedent," language broad enough to include all property which has so escaped, irrespective of the reason for it.

Discussing the question of classification, the court said:

The statute is not attacked as unconstitutional because of its classification. Nor could it be. "A legislature is not bound to impose the same rate of tax upon one class of property that it does upon another." Michigan Central Railroad Co. *v.* Powers, 201 U. S. 245, 293; 32 Sup. Ct. 459, 466 (50 L. Ed. 744). A classification for purposes of the penalty tax of property of an estate which has not borne its share of the general taxes as distinguished from other property which has borne its share of such taxes is not such an arbitrary selection as to be unconstitutional.

The Supreme Court of the United States (Bankers Trust Co. *v.* Blodgett, 260 U. S. 647, decided January 22, 1923), considers the tax as a penalty and upholds it, even though the amount required to be paid might not correspond to what would have been paid if it had been taxed during the lifetime of the owner. The court said:

As pointed out by the supreme court of errors, executors and administrators do not own the property committed to them for administration. It goes to them subject to the liabilities and burdens upon it in the hands of its owner, and whatever interest distributees or creditors may have is subject to the same liabilities

and burdens. Subject, we may say, as the court decided, to the tax which the State has imposed on its disposition or devolution, and the tax does not take on a different quality or incident because it is, or has the effect of, a penalty. And the court, construing the statute, declared it was a provision for penalizing a delinquency—the delinquency of the decedent—and made to survive "by statutory sanction." "In effect," the court said, "this statute is a penalty imposed upon the estate because of the delinquency of the decedent and no less permissible than the penalty tax against the decedent kept alive by statutory sanction."

By whatever name the tax involved in these cases may be called, the fact remains that property was classified according to whether or not taxes had been paid upon it, and taxes were levied accordingly.

Louisiana levies a general inheritance tax with the following proviso:

And provided further, That this tax shall not be enforced when the property donated or inherited shall have borne its just proportion of taxes prior to the time of such donation or inheritance.

This general tax against all property excepting such as has "borne its just proportion of taxes" prior to the inheritance is, of course, identical with a tax upon the succession to property which has not borne its proportion of such taxes. The Louisiana tax is precisely like a Federal tax upon all securities which have not been subject to or have not paid a general income tax.

This law was construed by the Supreme Court of Louisiana in Succession of Kohn, 38 So. 898, which involved the question as to whether or not nontaxable bonds come within the exception above quoted; in other words, whether or not "tax-free" securities were subject to the tax. The court said:

In Plummer v. Coler, 178 U. S. 115, 20 Sup. Ct. 829, 44 L. Ed. 998, the Supreme Court, after reviewing the jurisprudence, State and Federal, on the subject of inheritance taxes, and the taxation of shares, privileges, and franchises, held that an inheritance tax was one not on property, but upon its transmission by will or descent, and that such tax was not invalidated or affected by the incidental fact that the property passing was composed wholly of United States bonds, exempt by express statute from all taxation, Federal, State, and municipal.

Hence, under article 235 of the constitution of 1898, it matters not whether the property of an estate is taxable or not—has or has not been taxed.

The next article withdraws from the operation of article 235 property which has borne its just proportion of taxes prior to the time of the opening of the succession, or, in other words, property which has been assessed, and the taxes thereon paid. If the lawmaker had intended to include property exempt from taxation, he would have said so. Nontaxable bonds can not be said to have borne their just proportion of taxes, as they are exempt from such burden. The lawmaker evidently referred to property subject to assessment and taxation on which taxes had been paid prior to the time of the devolution of the inheritance. Exemption from taxation is strictly construed, and can not be read into a statute by inference or implication.

Hence we are of opinion that the premium bonds and State bonds are subject to the inheritance tax.

This case is direct authority for the placing of such securities in a class by themselves and the levying of a special tax upon the right of succession to them.

Some of the decisions dealing with State inheritance tax law are based upon the principle that succession to property after the death of the owner is not a natural right but a privilege given by the State and one which the State might withhold in its entirety or to which it may annex such conditions as it pleases. This right or privilege is not, of course, dependent upon Federal law. The foundation of

such a levy by the Federal Government is its general power of taxation, and the right or privilege of inheritance or succession is a proper subject for such taxation and one which has been availed of by many governments by way of death duties from the earliest times. Knowlton *v.* Moore, 178 U. S. 41.

The conclusions upon this subject may be summarized as follows:

1. Inheritance or succession taxes may be levied upon estates which consist in whole or in part of tax-free securities.

2. These taxes need not be uniform except geographically.

3. Such securities may be classified according to whether or not taxes have been paid upon them during the life of the owner.

