75TH CONGRESS, 1st Session | SENATE | DOCUMENT No. 86

STATE TAXATION OF FEDERAL AGENCIES

LETTER

FROM

CHARLES WOOLF

PRESIDENT OF THE MARICOPA COUNTY TAXPAYERS' LEAGUE

TO

SENATOR CARL HAYDEN

SUBMITTING

A DETAILED STATEMENT OF THE LEGAL AUTHORITY FOR THE IMPOSITION OF STATE TAXATION ON NATIONAL BANKS AND OTHER FEDERAL INSTRUMENTALITIES TOGETHER WITH OPINIONS FROM THE EXECUTIVE BRANCH OF THE GOVERNMENT

PRESENTED BY MR. HAYDEN

JUNE 15 (calendar day, JULY 2), 1937.—Ordered to be printed

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INTRODUCTION

The denial to the several States of the right to tax the income or property of Federal instrumentalities engaged in proprietary or nongovernmental functions presents a question of general public concern. Last December Mr. Charles Woolf, of Phoenix, Ariz., president of the Maricopa County Taxpayers' League and a former president of the Arizona Bankers' Association, sent me a detailed statement of the legal authority for the imposition of such taxes. I had copies of Mr. Woolf's letter made and transmitted it quite generally throughout the executive branch of the Government. The responses which I received, assembled here for the information of the Senate, clearly illustrate the confusion with which the entire subject is surrounded and the need for action by Congress to clarify the problem.

CARL HAYDEN.

LETTER OF CHARLES WOOLF TO HON. CARL HAYDEN

PHOENIX, ARIZ., *December 14, 1936.*

Hon. CARL HAYDEN,
United States Senator, Phoenix, Ariz.

DEAR SENATOR: Recently I discussed with you the matter of taxation by the State or other local taxing units of national banks and other Federal instrumentalities, corporations, and agencies. At that time I said the Federal statute (U. S. C. A., title 12, sec. 348) permitted State and local taxation of national banks by any one of four separate methods, and also permitted such taxation of any real property of national banks. I then expressed the opinion that the taxation of those banks under the fourth permissible method, that is, "according to or measured by their net income"—a sort of excise tax for the privilege of doing business—is probably the fairest, most desirable and equitable method of taxing national banks and other corporations that must be similarly taxed to meet the conditions required by the section of the Federal statute above referred to.

I called your attention to the fact that there are now a large number of other Federal instrumentalities, corporations, and agencies in active business competition with national banks, and that these, for the most part, are subject either to very limited taxation by States and local taxing authorities or else entirely exempt from such taxes by express congressional action. You then requested that I prepare and let you have a list of these latter for such use as you might deem proper.

In compliance with your request I submit the following, which does not embrace all of the instrumentalities, agencies, and corporations engaged in proprietary enterprises, but I believe each of those below mentioned to be doing more or less business of a proprietary nature in Arizona, and on principle, I entertain the view that most, if not all, of them should, by appropriate congressional action, be made subject to taxation by the State or local taxing authorities, or both, on the business done in this State. Here, as in the case of national banks, I believe the fair and equitable method of taxing them to be a tax in the nature of an excise tax for the privilege of doing business in Arizona, the tax to be based upon or measured by net income from the proprietary business done in Arizona; and by proprietary business I, of course, mean business such as is usually engaged in by persons and corporations as distinguished from duties and activities that are essentially governmental in character.

Of the Federal instrumentalities, corporations, and agencies under investigation, and exclusive of national banks, I find there are 27 that, with the possible exception of one or two, are doing business to a greater or less degree in Arizona. These are listed below, and in connection with each there is a statement as to whether they are subject

to or exempt from any tax by the State or local taxing units, together with the citation of the Federal statute applicable to each in that respect. In instances where there is complete exemption the Federal statute concerning the matter of taxation and in such cases I have cited briefly the statute applicable to the agency or have given a brief statement as to the authority pursuant to which such agency appears to be functioning.

1. Federal Reserve banks, Federal Deposit Insurance Corporation, Federal land banks, National Farm Loan Associations, Federal Farm Mortgage Corporation, Federal Home Loan banks, Home Owners Loan Corporation, Federal Housing Administration, Federal Savings and Loan Corporation, and Reconstruction Finance Corporation. All these are tax exempt except upon real property, under the following Federal statutes, respectively: United States Code Annotated, title 12, section 531, section 264 (p), sections 931 and 933, section 1020 (f), section 1433, section 1463 (c), section 1714, section 1725 (e), and United States Code, Annotated, title 15, section 610.

2. Joint stock land banks are taxable upon real property and the shares are taxable as personal property of the owners thereof (U. S. C. A., title 12, secs. 932 and 933).

3. Production credit corporations, regional banks for cooperatives, and central bank of cooperatives. These are exempt from all taxes except upon real property and tangible personal property, until the stock held therein by the United States has been retired (U. S. C. A., title 12, sec. 1138 (c), common to all three).

4. Production credit associations are exempt from taxes except upon real property and tangible personal property, until the stock held therein by Production Credit Corporations has been retired (U. S. C. A., title 12, sec. 1138 (c)).

5. National agricultural credit corporations are taxable in the same manner and to the same extent permitted in the case of national banks (U. S. C. A., title 12, sec. 1261).

6. Federal savings and loan associations are exempt from taxes, except to such extent as other similar local mutual cooperative, thrift, and home financing institutions are taxed (U. S. C. A., title 12, sec. 1464 (h)).

7. National mortgage associations are taxable to extent but at rates not greater than applicable to locally chartered corporations (U. S. C. A., title 12, sec. 1722).

8. Federal credit unions. The shares in these may be taxed as personal property to the owners of such shares, or the unions may be taxed in the manner and at rates provided for local banking corporations (U. S. C. A., title 12, sec. 1768).

9. Resettlement Administration is not taxable but is authorized to pay in lieu of taxes such amounts as may be agreed upon between administrator and local authorities as the cost of public services supplied by local taxing units (U. S. C. A., title 40, secs. 432 and 433).

NOTE.—This agency was established in April 1935 by Executive order. It has the administration, among other things, of resettlement or rural rehabilitation projects (U. S. C. A., title 40, sec. 431).

10. Federal intermediate credit banks are exempt from taxes except, possibly, taxes upon real estate (U. S. C. A., title 12, secs. 1111 and 921).

11. Federal Land Bank Commissioner—Farm loans, regional agricultural credit corporations, Commodity Credit Corporation, Electric Home Farm Authority, and RFC Mortgage Co. I find nothing in the statutes relative to either the exemption or taxability of any of those, and, inasmuch as they all appear to be agencies or corporations created by the Federal Government, I assume that none of them can be taxed directly or indirectly without permission of Congress.

See United States Code Annotated, title 12, sections 1016 to 1019, inclusive, in relation to Federal Land Bank Commissioner—Farm loans; United States Code Annotated, title 12, sections 1148 and 1148 (a) in reference to regional agricultural credit corporations.

The Commodity Credit Corporation appears to be a business corporation organized in October 1933, under the laws of Delaware Its capital as of April 1936 was $100,000,000, subscribed by the Secretary of Agriculture, Governor of Farm Credit Administration, and Reconstruction Finance Corporation.

Electric Home Farm Authority appears to be a business corporation organized pursuant to Executive order as a District of Columbia corporation in August 1935, to replace a Delaware corporation organized in January 1934.

RFC Mortgage Co. was incorporated under the laws of Maryland in March 1935. Its authorized capital is $25,000,000, $15,000,000 of which appears to have been paid in through advance or loans by Reconstruction Finance Corporation.

12. Local agricultural credit corporations, livestock loan companies, etc., loans to, by Secretary of Agriculture. As to these, see United States Code Annotated, title 12, sections 1401–1404, inclusive. I find nothing in the Federal statute relative to the taxation of these. I assume, however, that they are not creatures of Federal statute but of local statutory origin or creation. If so, they may be subject to local taxation.

One further observation in connection with the excise tax on corporations above referred to. It appears that in most, if not all, of the States that have adopted this method of taxing national banks, business corporations in general are similarly taxed. Among these States are Massachusetts, New York, Oklahoma, California, Utah, Oregon, and Wisconsin. The usual rule is that this tax is applied or measured by the entire net income, irrespective of the source from which the income is derived, and there is no ad valorem tax on the personal property of the banks or of the corporations, but the real property is taxed on an ad valorem basis; and this is apparently true even though the income from real property is included in the net income by which the excise tax is measured. This may possibly be necessary to comply with the requirements of the Federal statute permitting national banks to be taxed by the States. If it is, it seems to me to be rather inconsistent as well as inequitable in that it necessarily means that both the income from the real estate as well as the real estate itself are taxed, the income under the excise tax and the real estate under the ad valorem tax. At the same time, there is no ad valorem tax on personal property.

Finally, unless there is some reason which I cannot conceive, it seems to me that common justice demands that every activity of a

proprietary nature engaged in by government, whether that government be the United States or any State, county, or municipality, should bear some fair proportionate part of the local burden of taxation for the simple reason that the governmental agency engaged in such proprietary business has all of the benefits of local government that are accorded to any individual or business institution by local government. They all participate in and have the benefits of all local public services and instrumentalities—the courts, the police, and public improvements of every kind. These considerations seem to me to fully justify an excise tax based upon or measured by the net income of all these governmental activities of a proprietary nature, as well as an ad valorem tax upon any real property owned or possessed by such agency. The only qualification I would make is that above suggested, namely, that if both the excise and the ad valorem tax are to be applied, income derived from real property should be excluded in arriving at the net income upon which the excise tax is predicated.

Trusting the foregoing will serve your purposes and that I may hear from you in regard to the same within a reasonable time after you return to Washington, I remain,

Cordially yours,

CHAS. WOOLF.

LETTER OF TRANSMITTAL

UNITED STATES SENATE,
COMMITTEE ON APPROPRIATIONS,
January 18, 1937.

The honorable the SECRETARY OF THE TREASURY,
Washington, D. C.

MY DEAR MR. SECRETARY: Herewith is a letter I have received from Mr. Charles Woolf, of Phoenix, Ariz., in which he makes a detailed statement of the statutory background of the various Federal agencies now performing proprietary or nongovernmental functions in the several States. Mr. Woolf urges that Congress enact suitable legislation to allow the States to tax these instrumentalities insofar as their operations are of a proprietary nature "according to or measured by their net income", as is now provided by law, as one way in which the States may tax national banks.

I shall appreciate it if you will direct that a careful study be made of this whole question with particular attention to the issue presented by Mr. Woolf as it affects the Treasury Department in order that I may make a suitable reply to his letter.

It seems to me that Congress might very properly give consideration to the fundamental question raised by him as to unfair competition with private enterprise by Federal agencies or instrumentalities which are untaxed or only partially taxed by the States.

Yours very sincerely,

CARL HAYDEN.

Substantially similar letters were sent to the following:

Attorney General of the United States.
Postmaster General of the United States.
Secretary of Agriculture.
Comptroller General of the United States.
Board of Governors of the Federal Reserve System.
Federal Housing Administration.
Reconstruction Finance Corporation.
Federal Home Loan Bank Board.
Tennessee Valley Authority.
Electric Home and Farm Authority.
Rural Electrification Administration.
Resettlement Administration.
Farm Credit Administration.
Export-Import Bank of Washington.
Comptroller of the Currency.
Bureau of the Budget.
Joint Committee on Internal Revenue Taxation.
The Brookings Institution.
Chamber of Commerce of the United States.

TREASURY DEPARTMENT

TREASURY DEPARTMENT,
Washington, February 1, 1937.

Hon. CARL HAYDEN,
United States Senate,
Washington, D. C.

MY DEAR SENATOR: Receipt is acknowledged of your letter of January 18, 1937, enclosing a letter received by you from Mr. Charles Woolf of Phoenix, Ariz., in which Mr. Woolf urges that Congress enact suitable legislation to allow the States to tax various Federal agencies and instrumentalities insofar as their operations are of a proprietary nature "according to or measured by their net income" as is now provided by law as one way in which the States may tax national banks.

The suggestion made by Mr. Woolf presents many problems, the careful consideration of which will necessarily consume a considerable period of time. A further communication will be directed to you when the results of the study of this proposal become available.

Very truly yours,

ROSWELL MAGILL,
Acting Secretary of the Treasury.

TREASURY DEPARTMENT,
Washington, May 1, 1937.

Hon. CARL HAYDEN,
United States Senate.

MY DEAR SENATOR: Your letter to the Secretary of the Treasury, dated April 28, 1937, enclosing a copy of a letter to Mr. Stanley Reed, Assistant Attorney General, with reference to the taxation of Federal instrumentalities of the several States, has been referred, in the Secretary's absence, to Mr. Magill. Your letter of the same date and on the same subject, addressed to Mr. Magill, has also reached this office. As Mr. Magill is absent from the city for a few days, I wish to acknowledge the receipt of both of these letters, and to assure you that they will be brought to his attention immediately upon his return.

Sincerely,

CLARA G. HUMPHRIES,
Secretary to Mr. Magill.

TREASURY DEPARTMENT,
Washington, May 12, 1937.

Hon. CARL HAYDEN,
United States Senate.

MY DEAR SENATOR HAYDEN: Reference is made to your letter of April 28, 1937, enclosing copy of letter of the same date addressed by you to Mr. Stanley Reed, Assistant Attorney General, on the desirability of Federal legislation to allow the several States to tax the various Federal agencies performing proprietary or nongovernmental functions. Your inquiry is prompted by a letter from Mr. Charles Woolf, Phoenix, Ariz., dated December 14, 1936, which letter embodies a detailed consideration of the problems of the local taxation of Federal instrumentalities and property.

You refer to a special committee composed of the Acting Director of the Bureau of the Budget, the Attorney General, and myself, appointed to study the taxation of Federal instrumentalities by local governments, and ask what progress the committee has made.

My understanding is that this study was confined to the question of the local taxation of Government-owned real estate or compensation by the Federal Government to the States or other local taxing units to offset the loss of tax revenue due to the extensive acquisition by the United States of real estate in the various States, and that such data as have been collected so far relate only to real estate, title to which is in the United States. It will be seen that the work of the committee may embrace but a small part of the problem outlined by Mr. Woolf. So far as the committee's activities are concerned you have already been advised, I believe, by the Acting Director of the Bureau of the Budget, that an early meeting of the committee is contemplated to consider such data as have been collected, with a view to making such recommendations as seem justified.

Very truly yours,

ROSWELL MAGILL,
Acting Secretary of the Treasury.

DEPARTMENT OF JUSTICE

DEPARTMENT OF JUSTICE,
Washington, D. C., February 25, 1937.

HON. CARL HAYDEN,
United States Senator,
Washington, D. C.

MY DEAR SENATOR HAYDEN: This will acknowledge your letter of February 18, 1937, to the Attorney General, with which you enclosed a copy of a letter from Mr. Charles Woolf, of Phoenix, Ariz., urging the passage of legislation by the Congress allowing the States to tax various Federal agencies which he says are now performing proprietary or nongovernmental functions in the several States. You bring the matter to the Attorney General's attention in his capacity as a member of a committee, of which the Secretary of the Treasury and the Acting Director of the Bureau of the Budget are the other members, appointed to study the taxation of Federal instrumentalities by local governments, and ask that the question be given careful study by the committee.

I am transmitting copies of your letter and that of Mr. Woolf to the members of the committee and beg to assure you that your suggestions and those of Mr. Woolf will be given every consideration.

Cordially yours,

STANLEY REED,
Acting Attorney General.

DEPARTMENT OF JUSTICE,
Washington, D. C., May 5, 1937.

Hon. CARL HAYDEN,
United States Senate,
Washington, D. C.

MY DEAR SENATOR: Your letter of April 28, 1937, addressed to Mr. Reed, referring to previous correspondence with the then Acting Attorney General in regard to Federal land-tax problems in the State of Arizona, is acknowledged. As you were previously advised, this problem is receiving intensive study by a special committee. As soon as the data is available, it is hoped that conclusions may be reached for the consideration of yourself and the many others interested.

I do not need to add that the many broad questions of policy make a quick conclusion impossible.

Sincerely yours,

HOMER CUMMINGS,
Attorney General.

POST OFFICE DEPARTMENT

POST OFFICE DEPARTMENT,
Washington, February 4, 1937.

Hon. CARL HAYDEN,
United States Senate.

MY DEAR SENATOR HAYDEN: The Postmaster General has referred to me your letter of January 28, transmitting a communication of Mr. Charles Woolf, an attorney of Phoenix, Ariz., suggesting the enactment of legislation enabling the States to tax Federal agencies performing proprietary or nongovernmental functions within their borders.

A careful reading of Mr. Woolf's letter does not reveal a reference to the Postal Savings System therein. It does not appear therefore, that comment by this Department on the subject of his communication is required inasmuch as the agencies enumerated by him are not under the jurisdiction of the Department.

Referring specifically to your letter it is believed postal-savings deposits and the interest accrued thereon are subject to the taxing power of the States unless the States in some manner have expressly exempted them from taxation However, the question has never been passed upon by the courts. It may be added that interest now accruing or paid on postal-savings deposits is exempt from the Federal income tax.

Very truly yours,

ROY M. NORTH,
Acting Third Assistant Postmaster General.

In connection with the foregoing discussion of the Postal Savings System there is printed herewith certain correspondence between Hon. Kenneth McKellar, chairman of the Senate Committee on Post Offices and Post Roads, and the Treasury and Post Office Departments.

UNITED STATES SENATE,
COMMITTEE ON POST OFFICES AND POST ROADS,
March 19, 1937.

The honorable the POSTMASTER GENERAL,
Washington, D. C.

DEAR SIR: By direction of the Committee on Post Offices and Post Roads I am transmitting herewith a copy of The Postal Savings System of the United States, recently published by the American Bankers Association. Your particular attention is directed to the findings on pages 67 and 68.

The committee will appreciate it if you will confer with the Secretary of the Treasury and agree with him upon the appointment of an interdepartmental committee to consider whether your two departments should recommend to Congress any changes in the Postal Savings Act of 1910 and the amendments thereto.

The committee will be pleased to give careful consideration to any recommendations thus made.

Yours very respectfully,

KENNETH MCKELLAR,
Chairman, Committee on Post Offices and Post Roads.

An identical letter was sent on the same date to the Secretary of the Treasury.

The summary from The Postal Savings System of the United States, issued by the committee on banking studies of the American Bankers' Association, is appended hereto.

VII. In Summation

The study made by the committee of the circumstances attending the enactment of the Postal Savings Act discloses that the principles underlying the establishment of the Postal Savings System were:

1. To furnish bankless communities with savings facilities.
2. To operate the System as a supplement to banks and not in competition with them.
3. To redeposit, insofar as possible, the funds received through the Postal Savings System in banks located in the same communities where the funds originated.
4. To guarantee the safety of the savings of the individual with small means.

The findings of the committee, based on the studies here reported, exhibit the digressions in the operation of the Postal Savings System from the principles underlying its establishment.

FINDING 1

Postal-savings depositories generally are not established in bankless communities, despite the fact that the aim of the Postal Savings Act was to furnish such communities with savings facilities.

Evidence

(*a*) 78.6 percent of the postal-savings depository offices are in bank towns.

(*b*) The bankless communities served by postal-savings depositories are, in 88 percent of the cases, within 15 miles from a bank town.

(*c*) Fourth-class post-office towns which have been shown to be, in the main, bankless communities have only 1.5 percent of the post offices therein designated as postal-savings depositories. Thus, of the 81,650 fourth-class post offices, only 482 are postal savings depositories.

(*d*) There are 33,262 bankless communities which have post offices, which, therefore, are potential depositories. Yet of this number only 1,544, or 4.6 percent of the total number, are postal-savings depository offices.

(*e*) In all classes of post offices the percentage of postal-savings depositories which are in bank towns is 99.4 percent of the first-class post offices, 95.5 percent of the second-class post offices, 67.1 percent of the third-class post offices, 18 percent of the fourth-class post offices.

FINDING 2

The Postal Savings System is in direct competition with banks, despite the fact that one of the principles upon which the passage of the Postal Savings Act was conditioned was that the System be supplemented rather than competitive in nature.

Evidence

(*a*) By locating postal-savings depositors in bank towns, the Postal Savings System is competing with banks for savings accounts.

(*b*) The statistics available point to the conclusion that the foreign-born members of this country's population are using private banking institutions, and it is believed, therefore, that the Government savings system is not necessary for them.

(*c*) While originally postal-savings deposits bore interest at a rate of 1½ percent lower than that paid by banks on savings accounts, now they bear interest at a rate equal to or higher than that paid by the majority of banks, and thus the Postal Savings System bids for savings accounts in competition with banks. Moreover, since the maximum of a postal-savings account has been raised, more of an individual's funds can be deposited in these postal-savings accounts.

FINDING 3

The disposition of the postal-savings funds is not that planned by the Congress which established the System.

Evidence

Postal-savings deposits are not being redeposited in banks in the community in which they are received. In some States more than the amount deposited in the postal-savings depositories of the State is placed on deposit with banks in the State. In other States, which are in the majority, only a negligible portion of the funds received in postal-savings depositories is redeposited in the banks. The reason for this state of facts may be that many banks are not able to accept postal-savings funds because the interest required to be paid on them is more than the banks can earn from the use of the funds; or it may be that the supervisory authorities of an individual State will not permit the banks to pay the interest required on postal-savings funds.

Whatever the reason, the striking fact is that of the $1,236,000,000 of assets in the Postal Savings System, only $385,000,000 are on deposit in banks, while $777,000,000 are invested in Government securities.

FINDING 4

The savings facilities offered by banks today are more adequate than in 1910.

Evidence

(*a*) In 1910 less than 40 percent of the national banks reported savings deposits. In 1935, 83 percent of the national banks had savings departments. This increase in savings facilities is attested to by the increase of 700 percent, since 1910, in the number of savings depositors in national banks, and by the increase of 1,000 percent in the amount on deposit in savings accounts in national banks.

(*b*) Of the total number of banks of all types in 1935, 12,803, or 78 percent, had savings departments. The number of savings depositors in these banks has doubled, and the amount of savings deposits has quadrupled since 1910.

