# TAXATION OF GOVERNMENTAL SECURITIES AND SALARIES

## HEARINGS

BEFORE THE

## SPECIAL COMMITTEE ON TAXATION OF GOVERNMENTAL SECURITIES AND SALARIES UNITED STATES SENATE

SEVENTY-SIXTH CONGRESS

FIRST SESSION

PURSUANT TO

**S. Res. 303 (75th Congress)**

A RESOLUTION ESTABLISHING A SPECIAL COMMITTEE ON THE TAXATION OF GOVERNMENTAL SECURITIES AND SALARIES

**PART 1**

JANUARY 18, 1939

Printed for the use of the Special Committee on Taxation of Governmental Securities and Salaries

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SPECIAL COMMITTEE ON TAXATION OF GOVERNMENTAL SECURITIES AND SALARIES

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# CONTENTS


Statement of— Page

Gardner, Warner W., special assistant to the Attorney General, Department of Justice ..... 81

Hanes, Hon. John W., Under Secretary of the Treasury ..... 4

Morris, Hon. James W., Assistant Attorney General ..... 36

Murphy, Henry C., principal economic analyst, Treasury Department ..... 34

O'Donnell, Al F., Assistant Director of Research and Statistics, Treasury Department ..... 34

Wenchel, John Philip, Chief Counsel, Bureau of Internal Revenue ..... 60

# TAXATION OF GOVERNMENTAL SECURITIES AND SALARIES

WEDNESDAY, JANUARY 18, 1939

UNITED STATES SENATE,
SPECIAL COMMITTEE ON TAXATION OF
GOVERNMENTAL SECURITIES AND SALARIES,
*Washington, D. C.*

The special committee met, pursuant to call, at 10 a. m., in the committee room of the Senate Finance Committee, Senate Office Building, Senator Prentiss Brown, chairman, presiding.

Present: Senators Brown (chairman), Logan, Townsend, and Austin.

The CHAIRMAN. The committee will come to order.

We will have the resolution creating this special committee incorporated in the record, and the President's Message of April 25, 1938, also incorporated, immediately following the resolution.

[S. Res. 303, 75th Cong., 3d sess.]

RESOLUTION

*Resolved*, That there is hereby established a special committee on the taxation of governmental securities and salaries, to be appointed by the President of the Senate, which shall be composed of three Senators who are members of the Committee on Finance and three Senators who are members of the Committee on the Judiciary. The committee shall select a chairman from among its members. A vacancy in the committee shall not affect the power of the remaining members to execute its functions, and shall be filled in the same manner as the original appointment.

SEC. 2. It shall be the duty of the committee to make a thorough study and investigation with respect to the taxation, and the exemption from taxation, of (1) securities issued by or under the authority of the United States or the several States or political subdivisions thereof; (2) income derived from such securities; and (3) income received as compensation from the United States or from any State or political subdivision thereof. The committee shall report to the Senate the result of its study and investigation, together with such recommendations as it deems advisable, not later than March 1, 1939, at which time all authority conferred by this resolution shall expire.

SEC. 3. The committee, or any subcommittee thereof, shall have power to hold hearings and to sit and act at such times and places, to require by subpena or otherwise the attendance of such witnesses and the production of such books, papers, and documents, to administer such oaths, to take such testimony, to have such printing and binding done, and to make such expenditures as it deems advisable. Subpenas shall be issued under the signature of the chairman of the committee and shall be served by any person designated by him.

The expenses of the said investigation, which shall not exceed $5,000, shall be paid out of the contingent fund of the Senate, upon vouchers approved by the chairman of the committee.

SEC. 4. The committee shall have power to employ and fix the compensation of such officers, experts, and employees as it deems necessary in the perform-

ance of its duties, but the compensation so fixed shall not exceed the compensation fixed under the Classification Act of 1923, as amended, for comparable duties. The committee is authorized to request the use of the services, information, facilities, and personnel of the departments and agencies in the executive branch of the Government and of the Joint Committee on Internal Revenue Taxation.

The President's Message of April 25, 1938, is as follows:

TERMINATION OF TAX EXEMPTION—MESSAGE FROM THE PRESIDENT OF THE UNITED STATES TRANSMITTING HEREWITH A RECOMMENDATION FOR APPROPRIATE LEGISLATION ENDING TAX EXEMPTION ON GOVERNMENT SALARIES OF ALL KINDS, CONFERRING POWERS ON THE STATES WITH RESPECT TO FEDERAL SALARIES AND POWERS TO THE FEDERAL GOVERNMENT WITH RESPECT TO STATE AND LOCAL GOVERNMENT SALARIES

THE WHITE HOUSE,
*April 25, 1938.*

*To the Congress of the United States:*

The sixteenth amendment to the Constitution of the United States, approved in 1913, expressly authorized the Congress "to lay and collect taxes on incomes, from whatever source derived." That is plain language. Fairly construed this language would seem to authorize taxation of income derived from State and municipal, as well as Federal bonds, and also income derived from State and municipal as well as Federal offices.

This seemingly obvious construction of the sixteenth amendment, however, was not followed in judicial decisions by the courts. Instead a policy of reciprocal tax immunity was read into the sixteenth amendment. This resulted in exempting the income from Federal bonds from State taxation and exempting the income from State bonds from Federal taxation.

Whatever advantages this reciprocal immunity may have had in the early days of this Nation have long ago disappeared. Today it has created a vast reservoir of tax-exempt securities in the hands of the very persons who equitably should not be relieved of taxes on their income. This reservoir now constitutes a serious menace to the fiscal systems of both the States and the Nation because for years both the Federal Government and the States have come to rely increasingly upon graduated income taxes for their revenues.

Both the States and the Nation are deprived of revenues which could be raised from those best able to supply them. Neither the Federal Government nor the States receive any adequate, compensating advantage for the reciprocal tax immunity accorded to income derived from their respective obligations and offices.

A similar problem is created by the exemption from State or Federal taxation of a great army of State and Federal officers and employees. The number of persons on the pay rolls of both State and Federal Government has increased in recent years. Tax exemptions claimed by such officers and employees—once an inequity of relatively slight importance—has become a most serious defect in the fiscal systems of the States and the Nation, for they rely increasingly upon graduated income taxes for their revenues.

It is difficult to defend today the continuation of either of these rapidly expanding areas of tax exemption. Fundamentally, our tax laws are intended to apply to all citizens equally. That does not mean that the same rate of income tax should apply to the very rich man and to the very poor man. Long ago the United States, through the Congress, accepted the principle that citizens should pay in accordance with their ability to pay, and that identical tax rates on the rich and on the poor actually worked an injustice to the poor. Hence the origin of progressive surtaxes on personal incomes as the individual personal income increases.

Tax exemptions through the ownership of Government securities of many kinds—Federal, State, and local—have operated against the fair or effective collection of progressive surtaxes. Indeed, I think it is fair to say that these exemptions have violated the spirit of the tax law itself by actually giving a greater advantage to those with large incomes than to those with small incomes.

Men with great means best able to assume business risks have been encouraged to lock up substantial portions of their funds in tax-exempt securities. Men with little means who should be encouraged to hold the secure obligations

of the Federal and State Governments have been obliged to pay a relatively higher price for those securities than the very rich because the tax-immunity is of much less value to them than to those whose incomes fall in the higher brackets.

For more than 20 years Secretaries of the Treasury have reported to the Congress the growing evils of these tax exemptions. Economists generally have regarded them as wholly inconsistent with any rational system of progressive taxation.

Therefore, I lay before the Congress the statement that a fair and effective progressive income tax and a huge perpetual reserve of tax-exempt bonds can not exist side by side.

The desirability of this recommendation has been apparent for some time, but heretofore it has been assumed that the Congress was obliged to wait upon that cumbersome and uncertain remedy—a constitutional amendment—before taking action. Today, however, expressions in recent judicial opinions lead us to hope that the assumptions underlying these doctrines are being questioned by the court itself and that these tax immunities are not inexorable requirements under the Constitution itself but are the result of judicial decisions. Therefore, it is not unreasonable to hope that judicial decision may find it possible to correct it. The doctrine was originally evolved out of a totally different set of economic circumstances from those which now exist. It is a familiar principle of law that decisions lose their binding force when the reasons supporting them no longer are pertinent.

I, therefore, recommend to the Congress that effective action be promptly taken to terminate these tax exemptions for the future. The legislation should confer the same powers on the States with respect to the taxation of Federal bonds hereafter issued as is granted to the Federal Government with respect to State and municipal bonds hereafter issued.

The same principles of just taxation apply to tax exemptions of official salaries. The Federal Government does not now levy income taxes on the hundreds of thousands of State, county, and municipal employees. Nor do the States, under existing decisions, levy income taxes on the salaries of the hundreds of thousands of Federal employees. Justice in a great democracy should treat those who earn their livelihood from government in the same way as it treats those who earn their livelihood in private employ.

I recommend, therefore, that the Congress enact legislation ending tax exemption on Government salaries of all kinds, conferring powers on the States with respect to Federal salaries and powers to the Federal Government with respect to State and local government salaries.

Such legislation can, I believe, be enacted by a short and simple statute. It would subject all future State and local bonds to existing Federal taxes; and it would confer similar powers on States in relation to future Federal issues.

At the same time, such a statute would subject State and local employees to existing Federal income taxes and confer on the States the equivalent power to tax the salaries of Federal employees.

The ending of tax exemption, be it of Government securities or of Government salaries, is a matter, not of politics, but of principle.

FRANKLIN D. ROOSEVELT.

The CHAIRMAN. The chairman will make a short preliminary statement.

As we see the inquiry before this committee, it divides itself into two parts: first, should we tax the income from State and municipal bonds, hereafter issued; and, second, the salaries that are paid to employees of the States and the various subdivisions of the States, and at the same time grant to the States the right to levy a tax on income from Federal bonds and on the salaries of employees of the Federal Government.

The next question that comes up, and which the committee would like to hear from the departments of the Government on, is, can this be done by statute, or is a constitutional amendment required, and it seems to me, as a corollary to that proposition, there is a further question. If it can be done by statute, should it be so done, or

should the Congress submit the question to the States for a clear-cut expression from them as to what they think should be done.

There are many incidental problems to this, but I think those are the main propositions upon which to base our inquiry.

I have asked Mr. Hanes, the Under Secretary of the Treasury, to appear here and present the Treasury's views upon this question. We will now hear from Mr. Hanes.

## STATEMENT OF HON. JOHN W. HANES, UNDER SECRETARY OF THE TREASURY

Mr. HANES. The Treasury Department urges approval of the proposal that the issuance of Federal, State, and local governmental securities exempt from income taxes be discontinued. It likewise urges approval of the proposal to tax the salaries and compensation of State and local employees and to consent to the taxation of the salaries of Federal employees by State and local governments. This position is summarized in President Roosevelt's Message to Congress of April 25, 1938, in which he said:

> I * * * recommend to the Congress that effective action be promptly taken to terminate these tax exemptions for the future * * *. Such legislation can, I believe, be enacted by a short and simple statute. It would subject all future State and local bonds to existing Federal taxes; and it would confer similar powers on States in relation to future Federal issues. At the same time, such a statute would subject State and local employees to existing Federal income taxes; and confer on the States the equivalent power to tax the salaries of Federal employees. The ending of tax exemption, be it of government securities or of government salaries, is a matter, not of politics but of principle.

The discontinuance of the issuance of tax-exempt securities by Federal, State, and local governments has been urged consistently by the Treasury Department during many administrations. Condemnation of the inequity resulting from the issuance of such securities has been voiced by former Secretaries Glass, Houston, Mellon, and Mills and by Secretary Morgenthau and my predecessor, former Under Secretary Magill. Almost without exception every spokesman of the Treasury Department since the advent of progressive income taxation has urged the elimination of tax exemption; none has ever spoken in favor of its retention. A typical position was that taken by former Secretary Mellon who, more than 15 years ago, wrote the acting chairman of the Committee on Ways and Means:

> * * * it is almost grotesque to permit the present anomalous situation to continue, for as things now stand we have on the one hand a system of highly graduated Federal income surtaxes and on the other a constantly growing volume of securities * * * which are fully exempt from these surtaxes, so that taxpayers have only to buy tax-exempt securities to make the surtaxes ineffective—December 21, 1922.

Former Presidents of the United States, including Presidents Harding, Coolidge, and Hoover, have urged the elimination of tax exemption. This position has been endorsed by a great majority of the individuals and civic organizations who have studied the problem. Prof. T. S. Adams, whom some of you will remember from his frequent appearances before congressional committees, stressed

* * * the seriousness of the social problem that is likely to be created if there arises in this country a situation in which the wealthiest men—the men most able to bear taxation—get themselves, by reason of the existence of these tax-free bonds, into an isle of safety, in which they are absolutely sheltered from the burden of supporting government, to which, as Justice Holmes of the Supreme Court has said, they owe their protection and in some senses their lives.—National Tax Association Proceedings, 1922.

Views substantially similar have been expressed by Professors Seligman and Haig, to mention but two of a long list of scholars. There have been remarkably few dissenting voices. Over the years there may have been some difference in the means advocated but not in the end sought.

For the most part, attention in the past has been directed to the exemption enjoyed by Government securities, but analogous though lesser problems arise with regard to the exemption of Government salaries.

The reasons which have led so many persons with such different social and economic viewpoints to the same conclusion are constantly becoming more pressing and of more and more practical importance. The time for eloquent dissertations on the evils of tax exemptions is over; the time for action has arrived. Unless we act soon the possibilities of removing the evil within our lifetime will become remote because the last of the outstanding tax-exempt debt will not be retired for many years to come.

The elimination of income-tax exemptions is necessitated by three important considerations: First, effects on the distribution of the tax burden; second, effects on the national economy; and third, effects on revenues and costs of government. I shall discuss these three considerations first with respect to securities, leaving treatment of salaries until later.

The first consideration is the effects on the distribution of the tax burden. In his message of last April the President said:

* * * a fair and effective progressive income tax and a huge perpetual reserve of tax-exempt bonds cannot exist side by side.

Some persons with large incomes are able to escape income taxes entirely, or in large part, through the device of tax-exempt securities. To the extent to which they are able to do this the application of the principle of progressive income taxation by the Federal Government and by the States is nullified.

There would be no unfairness in this if each individual holder of tax-exempt securities had to accept a decrease in his interest return proportionate to the value of the tax-exemption privilege to him. This, however, cannot be the case. The value derived from tax exemption varies with the rate of tax to which the interest would have been subject had it been taxable. Thus, the value of the tax-exemption privilege varies widely among different purchasers having different incomes. The cost of acquiring this privilege, on the other hand, is the same to all.