4. A special tax may be levied upon the succession to securities upon the income from which no taxes were paid during the life of the owner, or during a certain period preceding his death, including both those as to which payment of income tax was evaded and those the income from which was exempt.

5. This tax may be exclusively upon this class of securities or may be by the levy of an amount upon them additional to the levy against the other class.

6. Since the theory of the classification is the equalization of the tax burden, the additional tax should approximate as near as may be the amount which would have been paid had the securities been subject to the income tax during the life of the owner, or during a stated period preceding his death.

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LETTER FROM MR. A. W. GREGG

ASSISTANT TO THE SECRETARY OF THE TREASURY

TO THE

HON. W. R. GREEN

LETTER FROM MR. A. W. GREGG, ASSISTANT TO THE SECRETARY OF THE TREASURY, TO THE HON. W. R. GREEN.

The letter from Mr. A. W. Gregg, Assistant to the Secretary of the Treasury, is, in part, as follows:

JANUARY 4, 1924.

Hon. W. R. GREEN,
Chairman Ways and Means Committee,
House of Representatives.

MY DEAR MR. CHAIRMAN: Prior to its adjournment before the holidays the committee requested that I prepare for the assistance of the committee a digest of the decisions and arguments affecting the question of whether Congress has the power to levy a tax upon the income from securities issued by States or political subdivisions thereof. In accordance with that request the following is submitted.

Two questions will be considered, (1) whether the Federal Government has the general power to lay a tax upon income derived from securities issued by States or political subdivisions thereof; (2) in the event that Congress may not lay a tax upon income from all such securities, whether the income from any obligation issued by States or political subdivisions thereof may be taxed by the Federal Government.

The earliest decision of the Supreme Court upon the question of the power of the United States to tax State instrumentalities is The Collector *v.* Day (1870), 11 Wall. 113. Under the Civil War income tax acts a tax was assessed on the salary of Hay, a probate judge in Massachusetts. He paid the tax under protest and brought action to recover it. It was held by the Supreme Court that Congress had no power to impose a tax upon the salary of a State judicial officer. The court cited Dobbins *v.* Commissioners (1842), 16 Pet. 435; McCulloch *v.* Maryland (1819), 4 Wheat. 316; and Weston *v.* Charleston (1829), 2 Pet. 449, as establishing the proposition "that the State governments can not lay a tax upon the constitutional means employed by the Government of the Union to execute its constitutional powers," and concluded that, on the same principle, the United States can not tax the means and instrumentalities employed by the States for carrying on their governmental operations. The court's reasoning is indicated in the following passage (pp. 125, 187):

> 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 are employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that government.
>
> * * * the means and instrumentalities employed for carrying on the operations of their governments, for preserving their existence, and fulfilling the high and responsible duties assigned to them in the Constitution, should be left free and unimpaired, should not be liable to be crippled, much less defeated, by the taxing power of another government * * *.

This decision was followed in the cases of a judge of the superior court of New York City (Freedman *v.* Sigel (1875), Fed Cas. No. 5989) and of a State's attorney in Maryland (U. S. *v.* Ritchie (1872), Fed. Cas. No. 16168).

In the case of Pollock *v.* Farmer's Loan & Trust Co. (1895), 157 U. S. 429, a bill by a stockholder to enjoin the defendant corporation from paying an income tax under the act of August 15, 1894 (28 Stat. 309), it was urged that the act was unconstitutional on the grounds, (1) that in imposing a tax on the income or rents of real and personal property, it imposed a direct tax upon the property itself, which was void because not apportioned among the States; (2) that in imposing indirect taxes, it violated the constitutional requirement of uniformity; (3) that in imposing a tax upon income received from State and municipal bonds, it exceeded the constitutional powers of the Federal Government. With reference to this third point, Chief Justice Fuller said (p. 585):

> It is contended that although the property or revenues of the States or their instrumentalities can not 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, and that reason is given by Chief Justice Marshall in Weston *v.* Charleston, 2 Pet. 449, 468, where he said: 'The right to tax the contract to any extent, when made, must operate upon the power to borrow before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burden on the operations of government. It may be carried to an extent which shall arrest them entirely. * * * The tax on Government stock is thought by this court to be a tax on the contract, a tax on the power to borrow money on the credit of the United States, and consequently to be repugnant to the Constitution.' Applying this language to these municipal securities, 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.

It is clear, therefore, that prior to the adoption of the sixteenth amendment Congress had no power to levy a tax, directly or indirectly, upon securities issued by States or a political subdivision thereof. There remains to be considered the effect of the sixteenth amendment.