(*c*) The banking profession has endeavored to meet the needs of communities too small to support a bank. Their methods have taken one of several forms:

In some States banks have opened bank "windows" or "offices." In other States, systems of branch banks have been established. The combined total of such "offices" and branches in 1935 was 3,173.

Another solution which is being successfully practiced is the "banking by mail" service.

In considering the availability of banking facilities it must be remembered that the means of transportation today are much superior to those of 1910, and therefore a bank today can adequately service a much larger area.

(*d*) The protection for deposits sought in 1910 and offered by the Postal Savings System now is provided also by banks through their membership in the Federal Deposit Insurance Corporation. Of the 19,059 banks and branches in operation December 31, 1935, 17,296, or 90.8 percent, are members of the Federal Deposit Insurance Corporation, and more than 98 percent of all accounts in the banks which are members of the Federal Deposit Insurance Corporation are insured in full.

(*e*) The savings facilities offered by banks are more adequate than those furnished by the Postal Savings System.

There are 12,033 bank towns to the 7,214 postal-savings towns. The area in square miles per bank town is 252, to the 420 per postal-savings town.

The number of insured banks and branches in the 48 States and the District of Columbia is 17,296, whereas the number of postal-savings depositories, including branches, is 8,036.

POST OFFICE DEPARTMENT,
Washington, D. C., March 26, 1937.

Hon. KENNETH MCKELLAR,
Chairman, Committee on Post Offices and Post Roads,
United States Senate.

MY DEAR SENATOR MCKELLAR: Receipt is acknowledged of your letter of March 19, transmitting a copy of the Postal Savings System of the United States, recently prepared by the American Bankers' Association, and requesting that an interdepartmental committee be appointed to advise you regarding certain features of the report and legislation desired at this time, if any. I have followed your suggestion in the matter and a committee has been appointed to study the situation, and you will be advised as to their conclusions within a short time.

Thanking you for your interest in this matter, I am,

Most cordially yours,

W. W. HOWES,
Acting Postmaster General.

TREASURY DEPARTMENT,
Washington, March 23, 1937.

Hon. KENNETH MCKELLAR,
United States Senate, Washington, D. C.

MY DEAR SENATOR MCKELLAR: For the Secretary of the Treasury, I am acknowledging receipt of your letter of March 19 and the accompanying copy of The Postal Savings System of the United States, issued by the American Bankers Association.

Pursuant to your suggestion, an interdepartmental committee has been appointed, consisting of Mr. Wayne C. Taylor, Assistant Secretary of the Treasury, and Mr. Roy M. North, Acting Third Assistant Postmaster General, to consider whether there should be any recommendations to Congress for changes in the Postal Savings Act of 1910, as amended. When this committee has canvassed this situation it will report to the Senate Committee on Post Offices and Post Roads of which you are chairman, as requested.

Very truly yours,

ROSWELL MAGILL,
Acting Secretary of the Treasury.

POST OFFICE DEPARTMENT,
Washington, D. C., May 19, 1937.

Hon. KENNETH MCKELLAR,
Chairman, Committee on Post Offices and Post Roads,
United States Senate.

MY DEAR SENATOR MCKELLAR: Reference is made to your letter of March 19, transmitting a copy of the Postal Savings System of the United States, which was recently prepared by a committee appointed by the American Bankers' Association. You directed attention to the findings on pages 67 and 68 of the report and requested us to consider whether we should recommend to Congress any changes in the Postal Savings Act of 1910 and the amendments thereto.

Following your suggestions, an interdepartmental study was made of the report and our findings are set forth briefly as follows:

The statement of the committee that it was the intent of Congress that postal-savings depositories be established only in bankless communities, we feel is based upon a mistaken understanding of the attitude of the Congress during the debates incident to the passage of the original postal-savings legislation. The committee was quite possibly misled in this particular by lack of complete information regarding a subject debated so many years ago. The discussions in Congress preceding the passage of the organic act indicate that while some Members felt the System should be restricted to communities without banking facilities, it is clear that many, if not the majority of the Members felt the System should be widespread and established at all money-order post offices. The representations of the banking fraternity during the hearings on the organic act no doubt had considerable weight in framing that legislation, but Congress, in its wisdom, left much discretion to the board of trustees and, after the System had been in operation about 20 months,

amended the original law to delegate specifically to the Postmaster General the responsibility for the selection and designation of post offices as postal-savings depositories.

A study of the operation of the System clearly shows its need in all of the large cities as well as in many of the smaller towns. As of June 30, 1936, 997 first-class, 2,654 second-class, 3,414 third-class, and 506 fourth-class offices were postal-savings depositories. It is true that only a small number of the 31,507 fourth-class offices are depositories. Experience has shown that it would be folly to establish depositories at all of the smaller offices for the reason that there is no need for the service in many of the rural communities. However, provision has been made for patrons of all nondepository post offices to open accounts and make deposits by mail at any postal-savings depository, thus extending reasonable facilities to all. The Postal Savings System is now serving in excess of 1,500 communities that are not provided with banking facilities, and to deprive these communities of the means of protecting their savings would be a backward step subject to criticism.

It is claimed by the committee that instead of operating as a supplement to banks the System is, in fact, in competition with them. The System has consistently refrained from anything that might be construed as active competition. Postmasters are not permitted to advertise the System through newspapers or otherwise. They are prohibited from any activity designed to induce bank depositors to transfer their funds to postal savings. Each depository is required to post in the lobby a placard which merely announces that postal-savings facilities are available at that office, the rate of interest paid, and that "the faith of the United States of America is solemnly pledged to the payment of deposits with accrued interest." The Post Office Department supplies post offices with leaflets briefly outlining the operation of the Postal Savings System. Neither the poster nor the leaflet contains any matter that might be construed as promotional in character. During the period from 1917 to 1930 postal-savings deposits remained practically stationary. In the 3 years that followed the deposits increased from $175,271,000 to $1,187,186,000, due almost entirely to badly demoralized economic conditions and the consequent general impairment of confidence in banking institutions. During all of the period of rapidly increasing postal-savings deposits the commercial interest rate was much higher than was paid by the Postal Savings System.

After the passing of the Banking Act of 1933 and the coincident general reduction in the rate of interest paid by banks, the rate of increase in postal-savings deposits fell off sharply, the net increase in deposits for the fiscal years 1934 to 1936, inclusive, amounting to less than $44,500,000. Of this increase, about 40 percent, or $17,560,000, occurred during June 1936, the month in which veterans received their adjusted-service bonds. On June 30, 1934, savings-bank deposits aggregated $20,495,388,000, and postal-savings deposits totaled $1,195,302,634. Two years later savings deposits amounted to $22,603,931,000, as compared with $1,228,643,602 in postal savings, a decrease in ratio from 5.8 to 5.4 percent. In other words, from the time the rate of interest paid by banks was reduced so as to more nearly parallel that paid by the Postal Savings System, the increase in postal-savings deposits was proportionately less than the increase of savings deposits in banks.

It cannot be asumed that a reduction in the interest rate paid by the Postal Savings System would force its patrons to resume banking relations. If the first consideration of a depositor were a high interest return on his savings he would secure the more attractive rates offered by building and loan associations. It is believed that a reduction in interest rate would have little effect on the volume of postal-savings deposits. Although postal-savings patrons would probably withdraw little, if any, of their deposits from the System, they would undoubtedly feel it an injustice to deprive them of a portion of the interest they now receive for their money, particularly when it is generally known that the Postal Savings System is self-supporting at the present interest rates paid to depositors. Postal-savings patrons have come to look upon the safeguarding of their funds by the Postal Savings System as a just protection of the people by the Government and any evident intent to encourage the discontinuance of that protection would no doubt arouse resentment.

The committee finds that the disposition of the postal-savings funds is not that planned by the Congress which established the System. While it is true that many banks are now without postal-savings deposits, with the exception of the years following the World War when under Presidential

authority funds of the System were withdrawn from the banks for the purchase of Liberty Bonds, postal-savings funds were, prior to the banking crisis in 1933, largely redeposited in banks. The System has always been willing and anxious to cooperate with all banks which desire deposits, and the reasons that a large part of the funds are now invested in Government securities are that many banks are unwilling to accept deposits at the established interest rate of 2½ percent and that in two of the States, New York and New Jersey, the banking authorities have restricted the interest rate to 2 percent, thus depriving local banks of postal-savings funds. While it is true that for the past year or two many banks have not been interested in securing postal-savings deposits, there is every reason to believe that present conditions point to a change of attitude. This is evidenced by increasing demand on the part of banks for postal-savings deposits due to the recent slight hardening of interest rates.

The committee of the American Bankers' Association finds that the savings facilities offered by banks today are more adequate than in 1910. The report sets forth in detail the great increase in the savings facilities offered by banks. We concur in the finding that banking institutions offer far better banking facilities than those afforded by the Postal Savings System. It is contended by some that the guaranty extended to deposits in insured banks since the enactment of the Federal Deposit Insurance Act has made unnecessary the maintenance of the Postal Savings System. We do not share that view. It is our belief that to a large extent the Postal Savings System serves a special clientele which would not maintain bank accounts even if there were no postal-savings facilities. We do not feel that the need for the Postal Savings System has lessened materially. In this connection, the provisions of present banking law that after July 1, 1942, all national banks, as at present, and all State banks with deposits of $1,000,000 or more, must be members of the Federal Reserve System if they are to be insured by the Federal Deposit Insurance Corporation, might be taken into consideration.

In conclusion, we believe that the Postal Savings System provides a useful service, is not in direct, active competition with banks, and that no legislative action tending to limit its usefulness should be taken.

Very truly yours,

WAYNE C. TAYLOR,
Assistant Secretary of the Treasury.
ROY M. NORTH,
Acting Third Assistant Postmaster General.

P. S.—Dear Senator McKellar: I agree with this report.

JAMES A. FARLEY, *Postmaster General.*

DEPARTMENT OF AGRICULTURE

DEPARTMENT OF AGRICULTURE,
Washington, March 27, 1937.

Hon. CARL HAYDEN,
United States Senate.

MY DEAR SENATOR HAYDEN: Your letter of January 18, 1937, with the accompanying letter from Mr. Charles Woolf has been received. A similar letter, addressed to Dr. W. W. Alexander, Administrator of the Resettlement Administration, has been referred to me, since the Resettlement Administration is now a part of the Department of Agriculture. These letters raise the question of the advisability of the Congress permitting taxation by State and local governments of all Federal agencies of a proprietary nature, as is always permitted in the case of national banks.

Involved in any discussion of the points raised in these letters are several concepts which have important implications. The question as to whether a particular governmental activity should be classified among those essentially governmental in character or with those proprietary in nature is frequently difficult to answer. A history of government is a story of the expansion of its functions. Even education and road building at one time went through a transitional stage from the proprietary to the governmental. This expansion process continues, and thus at any time there are activities which are difficult to classify in this respect.

In considering legislation permitting taxation of Federal agencies by State and local governments the fact that the agency is engaged in a "business such as is usually engaged in by persons and corporations" may not be a sufficient indication of its proprietary nature. The Rural Rehabilitation Division of the Resettlement Administration, for example, is engaged in the business of making loans to farmers in need of rehabilitation. Private enterprise is also engaged in the business of providing credit to farmers. But many of the Resettlement Administration loans are made to persons who could not furnish sufficient security to obtain loans from private credit agencies. The program is nevertheless in the public interest since, in a manner that preserves the initiative and independence of the borrowers, it prevents the growth of the list of economic casualties who must otherwise eventually appear on the relief rolls. From this point of view the rural rehabilitation program may be judged as essentially governmental in character, despite the fact that (in part) its activities are similar in form to those carried on by private enterprise. And, of course, it is conducted on a nonprofit basis and thus does not yield a "net income" on which to levy a tax such as is suggested by Mr. Woolf. However, that portion of Mr. Woolf's letter which states that every activity of a proprietary nature engaged in by government should bear some share of the burden of local taxation since they enjoy the benefits of the services supported by such taxation, raises more pertinent questions in connection with the activities of the Resettlement Administration. While the projects described below are not an activity of a truly proprietary nature, their development does have an effect on the fiscal problems of the local governments concerned.

You may recall that the Administration purchases land for two main types of projects. First, good farm land is purchased and developed for selected farmers in need of rehabilitation. Ordinarily these projects are described as "resettlement" projects. Second, poor farm land is purchased and developed for forestry, grazing, and other similar purposes. On these projects, of course, no one is being resettled and residents at the time of purchase are being given an opportunity of relocating elsewhere. These projects are designated as "land-utilization" projects.

The purchase of these lands has an effect on the local governments and their fiscal problems since the lands are removed from the property-tax base as a result of Federal ownership. It will be seen that if compensation is made to local governments because of such ownership, the problem is different for the two types of projects.

For the resettlement projects the local governments must supply the ordinary public services, such as education, protection of person and property, road upkeep, etc. For land-utilization projects, because of the reduction or elimination of settlement, the need for such public services is lessened, or in some cases entirely removed, and the costs of local government correspondingly reduced.

Legislation treating compensation for projects on which people are settled is now in effect. As Mr. Woolf indicates on page 3 of his letter, it is provided that the Resettlement Administration may, upon request of taxing units concerned, enter into an agreement whereby payments in lieu of taxes are made for services supplied for the benefit of "any resettlement project or any rural rehabilitation project for resettlement purposes."

Contracts for such payments have been concluded and payments have been made in a number of States, and negotiations for other agreements are being carried on. Payments made are usually equivalent to the amount of the property taxes that would have been levied in case the property were taxable.

With regard to land-utilization projects, the administration recognizes the necessity of preventing undue hardships to the local governments concerned, and it is making studies of many representative projects with the view of determining their effect on the local governments.

In some cases it is found that the development of these projects results in material benefits to the communities in which they are located. For example some of the lands purchased for these projects were chronically tax delinquent. As the residents thereon located elsewhere and the cost of roads, schools, and other public services was thus reduced, the net effect was a saving to the local governments concerned. In other instances, projects are to be transferred to other agencies for administration, these agencies now being subject to laws providing for compensation to the States, such as the Forest Service. Some projects are to be turned over to the States, to be administered by them for the benefit of their citizens. However, the whole question of costs and benefits to local governments is being given careful consideration by the Resettlement

Administration. There are a number of Federal agencies purchasing land for purposes similar to those of the Land Utilization Division of the Resettlement Administration. For this reason, uniformity of policy with respect to similar classes of land needs also to be considered, and we are working with these other agencies toward that end. Progress is being made and we hope shortly to have an equitable solution of the problem to suggest.

We trust that this letter supplies the information you have requested.

Sincerely,

H. A. WALLACE, *Secretary.*

GENERAL ACCOUNTING OFFICE

GENERAL ACCOUNTING OFFICE,
Washington, May 12, 1937.

Hon. CARL HAYDEN,
United States Senate.

MY DEAR SENATOR: I have your letter of May 10, 1937, with enclosure, relative to the request of Charles Woolf, Phoenix, Ariz., that Congress enact suitable legislation to allow the States to tax Federal agencies performing proprietary or nongovernmental functions according to or measured by their net income.

Your letter and enclosure will be given prompt attention and I shall be pleased to advise you further with reference thereto at a later date.

Sincerely yours,

R. N. ELLIOTT,
Acting Comptroller General of the United States.

GENERAL ACCOUNTING OFFICE,
Washington, May 19, 1937.

Hon. CARL HAYDEN,
United States Senate.

MY DEAR SENATOR: Receipt was acknowledged May 12 of your letter of May 10, 1937, as follows:

"Herewith is a copy of a letter I have received from Mr. Charles Woolf, of Phoenix, Ariz., in which he makes a detailed statement of the statutory background of the various Federal agencies now performing proprietary or nongovernmental functions in the several States. Mr. Woolf urges that Congress enact suitable legislation to allow the States to tax these instrumentalities insofar as their operations are of a proprietary nature according to or measured by their net income, as is now provided by law as one way in which the States may tax national banks.

"I shall appreciate it if you will direct that a careful study be made of this whole question with particular attention to the issue presented by Mr. Woolf as it affects the various Federal lending agencies to which he refers.

"It seems to me that Congress might very properly give consideration to the fundamental question raised by him as to unfair competition with private enterprise by Federal agencies or instrumentalities which are untaxed or only partially taxed by the States."

The Federal agencies referred to by Mr. Woolf in his letter of December 14, 1936, to you, include: (1) agencies of the United States not under any of the executive departments but functioning as a part of the constitutional executive branch of the Government, such as the Federal Housing Administration and the Farm Credit Administration; (2) the Government-owned and controlled corporations created (*a*) by the Congress, such as the Reconstruction Finance Corporation and Federal Joint Stock Land Bank; or (*b*) under State laws pursuant to authority granted by the Congress; or (*c*) organized by private parties under State laws and whose capital stock was subsequently purchased by the United States; or (*d*) corporations organized under State laws by administrative officials of the United States without any express statutory authority, which would include the RFC Mortgage Co., the Commodity Credit Corporation, the Export-Import Banks, and many others.

These Government-owned and controlled agencies are not to be confused with national banks, Federal credit unions, and some railroad companies which

have been chartered pursuant to Federal statutes, but are privately owned and operated for private profit. As to these latter the Federal Government has given its statutory consent to their taxation by the States as mentioned by Mr. Woolf, generally subject to the requirement that the taxes be not discriminatory as between such agencies and similar privately owned businesses operating in the respective States.

As you know, the immunity of Federal agencies and instrumentalities from State taxation and the immunity of State agencies and instrumentalities engaged in governmental functions from Federal taxation are not matters of express provisions in the Federal Constitution. Such immunity from taxation is based on the doctrine of implied power first stated by the Supreme Court of the United States in *McCulloch* v. *Maryland* (4 Wheat. 316). As stated by that court in *Indian Motocycle Co.* v. *United States* (283 U. S. 570, 575);

"It is an established principle of our constitutional system of dual government that the instrumentalities, means, and operations whereby the United States exercises its governmental powers are exempt from taxation by the States, and that the instrumentalities, means, and operations whereby the States exert the governmental powers belonging to them are equally exempt from taxation by the United States. This principle is implied from the independence of the National and State Governments within their respective spheres and from the provisions of the Constitution which look to the maintenance of the dual system (*Collector* v. *Day*, 11 Wall. 113, 125, 127; *Willcuts* v. *Bunn*, 282 U. S. 216, 224–225). Where the principle applies it is not affected by the amount of the particular tax or the extent of the resulting interference, but is absolute (*McCulloch* v. *Maryland*, 4 Wheat. 316, 430; *United States* v. *Baltimore & Ohio R. Co.*, 17 Wall. 322, 327; *Johnson* v. *Maryland*, 254 U. S. 51, 55–56; *Gillespie* v. *Oklahoma*, 257 U. S. 501, 505; *Crandall* v. *Nevada*, 6 Wall. 35, 44–46).

"Of course, the reasons underlying the principle mark the limits of its range. Thus, as to persons or corporations which serve as agencies of government, National or State, and also have private property or engage on their own account in business for gain, it is well settled that the principle does not extend to their private property or private business, but only to their operations or acts as such agencies; and, in harmony with this view, it also has been held where a State departs from her usual governmental functions and 'engages in a business which is of a private nature,' no immunity arises in respect of her own or her agents' operations in that business. While these decisions show that the immunity does not extend to anything lying outside or beyond governmental functions and their exertion, other decisions to which we now shall refer show that it does extend to all that lies within that field."

The suggestion contained in the letter of December 14, 1936, from Mr. Woolf, and mentioned in your above-quoted letter, as to State taxation of certain Federal instrumentalities would appear proper with respect to activities falling within the second paragraph of the above-quoted extract from the opinion in the *Indian Motocycle Company case;* that is, there should be no immunity when the agency or instrumentality of the United States is engaged in "anything lying outside or beyond governmental functions", and that the Congress might well give consent to their taxation by the States in such instances on the same basis as similar privately owned business is taxed in such States.

Mr. Woolf has stated in his letter of November 14, 1936, that:

"* * * unless there is some reason which I cannot conceive, it seems to me that common justice demands that every activity of a proprietary nature engaged in by government, whether that government be the United States or any State, county, or municipality, should bear some fair proportionate part of the local burden of taxation for the simple reason that the governmental agency engaged in such proprietary business has all of the benefits of local government that are accorded to any individual or business institution by local government. They all participate in and have the benefits of all local public services and instrumentalities—the courts, the police, and public improvements of every kind. These considerations seem to me to fully justify an excise tax based upon or measured by the net income of all these governmental activities of a proprietary nature, as well as an ad valorem tax upon any real property owned or possessed by such agency. * * *"

However, the matter is not as simple as it would at first appear, because of the uncertainty as to what constitutes "governmental functions" or "activities of a proprietary nature." The Supreme Court of the United States pointed

out in an opinion of March 15, 1937, in *Brush* v. *Commissioner of Internal Revenue* (81 U. S. Law Edition 443, 453) that there was probably no topic of the law in respect of which the decisions of the State courts are in greater conflict and confusion than that which deals with the differentiation between the governmental and corporate powers of municipal governments and that:

"The phrase 'governmental functions', as it here is used, has been qualified by this court in a variety of ways. Thus, in *South Carolina* v. *United States* (199 U. S. 437, 461, 50 L. ed. 261, 268, 26 S. Ct. 110, 4 Ann. Cas. 737) it was suggested that the exemption of State agencies and instrumentalities from Federal taxation was limited to those which were of a strictly governmental character, and did not extend to those used by the State in carrying on an ordinary private business. In *Flint* v. *Stone Tracy Co.* (220 U. S. 107, 172, 55 L. ed. 389, 421, 31 S. Ct. 342, Ann. Cas. 1912B, 1312) the immunity from taxation was related to the essential governmental functions of the State. In *Helvering* v. *Powers* (293 U. S. 214, 225, 79 L. ed. 291, 295, 55 S. Ct. 171) we said that the State 'cannot withdraw sources of revenue from the Federal taxing power by engaging in businesses which constitute a departure from usual governmental functions and to which, by reason of their nature, the Federal taxing power would normally extend.' And immunity is not established because the State has the power to engage in the business for what the State conceives to be the public benefit. *Ibid.* In *United States* v. *California* (297 U. S. 175, 185, 80 L. ed. 567, 573, 56 S. Ct. 421) the suggested limit of the Federal taxing power was in respect of activities in which the States have traditionally engaged."