The relative advantage of tax exemption to a person with a large income and to one with a small income may be seen by comparing the positions of a married man with net income from other sources of $500,000 and a married man with similar net income of $5,000. To the man with a net income of $500,000, a 3 percent fully tax-exempt security affords the same return after Federal income tax as a tax-

able security yielding 10.71 percent. To put the case the other way round, he would do as well, after Federal income taxes, with a yield of 0.84 of 1 percent on a tax-exempt security as he would with a yield of 3 percent from a taxable security. Contrast this situation with that of the man with an income of $5,000. In his case a 3 percent tax-exempt security is the equivalent of only a 3.2 percent taxable security. If the incomes are also subject to State taxation, the differential in favor of the person with the large income is even greater.

These benefits from tax exemption may be compared to the price paid for them in the form of lower yields. Under present conditions we estimate, upon the basis of an examination of actual market yields, that the differential between the yields of completely taxable and wholly tax-exempt high-grade securities varies from zero, or practically zero, for the shortest maturities up to about one-fourth to one-half of 1 percent for the longest. The yield differential in favor of long-term partially tax-exempt securities, that is, those that are exempt only from normal income tax, as compared with completely taxable securities of equal quality is estimated at from five one-hundredths to fifteen one-hundredths of 1 percent.

The reason for the small differential in interest rates, despite the high preferential value of the tax-exemption privilege is that the interest saving to the Government arising from the issuance of tax-exempt securities is measured only by the value of tax exemption to those bondholders who fall in the lowest tax bracket. The differential in interest is relatively small compared to the benefit of the tax exemption to persons in the higher income brackets. Because the outstanding supply of tax-exempt bonds is large it is necessary to sell some of them to investors in the lower tax bracket who will pay for tax exemption only what it is worth to them.

The present volume of tax-exempt securities exceeds $65,000,000,000, including about $15,000,000,000 held by governments and their agencies. We estimate that the remaining $50,000,000,000 is distributed in the chart.

As is indicated in the chart, the outstanding amount of tax-exempt securities is greatly in excess of the demand for such securities on the part of individuals who are subject to the high income-tax rates. In consequence, substantial portions of them have to be disposed of to institutional investors and to individuals to whom the tax-exemption privilege has little or no value. It would follow, considering this factor alone, that there should be no appreciable differential between the yields of taxable and tax-exempt securities.

The interest differential, however, is affected also by another factor. The holding of Government securities has many advantages apart from the privilege of tax exemption. These advantages cannot be duplicated in private securities, whatever the yield. The purchase of governmental securities is mandatory upon seekers after absolute safety. United States Government securities, moreover, afford institutional investors a degree of liquidity which is in practice obtainable in no other way. In addition, public securities as a whole have important legal and psychological advantages which make them extremely attractive to certain classes of holders, for example, banks and trustees, despite wide differentials in yield as compared with taxable securities.

As a result of these collateral advantages, many investors, both individual and institutional, find it advisable to purchase such securities, tax-exemption privilege and all. They are willing to buy these securities despite the fact that they are unable to derive much, if any, benefit from the tax-exemption privilege and would pay little or nothing for it could it be purchased separately. Other investors who would be willing to pay a high price for tax exemption by itself are not nearly as attracted to the other characteristics of governmental securities.

The inequities in the distribution of the tax burden arising from tax exemption may now be clearly seen. Persons with large incomes derive much greater benefits in reduced taxes than they pay for through sacrifice of interest returns. Part of this excess benefit falls as a burden on holders of tax-exempt securities who need them for other reasons but must pay the same premium as do the individuals in the higher income brackets. The remaining excess benefit must be paid by the general taxpayer who is called upon to make up the deficit in revenue. Neither of the burdened groups is as able to bear the additional load as are the individuals in the higher income brackets who receive the benefits.

I now turn to the effect of the issuance of tax-exempt securities upon the general functioning of our economy. In short, that effect is to discourage investment in enterprises involving risk. Industry finds it difficult to compete with tax-exempt securities in attracting the capital of individuals in the higher income brackets. The fact, previously mentioned, that to the man with net income from other sources of $500,000 a 3 percent fully tax-exempt security is equal in net yield to a taxable security yielding 10.71 percent, clearly indicates the reason.

It is highly important that capital should have an adequate incentive to enter venturesome enterprises. We are confronted today with a great surplus of capital which does not desire to take a chance, and a distinct shortage of that which does. Venturesome capital is needed to induce the investment of cautious capital. New enterprises can be started and old ones that are subject to rapid technological and stylistic change can be continued only with capital willing to take a chance.

Moreover, even our most stable industries need a margin of enterprising capital willing to absorb the shock of the risks to which even these industries are subject, in order to permit them to secure senior capital through the issuance of bonds and preferred stock.

The employment of a dollar of venturesome capital may permit the employment of several dollars of senior capital, but if no one is willing to take a chance, projects may be abandoned even if the earnings prospects are promising.

The current superabundance of cautious capital and shortage of enterprising capital is one of the major problems confronting our economy. One of its most important underlying causes has been developing for several generations. I have reference to the growing institutionalization of investment. Savings which are committed to the care of institutions such as banks or insurance companies tend to be removed from the enterprise capital market and committed to senior capital investments. Hence, it is more important than formerly that an adequate proportion of investment by individuals be di-

rected to the enterprise capital market if we are to give full employment to labor and increase the level of national well-being.

This, of course, is not to imply that there is anything objectionable about purchasing Government bonds or high-grade corporate securities. What it does imply is that this type of investment needs no encouragement at present since the supply of funds available for these purposes is more than adequate, while there is a shortage of funds willing to take a chance.

The CHAIRMAN. Mr. Secretary, as I follow your argument, it occurs to me that the question arises as to why the Treasury does not attempt to sell its securities at lower interest rates than it does. From all you say, it would seem that the market is ready to absorb whatever the Treasury offers. From this entire argument, it seems to me to indicate that we could very easily borrow money at a lower rate.

Mr. HANES. I think at the present time we are borrowing money at the lowest interest rate that it was ever borrowed at. I do not see how we could get it much lower.

The CHAIRMAN. The main question was addressed to the demand and the advantage to holders of governmental securities, and, while the interest rate is low, the entire argument seems to me to point out that it could be lower.

Mr. HANES. As I say, we are rapidly approaching the point of negative interest, and I do not see how it could be very much lower than we have been getting.

The CHAIRMAN. All right. You may proceed.

Mr. HANES. Two conditions are required to cause men to take a chance: First, a reasonable probability of gain; and second, the necessity for taking the chance to make the gain. No man will call "tails" on the toss of a coin if he knows it has heads on both sides, but neither will he bet at all on a fair coin if he has a chance to call "heads" on the double-headed one. This is not to imply that stopping the issuance of tax-exempt securities alone will restore the free flow of enterprise capital. The problem is a complicated one with many angles. However, it should be emphasized that tax exemption not only provides a profitable alternative to risk taking but provides that alternative to those persons most able to take risks. It would be easier, in other words, to get a man with an income of half a million dollars to take a chance in order to earn 10 percent from a taxable venture if he no longer had available the opportunity to gain as much without taking a chance by purchasing a riskless tax-exempt security.

The stimulation of enterprise capital resulting from the discontinuance of the issue of tax-exempt securities will occur gradually only as the existing supply of such securities is reduced through retirement. The resultant growing scarcity will force their prices up and their yields down to low levels and consequently will tend to make venturesome investments increasingly attractive.

At present, however, the volume of tax-exempt securities is increasing. The sooner we reverse our course the sooner we shall be laying, in this respect at least, the foundation for a sound flow of capital into enterprise.

Stopping the issuance of tax-exempt securities would have another desirable effect. It would make Federal, State, and local securities

more suitable instruments for investment on the part of persons in the lower- and middle-income classes.

As a result of the tax-exemption privilege, these securities have been made most attractive to persons in the highest income groups. Persons of relatively slender means—who may, as in the case of widows or aged persons, be absolutely dependent upon investment income for subsistence—frequently do not find public securities sufficiently remunerative investments. The need for greater income often forces them to compromise with security by taking risks they should not have to take. Removal of the exemptions by increasing yields somewhat would make public obligations a more suitable investment for them. As the situation stands now, we are encouraging venturesome investment by those who ought not to take risks and discouraging it in the case of those who should.

The practice of granting a tax-exemption privilege which is worth much to persons with large incomes but little to persons of modest means has turned the investment market on end. It has made it far harder to fit the security to the needs of the purchaser than would otherwise be the case. The elimination of the tax-exemption privilege from future issues of public securities would, therefore, in this respect also, make for a better and sounder investment market.

The benefit from the cessation of future issues of tax-exempt securities in the form of a better and sounder investment market would be realized in the very near future. The other benefits, however, would not be secured at once. That would require a longer time because it will take approximately 50 years for all of the present tax-exempt securities to be retired and because as their quantity decreases they will tend to be concentrated in the hands of persons in the higher-income groups.

The CHAIRMAN. Before you leave the first point, I take it your office believes it would require considerable time to bring these benefits to the people of this country, applying both to Federal and State securities?

Mr. HANES. Yes, sir.

The CHAIRMAN. In other words, there is no disposition on the part of the Treasury to attempt to tax the income on the State and municipal bonds that have been heretofore issued?

Mr. HANES. None whatsoever.

The CHAIRMAN. I am glad to have that made clear, for there has been considerable talk about that question. That is the policy of the administration?

Mr. HANES. Yes, sir; that is certainly the Treasury's position.

The CHAIRMAN. That has been mine, and I am glad that you confirm it.

Mr. HANES. Yes, sir.

The CHAIRMAN. All right. You may proceed.

Mr. HANES. My next point relates to the effects of removing income-tax exemptions from governmental securities on the costs and revenues of government. This point is not as important as those previously discussed. Even if the elimination of tax exemption resulted in a net cost to Government, it would still be highly desirable because of its effects on the operation of the economy and on the equity of the distribution of the tax burden.

However, there is every reason to believe that the elimination of tax-exempt securities would in fact result in a substantial net financial gain to government as a whole. This follows logically from the previous discussion which pointed out that when a large volume of tax-exempt securities is outstanding, the reduction in interest cost to government due to the exemption is much less than the reduction in the taxes of taxpayers in the higher-income brackets.

To estimate the probable amount of net gain, however, is extremely difficult because of the unpredictability of future borrowing and future distribution of the ownership of such securities. It is clear that in the next few years neither the additional tax revenue nor the additional interest cost will be considerable. However, to estimate the actual amounts would be hazardous.

With respect to the long-run effects of stopping the issuance of tax-exempt securities a fairly good picture can be secured, but only if one is willing to make certain assumptions regarding the volume of future borrowing and the future distribution of security ownership. In the following estimates the present situation has been projected into the future, taking account of the results that would flow from having public securities taxable instead of tax-exempt.

The additional annual income-tax revenue and increases in interest cost for years following the complete retirement of tax-exempt securities are estimated as follows:

| | Minimum | Maximum |
|---|---|---|
| Income-tax revenue: Annual increase to the Federal Government | $179,000,000 | $337,000,000 |
| Interest costs: | | |
| Annual increase to the Federal Government and Federal instrumentalities | 19,000,000 | 50,000,000 |
| Annual increase to the State and local governments | 40,000,000 | 105,000,000 |

No estimate is here included of the increased revenue to State and local governments.

The elimination of the exemption of governmental salaries from income taxes requires less consideration. Although of substantial importance from the point of view of tax justice, it is of less economic and fiscal significance than the problem of tax-exempt securities.

At the outset it should be noted that the exemption in the case of Government salaries is less complete than in the case of securities. Federal employees are, of course, subject to Federal income taxes, and State and local employees can be, and frequently are, subjected to State income taxes. Such inequities as exist arise from the exemption of State and local employees from Federal income taxes and Federal employees from State income taxes.

The general level of governmental salaries is relatively low and few governmental employees have large incomes from sources other than their salaries which would enable them to derive particular benefit from exemption of their salaries. It is estimated that at the close of 1937 the 2,600,000 State and local officers and employees drew an average salary of less than $1,400 per year. Approximately 15 percent received a salary of $1,000 or less, and for another 60 percent the salary ranged from $1,000 to $2,500. Only 25 percent of State and

local employees received more than $2,500, which is the exemption accorded a married individual with no dependents under the Federal income tax.

In view of this relatively low salary level, the elimination of the Federal income-tax exemption now accorded State and local employees would probably produce about $16,000,000 additional Federal revenue. This represents an effective rate of less than one-half of 1 percent of total State and local salaries.

The probable effect of the elimination of tax exemption on State and local governments themselves is also likely to be minor. State governments with their relatively small volume of salaries—15 percent of combined State and local—would appear to stand to gain more from taxation of Federal officers and employees than they might lose in increased pay rolls. They may, in fact, gain more than the Federal Government. To be sure, the structure of State income taxes varies so widely as virtually to preclude precise estimation.

In the case of local governments the situation is less favorable. Local governments themselves do not levy income taxes and, therefore, would not profit directly from the elimination of tax exemption. This circumstance is mitigated, however, by the fact that some States share their income-tax revenues with local units and others devote portions of their tax collections to financing such local functions as highways, education, and welfare.

The CHAIRMAN. Have you a list of the States that do have income taxes?

Mr. HANES. I do not have it with me. We can insert that in the record.

The CHAIRMAN. You will put that into the record?

Mr. HANES. Yes, sir. (See Table IV at conclusion of Mr. Hanes' testimony.)

The principal point to be made in favor of eliminating tax-exempt salaries is that the government employee would then stand in the same position as the private employee. Any discrimination that exists would be removed.

It has been mentioned previously that the great body of opinion, both governmental and private, has over a period of years favored the elimination of tax exemption. In the interests of completeness, it should be noted, however, that certain objections have been raised. One such objection is that since intergovernmental exemptions have been imbedded in our legal structure for many years, action should be delayed until further study is made of the problem.

This, of course, is an objection invariably raised whenever it is proposed to change an existing situation. In the present case it has little merit. Ever since the graduated surtaxes were introduced, the question of taxing Government interest and salaries has concerned economists and public officials. The subject has been studied and analyzed by many outstanding authorities, who, as previously pointed out, have, with very few exceptions, condemned such exemptions and recommended their elimination. A step which has had a quarter of a century of study and discussion cannot be said to be taken without due consideration. It is not likely that any

significant change in views would result from delay and further study.