The sixteenth amendment provides that: "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."

At the time the sixteenth amendment was being considered by the legislatures of the several States it was urged by various writers and public men that the proposed amendment gave Congress the power to tax the salaries of officers and employees of the States and the income from State and municipal securities. (See Foster, Income Tax, p. 78 et seq.; Miner, The Proposed Income Tax Amendment, 15 Va. L. Reg. 737, 753; Hubbard, The Sixteenth Amendment, 33 Harvard Law Review, 794.) The contrary view was urged with equal strength. (See Cong. Rec., vol. 45, pp. 1694–1699, 2245–2247, 2539–2540, and Ritchie, Power of Congress to Tax State Securities, 5 Am. Bar Assoc. Journal, 602.)

In the first case which arose under the sixteenth amendment, the case of Brushaber *v.* Union Pacific R. R. Co., 240 U. S. 1, the Supreme

Court committed itself on the question of whether or not the sixteenth amendment gave to Congress any new power of taxation. This case was a suit by a stockholder to restrain the defendant corporation from paying an income tax imposed by the tariff act of 1913, on the ground that it was unconstitutional. Chief Justice White, in the course of upholding the validity of the act, said (pp. 17, 18, 19):

It is clear on the face of this text that it (the amendment) 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 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 subjected to the regulation of apportionment. * * *

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. * * *

* * * 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.

Again, in Stanton *v.* Baltic Mining Co. (1916), 240 U. S. 103, an action in form similar to the Brushaber case, Chief Justice White said, in upholding the constitutionality of the same act (p. 112):

* * * 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. Hark, of course, in saying this we are not here considering a tax not within the provisions of the sixteenth 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.

Similar dicta occur in Eisner *v.* Macomber (1920), 252 U. S. 189, 204, and in Peck & Co. *v.* Lowe (1915), 247 U. S. 165.

Although it appears that in none of these cases was it necessary to pass upon the issue, it is significant that the court saw fit to announce in each of them that the amendment did not extend the taxing power of Congress to cover any new subjects.

The opinion of Evans *v.* Gore (1920), 253 U S. 245, throws a more direct light upon the views of the Supreme Court regarding the scope of the sixteenth amendment. The action therein was brought by

a United States district judge, appointed in 1899, to recover a tax paid upon his salary under the revenue act of 1918 (40 Stat. 1062). His chief contention was that the effect of the act, in imposing a tax on his salary, was to diminish his compensation, and that to this extent was repugnant to the third article of the Constitution, providing that his salary should not be diminished during his continuance in office. The court came to the conclusion that the prohibition prevented diminution by taxation, and the court, after reciting the history of the adoption of the sixteenth amendment, concluded:

> True, Governor Hughes, of New York, in a message laying the amendment before the legislature of that State for ratification or rejection, expressed some apprehension lest it might be construed as extending the taxing power to income not taxable before; but his message promptly brought forth from statesmen who participated in proposing the amendment such convincing expositions of its purpose, as here stated, that the apprehension was effectively dispelled and ratification followed.
>
> Thus the genesis and words of the amendment unite in showing that it does not extend the taxing power to new and 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. And we have so held in other cases.

In conclusion, then, it is evident that, since the ratification of the sixteenth amendment, the Supreme Court of the United States, in dicta and decision, has consistently adhered to the view that the amendment does not extend the taxing power of Congress to new or excepted subjects. Prior to the adoption of the sixteenth amendment, it was established that, in general, income from State and municipal bonds was exempt from taxation by the Federal Government. In view of these two lines of decisions it appears evident to me that, in the absence of a constitutional amendment, a tax upon the income derived from State and municipal securities would be held by the Supreme Court to be beyond the constitutional powers of Congress.

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Respectfully,

A. W. GREGG.

LETTER FROM MR. WILLIAM L. FRIERSON

FORMER SOLICITOR GENERAL OF THE UNITED STATES

TO THE

HON. JAMES M. FREAR

LETTER FROM MR. WILLIAM L. FRIERSON, FORMER SOLICITOR GENERAL OF THE UNITED STATES, TO THE HON. JAMES M. FREAR.

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CHATTANOOGA, TENN., *December 20, 1923.*

Hon. JAMES M. FREAR,
House of Representatives, Washington, D. C.