The said *Brush case* was concerned with the claimed immunity from Federal taxation of the income of a chief engineer of the bureau of water supply of the city of New York and that case may be compared with the case of *People of the State of New York ex rel Rogers* v. *Graves et al.*, decided January 4, 1937, by the Supreme Court of the United States (81 U. S. L. ed. 202, 207) where there was involved the claimed immunity from State income taxation of the salary paid by the Panama Railroad Co. to its general counsel. There was a dissenting opinion in the *Brush case* by Mr. Justice Roberts, concurred in by Mr. Justice Brandeis, where the subject was examined in the light of present-day conditions.

You will understand, of course, that the property, and so forth, of Federal agencies and instrumentalities is not only exempt from State taxation except where Federal consent has been specifically given in statutes to that effect and that similar State agencies and instrumentalities engaged in the performance of governmental functions are exempt from Federal taxation, but the salaries of officers and employees of Federal agencies and instrumentalities are exempt from State taxation and the salaries of State agencies and instrumentalities are exempt from Federal taxation, the exemption being based as stated upon the principle applied in *McCulloch* v. *Maryland* (4 Wheat. 316). In other words, the scope of the problem is broader than as stated in the letter of December 14, 1936, from Mr. Woolf; there being involved not merely State taxation of instrumentalities and agencies of the Federal Government, but State taxation of the salaries of officers and employees of such Federal instrumentalities and agencies and reciprocal Federal taxation of similar State instrumentalities and agencies and the salaries of the officers and employees thereof. Attention is particularly invited to the statement of Mr. Justice Roberts in the cited *Brush case* that the "claimed exemption in that case may well extend to millions of persons (whose work nowise differs from that of their fellows in private enterprise) who are employed by municipal subdivisions and districts throughout the Nation."

There appears unfairness in the Federal Government giving its statutory consent to State taxation of Federal agencies and instrumentalities engaged in what Mr. Woolf terms activities "of a proprietary nature" in the absence of corresponding consent of the States to Federal taxation of State instrumentalities and agencies and the salaries of employees thereof. The immunity from taxation has been, and is, a reciprocal arrangement derived from the implied powers of the Federal Constitution and any withdrawal of such immunities likewise should be a reciprocal one. Also, any such withdrawal should be of some classification other than that of "governmental functions" for the reason—as pointed out by the Supreme Court of the United States in the above-quoted extract from its opinion in the *Brush case*—such a classification has led to much doubt and confusion in the law and the phrase "proprietary nature"

does not add to the clarification thereof. Possibly to meet this problem any withdrawal of immunity from taxation should be by a specific enumeration in a statute or statutes of the particular agencies and as to their particular property or incomes which may be subject to State taxation.

It is, of course, a question of policy for the determination of the legislative branch of the Federal Government as to the action, if any, which should be taken either in the matter of discontinuing or curtailing such Federal nongovernmental activities or in the matter of withdrawal of immunity from State taxation of particular Federal administrative agencies and whether such withdrawal of immunity as to the various States should be made dependent upon the withdrawal of immunities from Federal taxation of State agencies and instrumentalities and their employees, but undoubtedly the problem is a very serious one and growing more so each year with the expansion of both Federal and State governmental activities into fields not strictly governmental or sovereign in character, and one with respect to which this office is not prepared to offer or suggest a solution.

Sincerely yours,

R. N. ELLIOTT,
Acting Comptroller General of the United States.

FEDERAL RESERVE SYSTEM

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Washington, February 24, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

DEAR SENATOR HAYDEN: At the request of Chairman Eccles, I am replying to your letter to him dated January 18, 1937, regarding the question of the desirability of Congress enacting legislation to permit the States and their political subdivisions to tax Federal instrumentalities insofar as their operations are of a proprietary nature. Enclosed with your letter was a copy of a letter from Mr. Charles Woolf, Phoenix, Ariz., submitting certain data regarding a number of Federal agencies which he believes are doing more or less business of a proprietary nature in Arizona. Mr. Woolf expresses the view that these Federal agencies should be made subject to State or local taxation, or both, on their proprietary business, and states that by proprietary business he means business such as is usually engaged in by persons and corporations as distinguished from duties and activities that are essentially governmental in character.

Careful thought has been given to this matter, and it is the opinion of the Board of Governors that Federal Reserve banks should not be brought within the scope of such legislation, since they do not exercise proprietary functions and do not come into competition with private enterprise.

Among the more important functions of the Federal Reserve banks are the holding of the reserves of member banks, the making of discounts for and advances to member banks, the furnishing of an elastic currency in the form of Federal Reserve notes, the providing of a national system for the clearing and collection of checks, the conduct of open-market operations with the view of accommodating commerce and business and with reference to their effect on credit conditions, and the performance of many important fiscal agency functions for the Federal Government. It is manifest that the performance of these functions does not constitute the doing of a proprietary business which should be the subject of State or local taxation.

In addition to the functions mentioned above, the Federal Reserve banks have authority under the provisions of the last paragraph of section 13 and the provisions of section 13b of the Federal Reserve Act to perform certain functions which, upon first impression, might possibly be thought to constitute a proprietary business. However, a thorough study of the qualifications which circumscribe the authority granted in these sections, and, more especially, an examination of the actual functioning of the Federal Reserve banks under these provisions of the law, will demonstrate that the activities of the Federal Reserve banks under these sections are not in competition with private enterprise and do not constitute the carrying on of a proprietary business.

Under the provisions of the last paragraph of section 13 of the Federal Reserve Act, which was added by the Emergency Banking Act of March 9, 1933, the Federal Reserve banks may make loans to individuals, partnerships, and corporations on the security of direct obligations of the United States. These loans may be made for periods not in excess of 90 days and must be made at rates which are subject to the review and determination of the Board of Governors of the Federal Reserve System. The total amount of loans which the Federal Reserve banks made under the authority of this provision during the years 1935 and 1936 was $5,000, and the amount outstanding on December 31, 1936, the last date for which figures are available, was only $1,000. The purpose of this provision of the law was to enable the Federal Reserve banks to make advances to individuals and corporations for pay-roll and other necessary purposes at a time when the commercial banks of the country were closed. With the passing of this emergency little use was made of this authority.

Under the provisions of section 13 b of the Federal Reserve Act, which was added by the act of June 19, 1934, Federal Reserve banks may make loans for periods not exceeding 5 years to established industrial or commercial businesses. However, the law provides that such loans may be made only "in exceptional circumstances", when it appears that the borrower "is unable to obtain requisite financial assistance on a reasonable basis from the usual sources." As you are no doubt aware, the authority contained in section 13 b of the Federal Reserve Act was granted for the purpose of enabling the Federal Reserve banks to supply a credit need which it was felt was not being supplied by banks or other private financial institutions, and not to enable Federal Reserve banks to compete with such institutions. In accordance with the requirements of the law, the Federal Reserve banks have scrupulously avoided the making of loans which the borrower could obtain from the usual sources and have made advances under this section to commercial and industrial businesses only in cases where banks and other institutions were unable or unwilling to make the requisite advances. The volume of advances being made under this section is comparatively small at the present time and is rapidly declining. The law also provides that the Federal Reserve banks shall have power to extend credit to any bank or other financing institution for periods not exceeding 5 years on the security of obligations of such institutions issued for the purpose of providing working capital to established industrial or commercial businesses, but it is believed to be clear that this authority does not involve a proprietary function.

It is essential to keep in mind that the Reserve banks are not operated for the purpose of making profits, either for the Reserve banks themselves or for the member banks who own the stock of the Reserve banks. They are the agencies through which national credit policies are effectuated. The law requires that discount rates of Federal Reserve banks be fixed with a view to accommodating commerce and business, and that open-market operations of the Federal Reserve banks be governed with a view to the same considerations and with regard also to the bearing of such operations upon the general credit situation of the country. The Federal Reserve banks are, therefore, conducted for public rather than private purposes.

Even when they are not called upon to extend credit to their member banks, the Federal Reserve banks render countless daily services to the public and to the Government. For instance, during the calendar year ending June 30, 1936, the Federal Reserve banks collected free of charge checks amounting to $218,000,000,000 and, as fiscal agents of the Government, handled the issue, redemption, and exchange of Government obligations amounting to more than $27,000,000,000.

Moreover, Federal Reserve banks act as depositaries and fiscal agents of the United States and in this capacity perform many services which are of great value to the Government. Since 1920 they have carried on the functions of the former subtreasuries which were abolished by law in that year. As depositaries and fiscal agents of the United States they maintain accounts for the Treasurer of the United States, collect checks deposited for the credit of the Treasurer, cash checks of Government disbursing officers, act for the Treasury and other governmental agencies in the flotation of new issues of securities, redeem bonds and coupons of the Government, and perform many other similar services. The fiscal agency functions of the Federal Reserve banks include also the handling of securities and the disbursement of funds for such institutions as the Reconstruction Finance Corporation, the

Federal Deposit Insurance Corporation, the Home Owners' Loan Corporation, the Federal Home Loan banks, the Farm Credit Administration, the Federal Land banks, the Federal Farm Mortgage Corporation, the Federal Intermediate Credit banks and other governmental agencies. Those agencies could not have been placed into operation so quickly nor could they have functioned so economically and efficiently had it not been for the fiscal machinery of the Federal Reserve banks already in existence.

Since its enactment in 1913 the Federal Reserve Act has provided that Federal Reserve banks, including the capital stock and surplus therein and the income derived therefrom, shall be exempt from Federal, State, or local taxation, except taxes upon real estate. This exemption from taxation was enacted by Congress in recognition of the fact that the functions of the Federal Reserve banks are governmental rather than proprietary in nature and it is respectfully submitted that there has been no change in the situation which would make advisable the removal of this protection from these banks, which at present constitute one of the most effective and economical agencies serving the United States Government and its instrumentalities in the handling of fiscal operations and in effectuating national credit policies.

As you requested, a carbon copy of this letter is enclosed. It is hoped that the above discussion will be of assistance to you in this matter and that you will feel free to call upon us at any time when you think we may be of assistance.

Very truly yours,

CHESTER MORRILL, *Secretary.*

FEDERAL HOUSING ADMINISTRATION

FEDERAL HOUSING ADMINISTRATION,
Washington, January 22, 1937.

Hon. CARL HAYDEN,
United States Senator, Washington, D. C.

MY DEAR SENATOR HAYDEN: Under date of January 18 you addressed a letter to me which enclosed copy of a letter received from Mr. Charles Woolf, attorney at law, Phoenix, Ariz., in which he makes a detailed statement of the statutory background of the various Federal agencies now performing proprietary or nongovernmental functions in the several States.

You stated you would appreciate it if I would direct that a careful study be made of this whole question, with particular attention to the issue presented by Mr. Woolf, as it affects the Federal Housing Administration. This involves a fundamental question relating to the possibility of unfair competition with private enterprise by Federal agencies or instrumentalities which are untaxed or are only partially taxed by the States.

I will be very glad to have such a study made and will communicate further with you as soon as possible.

Very truly yours,

STEWART MCDONALD, *Administrator.*

FEDERAL HOUSING ADMINISTRATION,
Washington, February 2, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

MY DEAR SENATOR HAYDEN: Further reference is made to your letter of January 18, enclosing copy of a letter received by you from Mr. Charles Woolf, of Phoenix, Ariz., urging that Congress enact suitable legislation to allow the States to tax the various Federal agencies insofar as their operations are of a proprietary nature "according to or measured by their net income." You suggested that I have a careful study made of this question as it affects the Federal Housing Administration.

It does not seem to me that the Federal Housing Administration could be affected one way or the other under the present legislative set-up, for the reason that it has no net income and never will have unless the law is changed.

The National Housing Act, as amended, provides for the issuance of debentures guaranteed as to principal and interest by the United States, in exchange

for the conveyance of foreclosed properties. The Administration receives these properties and holds them until such time as they can be disposed of in a satisfactory manner. Should the proceeds of such properties exceed the amount of the debentures, certificate of claim, and necessary expense of holding and disposing of the property, the excess must, according to law, be returned to the original mortgagor and the Federal Housing Administration may in no way derive a profit from these transactions.

So far as concerns the general reinsurance fund which is created by the National Housing Act, all earnings whatsoever must, by the provisions of the existing law, be credited to the account of this fund. This means that all income must be credited to the fund and the result of the handling of this fund is that any excess over and above the operating expenses of the Administration must ultimately be disbursed or credited to the mortgages which make up the various mortgage groups, and either returned in cash to the original mortgagors, or applied to liquidate the mortgage in advance of the stipulated maturity date. By reason of this, all income of this Administration over and above its operating expenses must be held for the benefit of the mortgage groups and must ultimately be applied for the benefit of the same, and there is no net income and cannot be as the law now reads.

All foreclosed properties which are conveyed to this Administration pay the regular and usual real property taxes at all times, including the period during which they are held by this Administration.

For the purpose of its own operations, and by way of permanent ownership for its own account, the Federal Housing Administration owns no real property of any kind.

From this, you will see that this Administration is a nonprofit administration similar to corporations created by the various States as nonprofit corporations.

Yours respectfully,

STEWART MCDONALD, *Administrator.*

RECONSTRUCTION FINANCE CORPORATION

RECONSTRUCTION FINANCE CORPORATION,
Washington, February 1, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

DEAR SENATOR HAYDEN: I have your letter of January 18, 1937, together with the enclosed copy of a letter from Mr. Charles Woolf, of Phoenix, Ariz., in which it is suggested that Congress permit each of the 48 States to levy a tax upon Government corporations for the privilege of doing business within its boundaries, the tax to be measured by net income.

I shall be glad to express my views on this subject insofar as they affect the Reconstruction Finance Corporation.

1. At the outset, I should like to emphasize that the Reconstruction Finance Corporation is not operated for profit. This was recognized by the Supreme Court in *Baltimore National Bank* v. *Maryland State Tax Commission* (297 U. S. 209, 211). Whatever income it has represents, for the most part, the difference between what it pays for money borrowed from the United States Treasury and what it receives in return. The present spread between interest paid and interest received is approximately three-fourths of 1 percent. Out of this spread the Corporation pays its administrative expenses, which have averaged approximately one-half of 1 percent since the organization of the Corporation. The balance is being reserved to cover losses that are inevitable in operating such an emergency corporation on the large scale on which it is operated.

2. I understand that, as a matter of tax law, we are not "doing business" in 22 States, including Arizona, in which we do not maintain agencies. In those instances our business is being handled by agencies in neighboring States. Therefore, even if Congress waived our governmental immunity from taxation, 22 States could not tax the Corporation for the privilege of doing business. See Fletcher on Corporations, volume 18, section 8804; and opinion of the

Attorney General of Arizona, summarized in the Corporation Trust Co.'s What Constitutes Doing Business (1934), page 12.

Consequently, under Mr. Woolf's proposal it would seem that while the 26 States in which we do business might be able to tax this Corporation on the basis of net profit resulting from loans made to citizens of all the 48 States, yet the other 22 States in which we do not do business would not receive any taxes from this Corporation by reason of net profit arising from loans to their residents.

Further, since the sums paid by this Corporation for taxes would diminish the Federal revenue by a corresponding amount, the deficiency would ultimately have to be made up by Federal taxpayers in all States. This means that the Federal taxpayers residing in Arizona and the other 21 States in which we do not do business would in effect be contributing revenue to the remaining 26 States in which they do not reside.

3. Mr. Woolf also seems to believe that by permitting the States to tax Government agencies in the manner urged, unfair competition by such agencies with private capital will be eliminated.

This objective assumes the existence of such unfair competition, apparently on the theory that all institutions which lend money necessarily compete with one another, a contention which the Supreme Court rejected in *First National Bank of Shreveport* v. *Louisiana Tax Commission* (289 U. S. 60).

The fact is that this Corporation does not compete with private capital. We have advanced moneys to borrowers only when private capital was not available at reasonable rates, and we have declined applications when we have found that the funds could be obtained from private sources.

The Committee on Banking and Currency of the House of Representatives recognized this fact in stating:

"The Reconstruction Finance Corporation has not replaced existing capital; it has supplied additional capital and then only when funds were not available from private sources" (H. Rept. 2199, 74th Cong., 2d sess.).

An examination of the list of our loans as set forth in our quarterly reports to Congress, in the light of economic conditions during the period when they were made, will make it even more evident that our policy has been to cooperate, not to compete with private capital.

4. Finally, Mr. Woolf's proposal would complicate the operation of this Corporation's affairs and increase administrative costs. Aside from extensive changes in our bookkeeping system that would be needed to allocate our income and expenses to each individual State, the question of State tax savings might enter into the determination of many questions of policy. For instance, to simplify procedure and avoid taxes, it might be found advisable to curtail local service by discontinuing field offices and centralizing administration in Washington.

In view of the foregoing it seems to me that it is not feasible to apply Mr. Woolf's suggestion to this Corporation.

With best wishes,

Sincerely yours,

JESSE JONES, *Chairman.*

HOME OWNERS' LOAN CORPORATION

FEDERAL HOME LOAN BANK BOARD,
Washington, January 19, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

MY DEAR SENATOR: I have before me your letter of January 18 including a letter from Mr. Charles Woolf of Phoenix, Ariz., in which you request our opinion concerning the enactment of suitable legislation to allow States to tax certain of the Federal instrumentalities.

This matter is being referred to our legal department. As soon as I have the benefit of their advice, I shall be glad to communicate with you further.

Sincerely yours,

JOHN H. FAHEY, *Chairman.*

FEDERAL HOME LOAN BOARD,
Washington, February 11, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

MY DEAR SENATOR: I have your letter of January 18, 1937, and the enclosed copy of the letter from Mr. Charles Woolf, Title and Trust Building, Phoenix, Ariz., on the subject of taxation of agencies of the Federal Government performing proprietary or nongovernmental functions in the several States.

Mr. Woolf has raised with you a most difficult problem, as all of us know. The section of the Federal statute dealing with the taxation of the national banks has been the subject of extensive discussion, both in Congress and out of Congress, and that section was changed only a few years ago to the present basis, which appears to be more acceptable than the former basis. It appears that the reason why the present statute for the taxation of national banks was adopted, and is more acceptable, is that it gives the liberty to the States of taxing national banks in any one of four different ways; and, therefore, different States can more nearly apply their own theory of taxation to national banks.

I agree that when the Government, national, State, or local, undertakes to perform a business function which comes in competition with private business, the agency carrying on such function should pay reasonable taxes, all things considered.

We have endeavored in our recommendations to Congress substantially to take this position. Home Owners' Loan Act of 1933, section 4 (c), provides: "* * * any real property of the Corporation shall be subject to taxation to the same extent, according to its value, as other real property is taxed."

Home Owners' Loan Corporation was organized as a relief agency, and its relief, as you know, extended not only to individual home owners with whom it was primarily concerned, but also to the relief of financial institutions holding frozen mortgages, and to the relief of State, county, and local taxing authorities as well. The Corporation paid more than $228,453,000 in back taxes to State, county, and local taxing authorities in connection with the closing of its loans, and for the account of its borrowers. It is concerned, of course, to see to it that all such taxes are paid from time to time on all of these properties on which it holds loans. It pays taxes, as is indicated above, on all the property it owns. We believe that this is a reasonable tax basis, all things considered, for the Corporation.

Federal savings and loan associations are subject to tax on the same basis as similar institutions operating under State charter are subject to tax by the States, and this appears to be a reasonable basis.

Therefore, while in general agreement with the proposition that all business organizations ought to be taxed on a reasonable basis, I recognize the great difficulty you have in dealing with the problem.

We feel that the basis of taxation of Home Owners' Loan Corporation and Federal savings and loan associations, which are the only two agencies under the direction of this Board doing business in the State of Arizona, is substantially a fair basis of taxation, although recommendations for slight changes in wording may be necessary to meet particular problems.

Very truly yours,

JOHN H. FAHEY, *Chairman.*

TENNESSEE VALLEY AUTHORITY

TENNESSEE VALLEY AUTHORITY,
Knoxville, Tenn., January 21, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

MY DEAR SENATOR HAYDEN: In Dr. Morgan's absence I am acknowledging receipt of your letter of January 18 and a copy of Mr. Woolf's inquiry to you concerning taxation by the States of Federal agencies which perform proprietary or nongovernmental functions in the States. We shall be glad to bring your letter to the Chairman's attention when he returns to Knoxville.

Sincerely yours,

WALTER KAHOE,
Assistant to the Chairman.

TENNESSEE VALLEY AUTHORITY,
Knoxville, Tenn., January 27, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

DEAR SENATOR HAYDEN: Your letter of January 18, concerning taxation by the States of Federal agencies which perform proprietary or nongovernmental functions, was waiting for me when I returned to the office. This is a matter which involves Board policy, and the answer to your inquiry is awaiting consideration by the Board. We hope to send you a detailed reply before long.

Sincerely yours,

ARTHUR E. MORGAN,
Chairman of the Board.

TENNESSEE VALLEY AUTHORITY,
Knoxville, Tenn., February 16, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

DEAR SENATOR HAYDEN: This is in further reply to your letter of January 18 enclosing a copy of Mr. Woolf's inquiry to you concerning taxation by the States and lesser political units of Federal agencies operating within their boundaries. This problem is one that has received considerable study, not only by this agency but also on behalf of all Federal agencies, by the committee appointed by the President on December 17, 1935. This committee, composed of the Attorney General, the Secretary of the Treasury, and the Acting Director of the Budget, was to study the problem arising from the acquisition of real property by the Federal Government, and the consequent loss of tax revenues by the States and other political units because of the exemption of such property from State and local taxation. The Tennessee Valley Authority has been cooperating with this committee in supplying information concerning the Authority's operations in the valley, and we understand that its report will be forthcoming in the very near future.

Your inquiry, however, goes further and questions the advisability of taxing Federal "instrumentalities insofar as their operations are of a proprietary nature according to or measured by their net income." Since you direct attention particularly to the Tennessee Valley Authority's making such a study, your statement assumes that the activities of the Authority are of a proprietary nature. With this assumption I cannot agree. Our sales of electricity amount only to a disposition of the Government's property generated at constitutionally built dams, which sales were held to be a constitutional or governmental function in the case of *Ashwander, et al.* v. *Tennessee Valley Authority, et al.* The case of *South Carolina* v. *United States* (199 U. S. 439), decided that when a State engaged in a proprietary business its activity in this regard might be taxed by the Federal Government. But the converse of this proposition that the Federal Government can be taxed by a State has never been decided, presumably because the Federal Government is one of delegated powers and accordingly any activity within those delegated powers involves the exercise of governmental powers.