Another contention is that the evils of tax exemption are of little importance and that accordingly there is no pressing need for action. It is urged that only a relatively small proportion of the population can benefit financially and that their benefits are substantially offset by sacrifices on the part of others, so that the revenue loss to Government is minor. This objection is not well taken. On the basis of an average interest differential attributable to tax exemption, everyone with more than $18,000 annual surtax net income can derive a net tax advantage from buying tax-exempt securities. The remainder can receive no such advantage. In 1936 there were 96,000 persons with surtax net incomes above $18,000. While this is a relatively small proportion of the population, they received over $4,000,000,000 of net income or more than one-fourth of the total net income of persons filing returns. The fact that a relatively small group, only about 1 person in 1,000, can benefit from tax exemption is a much stronger reason for eliminating exemptions than if a large majority benefited.

It is also urged that the removal of tax exemptions would increase State and local governmental costs. Some persons refer to such an increase as a burden imposed by the Federal Government. A few even ominously forecast the end of our Federal system of government if exemption is eliminated.

Before considering the facts bearing on this objection, it should be recalled that taxpayers are not divided into Federal taxpayers, State taxpayers, and local taxpayers. All our citizens are taxpayers directly or indirectly to all three types of government. To attempt to break the taxpayer into pieces and to set his interests as a State or local taxpayer against his interests as a Federal taxpayer gives a false impression of his total position. Even if the majority of the taxpayers were obliged to pay slightly more than they now do in taxes to State and local jurisdictions to defray added costs, this would be more than offset by a reduction in Federal taxes because of the additional amounts paid by taxpayers with high incomes now benefiting from tax exemption.

Furthermore, fiscal relations of Federal, State, and local governments have undergone important changes. Federal grants for highways, relief, and social security, and Federal loans and grants for public works and other services of the Federal Government have all had a markedly more important effect in lowering the costs bearing on State and local governments for the services the citizens receive than is involved in the cost that might result from the elimination of tax-exempt securities.

Turning to the factual merits of the objection, it will be seen that increases in cost are likely to be small and to be postponed. Any added expense to borrowing jurisdictions would be felt only gradually as new issues were put on the market. It would be many years before the amount of additional interest involved became appreciable. Furthermore, States and localities stand to gain considerable amounts of revenue. States imposing income taxes will be in a position to

tax interest on Federal securities and salaries of Federal employees. Such taxes are often shared with local units of government.

The objection that possible increases in costs due to the taxation of government interest and salaries constitutes a burden imposed by the Federal Government on State and local governments is without merit. The tax is imposed not on governments but on private citizens. There is thus no direct increase in costs of government. Any increase that may take place is an indirect one; it would have to be shifted from the taxpayer to the government in the form of higher interest or higher salaries. Furthermore, the taxes are uniform and do not select government interest or salaries for relatively higher taxation. To the extent to which tax exemption creates a differential between government interest rates and private interest rates, government is able to borrow at less than the going rate. The same thing is true in the case of salaries. The elimination of tax exemption merely restores government in its relation to employee and investor to the same competitive position it occupied before income taxes were imposed. The proposal to repeal the exemption privilege is tantamount to the termination of a special benefit enjoyed by governments and not to the imposition of any burden upon the State and local governments.

In summary, the position of the Treasury Department is that no more tax-exempt governmental securities should be issued, and that reciprocal tax exemptions of governmental salaries should be eliminated. It is believed that this action will lead to a more equitable distribution of the tax burden, will have a highly desirable effect on the operation of industry and the national economy and will yield a net financial gain to the government. It is our opinion further that the objections raised to the elimination of tax exemption are not in general valid, and that to the extent they may be, are outweighed by the very real advantages to be gained by that action.

Mr. Chairman, there are several tables and a chart here, which, if the committee so wishes, the experts of the Treasury will be delighted to explain. I would like to have Mr. Murphy explain them.

(The tables and chart referred to are as follows:)

TABLE I.—*Gross annual yield required on a taxable security by a married man with no children or other dependents, to provide the same net yield after Federal income taxes as on a wholly tax-exempt security at various yields, for selected cases*

| Net income from other sources | Yield on tax-exempt security, percent | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| $5,000 | 1.04 | 2.08 | 3.12 | 4.16 | 5.20 |
| $10,000 | 1.10 | 2.20 | 3.30 | 4.40 | 5.50 |
| $20,000 | 1.18 | 2.36 | 3.54 | 4.72 | 5.90 |
| $50,000 | 1.45 | 2.90 | 4.35 | 5.80 | 7.25 |
| $100,000 | 2.44 | 4.88 | 7.32 | 9.76 | 12.20 |
| $500,000 | 3.57 | 7.14 | 10.71 | 14.28 | 17.85 |
| $1,000,000 | 4.17 | 8.34 | 12.51 | 16.68 | 20.85 |

TABLE II.—*Annual yield required on a wholly tax-exempt security by a married man with no children or other dependents, to equal the net yield after Federal income taxes on a taxable security at various gross yields, for selected cases*

| Net income from other sources | Gross yield on taxable security, percent | | | |
|---|---|---|---|---|
| | 2 | 3 | 4 | 5 |
| $5,000 | 1.92 | 2.88 | 3.84 | 4.80 |
| $10,000 | 1.82 | 2.73 | 3.64 | 4.55 |
| $20,000 | 1.70 | 2.55 | 3.40 | 4.25 |
| $50,000 | 1.38 | 2.07 | 2.76 | 3.45 |
| $100,000 | .82 | 1.23 | 1.64 | 2.05 |
| $500,000 | .56 | .84 | 1.12 | 1.40 |
| $1,000,000 | .48 | .72 | .96 | 1.20 |

Source: Treasury Department, Division of Research and Statistics.

TABLE III.—*Estimated distribution of tax-exempt securities by classes of holders, June 30, 1937*

[In billions of dollars]

| | Wholly exempt | | | Partially exempt U.S. Government and Federal instrumentalities | Total |
|---|---|---|---|---|---|
| | State and local | Federal instrumentalities | U.S. Government | | |
| Governments and their agencies, trust funds, sinking funds and investment funds, and Federal Reserve banks | 4.3 | 0.8 | 3.5 | 6.5 | 15.1 |
| Active banks, excluding mutual savings banks | 2.8 | .3 | 5.9 | 8.7 | 17.7 |
| Insurance companies | 1.8 | ..... | 1.3 | 3.7 | 6.8 |
| Other corporations | .8 | .1 | 1.1 | .8 | 2.8 |
| Mutual savings banks | .8 | ..... | .3 | 2.1 | 3.2 |
| Other tax-exempt institutions | .5 | ..... | .1 | .4 | 1.0 |
| Individuals | 8.3 | 1.0 | 2.9 | 6.8 | 19.0 |
| Total | 19.3 | 2.2 | 15.1 | 29.0 | 65.6 |

Source: Treasury Department, Division of Research and Statistics.

TABLE IV. *Extent of State taxation of net income as of January 1, 1939*

1. INDIVIDUAL INCOME TAXES

Individual income taxes measured by net income are now imposed by 31 States. These States are:

| | | | |
|---|---|---|---|
| Alabama | Iowa | Missouri | South Carolina |
| Arizona | Kansas | Montana | South Dakota |
| Arkansas | Kentucky | New Mexico | Utah |
| California | Louisiana | New York | Vermont |
| Colorado | Maryland[1] | North Carolina | Virginia |
| Delaware | Massachusetts[2] | North Dakota | West Virginia |
| Georgia | Minnesota | Oklahoma | Wisconsin |
| Idaho | Mississippi | Oregon | |

In addition to the above-mentioned States which levy general income taxes, three States tax income from intangibles. These are:

Ohio Tennessee New Hampshire

Of the 31 States which tax general income, all but three levy progressive rates. Maryland, Massachusetts, and Vermont, as well as the three States which tax only income from intangibles, levy flat rates.

[1] The Maryland law which imposed a temporary tax on income for the calendar years 1936 and 1937 has not yet been extended.

[2] Although imposed on selected categories of income, the Massachusetts tax so closely approaches a general tax that it is here included with that group.

### 2. CORPORATE INCOME TAXES

Corporate income taxes measured by net income are now imposed by 32 States. These States are:

| | | | |
|---|---|---|---|
| Alabama | Iowa | Missouri | Pennsylvania [2] |
| Arizona | Kansas | Montana | South Carolina |
| Arkansas | Kentucky | New Mexico | South Dakota |
| California | Louisiana | New York | Tennessee [3] |
| Colorado | Maryland [1] | North Carolina | Utah |
| Connecticut | Massachusetts | North Dakota | Vermont |
| Georgia | Minnesota | Oklahoma | Virginia |
| Idaho | Mississippi | Oregon | Wisconsin |

In addition to the above-mentioned States which levy taxes on all corporate net income, Ohio imposes a tax on corporate income derived from intangibles. Of the 32 States which tax all corporate net income, all apply flat rates except Arizona, Idaho, Mississippi, North Dakota, South Dakota, and Wisconsin. Ohio imposes a flat rate on intangibles.

[1] The Maryland law which imposed a temporary tax on income for the calendar years 1936 and 1937 has not yet been extended.
[2] The Pennsylvania law which originally levied a tax on corporate income for the calendar years 1935 and 1936 was extended to the calendar years 1937 and 1938. It has not yet been further extended.
[3] In addition to the tax on all corporate net income, a second income tax is restricted in its base to interest and dividends.

TABLE V.—*Treatment of interest from governmental obligations under State individual income taxes as of Jan. 1, 1939*

| | Interest from obligations of the | | | | | |
|---|---|---|---|---|---|---|
| | Home State | Other States | Political subdivisions of the— | | Federal Government and its agencies | Territories and possessions |
| | | | Home State | Other States | | |
| Alabama | Exempt | Taxed | Exempt | Taxed | Exempt | Exempt. |
| Arizona | do.[1] | do | do.[1] | do | do | Do. |
| Arkansas | do | do | do | do | do | Do. |
| California | do.[1] | do | do.[1] | do | do | Taxed. |
| Colorado | Taxed | do | Taxed | do | do | Do. |
| Delaware | Exempt | do | Exempt | do | do | Exempt. |
| Georgia | do | do | do | do | do | Do. |
| Idaho | Taxed | do | Taxed | do | do | Do. |
| Iowa | do | do | do | do | do | Do. |
| Kansas | do | do | do | do | do | Do. |
| Kentucky | Exempt | do | Exempt | do | do | Taxed. |
| Louisiana | do | do | do | do | do | Exempt. |
| Maryland | do | do | do | do | do | Taxed. |
| Massachusetts | do.[1] | do | do.[1] | do | do | Exempt. |
| Minnesota | do | do | do | do | do | Do. |
| Mississippi | do.[4] | do | do.[4] | do | do | Do. |
| Missouri | do | do | do | do | do | Do. |
| Montana | Taxed | do | Taxed | do | do | Do. |
| New Hampshire | Exempt | do | do.[1] | do | do | Do. |
| New Mexico | do | Exempt | Exempt | Exempt | do | Do. |
| New York | do | Taxed | do | Taxed | do | Do. |
| North Carolina | do | do | do | do | do | Do. |
| North Dakota | do | do | do | do | do | Do. |
| Ohio | Taxed | do | Taxed [6] | do | do | Do. |
| Oklahoma | do | do | do | do | do | Do. |
| Oregon | do | do | do | do | do | Do. |
| South Carolina | Exempt | do | Exempt | do | do | Do. |
| South Dakota | do | do | do | do | do | Do. |
| Tennessee | do | do | do | do | do | Do. |
| Utah | do | do | Taxed | do | do | Do. |
| Vermont | do | do | Exempt | do | do | Do. |
| Virginia | do | do | Taxed | do | do | Taxed. |
| West Virginia | do | do | Exempt | do | do | Exempt. |
| Wisconsin | Taxed | do | Taxed | do | do | Taxed. |

[1] Restricted to interest from bonds.
[2] Restricted to post-1902 issues.
[3] Restricted to post-1906 State and post-1908 local issues marked "tax-exempt."
[4] Restricted to issues specifically exempt by statutory authorization.
[5] Applicable to post-1923 issues.
[6] Applicable to post-1912 issues.

TABLE VI.—*Treatment of interest from governmental obligations under State corporate taxes measured by net income as of Jan. 1, 1939*

| | Interest from obligations of the— | | | | | |
|---|---|---|---|---|---|---|
| | Home State | Other States | Political subdivisions of the— | | Federal Government and its agencies | Territories and possessions |
| | | | Home State | Other States | | |
| Alabama | Exempt | Taxed | Exempt | Taxed | Exempt | Exempt. |
| Arizona | do.[1] | do | do.[1] | do | do | Do. |
| Arkansas | do | do | do | do | do | Do. |
| California | Taxed | do | Taxed | do | Taxed | Taxed. |
| Colorado | do | do | do | do | Exempt | Do. |
| Connecticut | do | do | do | do | Taxed | Do. |
| Georgia | Exempt | do | Exempt | do | Exempt | Exempt. |
| Idaho | Taxed | do | Taxed | do | do | Do. |
| Iowa | do | do | do | do | do | Do. |
| Kansas | do | do | do | do | do | Do. |
| Kentucky | Exempt | do | Exempt | do | do | Taxed. |
| Louisiana | do | do | do | do | do | Exempt. |
| Maryland | do | do | do | do | do | Taxed. |
| Massachusetts | do.[1] | do | do.[1] | do | Taxed | Do. |
| Minnesota | do | do | do | do | Exempt | Exempt. |
| Mississippi | do.[1] | do | do.[1] | do | do | Do. |
| Missouri | do | do | do | do | do | Do. |
| Montana | Taxed | do | Taxed | do | Taxed | Taxed. |
| New Mexico | Exempt | Exempt | Exempt | Exempt | Exempt | Exempt. |
| New York | Taxed | Taxed | Taxed | Taxed | Taxed | Taxed. |
| North Carolina | Exempt | do | Exempt | do | Exempt | Exempt. |
| North Dakota | do | do | do | do | do | Do. |
| Ohio | Taxed | do | Taxed [4] | do | do | Do. |
| Oklahoma | do | do | do | do | do | Do. |
| Oregon | do | do | do | do | Taxed | Taxed. |
| Pennsylvania | Exempt | Exempt | Exempt | Exempt | do | Do. |
| South Carolina | do | Taxed | do | Taxed | Exempt | Exempt. |
| South Dakota | do | do | do | do | do | Do. |
| Tennessee | Taxed [5] | do | Taxed [5] | do | Taxed [5] | Taxed. |
| Utah | do | do | do | do | do | Do. |
| Vermont | Exempt | do | Exempt | do | Exempt | Exempt. |
| Virginia | do | do | Taxed | do | do | Taxed. |
| Wisconsin | Taxed | do | do | do | do | Do. |

[1] Restricted to interest from bonds.
[2] Restricted to post 1906 State and post 1908 local issues marked "Tax exempt."
[3] Restricted to issues specifically exempt by statutory authorization.
[4] Applicable to post 1912 issues.
[5] Exempt from stocks and bonds tax.