DEAR MR. FREAR: I am in receipt of your letter of December 17, evidently referring to a conversation which I had recently with Senator Shields. I did not, however, state that the case of Evans *v.* Gore is authority for the statement that so-called tax-free securities can not be reached for income-tax purposes. I did say that while I have not given the subject serious consideration, if my argument in Evans *v.* Gore had been successful and the dissenting opinion of Mr. Justice Holmes in that case had been the opinion of the court, I would have little doubt that the income from such securities could be included in taxable income. The majority opinion in that case, however, makes the question more doubtful.

So far as obligations of the Federal Government which may be issued in the future are concerned, there can be no doubt of the power of Congress to make income from them taxable. The question, I presume, in which you are interested is the power of Congress to treat State, county, and municipal bonds, or rather the income from them, as taxable income.

Of course, it is settled that bonds of this kind as such can not be taxed by the Federal Government, and I think it is equally true that the income from them as such can not be taxed.

There are, however, two recent decisions of the Supreme Court which I used in Evans *v.* Gore and which I think have established a principle which may make it possible for Congress in levying a general income tax to require income from such bonds to be included in gross income as the basis for arriving at the taxable net income. I refer to U. S. Glue Co. *v.* Oak Creek, 247 U. S. 321, and Peck & Co. *v.* Lowe, 247 U. S. 165. The first of these cases involved a State income tax, and the question was whether in computing net income profits derived from transactions in interstate commerce could be included. The second involved the question whether in computing taxable income under the Federal statutes profits derived from the business of exporting goods could be included.

Of course, it was clear that no State could levy a tax which would be a burden on or amount to a regulation of interstate commerce. And it was equally clear that Congress was expressly prohibited by the Constitution from taxing exports. The court, however, held in these cases that when the State taxed merely the net income of a person or corporation the net profit derived from interstate commerce constituted a part of the taxable income, and that including net profits derived from the business of exporting as a part of the taxable income for Federal purposes was not a violation of the pro-

vision against taxing exports. In the latter case the court said, speaking of the tax: "It is not laid on income from exportation because of its source, or in a discriminative way, but just as it is laid on other income. The words of the act are 'net income arising or accruing from all sources.' There is no discrimination. At most, exportation is affected only indirectly and remotely."

The principle thus established seems to be that a general tax upon net income is not a tax upon the sources from which particular parts of the income are derived. I thought that this principle controlled Evans *v.* Gore. If the court had agreed with me, I would have little doubt that it applied to income derived from so-called tax-free securities. I am, however, in some doubt as to whether this conclusion follows in view of the decision in that case. I am not convinced, however, that that decision settles the question against the Government. I think it can be distinguished from the question you are now considering. In Gore *v.* Evans the specific provision of the Constitution invoked was that which forbids the diminution of a judge's compensation during his term. The court reached the conclusion that to tax a judge's salary, even treating it as a part of his net income when the tax levied by the Government which paid his salary, was a substantial diminution of the salary. Having reached this conclusion, Mr. Justice Van Devanter distinguished Gore *v.* Evans from the cases I have referred to, upon the ground that the Constitution expressly forbids such a diminution.

The Constitution contains no express mention of State or municipal securities. As a matter of construction, it has long been settled that securities of this kind, as such, are not taxable by the Federal Government, because the Constitution does not permit the Federal Government to tax the governmental instrumentalities of the States, and neither does the Constitution contain any reference to the power of the States to tax interstate commerce. The conclusion that this can not be done was reached through a construction of the clause giving Congress the power to regulate interstate commerce. There is an express prohibition against the taxing of exports, but, as I have stated, the court has held that the taxing of all of a man's net income which includes some income derived from export business is not such a tax as violates this provision. I can not see any reason why the same principle does not apply to income derived from State and municipal bonds. The difficulty seems to be in reconciling this conclusion with the decision in Evans *v.* Gore. The doubt in my mind is whether the court would hold income from such securities falls in the class of cases controlled by the two cases I have referred to or by Gore *v.* Evans.

As stated above, I have given this question no serious consideration, but have merely given you the impressions made on my mind when I was preparing the argument in Evans *v.* Gore. I think, however, that the question is one well worthy of careful consideration.

Yours truly,

WM. L. FRIERSON.

TAX-FREE *v.* TAXABLE BONDS

TAX-FREE v. TAXABLE BONDS.

[Reprinted from a chart of THE BOND BUYER, of New York.]

Income from certain United States Government, State, and municipal bonds is exempt from the Federal income tax, rate of which, for 1923 income, ranges from 4 per cent to 58 per cent, according to amount of income. This table has been compiled to indicate the approximate yield which taxable bonds must return to equal the return from tax-free bonds yielding from 3 per cent to 6 per cent.