There remains, of course, the problem of whether the Federal Government voluntarily should make contributions to the local governments when carrying on its functions within the borders of a State. Section 13 of the Tennessee Valley Authority Act, providing for payments of a certain percentage of the gross revenues from power generated in the States of Alabama and Tennessee, seems to be a provision somewhat along the lines you suggest. I understand, however, that there was considerable opposition to even this provision, since it was felt by some that the States in this area were benefiting substantially from the Federal Government's expenditures on behalf of the Authority and were not equitably entitled to payments in lieu of taxes in addition. Although you may feel that this provision should be enlarged or extended in its application, you will note that Congress has already committed the Authority to the principle of making contributions based on gross revenues from sales of power to the States of Tennessee and Alabama.

The Authority has been disturbed with the problem of actually depriving the local governments of tax revenues, which deprivation was brought about directly through the Federal Government's activities. For example, the taking

of land for reservoirs and reservations, and the purchase of electrical facilities from private utilities, have caused a reduction of State and county tax revenues. Our studies of the problem of the taking of real property have been directed along the lines of cooperating with and furnishing information to the President's committee mentioned above. On the question of removing electrical property from taxation, however, we have devised the plan of selling the properties so acquired to local cooperative associations incorporated under State law and subject to State and local taxation. Under such a plan, States and other political units not only received all of their tax revenues from such property, but in addition are the beneficiaries of the Federal Government's activities in that particular area.

The Tennessee Valley Authority will continue its work with the committee studying this question, and I feel that, because of such cooperation, it would be inadvisable for the Authority to direct a separate study along the same line. However, if there is any further information which you desire about the Authority's activities along this line, I will be glad to supply it.

In accordance with your request, I enclose a copy of this reply.

Sincerely yours,

ARTHUR E. MORGAN,
Chairman of the Board.

ELECTRIC HOME AND FARM AUTHORITY

ELECTRIC HOME AND FARM AUTHORITY,
Washington, May 7, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

DEAR SENATOR HAYDEN: This will acknowledge receipt of your letter of April 28, 1937, with reference to the proposal of Mr. Charles Woolf, of Phoenix, Ariz., that Congress enact such legislation as will permit each of the States to levy a tax upon Government corporations which are doing business within the respective States.

It is not believed that the activities of Electric Home and Farm Authority have relation to or are affected by the proposed legislation. Electric Home and Farm Authority operates as a nonprofit finance company, discounting those contracts submitted to its office in the District of Columbia which represent the conditional sale of electric appliances. So that, as a matter of tax law, the Authority is not "doing business" in the States and would be unaffected by waiver of its governmental immunity. Mr. Woolf may be interested to know that this Authority has not as yet engaged in any business transaction with citizens or firms of the State of Arizona.

With the above qualifications, my views upon the general terms of Mr. Woolf's proposal are fully expressed in the letter to you from Chairman Jones, of the Reconstruction Finance Corporation, dated February 1, 1937, with reference to the same subject.

Very truly yours,

EMIL SCHRAM, *President.*

RURAL ELECTRIFICATION ADMINISTRATION

RURAL ELECTRIFICATION ADMINISTRATION,
Washington, January 28, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

MY DEAR SENATOR HAYDEN: I discussed with our general counsel your letter of January 18 and the letter which you enclosed from Mr. Charles Woolf at Phoenix, Ariz. The question of the taxation of Federal agencies performing proprietary functions in the several States is one that does not affect our operation. We are a lending agency only and the projects which we finance are owned and operated wholly by public and private agencies within the several States.

Yours very sincerely,

MORRIS L. COOKE, *Administrator.*

FARM CREDIT ADMINISTRATION

FARM CREDIT ADMINISTRATION,
Washington, D. C., January 21, 1937.

Hon. CARL HAYDEN,
United States Senate.

MY DEAR SENATOR HAYDEN: I have your letter of January 18, 1937, enclosing a copy of a letter of December 14, 1936, addressed to you by Mr. Charles Woolf, of Phoenix, Ariz., suggesting Federal legislation to permit a partial taxation by the States of certain corporate Federal instrumentalities now tax exempt in their entirety, or nearly so.

I note your request that a careful study be made of the question, with particular attention to the issue presented by Mr. Woolf as it affects the Farm Credit Administration and its various subsidiary and related lending agencies, in order that you may be in a position to make a suitable reply to his letter.

In accordance with your suggestion, I shall have this matter given careful attention, and I shall be pleased to send you a further letter discussing Mr. Woolf's suggestion as soon as possible.

Sincerely,

W. I. MYERS, *Governor.*

FARM CREDIT ADMINISTRATION,
Washington, D. C., February 23, 1937.

Hon. CARL HAYDEN,
United States Senate.

MY DEAR SENATOR HAYDEN: In accordance with my letter to you of January 21, 1937, I have had careful consideration given to the suggestions contained in Mr. Charles Woolf's letter to you of December 14, a copy of which was enclosed with your letter to me of January 18.

It may be well at the outset of our consideration of the proposals made by Mr. Woolf to note that they are based upon the conception that certain corporate instrumentalities of the Federal Government are engaged to a large extent in what he designates as "proprietary business", which he defines to mean "business such as is usually engaged in by persons and corporations as distinct from duties and activities which are essentially governmental in character."

The corporations functioning within the Farm Credit Administration were organized in every instance to carry out a national and governmental purpose. The primary reason for their existence was in each instance a need for governmental aid in connection with agricultural credits. They are all beyond any question governmental agencies or instrumentalities. While they may perform some functions which are similar to the functions performed by private business enterprises, it would be impossible to separate their functions and divide them into two classes (governmental and nongovernmental or proprietary) because their whole reason for existence was a need for credits beyond the power of private capital to supply on terms as favorable as those which could be offered by the instrumentalities in question. In this connection, since Mr. Woolf is an attorney, our General Counsel has suggested that he may be interested in rereading the opinion of Mr. Chief Justice Marshall in the case of *Osborn* v. *U. S. Bank* (9 Wheat. 738, pp. 860, 862, and 867).

If, under its constitutional powers, Congress had provided that a department or bureau of the Federal Government itself should make the loans which have been and are being made by the various corporate instrumentalities mentioned in this letter, there is, of course, no question but that the States would have been without any power to impose taxes, since long established principles of law prohibit the taxation by States of any form of activity carried on by the Federal Government. This principle extends to corporations which are chartered to act as agencies of the Federal Government. The great majority of the corporations here discussed were organized to relieve the Government from the burden of financing the entire sum required for the making of the loans. They are enabled to make loans at a much lower rate of interest and on more favorable terms than could have been offered by private investors. By setting up the various corporate structures the Government was relieved of financing the loans in their entirety, as the corporations, through the sale of their bonds and debentures, have been enabled to supplement governmental funds with the funds of private investors. The working margin of these corporations is very slight.

Should Congress permit the taxation of any of them, it would be impossible to continue to extend credit to borrowers at rates or upon terms nearly as favorable as prevail today.

The Government owns the entire capital stock of the Federal Farm Mortgage Corporation, which, it will be remembered, was organized to take over the existing loans and continue the loaning activities formerly devolving upon the Land Bank Commissioner under the provisions of section 32 of the Emergency Farm Mortgage Act of 1933. It also owns the entire capital stock of the Federal intermediate credit banks and the production credit corporations. All of the stock of the regional agricultural credit corporations is held by the Reconstruction Finance Corporation, whose stock, as you know, is all held by the United States. The officers of the regional agricultural credit corporations receive their salaries directly from the Treasury of the United States.

The Government also has substantial stock holdings in the Federal land banks, the Central Bank for Cooperatives, and the banks for cooperatives. Indirectly it holds stock in the production credit associations through the ownership of their class A stock which is held by the production-credit corporations, all of whose stock is, as I have before indicated, held by the Government.

With the exception of national farm loan associations and regional agricultural credit corporations, all of the corporations functioning under the supervision of the Farm Credit Administration are empowered to act as fiscal agents of the United States Government. However, these local corporations are in fact a very necessary adjunct to the activities of banks and corporations that are specifically authorized to act as such agents.

As you know, national farm loan associations are owned in their entirety by farmer-borrowers. They are, however, unique among corporations, since they do not engage in any business in the ordinary sense of the term, but merely function for the purpose of strengthening the loans made by the Federal land banks through their cooperative features and the endorsement of all loans made through such associations. They are, therefore, integral parts of the Farm Loan System, and very recently they have been held by the Supreme Court to be instrumentalities of the United States (*The Knox National Farm Loan Association et al.* v. *Phillips*, Advance Opinions No. 389, Feb. 1, 1937).

It will be seen upon a review of the status of the various corporations functioning within the Farm Credit Administration, therefore, that they are all very closely allied with the Federal Government. Many are in fact incorporated arms of the Government itself, and all of them are performing governmental functions.

I think there is a real distinction between the taxation of the corporations that I have been discussing and of national banks, even though the latter are also Government instrumentalities. In this connection, it will be recalled that national banks are privately owned and operated for profit. Joint-stock land banks, although they are privately owned, have been held by the United States Supreme Court to be governmental instrumentalities (*Smith* v. *Kansas City Title and Trust Company*, 255 U. S. 180). It will be remembered that they have been in liquidation since the passage of the Emergency Farm Mortgage Act of 1933. Many of them have progressed very rapidly in their liquidation, and from the point of view of taxation by States there is very little reason to take them into account as potential revenue factors.

Principles of immunity from taxation long established and undoubtedly familiar to you are founded on a recognition of the separate fields of governmental activities occupied by the Federal Government and the several States. The immunity from taxation by the States of corporations established or used to carry out Federal governmental purposes is ably discussed in an article appearing in the Iowa Law Review for November 1936, to which you may find it of interest to refer. For your convenience, I am enclosing a photostatic copy of this article. Each Government (State and Federal) is recognized to be without the power to interfere with the operations of the other carried on within its particular sphere. Insofar as I am aware, there has never been any general permission granted by the Federal Government to the States to tax its activities, or the activities of corporations chartered to carry out governmental policies (although limited permission to tax confined largely to real estate has been given) and the same statement is true with respect to legislation by the States.

For the foregoing reasons I do not favor any Federal legislation which would permit additional taxation by States of the governmental instrumentalities functioning under the supervision of the Farm Credit Administration.

Sincerely,

W. I. MYERS, *Governor.*

(The following article, to which Mr. Myers refers, is reprinted from the Iowa Law Review for November 1936):

STATE TAXATION AND THE NEW FEDERAL INSTRUMENTALITIES

By Harold W. Stoke, Associate Professor of Political Science, University of Nebraska

Inauguration by the present administration of a host of Government-owned and Government-chartered corporations carrying on functions which have never before been assumed by the National Government has raised again the problem of intergovernmental taxation. Increased State and municipal activity, prompted by the demands of a more complicated industrial structure and the judicial expansion of the doctrine of public purpose in taxation, has for some time seemed to threaten a dessication of Federal revenue sources;[1] the more recent expansion of functions by the Federal Government in response to demands made upon that political unit now confronts the States with similar worries.[2] Both National and State Governments are thus faced with the necessity of raising constantly larger amounts of revenue at a time when both are encroaching upon the respective fields of taxation by enlarging the number and scope of their various enterprises.

It is clear that, so far as taxation by the Federal Government is concerned, immunity of the States turns primarily upon the type of function performed.[3] Where a State acts as a sovereign power, performing public duties by means of appropriate agencies, its instrumentalities and their activities are exempt from Federal taxation. But the Court has repeatedly held that this exemption applies not to all but only to strictly governmental instrumentalities. If a State undertakes enterprises which are proprietary in nature they become subject to taxation in the same manner and to the same extent as those carried on by private individuals or corporations.[4] Indeed, the rule is now so thoroughly established that, when cases involving this principle arise, the Court's one problem is to determine whether the agency taxed is a genuine governmental instrumentality by which the State exercises its sovereign powers.

Perhaps the most comprehensive discussion the Court has ever given to the distinction between governmental and proprietary functions is to be found in the case of *South Carolina* v. *United States*,[5] where South Carolina had established a system of liquor dispensaries wholly owned and operated by the State. The Court denied the contention that the dispensaries were instrumentalities of the State government and consequently tax exempt. "The exemption of State agencies and instrumentalities from national taxation is limited to those which are of a strictly governmental character and does not extend to those which are used by the State in the carrying on of an ordinary private business." A function voluntarily undertaken, said the Court, one customarily carried on by private persons and which the State operates at a profit to itself, cannot be regarded, because of the fact of State ownership, as a function so colored by its governmental association as to be exempt from taxation.[6]

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[1] See Cohen and Dayton, Federal Taxation of State Activities and State Taxation of Federal Activities (1925), 34 Yale L. J. 807, 809.

[2] (1935) 35 Col. L. Rev. 301.

[3] Some of the cases do emphasize as well the remoteness of the burden imposed by the tax. *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514 (1926); and *Willcutts* v. *Bunn*, 282 U. S. 216 (1931), are illustrative. Cf., however, the attitude of the Court in *Trinityfarm Construction Co.* v. *Grosjean* (291 U. S. 466, 471 (1933)). (1935) 35 Col. L. Rev. 301, 302, urges such a test as the most rational.

[4] "It is we think a sound principle that when a government becomes a partner in any trading company, it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and prerogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to its associates, and to the business which is to be transacted." (*Bank of the United States* v. *Planters' Bank*, 9 Wheat. 904, 907 (U. S. 1824)).

[5] 199 U. S. 437, 461 (1905).

[6] *Ohio* v. *Helvering*, 292 U. S. 360 (1934), applied the same doctrine to the taxation of State liquor stores in Ohio in the post-prohibition era.

The test of governmental activities suggested in the *South Carolina case* reappears in the recent decision in *Helvering* v. *Powers*.[7]

"The principle of immunity thus has inherent limitations * * * And one of these limitations is that the State cannot withdraw sources of revenue from the Federal taxing power by engaging in businesses which constitute a departure from usual governmental functions and to which, by reason of their nature, the Federal taxing power would normally extend."

While development of a completely satisfactory formula for differentiating State governmental from State proprietary functions must await further judicial decisions, it seems clear from the cases so far decided that the test will take its cue from a crystallization of present conceptions as to the scope of governmental action, so modified perhaps as always to allow inclusion of functions which only the State can adequately perform.[8] Such a test is eminently consistent with the motivation behind the decisions since *South Carolina* v. *United States*—the protection of Federal revenues from the inroads of increasing State enterprise.[9]

Expansion of the activities of the Federal Government constitutes, on the other hand, a potential threat to State revenues. The underlying reasoning of the *South Carolina case* can, therefore, apply as logically to taxation by the States of Federal enterprise.[10] The question, however, is not whether distinctions between governmental and proprietary functions might not be expediently applied to the activities of the Federal Government. The real question is, in the last analysis, whether the application of such distinctions to Federal functions is consistent with the necessity for maintaining Federal supremacy, and whether such distinctions can be reconciled with that interpretation of Federal powers to which the Court has most consistently adhered.

In discussing the converse question of constitutional immunity of State instrumentalities from Federal taxation, the Court has at least twice assumed, through Mr. Justice Stone, that the limitations imposed upon that immunity apply with equal force to State taxation of Federal instrumentalities.[11] Such, however, is but dictum; and it is significant that neither Mr. Justice Sutherland nor Mr. Chief Justice Hughes, in delivering opinions of the Court in like cases,[12] has phrased the *South Carolina rule* in terms applicable to the Federal Government.[13] In instances requiring a determination of the precise question, where dictum must translate itself into holding, some early cases did intimate that the Federal Government is no more free than are the States to claim tax immunity for all their agencies and enterprises. Thus, in *National Bank* v. *Commonwealth*,[14] the Court observed that—

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[7] 293 U. S. 214, 225 (1934). See also *United States* v. *California*, 56 Sup. Ct. 421, 426 (1936).

[8] See (1935) 33 Mich. L. Rev. 1283, and (1936) 84 U. of Pa. L. Rev. 664. *Cf.* the test suggested in (1935) 35 Col. L. Rev. 301, 302, to which reference is made in note 3, supra. The following are decisions in which Federal taxes have been held inapplicable to the State instrumentalities involved: *Collector* v. *Day*, 11 Wall. 113 (U. S. 1871) (salary of judicial officer); *United States* v. *Baltimore & Ohio Ry. Co.*, 17 Wall. 322 (1872) (municipal revenue); *Ambrosini* v. *United States*, 187 U. S. 1 (1902) (bonds for licensed liquor sellers); *Indian Motorcycle Co.* v. *United States*, 283 U. S. 570 (1930) (motorcycle bought for police service); *Burnet* v. *Coronado Oil & Gas Co.*, 285 U. S. 393 (1932) (income from lease of land owned by State for educational purposes).

[9] Note the reasoning of the Second Circuit in *Commissioner* v. *Ten Eyck*, 76 F. (2d) 515, 519 (C. C. A. 2d, 1935): "The Commission, in the instant case, a public corporation, maintaining and operating a public port, not for profit, is performing a usual governmental function, and is not withdrawing sources of revenue from the Federal taxing power. It has supplanted no private business to which the Federal taxing power would normally extend."

[10] This point is emphasized and arguments in its favor developed in note (1936), 49 Harv. L. Rev. 1323, 1326-1327.

[11] *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 523-524 (1926); *United States* v. *California*, 56 Sup. Ct. 421, 424 (1936). In the latter case Mr. Justice Stone observed: "The analogy of the constitutional immunity of State instrumentalities from Federal taxation, on which respondent relies, is not illuminating. That immunity is implied from the nature of our Federal system and the relationship within it of State and National Governments, and is equally a restriction on taxation by either of the instrumentalities of the other. Its nature requires that it be so construed as to allow to each government reasonable scope for its taxing power . . . which would be duly curtailed if either by extending its activities could withdraw from the other subjects of taxation traditionally within it."

[12] *Ohio* v. *Helvering*, 292 U. S. 360 (1934), cited note 6, *supra*; *Helvering* v. *Powers*, 293 U. S. 214 (1934), cited note 7, *supra*.

[13] See note (1936) 49 Harv. L. Rev. 1323, 1326, n. 19.

[14] 9 Wall. 353, 362 (U. S. 1869).

"The principle we are discussing [tax exemption] has its limitation, a limitation growing out of the necessity on which the principle itself is founded. That limitation is that the agencies of the Federal Government are only exempted from State legislation so far as that legislation may interfere with or impair their efficiency in performing the functions by which they are designed to serve that Government. Any other rule would convert a principle founded alone in the necessity of securing to the Government of the United States the means of exercising its legitimate powers into an unauthorized and unjustified invasion of the rights of the States."

Again, when California levied taxes upon a railroad built partially with Federal funds and performing Federal services, the Court, while denying the right of the State to tax the franchise, upheld the tax upon the property of the railroad.[15]

"There is a clear distinction between the means employed by the Government and the property of the agent employed by the Government. Taxation of the agency is taxation of the means; taxation of the property of the agency is not always, or generally, taxation of the means."

And in *Union Pacific Railroad Co.* v. *Peniston*[16] the Court said:

"It cannot be said that a State tax which remotely affects the exercise of a Federal power is for that reason alone inhibited by the Constitution. To hold that would be to deny to the States all power to tax persons or property."

Yet it should be pointed out that in all of these cases in which the Court upheld the application of a State tax to the property or activities of a corporation operating under a Federal charter or performing services for the Federal Government, no specific exemption from taxation was involved. The Court was feeling its way in the absence of statutory direction and was merely giving its own construction of the effects of State taxation upon the services performed by the agent for the Federal Government; taxation of the property of the agent was upheld only because it was not regarded as a tax upon the means employed by the Government to carry out its legitimate purposes. It is significant that the attempts to tax Federal franchises were uniformly held invalid regardless of the ownership of the corporation or the nature of its business. And it is significant that the Court has never upheld a State tax on any Federal agency to which Congress had specifically granted exemption.

Such was the judicial attitude during the period when, for the most part, the Federal Government confined itself to activities logically as well as traditionally governmental in nature. Until 1932 the United States had had little experience with Government-chartered corporations and still less with corporations owned or controlled by the Federal Government. Prior to the World War, the Panama[17] and Alaska[18] railroads represented the only Federal excursion into the field of Government-owned corporations. Greater experience had been had with corporations federally chartered but not exclusively owned or controlled by the Federal Government; even here, however, that experience had been limited to the creation of banking and credit corporations designed either for general financial uses[19] or for the supplying of more specialized financial facilities for agriculture.[20]

The war brought a change in the character of Government corporations. The Federal Government now became, uniformly, not only the incorporator but also the exclusive owner of a number of agencies which war-time developments made necessary. The first of these was the Emergency Fleet Corporation, formed by the United States Shipping Board in pursuance to the authority granted to it in the original Shipping Act.[21] All of its stock was subscribed

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[15] *Thomson* v. *Union Pacific Railroad Co.*, 9 Wall. 579, 591 (U. S. 1870).
[16] 18 Wall. 5, 30 (U. S. 1873).
[17] 32 Stat. 481 (1902).
[18] 38 Stat. 305 (1914), 48 U. S. C. A. secs. 301–305, 307.
[19] First United States Bank, 1 Stat. 191 (1791); Second United States Bank, 3 Stat. 266 (1816); National Banks, 13 Stat. 99 (1864), Rev. Stat. sec. 5133 (1875); Federal Reserve Banks, 38 Stat. 251 (1913), 12 U. S. C. A., sec. 221 (1927).
[20] Federal Land Banks, 39 Stat. 362, 363 (1916), 12 U. S. C. A., secs. 671–683 (1927); National Farm Loan Associations, 39 Stat. 365 (1916), 12 U. S. C. A., secs. 701, 711–722 (1927); Joint Stock Land Banks, 39 Stat. 374 (1916), 12 U. S. C. A., secs. 811–821 (1927). In 1923 the Federal Farm Loan Act, through which provision had been made for these corporations, was amended to authorize the Federal Intermediate Credit Banks, 42 Stat. 1454 (1923), 12 U. S. C. A., secs. 1021–1026 (1927), and the National Agricultural Credit Associations, 42 Stat. 1461 (1923), 12 U. S. C. A., secs. 1151, 1161, 1162, 1171 (1927).
[21] 39 Stat. 729 (1916), 46 U. S. C. A., secs. 802–805 (1928).

and paid for by the United States Shipping Board. Five additional war-time corporations were formed which have now gone out of existence—the United States Grain Corporation,[22] War Finance Corporation,[23] the United States Housing Corporation,[24] United States Sugar Equalization Board,[25] and the United States Spruce Corporation.[26] All of these instrumentalities were corporations entirely owned by the Federal Government.