## EXPLANATION OF TABLES VII AND VIII

### TAX-EXEMPT SECURITIES OWNED AND TAX-EXEMPT INTEREST RECEIVED BY INDIVIDUALS WITH NET INCOME OF $5,000 AND OVER, BY STATES AND NATURE OF OBLIGATIONS, AS REPORTED ON INDIVIDUAL INCOME-TAX RETURNS FOR 1935

The following two tables show by States the amount of wholly and partially tax-exempt obligations owned at end of year and the amount of wholly and partially tax-exempt interest received or accrued during year, as reported on individual income tax returns with net income of $5,000 and over, for 1935.

It should be emphasized that these statistics are known to be incomplete and that the break-down by States is subject to even greater limitations. The classification by States is determined by the place of filing of the income-tax return and is not necessarily indicative either of the domicile of the taxpayer or the actual situs of the tax-exempt securities. Incomplete reporting arises from the fact that information regarding the ownership of tax-exempt obligations required in the income-tax return is of an informational nature, not required in the computation of tax liability. There is evidence that interest received from tax-exempt obligations is more completely reported than the amount of obligations owned. If interest received from tax-exempt securities reported for the year 1935, for instance, is related to the reported amount of tax-exempt securities owned, it reveals an average rate of interest of 4.6 percent in the case of Federal securities and 7.3 percent in the case of State, local, Territorial, and insular obligations. Both of these percentages are obviously in excess of the probable interest rates applicable to these issues. Comparisons of the reported amount of tax-exempt securities owned and tax-exempt interest received or accrued for selected States reveal even greater discrepancies.

Some of this discrepancy between the reported amounts owned and interest received may be explained by the failure of partnerships and fiduciaries to report to partners and beneficiaries the amount of Government obligations held on their behalf in instances where the interest received is so reported. In any case the volume of tax-exempt securities held by individuals with incomes of $5,000 and over obviously is considerably in excess of the total indicated by the accompanying table. As far as concerns individuals with net incomes of less than $5,000, no State-by-State data are available. A special analysis of 1934 returns revealed that at the close of that year these individuals held $827,000,000 of Federal securities and $507,000,000 of State, local, Territorial, and insular obligations.

TABLE VII.—*Wholly and partially tax-exempt obligations reported on individual returns for 1935 with net income of $5,000 and over, showing amount owned at end of year, by States and nature of obligations*

| States | Total | Wholly tax-exempt obligations | | | Partially tax-exempt obligations | |
|---|---|---|---|---|---|---|
| | | Obligations of States and Territories or political subdivisions thereof and United States possessions | Obligations issued under Federal Farm Loan Act | Liberty 3½-percent bonds, Treasury notes, Treasury bills, and Treasury certificates of indebtedness [1] | Liberty 4- and 4¼-percent bonds, United States savings bonds and Treasury bonds | Obligations of certain instrumentalities of the United States [2] |
| Alabama | $10,576,000 | $6,438,000 | $219,000 | $995,000 | $1,915,000 | $1,008,000 |
| Arizona | 6,454,000 | 3,001,000 | 345,000 | 393,000 | 1,586,000 | 170,000 |
| Arkansas | 3,550,000 | 1,487,000 | 171,000 | 443,000 | 1,236,000 | 214,000 |
| California | 223,280,000 | 124,212,000 | 7,769,000 | 40,186,000 | 45,705,000 | 5,408,000 |
| Colorado | 53,135,000 | 31,754,000 | 2,316,000 | 6,804,000 | 10,877,000 | 1,384,000 |
| Connecticut | 101,378,000 | 61,729,000 | 7,050,000 | 16,432,000 | 15,250,000 | 918,000 |
| Delaware | 11,720,000 | 8,581,000 | 203,000 | 1,325,000 | 1,468,000 | 143,000 |
| District of Columbia | 80,369,000 | 39,153,000 | 7,420,000 | 14,477,000 | 17,498,000 | 1,821,000 |
| Florida | 36,268,000 | 19,613,000 | 2,057,000 | 5,013,000 | 8,194,000 | 1,391,000 |
| Georgia | 16,322,000 | 8,503,000 | 1,005,000 | 1,418,000 | 4,943,000 | 453,000 |
| Hawaii | 6,672,000 | 4,179,000 | 130,000 | 878,000 | 1,381,000 | 105,000 |
| Idaho | 794,000 | 240,000 | 15,000 | 113,000 | 391,000 | 36,000 |
| Illinois | 295,308,000 | 140,250,000 | 17,590,000 | 72,576,000 | 50,449,000 | 8,443,000 |
| Indiana | 60,428,000 | 13,775,000 | 14,773,000 | 5,359,000 | 23,371,000 | 3,150,000 |
| Iowa | 18,700,000 | 9,270,000 | 1,215,000 | 2,047,000 | 5,307,000 | 898,000 |
| Kansas | 12,152,000 | 4,813,000 | 794,000 | 944,000 | 5,206,000 | 395,000 |
| Kentucky | 33,152,000 | 15,476,000 | 4,125,000 | 2,354,000 | 9,355,000 | 1,842,000 |
| Louisiana | 35,086,000 | 17,159,000 | 810,000 | 8,615,000 | 7,253,000 | 1,249,000 |
| Maine | 42,399,000 | 28,693,000 | 2,660,000 | 3,888,000 | 6,384,000 | 774,000 |
| Maryland | 90,505,000 | 42,994,000 | 6,925,000 | 12,971,000 | 25,026,000 | 2,590,000 |
| Massachusetts | 241,377,000 | 143,469,000 | 19,345,000 | 43,409,000 | 32,361,000 | 2,794,000 |
| Michigan | 115,339,000 | 73,965,000 | 2,785,000 | 13,058,000 | 22,751,000 | 2,780,000 |
| Minnesota | 47,221,000 | 26,838,000 | 2,134,000 | 6,544,000 | 10,102,000 | 1,604,000 |
| Mississippi | 2,400,000 | 1,506,000 | 61,000 | 120,000 | 697,000 | 18,000 |
| Missouri | 88,017,000 | 30,627,000 | 5,988,000 | 18,990,000 | 29,016,000 | 3,396,000 |
| Montana | 4,056,000 | 689,000 | 144,000 | 949,000 | 2,053,000 | 222,000 |
| Nebraska | 13,850,000 | 5,178,000 | 2,349,000 | 2,013,000 | 3,436,000 | 874,000 |
| Nevada | 4,042,000 | 1,334,000 | 268,000 | 1,146,000 | 1,192,000 | 72,000 |
| New Hampshire | 9,299,000 | 3,449,000 | 888,000 | 2,100,000 | 2,591,000 | 270,000 |
| New Jersey | 245,505,000 | 165,030,000 | 8,823,000 | 41,339,000 | 26,123,000 | 3,589,000 |
| New Mexico | 2,096,000 | 1,025,000 | 203,000 | 171,000 | 551,000 | 147,000 |
| New York | 1,593,488,000 | 953,347,000 | 61,849,000 | 392,815,000 | 160,948,000 | 24,529,000 |
| North Carolina | 13,894,000 | 7,906,000 | 943,000 | 1,364,000 | 3,572,000 | 110,000 |
| North Dakota | 890,000 | 531,000 | 72,000 | 47,000 | 203,000 | 42,000 |
| Ohio | 195,312,000 | 44,657,000 | 27,918,000 | 43,713,000 | 73,823,000 | 5,202,000 |
| Oklahoma | 21,035,000 | 3,993,000 | 763,000 | 1,670,000 | 14,094,000 | 515,000 |
| Oregon | 9,898,000 | 3,642,000 | 862,000 | 726,000 | 4,449,000 | 219,000 |
| Pennsylvania | 595,520,000 | 386,383,000 | 51,545,000 | 62,228,000 | 83,662,000 | 11,702,000 |
| Rhode Island | 42,718,000 | 26,694,000 | 1,782,000 | 7,098,000 | 6,283,000 | 860,000 |
| South Carolina | 5,214,000 | 3,276,000 | 109,000 | 438,000 | 1,208,000 | 182,000 |
| South Dakota | 1,444,000 | 500,000 | 104,000 | 360,000 | 393,000 | 87,000 |
| Tennessee | 14,317,000 | 7,280,000 | 1,611,000 | 1,724,000 | 3,047,000 | 654,000 |
| Texas | 80,627,000 | 30,445,000 | 3,907,000 | 18,498,000 | 25,152,000 | 2,625,000 |
| Utah | 1,968,000 | 504,000 | 79,000 | 242,000 | 964,000 | 179,000 |
| Vermont | 6,334,000 | 3,589,000 | 534,000 | 489,000 | 1,522,000 | 199,000 |
| Virginia | 30,625,000 | 15,025,000 | 2,841,000 | 2,466,000 | 8,805,000 | 1,507,000 |
| Washington | 27,233,000 | 12,767,000 | 1,076,000 | 5,532,000 | 7,172,000 | 687,000 |
| West Virginia | 21,959,000 | 4,096,000 | 5,345,000 | 4,273,000 | 7,988,000 | 257,000 |
| Wisconsin | 48,403,000 | 20,702,000 | 2,003,000 | 14,786,000 | 9,387,000 | 1,525,000 |
| Wyoming | 2,741,000 | 706,000 | 568,000 | 344,000 | 926,000 | 196,000 |
| Total | 4,625,186,000 | 2,562,032,000 | 284,518,000 | 885,872,000 | 793,329,000 | 99,435,000 |

[1] Includes other obligations of United States issued on or before Sept. 1, 1917.
[2] Includes obligations of instrumentalities of the United States other than obligations issued under Federal Farm Loan Act, or such act as amended.

TABLE VIII.—*Wholly and partially tax-exempt obligations reported on individual returns for 1935 with net income of $5,000 and over, showing interest received or accrued during the year, by States and nature of obligations*

| States | Total | Wholly tax-exempt obligations | | | Partially tax-exempt obligations | |
|---|---|---|---|---|---|---|
| | | Obligations of States and Territories or political subdivisions thereof and United States possessions | Obligations issued under Federal Farm Loan Act | Liberty 3¼-percent bonds, Treasury notes, Treasury bills, and Treasury certificates of indebtedness [1] | Liberty 4- and 4¼-percent bonds, United States savings bonds and Treasury bonds [2] | Obligations of certain instrumentalities of the United States [3] |
| Alabama | $533,000 | $375,000 | $15,000 | $27,000 | $81,000 | $34,000 |
| Arizona | 307,000 | 211,000 | 10,000 | 20,000 | 58,000 | 7,000 |
| Arkansas | 212,000 | 115,000 | 15,000 | 27,000 | 47,000 | 9,000 |
| California | 12,323,000 | 8,462,000 | 409,000 | 1,419,000 | 1,833,000 | 201,000 |
| Colorado | 2,565,000 | 1,698,000 | 78,000 | 311,000 | 419,000 | 59,000 |
| Connecticut | 6,174,000 | 4,132,000 | 628,000 | 753,000 | 576,000 | 84,000 |
| Delaware | 661,000 | 493,000 | 25,000 | 82,000 | 57,000 | 4,000 |
| Dist. of Columbia | 4,898,000 | 3,274,000 | 454,000 | 517,000 | 593,000 | 60,000 |
| Florida | 2,591,000 | 1,540,000 | 134,000 | 475,000 | 393,000 | 49,000 |
| Georgia | 1,068,000 | 730,000 | 49,000 | 85,000 | 188,000 | 17,000 |
| Hawaii | 279,000 | 187,000 | 8,000 | 30,000 | 49,000 | 5,000 |
| Idaho | 66,000 | 25,000 | 1,000 | 17,000 | 22,000 | 2,000 |
| Illinois | 17,554,000 | 10,908,000 | 974,000 | 2,825,000 | 2,455,000 | 391,000 |
| Indiana | 3,014,000 | 928,000 | 699,000 | 273,000 | 1,017,000 | 97,000 |
| Iowa | 1,272,000 | 825,000 | 77,000 | 103,000 | 233,000 | 34,000 |
| Kansas | 720,000 | 377,000 | 33,000 | 49,000 | 246,000 | 14,000 |
| Kentucky | 1,531,000 | 836,000 | 106,000 | 75,000 | 389,000 | 66,000 |
| Louisiana | 2,053,000 | 1,369,000 | 73,000 | 213,000 | 362,000 | 36,000 |
| Maine | 2,003,000 | 1,434,000 | 129,000 | 172,000 | 235,000 | 33,000 |
| Maryland | 8,540,000 | 5,497,000 | 560,000 | 1,380,000 | 983,000 | 120,000 |
| Massachusetts | 15,419,000 | 10,038,000 | 1,132,000 | 2,456,000 | 1,672,000 | 121,000 |
| Michigan | 7,376,000 | 5,508,000 | 211,000 | 781,000 | 755,000 | 120,000 |
| Minnesota | 4,063,000 | 2,887,000 | 92,000 | 402,000 | 535,000 | 147,000 |
| Mississippi | 186,000 | 92,000 | 2,000 | 13,000 | 27,000 | 51,000 |
| Missouri | 7,568,000 | 3,237,000 | 311,000 | 2,613,000 | 1,260,000 | 147,000 |
| Montana | 257,000 | 137,000 | 4,000 | 33,000 | 78,000 | 4,000 |
| Nebraska | 635,000 | 308,000 | 97,000 | 60,000 | 136,000 | 35,000 |
| Nevada | 151,000 | 68,000 | 12,000 | 29,000 | 39,000 | 2,000 |
| New Hampshire | 557,000 | 232,000 | 37,000 | 159,000 | 115,000 | 13,000 |
| New Jersey | 13,837,000 | 10,466,000 | 643,000 | 1,524,000 | 1,069,000 | 135,000 |
| New Mexico | 86,000 | 43,000 | 9,000 | 10,000 | 21,000 | 4,000 |
| New York | 104,099,000 | 76,877,000 | 3,992,000 | 14,928,000 | 7,295,000 | 1,007,000 |
| North Carolina | 1,090,000 | 647,000 | 160,000 | 106,000 | 171,000 | 7,000 |
| North Dakota | 50,000 | 29,000 | 3,000 | 4,000 | 12,000 | 2,000 |
| Ohio | 10,870,000 | 3,090,000 | 1,655,000 | 1,895,000 | 3,751,000 | 509,000 |
| Oklahoma | 1,268,000 | 363,000 | 18,000 | 378,000 | 490,000 | 19,000 |
| Oregon | 535,000 | 259,000 | 59,000 | 47,000 | 160,000 | 9,000 |
| Pennsylvania | 29,295,000 | 20,613,000 | 2,498,000 | 2,693,000 | 2,979,000 | 511,000 |
| Rhode Island | 4,221,000 | 3,072,000 | 116,000 | 660,000 | 333,000 | 40,000 |
| South Carolina | 344,000 | 200,000 | 9,000 | 19,000 | 109,000 | 8,000 |
| South Dakota | 71,000 | 26,000 | 4,000 | 11,000 | 26,000 | 2,000 |
| Tennessee | 1,614,000 | 575,000 | 75,000 | 788,000 | 136,000 | 40,000 |
| Texas | 3,404,000 | 1,718,000 | 252,000 | 478,000 | 861,000 | 95,000 |
| Utah | 84,000 | 25,000 | 4,000 | 5,000 | 41,000 | 8,000 |
| Vermont | 452,000 | 330,000 | 23,000 | 42,000 | 51,000 | 5,000 |
| Virginia | 1,511,000 | 768,000 | 138,000 | 136,000 | 366,000 | 103,000 |
| Washington | 1,490,000 | 919,000 | 33,000 | 224,000 | 288,000 | 26,000 |
| West Virginia | 922,000 | 222,000 | 243,000 | 103,000 | 340,000 | 14,000 |
| Wisconsin | 2,411,000 | 1,377,000 | 103,000 | 454,000 | 401,000 | 76,000 |
| Wyoming | 114,000 | 52,000 | 10,000 | 11,000 | 36,000 | 4,000 |
| Total | 282,342,000 | 187,566,000 | 16,480,000 | 39,917,000 | 33,792,000 | 4,587,000 |