Example: Individual with income (subject to surtaxes) of about $50,000 purchases taxable bonds yielding 6.52 per cent, the income from which is subject, in his hands, to a normal tax of 8 per cent and a surtax (on income between $50,000 and $52,000) of 23 per cent, or a total of 31 per cent. Deducting the tax, his income from this bond is reduced to 4.50 per cent. In other words, for this person a tax-free bond yielding 4.50 per cent would be equivalent to a taxable bond yielding 6.52 per cent. In the table below the top line or row of figures represents yield (or basis) from tax-free bonds. In columns below is shown equivalent yield from taxable bonds when income (total amount subject to surtaxes) corresponds to amounts shown in extreme left-hand column.

This table is offered as a guide to assist the purchaser of bonds to choose intelligently between taxable and tax-free investments. It is computed on the theory that any change in an individual's taxable income resulting from a switching of investments from a taxable to a tax-free status, or vice versa, is effective at the highest brackets or the "top" of his income and, hence, the highest surtax rate has been applied in computing these equivalent yields. Because of the change of tax rates from year to year, it is useless to attempt an exact computation of the value of tax exemption over a series of years and for this reason we believe the chart is sufficiently comprehensive to serve the purpose for which it is intended.

Chart showing the effect of Federal income tax on yield from tax-free and taxable bonds in 1923.

Income subject to surtaxes between—	3	3½	3¾	4	4¼	4½	4¾	4¾	4¾	4¾	5	5½	6
	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.
$10,000 and $12,000...	3.33	3.89	4.17	4.44	4.72	4.86	5.00	5.14	5.28	5.42	5.56	6.11	6.67
$20,000 and $22,000...	3.57	4.17	4.46	4.76	5.06	5.21	5.36	5.50	5.65	5.80	5.95	6.55	7.14
$24,000 and $26,000...	3.66	4.26	4.57	4.88	5.18	5.34	5.49	5.64	5.79	5.95	6.10	6.70	7.31
$28,000 and $30,000...	3.75	4.37	4.69	5.00	5.31	5.46	5.62	5.77	5.93	6.09	6.25	6.87	7.50
$32,000 and $36,000...	3.89	4.54	4.87	5.19	5.51	5.67	5.84	6.00	6.16	6.32	6.49	7.14	7.79
$40,000 and $42,000...	4.05	4.73	5.07	5.40	5.73	5.90	6.07	6.24	6.41	6.58	6.75	7.43	8.11
$44,000 and $46,000...	4.17	4.86	5.21	5.55	5.90	6.07	6.25	6.42	6.59	6.77	6.94	7.63	8.33
$50,000 and $52,000...	4.35	5.07	5.43	5.80	6.16	6.34	6.52	6.70	6.88	7.06	7.25	7.97	8.69
$54,000 and $56,000...	4.47	5.22	5.60	5.97	6.34	6.52	6.71	6.89	7.08	7.27	7.46	8.21	8.96
$60,000 and $62,000...	4.68	5.46	5.86	6.25	6.64	6.83	7.03	7.22	7.42	7.61	7.81	8.58	9.37
$64,000 and $66,000...	4.84	5.65	6.05	6.45	6.85	7.05	7.26	7.46	7.66	7.86	8.06	8.86	9.68
$70,000 and $72,000...	5.08	5.93	6.37	6.78	7.20	7.41	7.62	7.81	8.04	8.25	8.47	9.33	10.17
$74,000 and $76,000...	5.26	6.14	6.58	7.01	7.45	7.67	7.89	8.11	8.33	8.55	8.77	9.65	10.53
$80,000 and $82,000...	5.55	6.48	6.94	7.40	7.86	8.09	8.33	8.56	8.79	9.02	9.25	10.18	11.10
$84,000 and $86,000...	5.77	6.73	7.22	7.68	8.16	8.40	8.65	8.89	9.13	9.37	9.62	10.57	11.52
$90,000 and $92,000...	6.12	7.14	7.65	8.16	8.68	8.94	9.20	9.45	9.70	9.95	10.20	11.21	12.25
$94,000 and $96,000...	6.38	7.45	7.98	8.51	9.04	9.31	9.58	9.84	10.10	10.36	10.62	11.70	12.77
$100,000 and $150,000.	6.82	7.96	8.52	9.10	9.66	9.94	10.22	10.50	10.79	11.07	11.36	12.50	13.65
$150,000 and $200,000.	6.98	8.15	8.72	9.31	9.89	10.18	10.47	10.76	11.05	11.34	11.63	12.80	13.95
Over $200,000.....	7.14	8.33	8.93	9.53	10.12	10.42	10.72	11.02	11.32	11.62	11.92	13.10	14.29