After the war only four Government corporations were created until the beginning of the Roosevelt administration. These were the Federal intermediate credit banks,[27] Inland Waterways Corporation,[28] Reconstruction Finance Corporation,[29] and the Federal home loan banks.[30] Since March 1933 some 20 Government-owned or Government-chartered corporations have been created.[31] A few of the more important may be mentioned.[32] The Tennessee Valley Authority [33] was formed to operate the properties of the Government at Muscle Shoals and to direct the development of the Tennessee Valley through reforestation, flood control, and other projects. The Corporation was authorized to issue $50,000,000 worth of bonds (later increased to $75,000,000) on the credit of the United States. The Federal Deposit Insurance Corporation [34] was created under the Banking Act of 1933 to insure bank deposits and to aid in liquidating closed banks. The Treasury subscribed originally for the capital stock of the Corporation, but eventually ownership is expected to pass into the hands of the Federal Reserve banks and their member banks, although the Corporation remains an instrumentality of the Federal Government.

An entire group of corporations has sprung from the agricultural program of the present administration.[35] The Farm Credit Act of 1933 authorized the organization of a central bank for cooperatives,[36] 12 banks for cooperatives (one for each of the Federal Reserve districts),[37] 12 production credit corporations,[38] and any necessary number of production credit associations.[39] These corporations are designed as a permanent system of credit facilities for the production and harvesting of crops, feeding of livestock, etc. Eventually they are to be owned and controlled by cooperative organizations of farmers in each of the 12 Federal land bank districts. The Federal Farm Mortgage Corporation [40] was formed to aid the Federal land banks in their farm debt refinancing program. This Corporation is authorized to issue bonds to secure the funds for its loans

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[22] 40 Stat. 276 (1917).
[23] 40 Stat. 506 (1918).
[24] 40 Stat. 594 (1918).
[25] 40 Stat. 276 (1917).
[26] 40 Stat. 888 (1918) There is a good review of these war-time corporations in *Skinner & Eddy Corp. v. McCarl*, 275 U. S. 1 (1927).
[27] 42 Stat. 1454 (1923), 12 U. S. C. A., secs. 1021–1026 (1927). By the same amendment to the Farm Loan Act provision was made for the National Agricultural Credit Associations. See note 20, *supra*.
[28] 43 Stat. 360 (1924), 49 U. S. C. A. secs. 151–152 (1928).
[29] 47 Stat. 5 (1932), 15 U. S. C. A. secs. 601–603 (Supp. 1935).
[30] 47 Stat. 725 (1932), 12 U. S. C. A. secs. 1421, 1422 (Supp. 1935).
[31] The study of the Government corporation has accordingly been accelerated enormously since the beginning of the Roosevelt administration. The following citations will be found especially useful: Field, Government Corporations: A Proposal (1935) 48 Harv. L. Rev. 775; Schnell, Federally Owned Corporations and Their Legal Problems (1936), 14 N. C. L. Rev. 234, 337; Thurston, Government Proprietary Corporations (1935), 21 Va. L. Rev. 465, 501; McIntire, Government Corporations as Administrative Agencies: An Approach (1936), 4 Geo. Wash. L. Rev. 161; Note, State Taxation and Regulation of the Tennessee Valley Authority (1934), 44 Yale L. J. 326; Note, State Taxation of Federal Instrumentalities: The Converse of South Carolina v. United States (1936), 49 Harv. L. Rev. 1023. See also, Van Dorn, Government Corporations (1926).
[32] The following corporations are also chartered or owned by the Federal Government and classifiable as governmental instrumentalities possessing some degree of tax exemption: Electric Home and Farm Authority, Executive Order No. 6514, Dec. 19, 1933; Federal Subsistence Homestead Corporation, Pub. L. No. 67, 73d Cong., 1st sess. (1933), sec. 208; Export-Import Banks of Washington, Executive Orders No. 6581, Feb. 2, 1934, and No. 6638, March 9, 1934; Emergency Housing Corporation, Executive Order No. 6470, Nov. 20, 1933; Tennessee Valley Associated Cooperatives, Inc., Jan. 24, 1934.
[33] 48 Stat. 58 (1933), 16 U. S. C. A. sec. 831 (Supp. 1935).
[34] 48 Stat. 168 (1933), 12 U. S. C. A. sec. 264 (Supp. 1935).
[35] It is by no means clear how the recent decision holding the Agricultural Adjustment Administration unconstitutional, *United States v. Butler*, 297 U. S. 1 (1936), will affect the existence and functions of the corporations which had been formed to assist in carrying out the agricultural policies.
[36] 48 Stat. 261 (1933), 12 U. S. C. A., sec. 1134f (Supp. 1935).
[37] 48 Stat. 257 (1933), 12 U. S. C. A., sec. 1134 (Supp. 1935).
[38] 48 Stat. 257 (1933), 12 U. S. C. A., sec. 1131 (Supp. 1935).
[39] 48 Stat. 259 (1933), 12 U. S. C. A., sec. 1131d (Supp. 1935).
[40] 48 Stat. 347 (1933), 12 U. S. C. A., sec. 1020f (Supp. 1935), amended by Executive Order No. 7126, Aug. 5, 1935

and the bonds issued are guaranteed as to principal and interest by the Federal Government. The Commodity Credit Corporation [41] was created to aid in the marketing of agricultural commodities, especially cotton. The original capital stock of $3,000,000 was subscribed by the Secretary of Agriculture and the Farm Credit Administration, and a loan of $250,000,000 obtained from the Reconstruction Finance Corporation. The Federal Surplus Relief Corporation [42] was formed to bridge the gap between the destitute unemployed and surpluses of farm commodities; its function is to purchase surplus food supplies and distribute them to those on relief.

A second group of Government corporations center around the house building and financing program. The most important of these is the Home Owners' Loan Corporation authorized under the Home Owners' Loan Act of 1933.[43] This Corporation was formed to grant long-term loans at low-interest rates to those who could not otherwise retain their homes through meeting regular payments or by refinancing. The Corporation is authorized to issue $200,000,000 in capital stock to the Treasury, and to issue bonds, the interest on which is guaranteed by the Government, to enable it to make some $4,500,000,000 in loans. The Home Owners' Loan Act also provides for the creation of a Federal Savings and Loan System,[44] to cooperate with local citizens in setting up loan associations in communities not now adequately served. A Federal Savings and Loan Insurance Corporation [45] has also been established under the authority of the National Housing Act. Its purpose is to insure the safety of accounts of investors and depositors in thrift and home-financing institutions. It has a capital stock of $100,000,000 subscribed by the Home Owners' Loan Corporation.

In some respects all of the Government corporations described are by statute exempt from State taxation. Real property of all of the corporations, with a few exceptions,[46] can be taxed by the States by express permission of the acts of Congress authorizing the corporations. But the franchises, capital stock, and other securities of the corporations, again with a few exceptions,[47] are declared exempt from taxation by the States. The tax exemption clauses of the charter of the Reconstruction Finance Corporation may be regarded as typical.[48]

"Any and all notes, debentures, bonds, or other such obligations issued by the corporation shall be exempt as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes), now or hereafter imposed by the United States, by any territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The corporation, including its franchise, its capital, reserve, and surplus, and its income shall be exempt from all taxation now or hereafter to be imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipal, or local taxing agency; except that any real property of the corporation shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed."

The extent of this particular immunity from State taxation has lately been tested in the case of *Baltimore National Bank* v. *State Tax Commission of Maryland*.[49] In the reorganized Baltimore Trust Co., now known as the Baltimore National Bank Co., the Reconstruction Finance Corporation purchased 10,000 shares of preferred stock. The State tax commission levied taxes upon these shares of stock in the same manner in which it has been accustomed to levy taxes upon national bank stock, contending that the ownership of the shares by the Reconstruction Finance Corporation, an admitted instrumentality of the Federal Government, did not affect the taxable status of the stock.

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[41] Executive Order No. 3634, Oct. 16, 1933; Pub. L. No. 1, 74th Cong., 1st sess. (Jan. 31, 1935), extending the life of the Corporation to Apr. 1, 1937.

[42] Pub. L. No. 93, 73d Cong., 2d sess. (Feb. 15, 1934); Executive Order No. 7150, Aug. 19, 1935.

[43] 48 Stat. 129 (1933), 12 U. S. C. A. sec. 1463 (Supp. 1935); Executive Order No. 7126, Aug. 5, 1935.

[44] 48 Stat. 645 (1933), 12 U. S. C. A. sec. 1464 (Supp. 1935).

[45] 48 Stat. 1256 (1935), 12 U. S. C. A. sec. 1725 (Supp. 1935); Executive Order No. 7126, Aug. 5, 1935.

[46] The Federal Farm Mortgage Corporation, 48 Stat. 347 (1934), 12 U. S. C. A. sec. 1020f (Supp. 1935) and Tennessee Valley Authority, 48 Stat. 58 (1933), 16 U. S. C. A. sec. 831 (Supp. 1935). For a discussion of the tax-exempt status of the latter, see note (1934) 44 Yale L. J. 326.

[47] Thus Federal Savings and Loan Associations are taxable by the States at the same rates at which they tax similar financial institutions. 48 Stat. 645 (1934), 12 U. S. C. A. sec. 1464 (h) (Supp. 1935).

[48] 47 Stat. 9 (1932), 15 U. S. C. A. sec. 610 (Supp. 1935).

[49] 56 Sup. Ct. 417 (1936).

With this contention the Supreme Court agreed, pointing out that Congress had expressly permitted the taxation of national bank stock and that the failure to include a specific exemption for shares owned by the Reconstruction Finance Corporation indicated an intention to continue their taxable status. The decision clearly turned upon the question of whether Congress intended to exempt bank stock owned by the Reconstruction Finance Corporation from State taxation. There was no hint that Congress might not exempt such shares if it so desired, and that desire has now been made manifest.[50]

The legal skirmish in the *Baltimore National Bank case* and its legislative aftermath present a question as to the effect of congressional grants of exemption.[51] It is true that when Congress has expressly conferred immunity from State taxation upon any agency, the Court has treated the matter as if controlled by the immunizing statute.[52] But the position has been taken that if the instrumentality is engaged in carrying out the sovereign powers of the Federal Government, it already possesses an immunity which the Court will enforce in the absence of statute; and if it does not possess immunity as a result of its character as a Federal instrumentality, by what power does Congress confer it?

This view proceeds, however, from a failure to appreciate the fact that the attributes of all Federal instrumentalities, not provided by the Constitution itself, are determined by Congress. A corporation or other agency created by Congress or authorized to perform services for the Federal Government may have only those rights and duties which Congress confers upon it.[53] The rights to own property, to sue or be sued, to buy or sell, must be vested expressly or by implication in the agent. Exemption from taxation is one of the rights or privileges which Congress can confer upon its legitimate instrumentalities, because in its judgment the grant is necessary for the proper functioning of the agent. Whether certain ends are constitutional is, of course, a matter for the Court to decide, but the selection of the means for the accomplishment of ends which have been judged constitutional and the determination of their character and scope must remain matters of legislative policy.[54]

Congress, therefore, may in its judgment waive the immunity which the Constitution offers, either expressly, as it has in the case of the real property of the Reconstruction Finance Corporation, or by implication from its silence, as the *Baltimore National Bank* decision determined had been done with respect to bank stock held by that corporation. Or Congress may, on the other hand, determine to endow its agent with the full exemption available under the Constitution. This it has now chosen to do in the case of the bank shares in the hands of the Reconstruction Finance Corporation.

The fundamental question, then, is the scope of the constitutional immunity offered to Federal agencies, within the framework of which Congress is free to exercise its discretionary power. In the case of State enterprise exemption rests, as has been seen, upon a determination of whether the instrumentality is governmental or proprietary; it is the thesis of the present article that as a matter of constitutional law and as a result of the differences in the kinds of activities open to the two governments, the power of the States to tax the instrumentalities of the Federal Government is much more circumscribed than is this corresponding power of the Federal Government to tax those of the States. The reasoning which leads to such a conclusion is direct. Since the Federal Government is one of limited powers, Congress has no general authority to create corporations or to establish enterprises save as means for carrying into

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[50] Pub. L. No. 482, 74th Cong., 2d sess. (Mar. 20, 1936).

[51] This point is raised but inconclusively discussed in note (1936) 49 Harv. L. Rev. 1323, 1329 1331. See also Traynor, *National Bank Taxation in California* (1929) 17 Calif. L. Rev. 83.

[52] *Ambrosini* v. *United States*, 187 U. S. 1 (1902); *McCurdy* v. *United States*, 246 U. S. 263 (1918); *Smith* v. *Kansas City Title and Trust Co.*, 255 U. S. 180 (1921); *Federal Land Bank* v. *Priddy*, 295 U. S. 229 (1935).

[53] "All that can be said of the corporation itself is that it has been incorporated by an act of Congress, and for its legal powers and duties that act must be exclusively referred to." *Bradfield* v. *Roberts*, 175 U. S. 291, 299 (1899). On the subject of suits against Federal agencies, the Court has recently held, "Whether Federal agencies are subject to suit and, if so, the extent to which they are amenable to judicial process, is thus a question of congressional intent." *Federal Land Bank* v. *Priddy*, 295 U. S. 229, 231 (1935). See *The Lake Monroe*, 250 U. S. 246 (1919); *Sloan Shipyards Corp.* v. *United States*, 258 U. S. 549 (1922); *Missouri Pacific Ry. Co.* v. *Ault*, 256 U. S. 554 (1921).

[54] In *Osborn* v. *United States Bank*, 9 Wheat. 738, 864 (U. S. 1824), the Court said: "Congress was of the opinion that the faculties [among them exemption from State taxation] were necessary to enable the bank to perform the services which are expected from it, and for which it was created. This was certainly a question proper for the consideration of the legislature."

execution some governmental power delegated by the Constitution. Hence, it follows that every legitimate instrumentality created by the Federal Government, is, ipso facto, governmental in character. If it is not, the question arises whether the Federal Government has the authority to create it at all.

In *McCulloch* v. *Maryland*,[55] Marshall discussed the nature of the power of Congress to create corporations.

"The power of creating a corporation, though appertaining to sovereignty, is not, like the power of making war, or levying taxes, or of regulating commerce, a great substantive and independent power which cannot be implied as incidental to other powers, or used as a means of executing them. It is never the end for which other powers are exercised, but a means by which other objects are accomplished. The power of creating a corporation is never used for its own sake, but for the purpose of effecting something else."

If this is true, it becomes clear that the Federal Government could not charter a corporation having for its purpose the earning of private profit entirely apart from the performance of governmental functions. Thus all of the banks which the Federal Government has created, the railroads it has chartered, the various boards and corporations it has brought into existence, are merely means selected by Congress for carrying into execution the delegated governmental functions.[56] And all of the New Deal Government corporations which survive the ultimate test of constitutionality will do so because it is possible to demonstrate their utility in giving effect to the governmental powers which are conferred upon the Federal Government by the Constitution.

Nor should it make any difference what powers of the Federal Government a given instrumentality is exercising. It has been suggested[57] that the "war powers" are peculiar in their "over-riding force in time of crisis" and hence that Government corporations engaged in exercising them are peculiarly inviolable.[58] War powers, however, cannot be differentiated from other Federal powers except as they require a greater number of agencies for their exercise, and affect more phases of social life. All of the powers of the Federal Government are qualitatively equal save as the Constitution itself may make distinctions among them. And presumably Congress may endow any agency which is held to be "necessary and proper" to the execution of any of its powers with whatever privileges and authority may be required for it to accomplish its purpose. In this respect every power of Congress is as plenary as the war powers, and every instrumentality may be made as powerful as the accomplishment of its purposes may require. This conclusion likewise destroys any distinction between those instrumentalities owned by the Government and those which it employs but does not own.[59] If it is admitted that an agency has a legitimate existence as a means for achieving a constitutional end, it must surely follow that Congress may endow it with tax exemption just as it may confer upon it any other powers or privileges (not specifically forbidden by the Constitution) which may be required to give the agency effectiveness.

The constitutional position of the States, on the other hand, is quite different. They have the power to charter corporations of a public or of a private nature,

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[55] 4 Wheat. 316, 411 (U. S. 1819).

[56] Sometimes the service which an agency is to perform is only remotely related to any actual need of the Government. The functions of the Federal land banks illustrate this fact. In the creation of these corporations it could scarcely be shown that the Government needed additional agencies to carry on its present services. The real purpose of the banks was to provide better facilities for financing farm loans. Yet Congress would have had no power to charter such corporations unless they were to serve governmental purposes. Lest the Supreme Court should refuse to agree that Congress could create corporations for the single purpose of making farm loans, Congress also gave the land banks power to serve as depositories of public funds and as purchasers of Government bonds. The Court held that these governmental services, though not the central purposes of the bank, were sufficient to give them the character of Government instrumentalities which could be exempted from State taxation. *Smith* v. *Kansas City Title and Trust Company*, 255 U. S. 180 (1921).

[57] Note (1936) 49 Harv. L. Rev. 1323, 1329.

[58] Government corporations formed for war purposes were unanimously held immune from State taxation even in the absence of express statutory exemption. *United States* v. *Coghlan*, 261 Fed. 425 (D. Md. 1919); *Clallam County* v. *U. S. Spruce Production Corp.*, 263 U. S. 341 (1923); *King County* v. *U. S. Shipping Board Emergency Fleet Corp.*, 282 Fed. 950 (C. C. A. 9th, 1932); *U. S. Housing Corp.* v. *City of Watertown*, 113 Misc. 679, 186 N. Y. Supp. 309 (Sup. Ct. 1920).

[59] *Cf.* the dicta of the *Thomson* and *Peniston cases*, notes 15 and 16, *supra*. But even when the Court upheld taxes upon the property of agents employed by the United States it did so only in the absence of express exemption and when in its judgment the tax laid no burden upon the exercise of the governmental function.

to perform governmental functions or to serve purely private ends. The power of the States to create corporations is immensely greater than that of the Federal Government, because the purposes which the States are free to serve by such means are far more numerous than those which fall within the scope of the Federal Government. Immunity from Federal taxation is, of course, enjoyed only by those corporations or other agencies which are the means by which the States carry out their strictly governmental powers. All other corporations, associations, or agencies, which the States may create may be subjected to such taxes as the Federal Government is free to impose. The distinction between governmental and proprietary functions is thus congenial to fundamental conceptions of the constitutional powers of the States; it is, however, foreign to established views of the nature of the Federal Government.

The contention has been made[80] that such reasoning "mistakes the basis of the *South Carolina case*. Regulation of the liquor traffic by a State monopoly would seem to be an exercise of the State police power. And the same State functions which were held 'proprietary' when Federal taxation was involved were held governmental when the power of the State constitutionally to support them by taxation was involved." Thus the argument is that since State governmental functions are taxed by the Federal Government under guise of labeling them as proprietary, the same procedure is open to the States in taxing agencies of the Federal Government. The contention, however, falls with its premise. A declaration that a State activity is within the public purpose concept is not a declaration that that activity is governmental in nature; rather it is a judicial determination that the State may direct its proprietary activities in a certain direction. Note the language of the opinion in *Ohio* v. *Helvering*,[81] the postprohibition analogy to the preprohibition *South Carolina decision:*

"The argument seems to be that the police power is elastic and capable of development and change to meet changing conditions. Nevertheless, the police power is and remains a governmental power, and applied to business activities is the power to regulate those activities, not to engage in carrying them on. * * * If a State chooses to go into the business of buying and selling commodities, its right to do so may be conceded so far as the Federal Constitution is concerned; but the exercise of the right is not the performance of a governmental function, and must find its support in some authority apart from the police power."[82]

The issue as to whether any of the activities of the Federal Government may be classed as proprietary has been squarely presented to the New York courts in the recent case of *People ex rel. Rogers* v. *Graves*.[83] Action was brought by the tax commissioner of New York against Rogers, the general counsel for the Panama Railroad Co., for failure to pay the State income tax upon his salary. In the hearing it was brought out that the Panama Railroad Co. was a New York corporation, organized in 1849, and acquired in 1904 by the United States as the sole owner. The corporation was engaged in operating a railroad, a steamship line which carried Government supplies between New York and Cristobal, a hotel, two dairies, and a commissary for the use of the employees of the Canal, the railroad company, and the armed forces. The appellate division of the New York Supreme Court upheld the tax on the ground that the corporation was not a Government agency performing governmental functions, but a corporation engaged in proprietary activities.

"The operation of steamships, railroads, stores, hotels, or dairies has not the slightest relationship to any governmental function. Common sense compels the conclusion that such activities are intrinsically, traditionally, and historically of a commercial and proprietary nature. And this is further reinforced when it is considered that the particular activities here in question have a background of 55 years of private, commercial operation. * * *

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[80] Note (1936) 49 Harv. L. Rev. 1323, 1324–1325.

[81] 292 U. S. 360, 369 (1934).

[82] Compare, on the other hand, Marshall's language in the *Osborn case* in evaluating the argument of counsel that the United States Bank was a private corporation, primarily devoted to the earning of private profit: "That the mere business of banking is, in its own nature, a private business, and may be carried on by individuals or companies having no political connection with the Government is admitted; but the bank is not such an individual or company. It was not created for its own sake, or for private profit. *It has never been supposed that Congress could create such a corporation.*" *Osborn* v. *United States Bank*, 9 Wheat. 738, 860 (U. S. 1824).

[83] 245 App. Div. 452, 283 N. Y. Supp. 538 (1935).