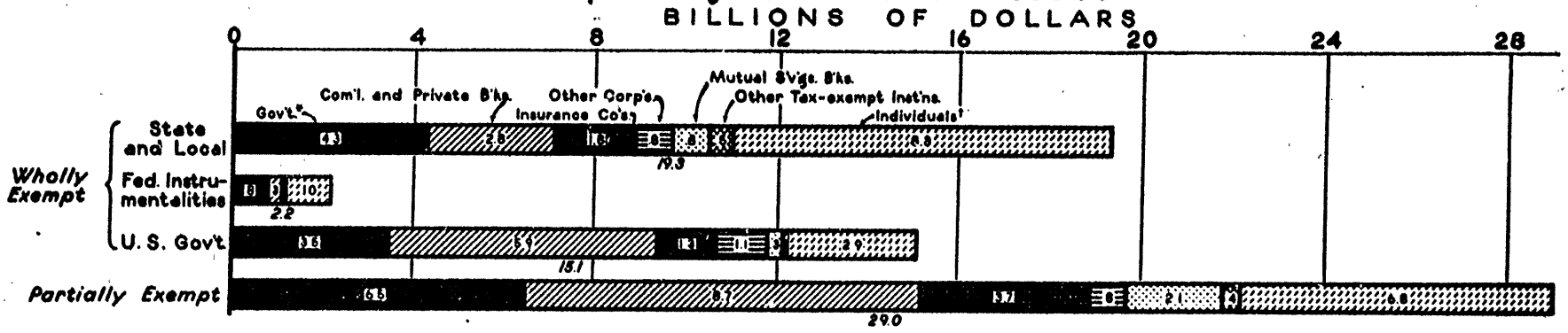
[1] Includes other obligations of United States issued on or before Sept. 1, 1917.
[2] Includes interest received on a principal amount not in excess of $5,000 which is wholly exempt from income taxes. (See line (e), column 3, schedule D, Form 1040.)
[3] Includes interest received on obligations of instrumentalities of the United States other than obligations issued under Federal Farm Loan Act, or such act as amended. (See line (f), column 3, schedule D, Form 1040.)

EXHIBIT 1

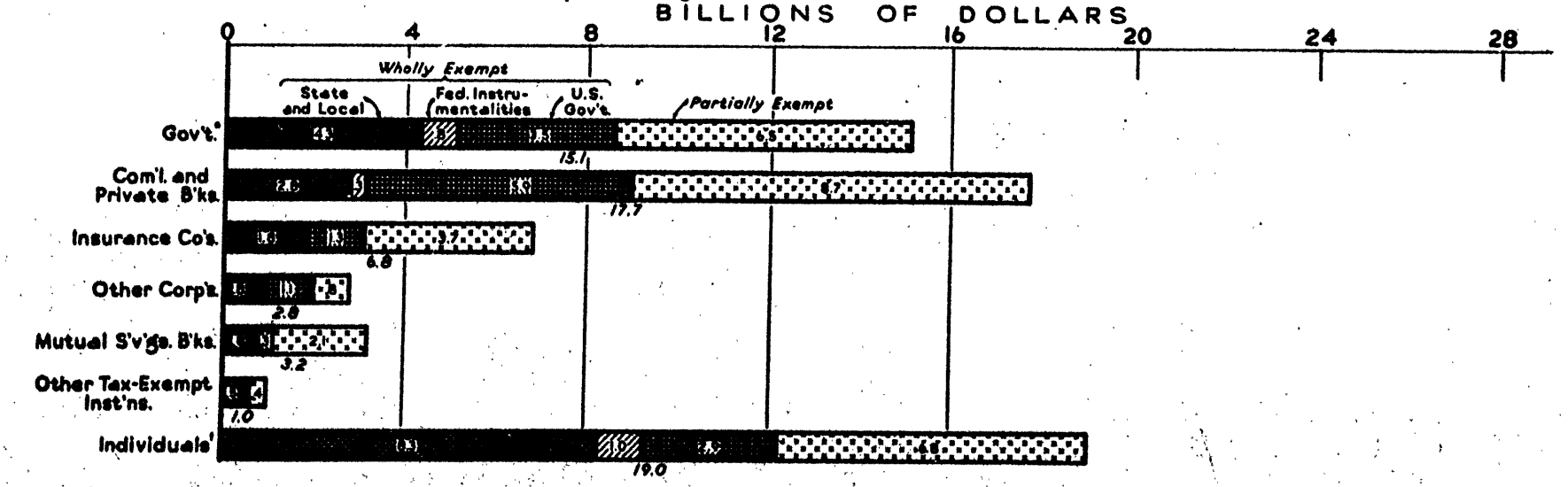
# ESTIMATED DISTRIBUTION OF TAX-EXEMPT SECURITIES

June 30, 1937

## Grouped by Classes of Issues




## Grouped by Classes of Holders




' Individuals, Trusts and Fiduciaries.
* Governments and their Agencies, Trust, Sinking and Investment Funds, and Federal Reserve Banks.

122256—39. (Face p. 18)

## EXHIBIT 2

*Statement of the public debt of the United States, October 31, 1938*

| Detail | Amount issued | Amount retired | Amount outstanding | |
|---|---|---|---|---|
| INTEREST-BEARING DEBT | | | | |
| Bonds: | | | | |
| 3% Panama Canal Loan of 1961 | $50,000,000.00 | $200,000.00 | $49,800,000.00 | |
| 3% Conversion Bonds of 1946–47 | 28,894,500.00 | | 28,894,500.00 | |
| 2½% Postal Savings Bonds (16th to 49th Series) | 117,870,060.00 | 2,820.00 | 117,867,240.00 | |
| | | | | $196,561,740.00 |
| Treasury Bonds: | | | | |
| 4¼% bonds of 1947–52 | 763,962,300.00 | 5,016,500.00 | 758,945,800.00 | |
| 4% bonds of 1944–54 | 1,047,088,500.00 | 10,395,600.00 | 1,036,692,900.00 | |
| 3¾% bonds of 1946–56 | 494,898,100.00 | 5,818,000.00 | 489,080,100.00 | |
| 3½% bonds of 1943–47 | 494,854,750.00 | 40,719,550.00 | 454,135,200.00 | |
| 3½% bonds of 1940–43 | 359,042,950.00 | 6,049,500.00 | 352,993,450.00 | |
| 3¼% bonds of 1941–43 | 594,230,050.00 | 49,360,000.00 | 544,870,050.00 | |
| 3⅛% bonds of 1946–49 | 821,405,000.00 | 2,779,000.00 | 818,627,000.00 | |
| 3% bonds of 1951–55 | 800,424,000.00 | 44,992,000.00 | 755,432,000.00 | |
| 3¼% bonds of 1941 | 835,043,100.00 | 589,900.00 | 834,453,200.00 | |
| 3¼% bonds of 1943–45 | 1,401,138,500.00 | 610,250.00 | 1,400,528,250.00 | |
| 3¼% bonds of 1944–46 | 1,518,858,800.00 | 121,150.00 | 1,518,737,650.00 | |
| 3% bonds of 1946–48 | 1,035,885,050.00 | 10,650.00 | 1,035,874,400.00 | |
| 3⅛% bonds of 1949–52 | 491,377,100.00 | 2,000.00 | 491,375,100.00 | |
| 2½% bonds of 1955–60 | 2,611,156,200.00 | 61,050.00 | 2,611,095,150.00 | |
| 2¾% bonds of 1945–47 | 1,214,453,900.00 | 24,950.00 | 1,214,428,950.00 | |
| 2½% bonds of 1948–51 | 1,223,496,850.00 | 1,000.00 | 1,223,495,850.00 | |
| 2½% bonds of 1951–54 | 1,626,688,150.00 | 1,000.00 | 1,626,687,150.00 | |
| 2¼% bonds of 1956–59 | 981,848,050.00 | 21,000.00 | 981,827,050.00 | |
| 2¼% bonds of 1949–53 | 1,786,504,050.00 | 360,900.00 | 1,786,143,150.00 | |
| 2½% bonds of 1945 | 540,843,550.00 | | 540,843,550.00 | |
| 2½% bonds of 1948 | 450,978,400.00 | | 450,978,400.00 | |
| 2¼% bonds of 1958–63 | 918,780,600.00 | | 918,780,600.00 | |
| 2½% bonds of 1950–52 | 866,397,200.00 | | 866,397,200.00 | |
| | | | | 22,712,422,150.00 |
| United States Savings Bonds:* | | | | |
| Series A–1935 | 216,231,344.50 | 36,504,204.75 | 179,727,139.75 | |
| Series B–1936 | 383,664,476.25 | 52,871,564.00 | 330,792,912.25 | |
| Series C–1937 | 477,136,177.50 | 41,836,618.00 | 435,299,559.50 | |
| Series C–1938 | 377,899,425.00 | 10,032,018.75 | 367,867,406.25 | |
| Unclassified sale | 55,943,605.16 | | 55,943,605.16 | |
| 3% Adjusted Service Bonds of 1945 | 1,824,687,300.00 | 1,521,745,000.00 | 302,942,300.00 | 1,369,630,622.91 |
| 4½% Adjusted Service Bonds (Government Life Insurance Fund Series 1946) | 500,157,956.40 | | 500,157,956.40 | |
| | | | | *803,100,256.40 |

## EXHIBIT 2—Continued

*Statement of the public debt of the United States, October 31, 1938*—Continued

| Detail | Amount issued | Amount retired | Amount outstanding | | |
|---|---|---|---|---|---|
| **INTEREST-BEARING DEBT** | | | | | |
| Treasury Notes: | | | | | |
| 1¼% Series E–1938 | $433,460,900.00 | $423,957,100.00 | $9,503,800.00 | | |
| 2¼% Series A–1939 | 1,293,714,200.00 | | 1,293,714,200.00 | | |
| 1⅛% Series B–1939 | 526,233,000.00 | 500.00 | 526,232,500.00 | | |
| 1¼% Series C–1939 | 941,613,750.00 | | 941,613,750.00 | | |
| 1⅜% Series D–1939 | 426,554,600.00 | | 426,554,600.00 | | |
| 1⅛% Series A–1940 | 1,378,364,200.00 | | 1,378,364,200.00 | | |
| 1½% Series B–1940 | 738,428,400.00 | | 738,428,400.00 | | |
| 1½% Series C–1940 | 737,161,600.00 | | 737,161,600.00 | | |
| 1½% Series A–1941 | 676,707,600.00 | | 676,707,600.00 | | |
| 1⅛% Series B–1941 | 503,877,500.00 | | 503,877,500.00 | | |
| 1¼% Series C–1941 | 204,425,400.00 | | 204,425,400.00 | | |
| 1¾% Series A–1942 | 426,349,500.00 | | 426,349,500.00 | | |
| 2% Series B–1942 | 342,143,300.00 | | 342,143,300.00 | | |
| 1¾% Series C–1942 | 232,375,200.00 | | 232,375,200.00 | | |
| 1⅛% Series A–1943 | 629,116,900.00 | | 629,116,900.00 | | |
| | | | | $9,066,568,450.00 | |
| 3% Old-Age Reserve Account Series 1941 to 1943 | 798,300,000.00 | | | 798,300,000.00 | |
| 3% Railroad Retirement Account: Series 1942 and 1943 | 87,700,000.00 | 15,000,000.00 | | 72,700,000.00 | |
| 4% Civil Service Retirement Fund: Series 1939 to 1943 | 470,000,000.00 | 6,600,000.00 | | 463,400,000.00 | |
| 4% Foreign Service Retirement Fund: Series 1939 to 1943 | 3,702,000.00 | 130,000.00 | | 3,572,000.00 | |
| 4% Canal Zone Retirement Fund: Series 1940 to 1943 | 4,170,000.00 | 124,000.00 | | 4,046,000.00 | |
| 4% Alaska Railroad Retirement Fund: Series 1941 to 1943 | 522,000.00 | | | 522,000.00 | |
| 2% Postal Savings System Series, maturing June 30, 1940, 1942, and 1943 | 65,000,000.00 | 23,000,000.00 | | 42,000,000.00 | |
| 2% Federal Deposit Insurance Corporation Series, maturing Dec. 1, 1939 and 1942 | 145,000,000.00 | 40,000,000.00 | | 105,000,000.00 | |
| | | | | | $10,556,108,450.00 |
| Certificates of Indebtedness: | | | | | |
| Special: | | | | | |
| 4% Adjusted Service Certificate Fund—Series 1939 | 32,000,000.00 | 8,800,000.00 | | 23,200,000.00 | |
| 2½% Unemployment Trust Fund—Series 1939 | 955,000,000.00 | 19,000,000.00 | | 936,000,000.00 | |
| | | | | | 959,200,000.00 |
| Treasury bills (maturity value): | | | | | |
| Series maturing: | | | | | |
| Nov. 2, 1938 $100,315,000.00 | Dec. 7, 1938 $100,148,000.00 | Jan. 4, 1939 | | $100,125,000.00 | |
| Nov. 9, 1938 100,025,000.00 | Dec. 14, 1938 100,000,000.00 | Jan. 11, 1939 | | 100,041,000.00 | |
| Nov. 16, 1938 100,493,000.00 | Dec. 21, 1938 100,043,000.00 | Jan. 18, 1939 | | 100,029,000.00 | |
| Nov. 23, 1938 100,058,000.00 | Dec. 28, 1938 100,026,000.00 | Jan. 25, 1939 | | 100,467,000.00 | |
| Nov. 30, 1938 100,506,000.00 | | | | | |
| | | | | | 1,302,276,000.00 |
| Total interest-bearing debt outstanding | | | | | 37,899,299,219.31 |

MATURED DEBT ON WHICH INTEREST HAS CEASED

| | | | |
|---|---|---|---|
| Old debt matured—issued prior to Apr. 1, 1917 (Payable on presentation) | | | |
| 2½% Postal Savings Bonds | | 3,211,710.26 | |
| 3½%, 4%, and 4¼% First Liberty Loan of 1932-47 | | 40,720.00 | |
| 4% and 4¼% Second Liberty Loan of 1927-42 | | 13,588,450.00 | |
| 4¼% Third Liberty Loan of 1928 | | 1,305,200.00 | |
| 4¼% Fourth Liberty Loan of 1933-38 | | 2,075,500.00 | |
| 3½% and 4¾% Victory Notes of 1922-23 | | 21,342,700.00 | |
| Treasury Notes, at various interest rates | | 653,300.00 | |
| Certificates of Indebtedness, at various interest rates | | 20,824,200.00 | |
| Treasury Bills | | 4,736,150.00 | |
| Treasury Savings Certificates | | 24,775,000.00 | |
| | | 239,600.00 | |
| Total outstanding matured debt on which interest has ceased | | | 93,542,330.26 |
| DEBT BEARING NO INTEREST | | | |
| Obligations required to be reissued when redeemed: (Payable on presentation) | | | |
| United States Notes | $346,681,016.00 | | |
| Less: Gold Reserve | 156,039,430.93 | | |
| | | 190,641,585.07 | |
| Obligations that will be retired on presentation: | | | |
| Old demand notes | | 53,012.50 | |
| National bank notes and Federal Reserve bank notes assumed by the United States on deposit of lawful money for their retirement | | 236,756,196.50 | |
| Fractional currency | | 1,978,715.78 | |
| Thrift and Treasury Savings Stamps, unclassified sales, etc. | | 3,247,896.14 | |
| Total outstanding debt bearing no interest | | | |
| Total gross debt [b] | | | 432,677,405.99 |
| Matured interest obligations, etc.: | | | |
| Matured interest obligations outstanding | | | 38,425,518,955.56 |
| Discount accrued on Treasury (War) Savings Certificates, matured series | | $54,204,283.94 | |
| Settlement warrant checks outstanding | | 3,503,820.00 | |
| Disbursing officers' checks outstanding and balances in certain checking accounts of governmental agencies | | 514,564.73 | |
| | | 557,344,628.46 | 615,597,297.13 |
| Balance held by the Treasurer of the United States as per daily Treasury Statement for October 31, 1938 | | | 39,041,116,252.69 |
| Deduct: Net excess of disbursements over receipts in reports subsequently received | | 2,569,150,637.94 | |
| | | 6,481,231.43 | 2,562,669,346.51 |
| Net debt, including matured interest obligations, etc.[c] | | | 36,478,446,906.18 |

The computed rate of interest per annum on the interest-bearing debt outstanding is 2.582 percent.
The gross debt per capita, based on an estimated population of 130,534,000, is $294.37.

[a] Amounts issued and retired include accrued discount; amounts outstanding are stated at current redemption values.
[b] The total gross debt, October 31, 1938, on the basis of daily Treasury Statement was $39,423,086,174.84, and the net amount of public debt redemptions and receipts in transit, etc., was $2,432,780.72.
[c] No deduction is made on account of obligations of foreign governments or other investments.

## DETAIL OF OUTSTANDING INTEREST-BEARING ISSUES AS SHOWN ON PAGE 1, OCTOBER 31, 1938

| Title | Authorizing act | Tax exemptions | Rate of interest | Date of issue | Redeemable (on and after) x | Payable | Interest payable |
|---|---|---|---|---|---|---|---|
| **INTEREST-BEARING DEBT** | | | | | | | |
| Bonds: | | | | | | | |
| Panama Canal loan of 1961 | Aug. 5, 1909, Feb. 4, 1910 and Mar. 2, 1911. | (a) | 3% | June 1, 1911 | | June 1, 1961 | Mar. 1, June 2, Sept. 1, Dec. 1. |
| Conversion bonds of 1946-47 | Dec. 23, 1913 | (a) | 3% | Jan. 1, 1916-17 | | 30 years from date of issue. | Jan. 1, Apr. 1, July 1, Oct. 1. |
| Postal Savings bonds (16th to 49th Series). | June 25, 1910 | (a) | 2½% | Jan. 1, July 1, 1919-35. | 1 year from date of issue | 20 years from date of issue. | Jan. 1, July 1. |
| Treasury Bonds: | | | | | | | |
| 4¼% bonds of 1947-52 | Sept. 24, 1917, as amended | (b) | 4¼% | Oct. 16, 1922 | Oct. 15, 1947 | Oct. 15, 1952 | Apr. 15, Oct. 15. |
| 4% bonds of 1944-54 | do | (b) | 4% | Dec. 15, 1924 | Dec. 15, 1944 | Dec. 15, 1954 | June 15, Dec. 15. |
| 3¾% bonds of 1946-56 | do | (b) | 3¾% | Mar. 15, 1926 | Mar. 15, 1946 | Mar. 15, 1956 | Mar. 15, Sept. 15. |
| 3½% bonds of 1943-47 | do | (b) | 3½% | June 15, 1927 | June 15, 1943 | June 15, 1947 | June 15, Dec. 15. |
| 3½% bonds of 1940-43 | do | (b) | 3½% | July 16, 1928 | June 15, 1940 | June 15, 1943 | Do. |
| 3¼% bonds of 1941-43 | do | (b) | 3¼% | Mar. 16, 1931 | Mar. 15, 1941 | Mar. 15, 1943 | Mar. 15, Sept. 15. |
| 3¼% bonds of 1946-49 | do | (b) | 3¼% | June 15, 1931 | June 15, 1946 | June 15, 1949 | June 15, Dec. 15. |
| 3% bonds of 1951-55 | do | (b) | 3% | Sept. 15, 1931 | Sept. 15, 1951 | Sept. 15, 1955 | Mar. 15, Sept. 15. |
| 3¼% bonds of 1941 | do | (b) | 3¼% | Aug. 15, 1933 | | Aug. 1, 1941 | Feb. 1, Aug. 1. |
| 3¼% bonds of 1943-45 | do | (b) | 3¼% | Oct. 15, 1933 | Oct. 15, 1943 | Oct. 15, 1945 | Apr. 15, Oct. 15. |
| 3¼% bonds of 1944-46 | do | (b) | 3¼% | Apr. 16, 1934 | Apr. 15, 1944 | Apr. 15, 1946 | Do. |
| 3% bonds of 1946-48 | do | (b) | 3% | June 15, 1934 | June 15, 1946 | June 15, 1948 | June 15, Dec. 15. |
| 3⅛% bonds of 1949-52 | do | (b) | 3⅛% | Dec. 15, 1934 | Dec. 15, 1949 | Dec. 15, 1952 | Do. |
| 2⅞% bonds of 1955-60 | do | (b) | 2⅞% | Mar. 15, 1935 | Mar. 15, 1955 | Mar. 15, 1960 | Mar. 15, Sept. 15. |
| 2¾% bonds of 1945-47 | do | (b) | 2¾% | Sept. 16, 1935 | Sept. 15, 1945 | Sept. 15, 1947 | Do. |
| 2¾% bonds of 1948-51 | do | (b) | 2¾% | Mar. 16, 1936 | Mar. 15, 1948 | Mar. 15, 1951 | Do. |
| 2¾% bonds of 1951-54 | do | (b) | 2¾% | June 15, 1936 | June 15, 1951 | June 15, 1954 | June 15, Dec. 15. |
| 2¾% bonds of 1956-59 | do | (b) | 2¾% | Sept. 15, 1936 | Sept. 15, 1956 | Sept. 15, 1959 | Mar. 15, Sept. 15. |
| 2½% bonds of 1949-53 | do | (b) | 2½% | Dec. 15, 1936 | Dec. 15, 1949 | Dec. 15, 1953 | June 15, Dec. 15. |
| 2½% bonds of 1945 | do | (b) | 2½% | Dec. 15, 1937 | | Dec. 15, 1945 | Do. |
| 2½% bonds of 1948 | do | (b) | 2½% | Mar. 15, 1938 | | Sept. 15, 1948 | Mar. 15, Sept. 15. |
| 2¼% bonds of 1958-63 | do | (b) | 2¼% | June 15, 1938 | June 15, 1938 | June 15, 1963 | June 15, Dec. 15. |
| 2½% bonds of 1950-52 | do | (b) | 2½% | Sept. 15, 1938 | Sept. 15, 1950 | Sept. 15, 1952 | Mar. 15, Sept. 15. |
| United States Savings Bonds: | | | | | | | |
| Series A-1935 | do | (c) | **2.9% | Various dates from Mar. 1, 1935. | After 60 days from issue date. | 10 years from issue date. | |
| Series B-1936 | do | (c) | **2.9% | Various dates from Jan. 1, 1936. | do | do | |
| Series C-1937 | do | (c) | **2.9% | Various dates from Jan. 1, 1937. | do | do | |
| Series C-1938 | do | (c) | **2.9% | Various dates from Jan. 1, 1938. | do | do | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Adjusted Service Bonds of 1945 | Sept. 24, 1917, as amended, and Adjusted Compensation Payment Act, 1936. | (4) | 3% | June 15, 1936 | On demand at option of holder. | June 15, 1945 | With principal (1) to date of maturity or (2) to date of prior redemption on and after June 15, 1937. |
| Adjusted Service Bonds (Government Life Insurance Fund Series 1946). | do | (5) | 4½% | do | On demand | On or after June 15, 1946. | June 15. |
| Treasury Notes: | | | | | | | |
| Series E-1938 | Sept. 24, 1917, as amended | (6) | 1¼% | Sept. 15, 1937 | | Dec. 15, 1938 | June 15, Dec. 15. |
| Series A-1939 | do | (6) | 2¾% | June 15, 1934 | | June 15, 1939 | Do. |
| Series B-1939 | do | (6) | 1¾% | July 15, 1935 | | Dec. 15, 1939 | Do. |
| Series C-1939 | do | (6) | 1½% | Sept. 16, 1935 | | Mar. 15, 1939 | Mar. 15, Sept. 15. |
| Series D-1939 | do | (6) | 1¾% | June 15, 1937 | | Sept. 15, 1939 | Do. |
| Series A-1940 | do | (6) | 1¾% | Mar. 15, 1935 | | Mar. 15, 1940 | Do. |
| Series B-1940 | do | (6) | 1½% | June 15, 1935 | | June 15, 1940 | June 15, Dec. 15. |
| Series C-1940 | do | (6) | 1½% | Dec. 16, 1935 | | Dec. 15, 1940 | Do. |
| Series A-1941 | do | (6) | 1½% | Mar. 16, 1936 | | Mar. 15, 1941 | Mar. 15, Sept. 15. |
| Series B-1941 | do | (6) | 1¼% | June 15, 1936 | | June 15, 1941 | June 15, Dec. 15. |
| Series C-1941 | do | (6) | 1¼% | Dec. 15, 1936 | | Dec. 15, 1941 | Do. |
| Series A-1942 | do | (6) | 1¼% | June 15, 1937 | | Mar. 15, 1942 | Mar. 15, Sept. 15. |
| Series B-1942 | do | (6) | 2% | Sept. 15, 1937 | | Sept. 15, 1942 | Do. |
| Series C-1942 | do | (6) | 1¾% | Dec. 15, 1937 | | Dec. 15, 1942 | June 15, Dec. 15. |
| Series A-1943 | do | (6) | 1¼% | June 15, 1938 | | June 15, 1943 | Do. |
| Old-Age Reserve Account: Series 1941 to 1943 | do | (4) | 3% | Various dates from Jan. 1, 1937. | After 1 year from date of issue. | June 30, 1941 to 1943. | June 30. |
| Railroad Retirement Account: Series 1942 and 1943 | do | (4) | 3% | Various dates from Aug. 6, 1937. | do | June 30, 1942 and 1943. | Do. |
| Civil Service Retirement Fund: Series 1939 to 1943 | do | (4) | 4% | Various dates from June 30, 1934. | do | June 30, 1939 to 1943. | Do. |
| Foreign Service Retirement Fund: Series 1939 to 1943 | do | (4) | 4% | do | do | do | Do. |
| Canal Zone Retirement Fund: Series 1940 to 1943 | do | (4) | 4% | Various dates from June 30, 1935. | do | June 30, 1940 to 1943. | Do. |
| Alaska Railroad Retirement Fund: Series 1941 to 1943 | do | (4) | 4% | Various dates from Feb. 1, 1937. | do | June 30, 1941 to 1943. | Do. |
| Postal Savings System: Series 1940, 1942, and 1943 | do | (4) | 2% | Various dates from Nov. 5, 1935. | do | June 30, 1930, 1942, and 1943. | June 30, Dec. 31. |
| Federal Deposit Insurance Corporation: Series 1939 and 1942 | do | (4) | 2% | Various dates from | do | Dec. 1, 1939 and | June 1, Dec. 1. |

Footnotes at end of table.