"It seems clear to us that the Panama Railroad Co. is a Government-controlled corporate agency engaged in a commercial, proprietary function. * * * Assuredly, the ownership and operation of stores, hotels, and dairies is akin to the operation of liquor stores, and the operation of a steamship line and a railroad comparable to the operation of a street railway. And this particularly where such operation is in continuation and expansion of earlier private commercial enterprises. The commercial nature of the functions of the Panama Railroad Co. are further marked by the fact that its operations are profitable and yield dividends to its stockholder, the United States. The operations constitute an activity to which, unquestionably, the taxing power of the State would normally extend."[64]

This conclusion, however, does not take into consideration the reasons why the Corporation was acquired by the United States, nor the services it performs which are essential to the successful administration of the Canal Zone. Acquisition by the United States of the then existing Panama Railroad Co., and its continuance as a New York corporation, was a matter of convenience. It demonstrated no purpose on the part of the United States to operate a railroad or hotels, stores, and dairies as commercially profitable enterprises; on the contrary these functions were means necessary to the construction of the Panama Canal, its administration and its defense.[65] If this is the purpose for which the United States acquired and operates the Panama Railroad Co., then it may engage in such activities as may be required for the success of that enterprise even though these activities are customarily classified as private. So-called "private" activities cannot be considered apart from the character and purpose of the entire Federal governmental enterprise. This is the firmly established doctrine of constitutional law dating from the *McCulloch* and *Osborn cases*. As said in *National Bank* v. *Union Trust Company*:[66]

"What these cases [*McCulloch* v. *Maryland* and *Osborn* v. *United States Bank*] established was that although a business was of a private nature and subject to State regulation, if it was of such a character as to cause it to be incidental to the discharge by a bank chartered by Congress of its public functions, it was competent for Congress to give the bank the power to exercise such private business in cooperation with or as part of its public authority." The judgment in *Rogers* v. *Graves* was based on the apparent similarity of the activities of the Government to those ordinarily under private control, but it did not explore at all the differences in purpose or in legal foundation."[67]

That the distinction between governmental and proprietary functions is applicable to State but not Federal agencies can be demonstrated from an entirely different angle. It is shown by the number of enterprises which, if engaged in by the States, are regarded by the Court as proprietary in character and subject to the taxing power of the Federal Government, but which, if engaged in by the Federal Government, are held to be governmental instrumentalities beyond the reach of the taxing power of the States, save as Congress may waive that immunity.

Perhaps the clearest example is that of banking. Banks chartered by the Federal Government become, regardless of their ownership, governmental in-

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[64] 245 App. Div. at 459, 460, 283 N. Y. Supp. at 544. *Aff'd, per curiam*, 2 N. E. (2d) 686 (N. Y. 1936).

[65] "I hope that nothing will be done to merge the corporate entity of the [Panama] Railroad Company into that of the Government or the [Panama Canal] Commission. Under the present arrangement, it is just as easy to have close supervision over the management of the railroad as if it were nominally operated by the Commission, and the corporate form secures the utmost convenience and elasticity of control." Statement of Hon. William H. Taft, Secretary of War, before the Senate Committee on Interoceanic Canals (Washington, 1905), p. 32, cited by Schnell, *supra*, note 31, at 241.

[66] 224 U. S. 416, 423 (1913).

[67] It may be possible for the Court to uphold the tax in this instance without passing upon the question of governmental functions, on the ground that Congress has not indicated its will in the matter and that the tax is too remote to be a burden upon a government instrumentality. It is true that the government is "two steps removed from the burden of it—by the interposition of the employee on whose salary the tax was levied and of the corporation which paid the salary." Comment (1936) 84 U. of Pa. L. Rev. 661, 666.

It may also be possible to distinguish the case on the theory that over territories the Federal Government possesses additional, broader functions, and could here engage in proprietary as well as strictly governmental activities. This possibility is based, of course, on the constitutional provision that "the Congress shall have power to dispose of and to make all needful rules and regulations respecting the territory or other property belonging to the United States. . . ." Art. IV, sec. 3.

strumentalities exempt from the taxing power of the States to the extent determined by Congress.[65] Thus in *Owensboro National Bank* v. *Owensboro*[66] the Court said,

"It follows then, necessarily from these conclusions that the respective States would be wholly without power to levy any tax, either direct or indirect, upon the national banks, their property, assets or franchises, were it not for the permissive legislation of Congress."

But the States may not establish banks as instrumentalities of government exempt from the taxing power of the United States. Regardless of whether the ownership of the bank is vested partially or exclusively in the State, banking is to be regarded as a proprietary function in which the State engages on the same terms as private individuals or corporations.

This view was reaffirmed in the recent case of *North Dakota* v. *Olson*.[70] North Dakota had by statute created a bank to be owned and operated solely by the government of the State. In 1921 Congress levied a general tax on the capital stock of corporations and the tax was assessed against the Bank of North Dakota. Answering the contention of the State, the Circuit Court of Appeals for the Eighth Circuit held, largely on the authority of the *Bank of United States* v. *Planters' Bank*,[71] that, so far as States are concerned, banking is a private business.

"It is well settled that when a State creates a corporation for the purpose of engaging in private business and acquires either a part or the whole of the capital thereof, it divests itself, so far as it concerns the transactions of such corporations, of its sovereign character and takes that of a private citizen. Instead of communicating to the corporation its privileges and prerogatives, it descends to the level of a private citizen. As to the transactions of such corporation, it cannot claim the privileges or immunities of a sovereign."[72]

It is clear that banking as carried on under the authority of the Federal Government is not, of itself, so different from banking as carried on under the authority of the States that it is necessarily a governmental function in the one case and a proprietary function in the other. The difference must surely lie in the different natures of the respective authorities under which the agencies are established.[73]

A second illustration that the distinction between governmental and proprietary activities is not valid when applied to the Federal Government is found in the field of public utilities. By the passage of the Boulder Canyon Project Act[74] in 1928, the Federal Government definitely entered a field which had always been regarded as a private industry.[75] The Tennessee Valley Authority, created in 1933[76] to operate the properties of the United States at Muscle Shoals and to manufacture and distribute electrical power, marked a significant extension of that policy. The corporation is a governmental instrumentality, although it is not clear that Congress intended to exempt all of its property from State taxation.[77] The constitutionality of the manufacture and

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[65] *McCulloch* v. *Maryland*, 4 Wheat. 316 (U. S. 1819); *Osborn* v. *United States Bank*, 9 Wheat. 738 (U. S. 1824); *Smith* v. *Kansas City Title and Trust Co.*, 255 U. S. 180 (1921); *Federal Land Bank* v. *Crosland*, 261 U. S. 374 (1923).

[66] 173 U. S. 664, 668 (1899).

[70] 33 F. (2d) 848 (C. C. A. 8th, 1928). A subsequent appeal to the Supreme Court was dismissed for lack of jurisdiction. 280 U. S. 528 (1929).

[71] 9 Wheat. 904 (U. S. 1824).

[72] 33 F. (2d) at 851. That banking is a proprietary function when engaged in by the States is also supported by the following decisions: *Briscoe* v. *Bank of Kentucky*, 11 Pet. 257, 323 (U. S. 1837) *Darrington* v. *Bank of Alabama*, 13 How. 12 (U. S. 1851); *Curran* v. *Bank of Arkansas*, 15 How. 304, 308 (U. S. 1853); *Georgia* v. *Chattanooga*, 264 U. S. 472 (1924); *Metropolitan Savings Bank and Trust Co.* v. *Farmers' State Bank*, 20 F. (2d) 775 (C. C. A. 8th, 1927).

[73] See *First National Bank of Wellington* v. *Chapman*, 173 U. S. 204 (1899); *First National Bank* v. *Adams*, 258 U. S. 362 (1922); *First National Bank* v. *Anderson*, 269 U. S. 341 (1926).

[74] 45 Stat. 1057 (1928), 43 U. S. C. A. sec. 617 (Supp. 1935).

[75] In the case of Boulder Dam, the Secretary of the Interior was empowered to make contracts for the sale to private corporations of the estimated output of electricity before work on the dam was started.

[76] 48 Stat. 58 (1933), 16 U. S. C. A. sec. 831 (Supp. 1935).

[77] The securities issued by the corporation are tax exempt so far as the States are concerned. The status of its real property is not clear. However, Congress has appropriated and the T. V. A. has paid to municipalities and other units of government sums of money which approximate the amounts which would have been due in taxes from a privately owned corporation. Note (1934) 44 Yale L. J. 326.

sale of electrical power by the Federal Government through the facilities of the Tennessee Valley Authority has now been decided [78] and it is unquestioned that the corporation can exercise its powers and enjoy its immunities only because it is carrying into execution governmental powers conferred by the Constitution upon the National Government. The issue was clearly stated by Judge Grubb in the district court.[79]

"If its program is more extensive [than reclamation, and the manufacture of munitions] and amounts to an engaging in and carrying on, independent of the question of surplus power and relation to a granted power, the general business of producing and selling electric power within the limits of Alabama, it is ultra vires of the power conferred or that could have been conferred by Congress on the Tennessee Valley Authority by its act of incorporation."

Thus the power of the Tennessee Valley Authority to manufacture and sell electrical energy is dependent upon the authority of the Federal Government to manufacture war munitions and to improve the navigability of streams. The fact that the power industry is confined for the most part to private corporations does not alter the fact that when carried on by the Federal Government the manufacture and distribution of power is a governmental function.[80]

On the other hand, ownership and operation of public utilities by States or municipalities does not give those activities the status of governmental instrumentalities exempt from Federal taxation. In *Flint* v. *Stone Tracy Company*,[81] the Court sustained the Federal excise tax of 1909 as applied to the incomes of public-service corporations owned wholly or in part either by municipalities or by the States themselves. The Court held that these were not governmental functions and hence were not beyond the Federal taxing power.

It is no part of the essential governmental functions of a State to provide means of transportation, supply artificial light, water, and the like. These objects are often accomplished through the medium of private corporations, and though the public may derive a benefit from such operations, the companies carrying on such enterprises are, nevertheless, private companies, whose business is prosecuted for private emolument and advantage. For the purpose of taxation they stand upon the same footing as other private corporations upon which special franchises have been conferred."

Although a lower Federal court later declared, despite this, that "the maintenance and operation of a street-railway system in connection with the public highway by a municipality is an exercise of a strictly governmental function",[82] *Helvering* v. *Powers* [83] conclusively determines that municipal rendition of public-utility services represents proprietary activity.

Thus it would seem to be clear that all the corporations created by the Federal Government which have a legitimate basis serve as agents in the performance of some power conferred by the Constitution. As agents of the Federal Government exercising powers delegated by the Constitution, they are performing functions which can only be classified as governmental. And in performing governmental functions they are, under the doctrines of the Supreme Court, exempt from the taxing powers of the States save as Congress may waive that immunity. As was observed at the outset, the Court has never set aside an exemption from State taxation which Congress had conferred on any Federal agency held to have a legitimate existence. While it is not to be expected that the Court will accept the view that Congress is the exclusive judge of what agencies are needed by the Federal Government to carry on its functions, such a position is not necessary to establish the validity of the argument now being made. If the Court determines that any particular agency of the Federal Government has a legitimate existence, it can hardly deny that it is carrying into execution some necessary and proper governmental power. And under its own rulings, if the governmental character of an instrumentality is established, tax exemption follows as a matter of course.

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[78] *Ashwander* v. *Tennessee Valley Authority*, 297 U. S. 288 (1936).
[79] *Ashwander* v. *Tennessee Valley Authority*, 8 F. Supp. 893, 895 (D. Ala. 1934).
[80] This issue was in point in *Alabama* v. *United States*, 282 U. S. 503 (1930), when Alabama sought to collect from the United States the tax which was regularly levied on the sale of power within the State. The case, an appeal from the Court of Claims, was dismissed, however, without a discussion of its merits, for lack of jurisdiction.
[81] 220 U. S. 107, 172 (1911).
[82] *Frey* v. *Woodworth*, 2 F. (2d) 725, 729 (E. D. Mich. 1924).
[83] 293 U. S. 214 (1934), cited and discussed at note 7, *supra*.

EXPORT-IMPORT BANK OF WASHINGTON

EXPORT-IMPORT BANK OF WASHINGTON,
Washington, March 18, 1937.

Senator CARL HAYDEN,
United States Senate.

DEAR SENATOR HAYDEN: Reference is made to your letter of January 18 regarding the proposal of Mr. Charles Woolf, of Phoenix, Ariz., to permit the various States to tax Federal agencies, such as the Export-Import Bank of Washington.

It is noted that Mr. Woolf suggests that the most fair and equitable method for the States to tax Federal agencies would be to impose "a tax in the nature of an excise tax for the privilege of doing business in Arizona, the tax to be based upon or measured by net income from the proprietary business done in Arizona; and by proprietary business I, of course, mean business such as is usually engaged in by persons and corporations as distinguished from duties and activities that are essentially governmental in character." Your letter also states that Congress might very properly give consideration to the fundamental question presented in regard to unfair competition with private enterprises by Federal agencies or instrumentalities.

Both statements are premised, apparently, on the assumption that the Federal agencies are actively in competition with private business. As you know, the Export-Import Bank is engaged in financing foreign trade, and every effort is made to provide that the credit facilities of the bank shall supplement rather than replace credit facilities of commercial banks. Credit is extended by the bank for longer periods or upon security which commercial banks (because of their obligations to depositors) are not in position to carry. In other words, the imposition of State taxes will not affect the competitive position of the bank, since in all instances the commercial banks are given the first opportunity to handle credits made available by this bank.

In considering the proposal, a fundamental question is presented as to whether the Federal financing agencies are engaged in proprietary business or governmental functions. The past 2 decades have witnessed a marked growth in the activities of the Federal Government in regard to the lending of money to its citizens. The decisions of the courts do not clearly state whether such activities are governmental or proprietary in nature. However, it is submitted that the continuance of such activities indicates that to an increasing degree they must be classified as governmental. It is our opinion that this is particularly true of the loans and credits established by the Export-Import Bank, which are noncompetitive and are designed to benefit our whole domestic economy. For your information there is enclosed copy of our annual report which reviews the main activities of the bank.

While the bank may utilize some of the public services of the different States, it should be pointed out that the extension of foreign trade credits enables the borrowers in the various States to carry on and transact additional business, with the result that the taxable income or property of such citizens is increased. Thus, indirectly, the States and local communities benefit from the expanded trade. The tax proposal ostensibly involves only the payment of taxes upon the net income of the agencies derived from the various States. Due to the nature of the risks involved and the character of the loans carried by the bank, it would appear that the imposition of such taxes would result in an indirect contribution by the Treasury to the various States. Further, the payment of such taxes will reduce to that extent the effectiveness of the bank because its interest rates would necessarily be increased.

Assuming that it is desirable to permit the taxing of Federal agencies as a matter of policy, care should be exercised by Congress in drafting the necessary legislation. Mr. Woolf refers to the Federal statute which permits national banks to be taxed by the various States. Apparently, it is his thought that a similar statute might be drawn permitting the various Federal agencies engaged in the making of loans to be taxed on a similar basis. It must be pointed out that a national bank with a fixed location in one city is in a different position than a Federal agency situated in Washington and engaged in making loans throughout the country.

In the case of the Export-Import Bank, such a statute would result in making the bank subject to tax almost entirely by the District of Columbia. In

almost all instances our notes are payable in Washington, D. C., and collateral is pledged here as security for such notes. While the borrower may be a citizen of Arizona or New York, the business is transacted in the District of Columbia and hence the net income would be subject to tax by the District. In some instances, the bank has designated commercial banks to act as its agents in handling certain transactions, particularly in financing the sale and exportation of cotton. No doubt such transactions would be made subject to tax in the States in which the agents are located.

In conclusion, it is our opinion that as a matter of policy the States should not be permitted to tax the bank as an agency of the Federal Government. However, if such taxes are to be imposed, the law should clearly define the limitations of such taxation in order that too great a burden will not be imposed on the agency.

Sincerely yours,

WARREN LEE PIERSON,
President.

COMPTROLLER OF THE CURRENCY

THE COMPTROLLER OF THE CURRENCY,
Washington, January 25, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

DEAR SENATOR: Your letter of January 18 is before me with reference to taxing Federal agencies in the State of Arizona which are in competition with State institutions on a basis similar to that under which States are permitted to tax national banks by Congress.

This involves a matter of general policy, and as the Office of the Comptroller of the Currency is a part of the Treasury, when questions of policy are involved, Secretary Morgenthau alone speaks for the Treasury. I have, therefore, submitted your letter to the Secretary, and I am sure that within a reasonable time you will hear from him.

With reference to that part of your letter dealing with the Federal Deposit Insurance Corporation, it would seem that this is on an entirely different basis, as the Federal Deposit Insurance Corporation is not in competition with any of the corporations or firms in your State. It is purely a governmental function, and, in fact, you are probably familiar with the criticism which has been made that the smaller banks of the Midwestern States are receiving greater benefits in proportion to the assessment than are the larger banks in the large cities. The Federal Deposit Insurance Corporation is not directly a part of the Treasury, and for that reason I am making this comment.

Cordially yours,

J. F. T. O'CONNOR, *Comptroller.*

BUREAU OF THE BUDGET

BUREAU OF THE BUDGET,
Washington, May 5, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

MY DEAR SENATOR HAYDEN: I may say in reply to your letter of April 28, 1937, regarding progress of the work of the President's taxation committee, that the preparation of the tables to accompany the first draft of report for the consideration of the committee will be completed by the end of the week, and I shall then endeavor to arrange for an early meeting of the committee for the purpose of going over this draft of report.

I regret the delays that have occurred in connection with this matter and shall be glad to keep you advised of our future progress.

Sincerely yours,

D. W. BELL, *Acting Director.*

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, January 28, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

MY DEAR SENATOR HAYDEN: Reference is made to your letter of January 18, enclosing a copy of a letter to you of December 14 from Mr. Charles Woolf, of Phoenix, Ariz.

Mr. Woolf furnishes a list of Federal instrumentalities that do financial business in your State and cites Federal statutes to show that they are subject to little or no taxation by State or local authorities. He urges Federal legislation authorizing the taxation of these instrumentalities by the States insofar as their business is of a "proprietary" nature, the tax to take the form, preferably, of an excise measured by the net income from such business. This form of taxation, he points out, is one of the four authorized in respect to national banks under section 548 of title 12 of the United States Code.

The proposal appears to involve two legal questions of far-reaching importance. One of them goes to the propriety of classifying Federal functions into governmental and nongovernmental. The other concerns the power of Congress to give up any immunity from taxation that the Federal Government may have under the Constitution.

As you request, however, I shall be glad to make a careful study of this whole question and to refer it to the appropriate committees at the earliest opportunity.

Yours sincerely,

L. H. PARKER, *Chief of Staff.*
(Per C. F. S.)

THE BROOKINGS INSTITUTION

THE BROOKINGS INSTITUTION,
Washington, D. C., January 25, 1937.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

DEAR SENATOR HAYDEN: This is in reply to your letter of January 18 enclosing copy of a letter addressed to you, signed by Charles Woolf, of Phoenix, Ariz. I enclose a memorandum prepared by a member of our staff which consists of notes on part of the items referred to in Mr. Woolf's letter. I regret that we have no studies of tax policy under way at present and are not in a position to undertake a study of the magnitude of the one suggested by Mr. Woolf.

Sincerely yours,

H. G. MOULTON, *President.*

JANUARY 25, 1937.

Memorandum to: Mr. Moulton.
From: Mr. Hardy.
Subject: Letter of Charles Woolf relative to taxation of Federal agencies, addressed to Senator Carl Hayden.

Mr. Woolf's suggestion is that Federal instrumentalities, corporations, and agencies which are engaged in financial activities should be made subject to taxation under the conditions now in force with respect to taxation of national banks, and should be taxed by the States in proportion to the net income derived from operations in the respective States.

It appears from his memorandum that the States are now empowered to levy taxes on this basis in the cases of national agricultural credit corporations (only one or two now in existence), national mortgage associations (none in existence), and Federal credit unions (all very small). It appears also that Federal savings and loan associations are subject to taxation on the basis suggested, provided local building and loan associations are similarly taxed. Land Bank Commissioner loans, referred to in paragraph 11 have all been

taken over by the Farm Mortgage Corporation; hence should have been included in paragraph 1 of the memorandum.

In the case of the RFC Mortgage Co., I question Mr. Woolf's conclusion that it cannot be taxed either directly or indirectly without permission of Congress. This company was chartered by the RFC under its general authority to deal with mortgage companies, and I do not see how such action by the RFC could confer upon it any greater exemption than the RFC enjoys. In fact, my understanding is that it is taxable like any other State-chartered corporation. However, the expenses of the RFC Mortgage Company are controlled by the RFC, which owns all the stock and furnishes practically all the operating staff and facilities, and could easily be made to absorb all the income if such action would result in tax saving. The FDIC does not carry on operations in the States which result in net income. The income of the Federal Reserve banks from operations in States where no banks or branches are located, arises from operations as correspondents of local banks, and I doubt if they could be reached by local taxation if all exemption were removed.

It would be difficult to establish net income for the F. H. A. and for the Federal Savings & Loan Insurance Corporation for many years, as their assessments go to build up reserves against future losses and are presumably intended not to yield net income but merely to cover prospective losses.

It is unlikely also that the Resettlement Administration derives or will derive any net income from its operations. This agency and the F. H. A. being direct agencies of the Federal Government the difficulty of working out a system of income taxation is greater than in the case of an incorporated agency. The HOLC is in liquidation and it is expected that its operations will show a loss, though it does make a showing of net income at present by setting up no reserve against future shrinkage of its operating income as the principal of its outstanding loans diminishes and the volume of foreclosures increases.

The Commodity Credit Corporation operates at a heavy loss. The Regional Agricultural Credit corporations are in liquidation and I presume a loss is being involved, though it may not appear on their books, since all of their operating expenses are paid by the RFC. With regard to the Federal land banks, Federal Farm Mortgage Corporation, Federal home-loan banks, RFC, and the Electric Home and Farm Authority and the Federal intermediate credit banks, the issues raised are of considerable importance. I do not see how we could make recommendation with regard to the taxation of these agencies except on the basis of a comprehensive study.