## DETAIL OF OUTSTANDING INTEREST-BEARING ISSUES AS SHOWN ON PAGE 1, OCTOBER 31, 1938—Continued

| Title | Authorizing act | Tax exemptions | Rate of interest | Date of issue | Redeemable (on and after) x | Payable | Interest payable |
|---|---|---|---|---|---|---|---|
| INTEREST-BEARING DEBT | | | | | | | |
| Certificates of Indebtedness: | | | | Dec. 1, 1934. | | 1942. | |
| Special: | | | | | | | |
| Adjusted Service Certificate Fund: | | | | | | | |
| Series 1939 | do | (e) | 4% | Jan. 1, 1938 | On demand | Jan. 1, 1939 | Jan. 1. |
| Unemployment Trust Fund: | | | | | | | |
| Series 1939 | do | (e) | 2½% | June 30, 1938 | do | June 30, 1939 | June 30, Dec. 31. |
| Treasury Bills: | | | | | | | |
| Series maturing: | | | | | | | |
| Nov. 2, 1938 | do | (e) | *.062% | Aug. 3, 1938 | | Nov. 2, 1938 | Nov. 2, 1938. |
| Nov. 9, 1938 | do | (e) | *.044% | Aug. 10, 1938 | | Nov. 9, 1938 | Nov. 9, 1938. |
| Nov. 16, 1938 | do | (e) | *.047% | Aug. 17, 1938 | | Nov. 16, 1938 | Nov. 16, 1938. |
| Nov. 23, 1938 | do | (e) | *.048% | Aug. 24, 1938 | | Nov. 23, 1938 | Nov. 23, 1938. |
| Nov. 30, 1938 | do | (e) | *.047% | Aug. 31, 1938 | | Nov. 30, 1938 | Nov. 30, 1937. |
| Dec. 7, 1938 | do | (e) | *.049% | Sept. 7, 1938 | | Dec. 7, 1938 | Dec. 7, 1938. |
| Dec. 14, 1938 | do | (e) | *.103% | Sept. 14, 1938 | | Dec. 14, 1938 | Dec. 14, 1938. |
| Dec. 21, 1938 | do | (e) | *.106% | Sept. 21, 1938 | | Dec. 21, 1938 | Dec. 21, 1938. |
| Dec. 28, 1938 | do | (e) | *.142% | Sept. 28, 1938 | | Dec. 28, 1938 | Dec. 28, 1938. |
| Jan 4, 1939 | do | (e) | *.032% | Oct. 5, 1938 | | Jan. 4, 1939 | Jan. 4, 1939. |
| Jan. 11, 1939 | do | (e) | *.022% | Oct. 13, 1938 | | Jan. 11, 1939 | Jan. 11, 1939. |
| Jan. 18, 1939 | do | (e) | *.018% | Oct. 19, 1938 | | Jan. 18, 1939 | Jan. 18, 1939. |
| Jan. 25, 1939 | do | (e) | *.026% | Oct. 26, 1938 | | Jan. 25, 1939 | Jan. 25, 1939. |

x Except where otherwise noted.

* Treasury bills are noninterest-bearing and are sold on a discount basis with competitive bids for each issue. The average sale price of these series gives an approximate yield on a bank discount basis as above indicated.

** Approximate yield if held to maturity.

Tax Exemptions:

(e) Exempt from the payment of all taxes or duties of the United States, as well as from all taxation in any form by or under State, municipal, or local authority. (The Supreme Court has held that this exemption does not extend to estate or inheritance taxes imposed by Federal or State authority.)

(b) Exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of bonds authorized by the act approved Sept. 24, 1917, as amended, the principal of which does not exceed in the aggregate $5,000, owned by any individual, partnership, association, or corporation, shall be exempt from the taxes provided for in clause (b) above.

(d) Exempt, both as to principal and interest, from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority.

(c) Exempt, both as to principal and interest, from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority; and the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest within the meaning referred to herein.

Any gain from the sale or other disposition of Treasury bills shall be exempt from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority; and no loss from the sale or other disposition of such Treasury bills shall be allowed as a deduction, or otherwise recognized, for the purposes of any tax now or hereafter imposed by the United States or any of its possessions.

*In hands of foreign holders.*—Bonds, notes, and certificates of indebtedness of the United States, shall, while beneficially owned by a nonresident alien individual, or a foreign corporation, partnership, or association, not engaged in business in the United States, be exempt both as to principal and interest from any and all taxation now or here-

(*) Exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (*a*) estate or inheritance taxes, and (*b*) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of bonds authorized by the act approved Sept. 24, 1917, as amended, the principal of which does not exceed in the aggregate $5,000, owned by any individual, partnership, association, or corporation, shall be exempt from the taxes provided for in clause (*b*) above. For the purposes of determining taxes and tax exemptions, the increment in value of savings bonds represented by the difference between the price paid and the redemption value received (whether at or before maturity) shall be considered as interest.

Attention is invited to Treasury Decision 4550 ruling that bonds, notes, bills, and certificates of indebtedness of the Federal Government or its agencies, and the interest thereon, are not exempt from the gift tax imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority.

Receivability in Payment of Certain Taxes:

*Federal estate or inheritance taxes.*—Treasury bonds and Treasury notes, bearing interest at a higher rate than 4 per centum per annum, which have been owned by any person continually for at least 6 months prior to the date of his death and which upon such date constitute part of his estate are receivable by the United States at par and accrued interest in payment of Federal estate taxes.

*Federal income and profits taxes.*—Treasury notes, Treasury certificates of indebtedness, and Treasury bills, maturing on tax-payment dates, are receivable at par in payment of income and profits taxes payable at the maturity of the notes, certificates, or bills.

## CONTINGENT LIABILITIES OF THE UNITED STATES, OCTOBER 31, 1938

COMPILED FROM LATEST REPORTS RECEIVED BY THE TREASURY

| Detail | Authorizing act | Amount of contingent liability | | | |
|---|---|---|---|---|---|
| | | Principal | Interest [1] | Total | |
| **Guaranteed by the United States:** | | | | | |
| Commodity Credit Corporation: | | | | | |
| ¾% notes, Series C, 1939 | Mar. 8, 1938 | $206,174,000.00 | $775,277.14 | | $206,949,277.14 |
| Federal Farm Mortgage Corporation: | | | | | |
| 3% bonds of 1944–49 | Jan. 31, 1934, as amended | 847,425,600.00 | 11,722,720.80 | $859,148,320.80 | |
| 3¼% bonds of 1944–64 | do | 98,028,600.00 | 407,090.99 | 98,435,690.99 | |
| 3% bonds of 1942–47 | do | 235,476,200.00 | 2,088,873.10 | 238,565,073.10 | |
| 2¾% bonds of 1942–47 | do | 103,147,500.00 | 472,759.38 | 103,620,259.38 | |
| 1½% bonds of 1939 | do | 100,122,000.00 | 250,305.00 | 100,372,305.00 | |
| 1¼% bonds of 1939 | do | 9,900,000.00 | 61,875.00 | 9,961,875.00 | |
| | | [2] 1,395,099,900.00 | 15,003,624.27 | | 1,410,103,524.2 |
| Federal Housing Administration: | | | | | |
| 3% debentures | June 27, 1934, as amended | 640,773.41 | 6,437.66 | 647,211.07 | |
| 2¾% debentures | do | 449,450.00 | 4,079.07 | 453,529.07 | |
| | | 1,090,223.41 | 10,516.73 | | 1,100,740.14 |
| Home Owners' Loan Corporation: | | | | | |
| 3% bonds, Series A, 1944–52 | June 13, 1933, as amended | 792,004,550.00 | 70,500.37 | 792,075,050.37 | |
| 2¾% bonds, Series B, 1939–49 | do | 965,462,875.00 | 6,637,555.53 | 972,100,430.53 | |
| 1½% bonds, Series F, 1939 | do | 325,254,750.00 | 2,032,842.19 | 327,287,592.19 | |
| 2¼% bonds, Series G, 1942–44 | do | 804,914,025.00 | 6,036,855.19 | 810,950,880.19 | |
| | | [3] 2,887,636,200.00 | 14,777,753.28 | | [4] 2,902,413,953.28 |
| Reconstruction Finance Corporation: | | | | | |
| 1½% notes, Series K | Jan. 22, 1932, as amended | 299,072,666.67 | 1,703,733.63 | 300,776,400.30 | |
| ⅞% notes, Series N | do | 211,460,000.00 | 522,903.80 | 211,982,903.80 | |
| | | 510,532,666.67 | 2,226,637.43 | | [5] 512,759,304.10 |
| Tennessee Valley Authority | May 18, 1933, as amended | | | | |
| United States Housing Authority | Sept. 1, 1937, as amended | (6) | | | |
| United States Maritime Commission | June 29, 1936, as amended | | | | |
| Total, based on guarantees | | | | | 5,033,326,798.93 |
| **On credit of the United States:** | | | | | |
| Secretary of Agriculture | May 12, 1933 | | | | |
| Postal Savings System: | | | | | |
| Funds due depositors | June 25, 1910, as amended | 1,252,475,339.90 | 33,979,563.98 | | [7] 1,286,454,903.88 |
| Tennessee Valley Authority | May 18, 1933, as amended | [8] 2,000,000.00 | 8,356.16 | | 2,008,356.16 |
| Total, based on credit of the United States | | | | | 1,288,463,260.04 |

| | | | | | |
|---|---|---|---|---|---|
| Other obligations: | | | | | |
| Federal Reserve notes (face amount) | Dec. 23, 1913, as amended | | | | [9] 4,306,329,338.26 |

[1] After deducting amounts of funds deposited with the Treasurer of the United States to meet interest payments.
[2] Includes only bonds issued and outstanding.
[3] Includes only unmatured bonds issued and outstanding. Funds have been deposited with the Treasurer of the United States for payment of matured bonds which have not been presented for redemption.
[4] Does not include $10,000,000 face amount of Series bonds and accrued interest thereon, held by the Treasury and reflected in the public debt.
[5] Does not include $665,945,431.04 face amount of notes and accrued interest thereon, held by the Treasury and reflected in the public debt.
[6] Notes in the face amount of $9,000,000 are held by the Treasury and reflected in the public debt.
[7] Figures as of August 31, 1938—figures as of October 31, 1938, are not available. Offset by cash in designated depository banks and the accrued interest amounting to $99,621,042.96, which is secured by the pledge of collateral as provided in the Regulations of the Postal Savings System, having a face value of $100,276,708.29, cash in possession of System amounting to $68,083,173.60, Government and Government-guaranteed securities with a face value of $1,105,354,950 held as investments, and other assets.
[8] Held by the Reconstruction Finance Corporation.
[9] In actual circulation, exclusive of $8,812,256.74 redemption fund deposited in the Treasury and $271,175,115 of their own Federal Reserve notes held by the issuing banks. The collateral security for Federal Reserve notes issued consists of $4,668,000,000 in gold certificates and in credits with the Treasurer of the United States payable in gold certificates, and $6,488,000 face amount of commercial paper.

## Detail of Contingent Liabilities as Shown Above, October 31, 1938

| Title— | Extent of guaranty by the United States | Tax exemptions | Rate of interest | Date of issue | Redeemable (on and after) | Payable | Interest payable |
|---|---|---|---|---|---|---|---|
| Guaranteed by the United States: | | | | | | | |
| Commodity Credit Corporation: | | | | | | | |
| ¾% notes, Series C, 1939 | Principal and interest | (a) | ¾% | May 2, 1938 | | Nov. 2, 1939 | May 2, Nov. 2. |
| Federal Farm Mortgage Corporation: | | | | | | | |
| 3% bonds of 1944–49 | do | (a) | 3% | May 15, 1934 | May 15, 1944 | May 15, 1949 | May 15, Nov. 15. |
| 3¼% bonds of 1944–64 | do | (a) | 3¼% | Mar. 15, 1934 | Mar. 15, 1944 | Mar. 15, 1964 | Mar. 15, Sept 15. |
| 3% bonds of 1942–47 | do | (a) | 3% | Jan. 15, 1935 | Jan. 15, 1942 | Jan. 15, 1947 | Jan. 15, July 15 |
| 2¾% bonds of 1942–47 | do | (a) | 2¾% | Mar. 1, 1935 | Mar. 1, 1942 | Mar. 1, 1947 | Mar. 1, Sept. 1. |
| 1½% bonds of 1939 | do | (a) | 1½% | Sept. 3, 1935 | | Sept. 1, 1939 | Do. |
| 1¼% bonds of 1939 | do | (a) | 1¼% | Nov. 1, 1937 | | Nov. 1, 1939 | May 1, Nov. 1. |
| Federal Housing Administration: | | | | | | | |
| 3% debentures | do | (b) | 3% | Various | | Various | Jan. 1, July 1. |
| 2¾% debentures | do | (c) | 2¾% | do | | do | Do |
| Home Owners' Loan Corporation: | | | | | | | |
| 3% bonds, Series A, 1944–52 | do | (c) | 3% | May 1, 1934 | May 1, 1944 | May 1, 1952 | May 1, Nov. 1. |
| 2¾% bonds, Series B, 1939–49 | do | (c) | 2¾% | Aug. 1, 1934 | Aug. 1, 1939 | Aug. 1, 1949 | Feb. 1, Aug. 1. |
| 1½% bonds, Series F, 1939 | do | (c) | 1½% | June 1, 1935 | | June 1, 1939 | June 1, Dec. 1. |
| 2¼% bonds, Series G, 1942–44 | do | (c) | 2¼% | July 1, 1935 | July 1, 1942 | July 1, 1944 | Jan. 1, July 1. |
| Reconstruction Finance Corporation: | | | | | | | |
| 1½% notes, Series K | do | (d) | 1½% | Various | | Dec. 15, 1938 | June 15, Dec. 15. |
| ¾% notes, Series N | do | (d) | ¾% | July 20, 1938 | | July 20, 1941 | Jan. 20, July 20. |
| Tennessee Valley Authority | (1) | | | | | | |
| United States Housing Authority | (2) | | | | | | |
| United States Maritime Commission | (3) | | | | | | |
| On credit of the United States: | | | | | | | |
| Secretary of Agriculture | (4) | | | | | | |
| Postal Savings System | (5) | | 2% | Date of deposit | | On demand | Quarterly from first day of month next following the date of deposit. |
| Tennessee Valley Authority: | | | | | | | |
| 2½% bonds, Series A, 1943 | (6) | (e) | 2½% | Sept. 1, 1938 | | Sept. 1, 1943 | Mar. 1, Sept. 1. |
| Other Obligations: | | | | | | | |
| Federal Reserve notes | (7) | | | | | | |

[1] The Tennessee Valley Authority is authorized and empowered to issue bonds not exceeding $50,000,000 in amount outstanding at any one time, having a maturity not more than 50 years from date of issue thereof, and bearing interest not exceeding 3½ percent per annum. Such bonds shall be fully and unconditionally guaranteed both as to principal and interest by the United States.

[2] The United States Housing Authority is authorized to issue obligations, in the form of notes, bonds, or otherwise, in an amount not to exceed $800,000,000, which shall be in such forms and denominations, mature within such periods not exceeding 60 years from

[a] Bonds and the income derived therefrom exempt from Federal, State, municipal, and local taxation (except surtaxes, estate, inheritance, and gift taxes).