UNITED STATES CHAMBER OF COMMERCE

CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA,
Washington, January 26, 1937.

Hon. CARL HAYDEN,
United States Senate.

MY DEAR SENATOR: As is suggested by Mr. Woolf in the letter to which, under date of January 18, you ask our attention, the general rule is that instrumentalities of the Federal Government are not subject to State and local taxation, except insofar as Congress explicitly gives its assent. The congressional enactments providing for the creation of practically all of the corporations mentioned by Mr. Woolf declare they are instrumentalities of the Federal Government. This appears to have become almost a matter of routine by reason of the decision of the United States Supreme Court in *Smith* v. *Kansas City Title & Trust Co.* (255 U. S. 180 (1921)), in which the court upheld the statute creating the Federal land banks merely because it made the banks instrumentalities of the Federal Government in being ready to act as its fiscal agents, if called upon, and accordingly upheld the further provision expressly making their bonds free from State and local taxation. How far the theory of instrumentality is carried may appear in the Supreme Court's decision of January 4, 1937, in *New York ex rel. Rogers* v. *Groves*, in which it was held that, although a Maine corporation privately owned for years, the Panama Railroad Co. has become an instrumentality of the Federal Government, and consequently the salary of its general counsel, resident in New York, is not subject to the income-tax law of New York. That the company engages also in carrying freight

and passengers for private persons, as with its subsidiary steamship line, was considered incidental, as had been the business of the Federal land banks in engaging in the farm-mortgage business.

On the other hand, when a State engages in the activities of private business it becomes subject to Federal taxation as to those activities, and State employees so occupied have their compensation subjected to the Federal income tax. This was the decision in *Ohio* v. *Helvering* (292 U. S. 360 (1934)), in which case it was held that the former conclusion still persists, that a State which operates liquor dispensaries must pay the Federal taxes levied upon liquor dealers. In *Indian Motocycle Company* v. *U. S.* (283 U. S. 570 (1931)), however, it was held that a Federal excise tax could not be levied upon the sale of a motorcycle to a subdivision of a State when the machine was to be used for police purposes—i. e., for purposes considered governmental.

You will recall, however, that a year ago the Supreme Court held that some assets of a Federal instrumentality were subject to State taxation, and Congress at once withdrew them from such taxation. In deciding *Baltimore National Bank* v. *State Tax Commission* (297 U. S. 209 (1936)) the Supreme Court worked out of the consent given by Congress to nondiscriminatory taxation of shares of national banks a consent for the State of Maryland to tax preferred stock held by the Reconstruction Finance Corporation to represent money it had placed in a national bank to increase its depleted capital. Within a month the Senate had passed a bill exempting such preferred stock from State taxation, on the ground that the operation of the Reconstruction Finance Corporation was not intended as a business venture but was solely for purposes of aid to a weakened institution. The bill became law on March 20, 1936 (Public, No. 482).

The circumstances in the case just mentioned are obviously different from those of the corporations which have been created with, as a kind of saving clause for purposes of constitutionality, a declaration that they are instrumentalities of the Federal Government, although their obvious purposes are wholly distinct from such an instrumentality. How tenuous the fiction becomes is illustrated in the case of the Federal credit unions, included in Mr. Woolf's list. After several States had enacted laws under which these small-loan agencies might be set up under State laws, a Federal statute authorized the charter by the Farm Credit Administrator of Federal credit unions technically authorized to act as depositaries of Federal public moneys, but in reality to engage only in the same small-loan business as credit unions existing under State laws. Of themselves, credit unions may have relatively little importance, particularly in comparison with other forms of agencies set up by the Federal Government, but they serve to illustrate how far the legal fiction we have mentioned has been carried. In their case there is the further peculiarity that, although they are intended to exist chiefly among employees in commerce and industry, their supervision is placed in the Farm Credit Administration.

As you will know, there are in addition to the long list of Mr. Woolf numerous other examples of withdrawal by the Federal Government of property from State and local taxation. That was the ground on which the taxpayers in a New Jersey township went into court and was successful in opposing the placing by the Resettlement Administration of a project in their midst. In constructing and operating apartment buildings in cities, the Public Works Administration has asserted exemption from State and local taxation, but has offered contributions to municipalities in consideration of the municipal services in education, fire protection, police protection, etc., that are enjoyed. In a somewhat different class, and probably presenting other problems, is the Postal Savings System, with deposits aggregating over a billion dollars, and with clear profits to the Government in the fiscal year of 1936 running into the millions of dollars and wholly free from every form of tax. It would seem only logical that, with deposit insurance in effect, there should be an endeavor to have these deposits transferred to insured banks, where they exist.

To these growing exemptions from State and local taxation there has been persistent attention and opposition from the chamber and the organizations that compose the chamber. Our committees on taxation have opposed the Federal Government taking over sources of taxation that should be left for the States and in any other way lessening the sources to which they must look for their revenues. Our committees on Government competition have emphasized the unfairness which all business men feel in the Government entering into competition with private enterprise and using tax exemption in

the process. Estimates made by our committees place the loss in taxes to States and their subdivisions well up in the millions of dollars.

Our committees have consistently opposed Government competition with the enterprises of its citizens because of these elements of unfairness. Given a fair field and no special privileges such as tax exemptions, and full cost accounting, representatives and responsible businessmen feel confident they can demonstrate the greater efficiency and lower costs of private initiative and private enterprise.

If Congress should enact legislation, either in its statute relating to reorganization or separately, requiring every agency of the Federal Government that competes with private enterprise to keep cost accounts according to established methods, and show all items of overhead, such as State and local taxes which would be payable by a private enterprise under the circumstances, publishing these true costs for public information, there would be demonstration of the taxes of which the States are being deprived and a clear indication of the public interest in connection with the operations which are in question.

Of course, without waiting for any demonstration of the amounts involved in State and local taxes, Congress could forthwith make all Federal agencies subject to Federal, State, and local taxation in all respects in which they engage in private business. Such action would seem necessarily in principle to extend to the tax status of securities issued by these agencies to finance their business operations. The chamber has urged that all future issues of Federal securities, and of securities issued by agencies, should be made subject to taxation as to interest and principal, in order that such securities may not be refuges from taxation, and in order that this much might be accomplished at once and without waiting for a constitutional amendment making future issues of Federal and State securities reciprocally taxable.

In mentioning tax exemption of agencies created by the Federal Government, Mr. Woolf does not mention some other advantages possessed by them. For example, they are also exempt from suit in any court, except insofar as Congress may have given its assent to their being sued.

Neither you nor Mr. Woolf, however, will care to have us discuss these other aspects of the problem created by the agencies which Mr. Woolf mentions. It has been our intention only to be responsive to your request, and not to go into these other matters, however interesting we may consider them.

Very truly yours,

JOHN M. REDPATH, *Executive Manager.*

COMMENTS BY CHARLES WOOLF

Comments by Mr. Charles Woolf on the conclusions reached in the foregoing letters are contained in the following correspondence:

PHOENIX, ARIZ., *April 5, 1937.*

Hon. CARL HAYDEN,
United States Senator,
Senate Office Building, Washington, D. C.

DEAR CARL: In connection with my letter to you of December 14, last, relative to the question of taxing Federal agencies on their proprietary activities, you have now furnished me with 18 letters by various Federal officers speaking for their respective agencies. Only 11 of those letters attempt to discuss or take any definite position concerning the question. The other seven are nothing more than acknowledgments of the receipt of your communications relative to the matter.

For convenient reference later herein, the 11 letters are identified as follows:

(*a*) Post Office Department, by Third Assistant Postmaster General (whose signature I cannot decipher), February 4, 1937;
(*b*) Reconstruction Finance Corporation, Jesse Jones, February 1, 1937;
(*c*) Federal Home Loan Bank, Mr. Fahey, February 11, 1937;
(*d*) Comptroller of the Currency, Mr. O'Connor, January 25, 1937;
(*e*) Federal Housing Administration, Mr. McDonald, February 2, 1937;
(*f*) Rural Electrification Administration, Mr. Cooke, January 28, 1937;
(*g*) Tennessee Valley Authority, Mr. Morgan, February 16, 1937;
(*h*) Board of Governors, Federal Reserve System, Mr. Morrill, February 24, 1937; and
(*i*) Farm Credit Administration, Mr. Meyers, February 23, 1937.
(*j*) Export-Import Bank of Washington, Mr. Pierson, March 18, 1937.
(*k*) Comptroller General of the United States, Mr. Elliott, May 10, 1937.

POST OFFICE DEPARTMENT

(*a*) In that letter it is said that inasmuch as the Post Office Department is not mentioned in my letter no comment is required. To this is the added statement:

"* * * it is believed postal savings and interest accrued thereon are subject to the taxing power of the States unless the States in some manner have expressly exempted them from taxation."

Comment: 1. There is, I think, a substantial basis for the suspicion that no constitutional warrant or authority exists for the establishment or operation of the Postal Savings System.

2. One major reason urged as justification for adoption of the System was that it would not compete with local banking institutions or take local funds out of the community, because those funds would be redeposited in local banks. It has not so operated. For example, on June 30, 1935, the postal savings deposits in Arizona were nearly 6½ million dollars, but only 3.6 percent of the amount was then on deposit in Arizona banks.

3. On June 30, 1935, total deposits in the Postal Savings System was over 1¼ billion dollars. Of this amount, $385,000,000 was then on deposit in banks and $777,000,000 was invested in United States securities.

4. The net income of the System (the profits) for the year ending June 30, 1935, was over 11¾ million dollars.

RECONSTRUCTION FINANCE CORPORATION

(*b*) In that letter Mr. Jones argues:

1. That R. F. C. "is not operated for profit";

2. That there are 22 of the 48 States in which R. F. C. is not doing business, Arizona being one of the 22, and hence "Arizona and the other 21 States in which we do not do business would in effect be contributing revenue to the remaining 26 States * * *";

3. That R. F. C. does not compete with private capital, but has "loaned money only when private capital was not available at reasonable rates"; and

4. That to tax R. F. C. "would complicate the operation" of the Corporation "and increase administrative costs", require changes in bookkeeping system, etc.

Comment: 1. *Baltimore National Bank* v. *Maryland Tax Commission* (297 U. S. 209) is cited by Mr. Jones as authority for his contention that R. F. C. should not be taxed because it "is not operated for profit." There is nothing in that case to justify his assumption. The Court, by way of side remark or observation relative to R. F. C. when organized, said: "The purpose that it aimed to secure is not profit to the Government * * *." That remark had nothing to do with the decision or the ground upon which the decision is based. As clearly pointed out by the Court, the decision turned upon the question as to whether the congressional permission, given in section 5219 (R. S. U. S.), to States to tax the shares in national banks was applicable to the shares of preferred stock held by the R. F. C. in the Baltimore National Bank. Here is what the Court said so far as the essential statements in the decision are concerned:

"* * * True, * * * the Reconstruction Finance Corporation is a governmental agency, but so also is a national bank * * *. The question thus reduces itself to this, whether there is sufficient reason to believe that immunity from taxes of this kind has been given to one agency though by long accepted decisions it has been denied to the other. * * *"

Having pointed out that section 5219 permitted State taxation of "all" shares of a national bank, the court said:

"In such a situation the burden is heavily on the suitor who would subject the word 'all' with its uncompromising generality to an expressed exception. The petitioner reminds us that the ends to be served by the Reconstruction Finance Corporation are even more predominately public than those of a national bank, since the bank, while promoting the fiscal needs of the Government, is acting at the same time for the benefit of its shareholders. The suggestion has its force, but force inadequate, we think, to carry the goal."

And concluding:

"All shares in national banks—no matter by whom owned—shall be subject to taxation * * *. Across petitioner's path there still lies the stumbling block of that uncompromising 'all.'"

2. The argument that R. F. C. is not doing business in Arizona or in 21 of the other States and that if it were taxed Arizona and the other 21 States would be contributing revenue to the remaining 26 States, is, to say the least, not impressive and, even with the limited knowledge I have, is not supported by the facts. Technically, R. F. C. may not be doing business in Arizona insofar as maintaining an office or place of business here, but the fact remains that it has loaned or invested money in substantial amounts in this State. One instance ought to be sufficient. That instance is its investment in "A stock" of the Valley National Bank. R. F. C. has, for the past 5 years, owned and still owns, through its holding of Valley National Bank class A stock, about 80 percent of that bank's capital of $1,565,000. So other stockholders have only about $324,000 invested in the bank. After R. F. C. bought in, or made the so-called loan, the State levied the regular tax on the amount represented by this R. F. C. investment. The matter was hung up in the courts by the bank during the time the case of *Baltimore National Bank* v. *Maryland Tax Commission* above referred to was in process of litigation. As the result of the decision in that case it momentarily appeared that Arizona would succeed in collecting the tax on the R. F. C. stock; but 1 month and 17 days after the decision in the Baltimore bank case Congress was good enough to pass a special exemption statute (act of Mar. 20, 1936, Public No. 482, U. S. C. A. title 12, sec. 51d) expressly exempting stock held by R. F. C. in national banks from taxation. It is not too much to say that as the result of this investment R. F. C. owns the control of the Valley

National Bank, the dominating banking institution of this State, which, as you know, has branches in most every town and city of any importance in Arizona. So, for practical purposes, R. F. C. is decidedly in the banking business in this State. Furthermore, its investment of $1,240,000 in that enterprise is tax exempt. With that decided advantage it occupies a most favorable position because every other bank in the State is paying and must continue to pay the taxes on its entire capitalization.

3. Again, Mr. Jones refers to *First National Bank of Shreveport* v. *Louisiana Tax Commission* (289 U. S. 60), to support his contention that R. F. C. "does not compete with private capital", and particularly for his contention to the effect that merely because an institution lends money it does not follow that in so doing it competes with another money-loaning concern. Nothing of the kind was decided in the case he cites. The banks in that case, as the decision clearly shows, failed because there was no evidence in the record showing that the banks, during the time involved, were loaning or would have loaned money on real-estate mortgages or taken on automobile purchase and other similar loans. Quite to the contrary, it appears that the banks would "never handle" such mortgages or loans. In this connection Mr. Jones said: "We have advanced money to borrowers only when private capital was not available at reasonable rates." Presumably, Mr. Jones considers the rate of 2.5 or 3 percent charged to the Valley National Bank to be reasonable, but suppose there were added to his "reasonable rate" the amount necessary to meet the State, city, and county taxes on the stock or debentures he bought in that bank—taxes aggregating $6 per hundred or better per annum—would he then consider his rate, plus this additional tax burden, a reasonable rate? That is what every other investor in local bank stock faces.

4. The argument that R. F. C. would have to make "extensive changes" in its "bookkeeping system", that its administrative costs would be increased and the operation of its affairs complicated, if Congress permitted it or its activities to be taxed by States, would not make much of an impression on any business executive engaged in the operation of his own business or that of a corporation. That executive within recent years has been forced by Federal and State legislation to make "extensive changes" in his "bookkeeping system" and accounting methods. By the same means his operating problems have been greatly complicated and his administrative costs greatly increased through the sheer necessity of making repeated and continued extensive reports, changing his accounting system to comply with the demands of Federal and State statutes and innumerable rules and regulations promulgated by Federal and State administrative officers. Mr. Jones, an extensive businessman himself, undoubtedly appreciates the harassing treatment to which private business has been subjected, and, naturally, he cringes from having to take the same kind of medicine in administering the affairs of R. F. C. Even so, is that any real reason why R. F. C. should be permitted to absorb a substantial part of the financial business of a State, have all the advantages, benefits, and protection of the local laws, courts, and other facilities provided by the State, be free of taxation by the State on its investments within the State and, in this situation, compete with private investors who have their money in similar enterprises and who must, through taxes, pay for the very protection and benefits accorded R. F. C. under the laws and facilities furnished by the State and maintained through local taxation?

HOME OWNERS' LOAN CORPORATION

(c) Mr. Fahey points to the Federal statute permitting the taxation of real property owned by agencies of which he is the head and says that while he is in general agreement with the idea that governmental business organizations ought to be taxed on a reasonable basis, he feels that the extent to which those agencies may be taxed under the present set-up "is substantially a fair basis."

Comment: 1. At the rate the Home Owners' Loan Corporation is foreclosing mortgages it may be that it will, in the process of time, be obliged to pay a substantial amount of taxes. On the other hand, if a bank or private mortgage concern paid no taxes, except on property taken under foreclosed mortgages, they would certainly occupy a most favorable position in comparison with the tax burden to which such institutions are now subjected. In this connection the fact that H. O. L. C. has, as suggested by Mr. Fahey, paid a large amount of back taxes on property against which it has taken mortgages, has nothing to do with the question as to whether or not these Federal business agencies should be taxed on substantially the same basis as similar private concerns. Any

money lender, for his own protection, must always see that the taxes on the security are paid to date of the loan. The amount so paid is taken out of the loan. That is all H. O. L. C. has done and any private lender would have done no less.

2. Equality is the fundamental basis of our whole governmental structure. Every citizen, in his personal rights as well as in his business activities, has the right under the guaranties of the Federal Constitution to be treated equally with every other citizen. When the Government enters business and exempts its activities in that respect from burdens it imposes on a private citizen, it discriminates against him in favor of itself and the particular group favored by its course of action. That is absolutism. It destroys the liberty of person and property—freedom perishes.

COMPTROLLER OF THE CURRENCY

(*d*) Mr. O'Connor confines his comment to the F. D. I. C., saying it "is not in competition with any of the corporations or firms in your State." He admits that criticism "has been made that the smaller banks of the Midwestern States are receiving greater benefits in proportion to the assessment than are the larger banks in the large cities."

Comment: 1. It is certain F. D. I. C. is in the insurance business. It exacts premiums for that insurance from the banks insured. It dominates the whole field in that respect. It operates for the special benefit of one class of citizens, namely, bank depositors, on their deposits up to a fixed amount. If it were a private concern in the same situation, it would certainly be subjected to taxes. Since it operates for the special benefit of a particular group it effects a discrimination in favor of itself and the group for which it operates.

2. Mr. O'Connor says: "It is a purely governmental function." That I question. Where is the constitutional authority for the Federal Government to enter the insurance field? Unless that authority can be found in the Constitution the activities of this agency are not a governmental function but are of a purely proprietary nature, and, like every other activity of that sort, ought to be taxed in exactly the same way as a private insurer.

FEDERAL HOUSING ADMINISTRATION

(*e*) Mr. McDonald takes the position that the F. H. A. is not "affected one way or the other under the present legislative set-up, for the reason that it has no net income"; but should any profits accrue to it those profits, or what he calls excess, will "be returned to the original mortgagor and the Federal Housing Administration may in no way derive a profit." Again, he says: "By reason of this, all income of this Administration over and above its operating expenses must be held for the benefit of the mortgage groups and must ultimately be applied for the benefit of the same."

Comment: 1. Here, again, is the plea of "no net income" to the agency and hence the agency should not be taxed. Is a private lending agency ever exempted from taxes merely because it has no net income?

2. Again, also, is the admission that this agency is operated for the special benefit of the mortgagor or mortgage groups—a discrimination in favor of the particular mortgagor or mortgage groups as against other citizens who happen to be mortgagors. This means that the mortgagor or mortgage groups under the F. H. A., as a class, benefit to the extent of the amount of taxes that would have to be paid by them indirectly through such increase in the interest rates as would be necessary to meet the taxes if their mortgagee F. H. A. had to pay taxes like a private lending agency. So, again, we have inequality—one group of citizens being treated by the Government more favorably than another group. Such a condition cannot continue under a government based on the concept of individual freedom.

RURAL ELECTRIFICATION ADMINISTRATION

(*f*) Mr. Cooke says: "We are a lending agency only and the projects we finance are owned and operated wholly by public and private agencies within the several States."

Comment: 1. Here, again, is the same discrimination, the favored class.

TENNESSEE VALLEY AUTHORITY

(*g*) Mr. Morgan, of the T. V. A., says:

1. He cannot agree "that the activities of the Authority are of a proprietary nature."

2. Sales of electricity by the Authority "amount only to a disposition of the Government's property generated at constitutionally built dams, which sales were held to be a constitutional or governmental function in the case of *Ashwander* v. *Tennessee Valley Authority*."

3. According to *South Carolina* v. *United States*, proprietary activities of a State are subject to Federal taxation.

4. Proprietary activities of the Federal Government are not subject to State taxation "because the Federal Government is one of delegated powers, and accordingly any activity within those delegated powers involves the exercise of governmental powers."

5. "The Authority has been disturbed with the problem of actually depriving local governments of tax revenues, which deprivation was brought about directly through the Federal Government's activities."

6. "* * * we have devised the plan of selling the properties * * * to local cooperative associations incorporated under State law and subject to State and local taxation. Under such a plan, States and other political units not only received all of their tax revenues from such property, but in addition are the beneficiaries of the Federal Government's activities in that particular area."

Comment: 1. His first statement is inaccurate. It overreaches anything said in the majority opinion of the Supreme Court in the *T. V. A. case* (297 U. S. 288). That opinion is limited strictly to one dam, the Wilson Dam. The Court said:

"Second. The scope of the issue.

"We agree with the circuit court of appeals that the question to be determined is limited to the validity of the contract of January 4, 1934. The pronouncements, policies, and program of the Tennessee Valley Authority and its directors, their motives, and desires did not give rise to a justiciable controversy save as they had fruition in action of a definite and concrete character constituting an actual or threatened interference with the rights of the persons complaining * * *.

"There is a further limitation upon our inquiry. As it appears that the transmission lines in question run from the Wilson Dam and that the electric energy generated at that dam is more than sufficient to supply all the requirements of the contract, the questions that are properly before us relate to the constitutional authority for the construction of the Wilson Dam and for the disposition, as provided in the contract, of the electric energy there generated.

"Third. The constitutional authority for the construction of the Wilson Dam.

"The Congress may not, 'under the pretext of executing its powers, pass laws for the accomplishment of objects not entrusted to the Government' [citing cases]."

The Court then reviews the history of the legislation authorizing and the circumstances prompting the construction of the Wilson Dam, pointing out that the authority for its construction lies in the National Defense Act of June 3, 1916, saying:

"* * * it authorized the President to cause an investigation to be made in order to determine 'the best, cheapest, and most available means for the production of nitrates and other products for munitions of war' * * * and 'to construct, maintain, and operate' on any such site 'dams, * * * as in his judgment is the best * * * or convenient for the generation of electrical or other power and for the production of nitrates or other products needed for munitions of war and useful in the manufacture of fertilizers and other useful products.' * * *.

"The Wilson Dam and its power plant must be taken to have been constructed in the exercise of the constitutional functions of the Federal Government.

"Fourth. The constitutional authority to dispose of electric energy generated at the Wilson Dam.

"The Government acquired full title to the dam site, with all riparian rights. The power of falling water was an inevitable incident of the construction of the dam * * *. The mechanical energy was convertible into electric

energy, and the water power, the right to convert it into electric energy, and the electric energy thus produced constitute property belonging to the United States [citing cases].

"Authority to dispose of property constitutionally acquired by the United States is expressly granted to the Congress by section 3 of article 4 of the Constitution (quoting section)."

After discussing other questions in connection with the case there is this statement near the foot of page 339 in the volume of reports where the opinion is recorded:

"We limit our decision to the case before us, as we have defined it. * * *"

And again, on page 340:

"* * * The Government is disposing of the energy itself, which simply is the mechanical energy, incidental to falling water at the dam, converted into the electric energy which is susceptible of transmission. The question here is simply as to the acquisition of the transmission lines as a facility for the disposal of that energy. And the Government rightly conceded at the bar, in substance, that it was without constitutional authority to acquire or dispose of such energy except as it comes into being in the operation of works constructed in the exercise of some power delegated to the United States. As we have said, these transmission lines lead directly from the dam, which has been lawfully constructed, and the question of the constitutional right of the Government to acquire or operate local or urban distribution systems is not involved. We express no opinion as to the validity of such an effort, as to the status of any other dam or power development in the Tennessee Valley, whether connected with or apart from the Wilson Dam, or as to the validity of the Tennessee Valley Authority Act or of the claims made in the pronouncements and program of the Authority apart from the questions we have discussed in relation to the particular provisions of the contract of January 4, 1931, affecting the Alabama Power Co."

2. That a Federal tax on proprietary activities of a State is constitutional and sound in principle, as determined in *South Carolina* v. *United States* (199 U. S. 439) cannot be questioned.

3. It is true, I think, that a State may not tax any activity which the Federal Government constitutionally engages in. However, merely because the powers of the Federal Government are delegated to it by the Constitution, and that it has only such powers as are expressly or by necessary implication conferred by the Constitution, it by no means follows that every activity which the Congress may by statute tell the Government it may engage in is a governmental function of that Government. The fact that its powers are delegated and limited can mean but one thing, namely, that it has no constitutional power or right to engage in any activity or undertaking that is not of a strictly governmental character within the Constitution. Unless the authority to engage in proprietary enterprises can be found in that document, then the Federal Government has no such right or power. Undoubtedly, Congress may constitutionally create instrumentalities, such as national banks, for example, and empower or require such instrumentalities to perform certain definite functions for or of the Federal Government. The functions so performed are clearly not taxable by any State, irrespective of whether Congress exempts such activities from taxation. On the other hand, if the instrumentalities so created engage, by congressional permission or otherwise, in proprietary enterprises or functions—activities not delegated to the Federal Government by the Constitution—all such activities should be subject to taxation by States and other local authorities wherein the activities are carried on; and, on principle, Congress has no power or authority to exempt such activities from State taxation.

4. The problem of local taxation and Tennessee Valley Authority's plan of avoiding such taxes, as suggested by Mr. Morgan in his two statements last above quoted, are definite signposts that the Federal Government, through the Tennessee Valley Authority, has gone far beyond its constitutional power in doing the things it is attempting under Tennessee Valley Authority. His two statements ought to be sufficient proof that Justice McReynolds was correct and amply justified in substantially everything, if not all, he said in his dissenting opinion in the *Ashwander case*. There is no more justification for exempting the proprietary activities of Tennessee Valley Authority from taxation than there is for wholly exempting national banks.

Mr. Morgan's statement last quoted above concerning Tennessee Valley Authority's plan of selling the properties, etc., evidences a studied effort (1) to

avoid local taxation and (2) to create a special class of beneficiaries of the Federal Government in the particular area covered by Tennessee Valley Authority's activities—a scheme of absolutism in a large territory and a discrimination in favor of a particular class of beneficiaries in that territory at the expense of the entire Nation.

FEDERAL RESERVE SYSTEM

(*h*) Mr. Morrill, speaking for Mr. Eccles, says:

"1. Federal Reserve banks should not be taxed since they do not exercise proprietary functions and do not come into competition with private enterprise.

"2. He admits that those banks have authority to and do make loans to individuals, partnerships, etc., but claims the volume of these loans is comparatively small at the present time and is rapidly declining.

"3. Reserve banks are not operated for the purpose of making profits either for themselves or for the member banks who own the stock of the Reserve banks."

"4. Reserve banks gratuitously render extensive services to the public and the Government.

"5. These banks are the fiscal agents of the United States and in that capacity perform many functions for the Federal Treasury.

"6. By congressional action these banks, their capital stock, etc., are immune from State and local taxation except taxes upon real estate, and he concludes with the assertion that this exemption was extended in recognition of the fact that the functions of the Federal Reserve banks are governmental rather than proprietary in nature, and it is respectfully submitted that there has been no change in the situation which would make favorable the removal of this protection. * * *"

Comment: 1. Knowing the activities these banks engage in and the vast volume of business they handle for their stockholders, the member banks, it is rather presumptuous to say "they do not exercise proprietary functions and do not come into competition with private enterprise." The fact is, they perform many functions in the way of clearing and collecting checks, not only of member banks but nonmember banks, just as the banks themselves have previously done and to a considerable extent still do. This is largely conceded by Mr. Morrill when he admits that these banks are authorized to and do make commercial and industrial loans; that they collect checks for their member banks aggregating billions of dollars; and that their capital stock is owned by the member banks. Aside from this, one of the major purposes for which those banks were created was and is to make loans at interest to member banks through discounting paper of member banks, just as any member or nonmember bank might or could do and, in fact, has done and continues to do.

2. When the Federal Reserve Act (sec. 289, title 12, U. S. C. A.) expressly provides for the payment of cumulative annual dividends of 6 percent on the paid-in capital stock—stock subscribed and owned by member banks—and that after the payment of these dividends the balance of the net earnings shall be carried into the surplus fund of the Reserve banks, how can it reasonably be said that these banks are not operated for profit? If an annual return of 6 percent on a tax-free investment, to say nothing of the surplus, is not a profit or a business operated for profit, then what business is operated for profit?

3. If these banks, like other banks, were obliged to pay State and local taxes, they probably could not, as Mr. Morrill says, render the vast amount of gratuitous services which he says they give to their member banks. Does not this very situation create a discrimination in favor of the Federal Reserve banks and their members to whom they are enabled to extend these gratuitous services by reason of the fact that they do not have to pay taxes? These banks do business all over the country. They have the benefit of all of the facilities maintained and operated at the expense of those who pay taxes. Again, they employ a vast number of people who draw annually for salaries, etc., a very large amount of money, and yet even those salaries are not subject to State income taxes. (See *New York ex rel. Rogers* v. *Graves*, as cited by the United States Supreme Court Jan. 4, 1937.)

4. Needless to say that insofar as these banks perform functions that are of an essential governmental nature for the Federal Treasury they should not be taxed by the States or locally. On the other hand, national banks must act as fiscal agents of the United States and, when required, must perform in

many respects the same functions for the Federal Treasury that are performed by the Federal Reserve banks, yet national banks are, by congressional permission, subjected to plenty of State and local taxes.

5. The fact that Congress has so far exempted Federal Reserve banks and everything in connection with them from State and local taxation is beside the question. Equally so are the considerations, whatever they may have been, that have prompted Congress to extend this immunity. The real question is, "Why should they not be taxed by the States, at least insofar as their business and activities are purely proprietary and, to a large extent, competitive with other financial institutions that are taxed?" Except in some relatively unimportant respects, they are not greatly different from national banks, and it is difficult to understand why they should occupy much, if any, different situation, insofar as State and local taxation are concerned, than national banks. The enclosed memorandum sufficiently demonstrates that national banks, just as Federal Reserve banks, are instrumentalities of the Federal Government.

FARM CREDIT ADMINISTRATION

(*i*) Mr. Meyers, the Governor of the Farm Credit Administration, to support his objection to State taxation of the agencies under his supervision, says:

"1. They are all governmental agencies. While they perform some functions similar to the functions performed by private enterprises, it would be impossible to separate their functions and divide them into two classes, (governmental and nongovernmental), because their whole reason for existence was a need for credit beyond the power of private capital to supply on terms as favorable as those which could be offered by the instrumentalities in question.

"2. Should Congress permit the taxation of any of them, it would be impossible to extend credit to borrowers at rates upon terms nearly as favorable as prevail today.

"3. I think there is a real distinction between taxation of the corporations that I have been discussing and of national banks, even though the latter are also governmental instrumentalities."

These three statements are the essence of his whole letter, though he unnecessarily devotes a good deal of space in the apparent attempt to demonstrate that his groups are Federal instrumentalities.

Comment: 1. Let it be granted that Mr. Meyers' agencies are all Federal instrumentalities, though there is ground for reservations as to some of them, and grant also that none of them can be taxed by the States without the consent of Congress. Still, is there any reason why Congress should not permit them to be taxed by the States on some basis at least similarly to what it has done in connection with national banks? Merely because they are governmental agencies or because they may perform some functions for the Government, insignificant though those functions may be in comparison with the proprietary business done, or because they were created and exist for the purpose of extending credit on more favorable terms than can be made by ordinary banks or other private lenders who must pay taxes, are not substantial or valid reasons why these agencies should have immunity from State taxes. Exactly the same reasons could be urged with equal force for national-bank immunity. Undoubtedly the latter could and would make much more favorable terms (interest rates) on loans if they were immune from all State taxes except taxes on their real property.

2. The *Osborn case* cited by Mr. Meyers and its predecessor (*McCulloch v. Maryland*) and many other cases that have followed that original case have no application to the question raised in this correspondence. There the Federal instrumentality, Bank of the United States, in the absence of congressional consent that it be taxed, successfully contested the right of the State to tax it. Congress not having consented that the State might tax the Federal instrumentality, the question was, "Could the State constitutionally tax the bank even though it did an extensive proprietary business in addition to the functions it performed for the Federal Government?" On the other hand, the question involved in this correspondence is, "Why should Congress not permit the taxation by States of these Federal agencies at least to the extent that it permits the taxation of national banks?"

3. It is legislation that would permit these agencies to be so taxed that Mr. Meyers objects to, as plainly indicated by the last paragraph in his letter, and he says, "I think there is a real distinction between the taxation of the corporations that I have been discussing and of national banks." However,

he nowhere indicates what that distinction is. If there is any admissible distinction I shall be very glad to have him point it out.

4. His argument that "If, under its constitutional powers, Congress had provided that a department or bureau of the Federal Government itself should make the loans—being made by the various corporate instrumentalities—there is no question but that the States would have been without power to impose taxes," is hardly admissible. First, it is at least doubtful if Congress has the constitutional power to authorize the Federal Treasury or other department or bureau to engage directly in the loaning business. Second, under such a scheme, at least as appears by Mr. Meyers' suggestion, the loans would be made from Government funds, but these agencies are not loaning Government funds, in any true sense, except possibly in relatively small amounts.

5. The real reason why Mr. Meyers objects to his agencies being taxed by the States plainly is that they could not loan money at the low rates of interest they demand if they were obliged to pay State and local taxes on the same basis, or in anything like the same proportion, that national banks must pay. Or, to put it another way, he does not want his agencies put on an equality with national banks or with any other lenders with whom he competes in the proprietary business carried on by his agencies. His agencies must be the favorites before the law and in the field of business operations in which they are engaged.

Finally, wrapped up in the question here involved are the same fundamentals of right and wrong that arose a century ago in connection with the Bank of the United States, and out of which came the *McCulloch* and the *Osborn cases*. That bank, though constitutionally created and performing essential and valuable governmental functions, was given a preference and unfair advantage in its proprietary operations against State banks and other citizens with whom it competed for business. The Supreme Court of the United States rightly held it to be immune from taxes, yet that very immunity and the failure of Congress to permit the States to tax it on some fair and equitable basis was the very thing that wrecked it. But the wreckage did not stop with the bank. It seriously embarrassed the second Jackson administration, discredited his successor, Van Buren, and finally wrecked the financial structure of the country and brought untold miseries upon the whole people. The history of that period ought to be a solemn warning that even though Congress may constitutionally create instrumentalities essential to the proper functions of the Government, yet when it endows those instrumentalities with privileges and immunities which place them and their beneficiaries in a favored class, having all the rights but little or none of the responsibilities of the ordinary citizen and the enterprises of the ordinary citizen with whom they compete, the results are apt to be fatal to those favored and, above all, disastrous to the whole country.

As has been indicated herein, it is the law that State proprietary activities and agencies are subject to Federal taxes. On the contrary, proprietary activities and agencies of the Federal Government cannot, in the absence of congressional consent, be taxed by the States. This situation produces some strange and inequitable situations, of which personal income taxes are an example. Under the first of these principles there can be but little doubt that the salaries and wages of officers and employees engaged in the operation of State proprietary activities and agencies are subject to Federal income taxes, but, under the second, the salaries and wage of officers and employees operating Federal proprietary activities and agencies are immune from State income taxes; and, in view of the recent decision of the Supreme Court in *New York ex rel. Rogers* v. *Graves*, it is believed this immunity extends even to the salaries and wages of officers and employees of national banks. So we have a vast army of citizens receiving a substantial portion of the national income and enjoying all the privileges and benefits of State government, but who, in the absence of the consent of Congress, cannot be taxed on their income for the support of State government.

As a practical matter, every proprietary activity or agency of the State or of the Federal Government necessarily brings the State or the Government, as the case may be, into competition with every citizen, individual or corporate, engaged in, or who has the right to engage in, the same activity. Similarly, every officer and employee of a proprietary activity or agency of the Federal Government, and by reason thereof exempt from State income taxes unless Congress consents, competes with every citizen who is not fortunate enough to occupy a Federal position. Under the principle of equality, tax immunity

of State and Federal proprietary enterprises or agencies, and Federal officers and employees operating such Federal activities or agencies, works an unjust and inequitable discrimination against every citizen engaged in, or who has the right to engage in, the same or similar activity and every citizen who is not on the Federal pay roll. Such a system of discriminations and favoritism is alien to and destructive of the principle of equality. It is a species of absolutism, opposed to free government and individual liberty. Both cannot long survive in the same society. Either the system must be abolished or else free government and individual liberty will disappear.

Congress has the undoubted power and duty to remove the tax immunity from all Federal proprietary activities and agencies, and all those Federal officers and employees engaged in the administration of the same, and may fully protect the Federal Government in every respect from oppressive State action by proper restrictions as to the taxes the States may exact, just as it has done in the case of the national banks. If it is essential that States and the Federal Government engage in proprietary enterprises, then let them, and all employees engaged in the operation of those enterprises, be placed on an equality with other citizens; let them bear the burden of taxation equally with the burdens imposed on all other citizens. Thus it is probably possible to maintain the principle of equality. Insofar as the Federal Government is concerned, the responsibility to abolish the prevailing system of discrimination, favoritism, and inequality rests with Congress.

Yours very truly,

CHAS. WOOLF.

PHOENIX, ARIZ., *May 11, 1937.*

Hon. CARL HAYDEN,
United States Senator,
Senate Office Building, Washington, D. C.

DEAR SENATOR HAYDEN: You asked that I let you have my comment concerning the letter of Mr. Pierson, president of the Export-Import Bank of Washington. His letter and copy of annual report, the latter apparently being for the year ending December 31 last, have been examined, and it appears that he, like the heads of other Federal agencies, is opposed to having his agency subjected to local taxation and for substantially the same supposed reasons others have offered and which have been previously commented upon.

Summarized, his arguments and the obvious answers thereto are:

Argument 1.—The Export-Import Bank does not compete with the commercial banks, but in financing foreign trade it supplements credit facilities of commercial banks.

Answer.—The taxability of a business or property is not dependent on whether the business or property is competitive with any other business or property.

Argument 2.—Because of the recent marked expansion of Federal activities in the lending field, these activities "must be classified as governmental" rather than proprietary.

Answer.—To say that because the Federal Government has extensively engaged, through numerous agencies, in the money-lending business, its activities in that particular should, for that reason, be deemed governmental rather than proprietary, is to beg the question. The activity is what it is, either governmental or proprietary. Certainly lending money on risks for which security is or is not taken, but for which interest to compensate for the risk is exacted, is essentially a proprietary, not a governmental function.

Argument 3.—While his agency may receive the benefit of "public services of different States", yet it should not be taxed, since it enables borrowers in the various States to transact additional business, thus increasing the taxable income or property of citizens, the States thereby are indirectly benefited.

Answer.—If that argument is sound, then every individual, bank, or money-loaning concern should be exempt from local taxation for exactly the same reason.

Argument 4.—If his agency were obliged to pay taxes, its effectiveness would be reduced, "because its interest rate would necessarily be increased."

Answer.—If commercial banks and other private money lenders were exempt from taxation they unquestionably could and would loan at greatly reduced interest rates.

Argument 5.—His agency should not be considered in the same status for taxable purposes as national banks because "a national bank has a fixed location in one city", while his agency is "situated in Washington and engaged in making loans throughout the country."

Answer.—A national bank is no longer confined to a single office at "a fixed location in one city." It may have branches throughout a State. The business of a national bank is not confined to the "one city" of its location. In fact, every national bank of any magnitude makes many loans not only outside of the city of its location but outside of the State of its domicile, and no doubt the larger ones do a much more extensive business "throughout the country" than the Export-Import Bank. Furthermore, it will be, I think, only a matter of a short time when the Federal law will make it permissible for a national bank to extend its activities through a branch-banking system throughout the country. As you know, even now national banks have branches in foreign countries.

Argument 6.—Since his agency is located in the District of Columbia, its situs for tax purposes is in that District; and, for the most part, any taxes that it might pay would be paid to the District of Columbia.

Answer.—That argument is insubstantial. Merely because the main office is in the District of Columbia is no reason at all why it should not be taxed in Arizona on such part of its business as is transacted in and has a taxable situs in Arizona. If his argument were sound, then Phelps Dodge Co., which, I believe, is a Delaware corporation but which at least has its main office in New York, would be taxable on its income in none but the State where its principal office is located. On that theory the net income on its business done in Arizona would not be subject to income taxes in Arizona.

Yours very truly,

CHAS. WOOLF.

PHOENIX, ARIZ., *May 25, 1937.*

Hon. CARL HAYDEN,
United States Senator,
Senate Office Building, Washington, D. C.

DEAR SENATOR HAYDEN: Receipt is acknowledged of your letter of the 19th instant enclosing letter of the same date by Mr. R. N. Elliott, Acting Comptroller General of the United States, having reference to the subject of my letter to you of December 14 last, and on which you request my comment.

At the outset I must say that Mr. Elliott is to be commended for his unbiased and intelligent statement concerning the subject. The closing paragraph of his letter admits, "the problem is a serious one and growing more so each year with the expansion of both State and governmental activities into fields not strictly governmental or sovereign in character."

There is not much that can be said with respect to Mr. Elliott's letter that can add substantially to comments made in my previous letters. There is, however, one important development that should be mentioned.

In paragraph 3 on page 13 and also in the third paragraph from the end of my letter of April 5 last, reference is made to the case of *New York ex rel Rogers* v. *Graves*, decided January 4 last, which establishes immunity for employees of corporations owned by the Federal Government from State income taxes, and by the same principles probably establishes similar immunity for employees of every Federal instrumentality, including national banks. At the time that letter was written the case of *Brush* v. *Commissioner of Internal Revenue* had been decided (Mar. 15, 1937) but the advance sheets containing the decision had not reached me. The *Brush case* establishes immunity (at least in that particular instance) of employees of State instrumentalities (in the particular instance, the engineer of the water department of the city of New York) from Federal income taxes.

As stated in Mr. Elliott's letter, the majority opinion, by Justice Sutherland, in the *Brush case*, points to the practical difficulty in many instances of drawing the line between those activities or instrumentalities that are governmental and those that are proprietary, that is, the difficulty of defining "governmental functions." Whatever that difficulty may be, the reasons on which the majority opinion is based points clearly to the conclusion that the gate has been opened whereby every employee of a State instrumentality may escape liability from Federal income taxes.

In the light of these recent developments there seems to be ample justification to assume that we may, for practical purposes, expect that every activity created or sponsored by the Federal Government will be considered a governmental function of the United States and that every activity created or sponsored by or pursuant to the authority of every State government will be considered a governmental function of the State, and, hence, every employee of every such Federal activity will be immune from State income taxes and, conversely, every employee of every such State activity will be immune from Federal income taxes. The glaring injustice and inequality thus created is the picture which undoubtedly prompted the following paragraph in Justice Roberts' dissenting opinion in the *Brush case*. He said:

"The importance of the case arises out of the fact that the claimed exemption may well extend to millions of persons (whose work nowise differs from that of their fellows in private enterprise) who are employed by municipal subdivisions and districts throughout the Nation and that, on the other hand, the powers of the States to tax may be inhibited in the case of hundred of thousands of similar employees of Federal agencies of one sort or another. Such exemptions from taxation ought to be strictly limited. *They are essentially unfair. They are unsound because Federal or State business ought to bear its proportionate share of taxation in order that comparison may be made between the cost of conducting public and private business.*"

We have here been speaking of the distorted picture as thus far developed in connection with *personal income taxes* alone. The same ugly picture is presented by the existing exemption of Federal instrumentalities themselves from States and local taxation—ad valorem taxes or other forms of taxes in lieu of ad valorem taxes. The only difference between the two pictures is that in the case of *personal income taxes* the knife cuts both ways—it strikes at the revenue of the Federal Government as well as at the revenue of the State government—while in the case of the exemption of Federal instrumentalities from ad valorem or State income taxes it is only the revenue of the State that is cut down.

Yours very truly,

CHAS. WOOLLEY.

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