[b] The National Housing Act as amended by the National Housing Act Amendments of 1938, approved February 3, 1938, reads in part as follows: "Such debentures as are issued in exchange for property covered by mortgages insured under section 203 or section 207 prior to the date of enactment of the National Housing Act Amendments of 1938 shall be subject only to such Federal, State, and local taxes as the mortgages in exchange for which they are issued would be subject to in the hands of the holder of the debentures. * * *

date of issue, bear such rates of interest not exceeding 4 percent per annum, be subject to such terms and conditions, and be issued in such manner and sold at such prices as may be prescribed by the Authority with the approval of the Secretary of the Treasury. Such obligations shall be fully and unconditionally guaranteed upon their face by the United States as to the payment of both principal and interest.

[3] Debentures authorized to be issued by the United States Maritime Commission under the Merchant Marine Act, 1936, as amended, shall be fully and unconditionally guaranteed as to principal and interest by the United States.

[4] The Secretary of Agriculture is authorized pursuant to act of May 12, 1933, to borrow money upon all cotton in his possession or control and deposit as collateral for such loans warehouse receipts for such cotton.

[5] The faith of the United States is solemnly pledged to the payment of the deposits made in Postal Savings depository offices, with accrued interest thereon.

[6] The Tennessee Valley Authority is authorized and empowered to issue on the credit of the United States serial bonds not exceeding $50,000,000 in amount, having a maturity not more than 50 years from the date of issue thereof, and bearing interest not exceeding 3½ percent per annum.

[7] Federal Reserve notes are obligations of the United States and shall be receivable by all national and member banks and Federal Reserve banks and for all taxes, customs, and other public dues. They are redeemable in lawful money on demand at the Treasury Department, in the city of Washington, District of Columbia, or at any Federal Reserve bank.

**Tax Exemptions:**

Such debentures as are issued in exchange for property covered by mortgages insured after the date of enactment of the National Housing Act Amendments of 1938 shall be exempt, both 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."

[8] Exempt, both as to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any District, Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority.

[9] Exempt, both 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.

[10] Bonds issued by the Tennessee Valley Authority on the credit of the United States as provided in the Tennessee Valley Authority Act of 1933, as amended, shall have all the rights and privileges accorded by law to Panama Canal bonds authorized by section 8 of the act of June 28, 1902, chapter 1302, as amended by the act of December 21, 1905 (ch. 3, sec. 1, 34 Stat. 5), as now compiled in section 743 of title 31 of the United States Code.

# SECURITIES OWNED BY THE UNITED STATES GOVERNMENT

## COMPILED FROM LATEST REPORTS RECEIVED BY THE TREASURY, OCTOBER 31, 1938

**Foreign Obligations:**

**Funded Indebtedness:**

Under the debt-funding agreements as authorized by acts of Congress and Moratorium agreements as authorized by the Act of Congress approved Dec. 23, 1931:

| | *Principal amount held* | | *Principal amount held* |
|---|---|---|---|
| Belgium | $400,680,000.00 | Hungary [b] | $1,908,560.00 |
| Czechoslovakia [a] | 91,879,671.03 | Italy | 2,004,900,000.00 |
| Estonia [b] | 16,466,012.87 | Latvia [b] | 6,879,464.20 |
| Finland | 8,195,841.19 | Lithuania [b] | 6,197,682.00 |
| France | 3,863,650,000.00 | Poland [b] | 206,057,000.00 |
| Germany (Austrian indebtedness) [a] | 25,980,480.66 | Rumania [d] | 63,860,560.43 |
| Great Britain | 4,368,000,000.00 | Yugoslavia | 61,625,000.00 |
| Greece | 31,516,000.00 | | |

$11,157,796,272.38

**Unfunded Indebtedness:**

Represented by obligations received for (1) cash advances made under authority of acts of Congress approved Apr. 24, 1917, and Sept. 24, 1917, as amended; (2) surplus war supplies sold on credit by Secretary of War under authority of acts of Congress approved July 9, 1918, and June 5, 1920; (3) relief supplies sold on credit by American Relief Administration under authority of act of Congress approved Feb. 25, 1919; and (4) relief supplies sold on credit by United States Grain Corporation under authority of act of Congress approved Mar. 30, 1920:

| | *Principal amount held* |
|---|---|
| Armenia | $11,959,917.49 |
| Nicaragua | (c) |
| Russia | 192,601,297.37 |

204,561,214.86

**German Bonds:**

For account of reimbursements of the costs of the United States Army of Occupation and the awards of the Mixed Claims Commission, under the funding agreement of June 23, 1930, as authorized by the act of Congress approved June 5, 1930 (bonds are in Reichsmarks, which for the purpose of this statement are converted at 40.33 cents to the Reichsmark):

| | | | |
|---|---|---|---|
| Army costs | | RM997,500,000 | $402,291,750.00 |
| Mixed claims [f] | RM2,040,000,000 | | |
| Private awards (estimated) | 1,415,000,000 | | |
| Government awards (estimated) | | 625,000,000 | 252,062,500.00 |
| | | RM1,622,500,000 | 654,354,250.00 |

Total foreign obligations $12,016,711,737.24

**Capital Stock of War Emergency Corporations:** [e]

| | | | |
|---|---|---|---|
| Capital stock of the United States Housing Corporation, issued | | | $70,000,000.00 |
| Less: amount retired | | $3,500,000.00 | |
| Cash deposited in Treasury on account of repayments on capital stock | | 32,321,070.87 | 35,821,070.87 |
| Capital stock of the United States Spruce Production Corporation | | | $34,178,929.13 |
| War Finance Corporation (in liquidation): | | | 100,000.00 |
| Capital stock outstanding | | | 1,000.00 |
| Total | | | 34,279,929.13 |

| | | | |
|---|---|---|---|
| Capital Stock, etc., of Other Governmental Corporations and Credit Agencies:[a] | | | |
| Capital stock of the Panama Railroad Co. | | | $7,000,000.00 |
| Capital stock of the Inland Waterways Corporation (acquired pursuant to the act approved June 3, 1924, as amended by act of May 29, 1928) | | | 12,000,000.00 |
| Reconstruction Finance Corporation: | | | |
| Capital stock | $500,000,000.00 | | |
| Notes, Series "O" | 665,945,431.04 | | |
| | | $1,165,945,431.04 | |
| Less: | | | |
| Funds expended for subscriptions to capital stock of other governmental corporations shown on this statement | 56,000,000.00 | | |
| Funds disbursed to other governmental agencies for making loans shown in this statement | 42,844,482.07 | | |
| | | 98,844,482.07 | |
| Capital stock of The RFC Mortgage Company acquired under the provisions of Sec. 5c of the Reconstruction Finance Corporation Act, approved Jan. 22, 1932, as amended[c] | | | 1,067,100,948.97 |
| Capital stock and paid-in surplus of the Federal National Mortgage Association purchased by the Reconstruction Finance Corporation[d] | | | 25,000,000.00 |
| Home Owners' Loan Corporation Series "J" Bonds, issued under provisions of Sec. 4 (c) of the Home Owners' Loan Act of June 13, 1933, as amended | | | 11,000,000.00 |
| Capital stock of the Home Owners' Loan Corporation, Home Owners' Loan Act of 1933, approved June 13, 1933, as amended | | | 10,000,000.00 |
| Less: Funds expended for subscriptions to capital stock of Federal Savings and Loan Insurance Corporation | $200,000,000.00 | | |
| | 100,000,000.00 | | |
| Capital stock of the Federal Savings and Loan Insurance Corporation, National Housing Act, approved June 27, 1934[e] | | | 100,000,000.00 |
| Capital stock of the Regional Agricultural Credit Corporations, Emergency Relief and Construction Act of 1932, approved July 21, 1932, as amended | | | 100,000,000.00 |
| Capital stock of Federal Home Loan Banks, act of July 22, 1932, as amended | | | 5,000,000.00 |
| Capital stock of the U. S. Housing Authority issued under Public, No. 412, dated Sept. 1, 1937 | | | 124,741,600.00 |
| U. S. Housing Authority Series "A" Notes, issued under provisions of Sec. 20 (d) of Public, No. 412, dated Sept. 1, 1937 | | | 1,000,000.00 |
| Capital Stock of the Federal Crop Insurance Corporation issued under provisions of Sec. 504 (a) of Public, No. 430, approved Feb. 16, 1938 | | | 9,000,000.00 |
| Capital stock of the Federal Farm Mortgage Corporation, Federal Farm Mortgage Corporation Act, approved Jan. 31, 1934, as amended | | | 5,000,000.00 |
| Capital stock of the Export-Import Bank of Washington, Executive order of Feb. 2, 1934, issued under authority of the National Industrial Recovery Act, approved June 16, 1922, as amended[b] | | | 200,000,000.00 |
| Capital stock of the Disaster Loan Corporation issued under authority of Public, No. 5, dated Feb. 11, 1937 | | | 21,000,000.00 |
| Capital stock of Production Credit Corporations acquired under the provisions of Sec. 4 of the Farm Credit Act of 1933, approved June 16, 1933, as amended | | | 10,000,000.00 |
| Capital stock of the Commodity Credit Corporation, Executive order of Oct. 16, 1933, issued under authority of the National Industrial Recovery Act approved June 16, 1933, as amended, and Public, No. 489, dated Apr. 10, 1936 | | | 120,000,000.00 |
| Capital stock of Electric Home and Farm Authority, Executive order dated Aug. 12, 1935, issued under authority of National Industrial Recovery Act, approved June 16, 1933, as amended | | | 100,000,000.00 |
| Capital stock of the Federal Deposit Insurance Corporation, Banking Act of 1933, approved June 16, 1933, as amended | | | 850,000.00 |
| Capital stock (preferred and full-paid income shares) of Federal Savings and Loan Associations, Home Owners' Loan Act of 1933, approved June 13, 1933, as amended | | | 150,000,000.00 |
| Capital stock of the Tennessee Valley Associated Cooperatives, Inc. | | | 47,053,200.00 |
| Capital stock of Federal Subsistence Homesteads Corporation, Executive order of July 21, 1933, issued under authority of the National Industrial Recovery Act, approved June 16, 1933, as amended | | | 1,000.00 |
| Capital stock of Federal Land Banks, Federal Farm Loan Act, approved July 17, 1916, as amended | | | 10,000.00 |
| Subscriptions to paid-in surplus of Federal Land Banks, Federal Farm Loan Act approved July 17, 1916, as amended | | | 124,960,250.00 |
| Capital stock of Federal Intermediate Credit Banks acquired pursuant to the Federal Farm Loan Act, approved July 17, 1916, as amended | | | 182,159,658.73 |
| Subscriptions to paid-in surplus of Federal Intermediate Credit Banks, pursuant to the Federal Farm Loan Act, approved July 17, 1916, as amended | | | 70,000,000.00 |
| | | | 30,000,000.00 |

Footnotes at end of table.

## SECURITIES OWNED BY THE UNITED STATES GOVERNMENT—Continued

### COMPILED FROM LATEST REPORTS RECEIVED BY THE TREASURY, OCTOBER 31, 1938—Continued

| | | |
|---|---|---|
| Capital Stock of War Emergency Corporations—Continued. | | |
| Capital stock of Central Bank for Cooperatives acquired under the provisions of Sec. 33 of the Farm Credit Act of 1933, approved June 16, 1933, as amended | $50,000,000.00 | |
| Capital stock of Banks for Cooperatives acquired under the provisions of Sec. 40 of the Farm Credit Act of 1933, approved June 16, 1933, as amended | 99,000,000.00 | |
| Total | | $2,681,876,057.70 |
| Other Obligations and Securities: | | |
| Obligations of Carriers acquired pursuant to Sec. 207 of the Transportation Act, approved Feb. 28, 1920, as amended | $5,007,000.00 | |
| Obligations of Carriers acquired pursuant to Sec. 210 of the Transportation Act, approved Feb. 28, 1920, as amended | 25,223,232.55 | |
| Obligations acquired by the Federal Emergency Administration of Public Works | 38,761,117.46 | |
| Notes received by the Farm Credit Administration evidencing outstanding advances made from the Revolving Fund created by the Agricultural Marketing Act | 98,024,636.43 | |
| Securities received from the Reconstruction Finance Corporation under provisions of Public, No. 432, dated Feb. 24, 1938 | 2,707,400.00 | |
| Securities received by the Secretary of the Navy on account of sales of surplus property | 4,635,766.22 | |
| Securities received by the United States Maritime Commission on account of sales of ships, etc | 61,054,190.32 | |
| Obligations of farmers for seed, feed, and drought relief loans made in pursuance of various acts from 1921 to 1938 | 142,229,339.42 | |
| Obligations of farmers for crop production loans made in pursuance of Sec. 2 of the act approved Jan. 22, 1932, as amended | 32,345,046.25 | |
| Obligations of Joint Stock Land Banks in pursuance of Sec. 30 (a) of the Emergency Farm Mortgage Act of 1933, approved May 12, 1933, as amended | 45,995.52 | |
| Securities received by the Farm Security Administration | 177,079,721.41 | |
| Securities received by the Rural Electrification Administration | 75,678,623.73 | |
| Securities received by the Puerto Rico Reconstruction Administration | 4,492,142.09 | |
| Securities received by the Secretary of Interior, Loans to Indians | 2,132,850.90 | |
| Total | | 669,467,068.30 |
| Grand total | | $15,402,334,792.39 |

### MEMORANDUM

| | |
|---|---|
| Amount due the United States from the Central Branch Union Pacific Railroad on account of bonds issued (Pacific Railroad Aid Bonds acts approved July 1, 1862, July 2, 1864, and May 7, 1878): | |
| Principal | $1,600,000.00 |
| Interest | 1,645,889.99 |
| Total | $3,245,889.99 |

NOTE.—This statement is made on the basis of the face value of the securities therein described as received by the United States, with due allowance for repayments. To the extent that the securities are not held in the custody of the Treasury, the statement is made up from reports received from other Government departments and establishments.

[a] Indebtedness of Czechoslovakia has been funded under the agreement of Oct. 13, 1925, but the original obligations have not been exchanged for the new bonds of that Government.

[b] Differences between principal here stated and face amount of obligations provided for in funding agreements represent deferred payments for which, under the funding agreements, gold bonds of the respective debtor governments have been or will be delivered to the Treasury.

[c] The German Government has been notified that the Government of the United States will look to the German Government for the discharge of this indebtedness of the Government of Austria to the Government of the United States.

[d] Original amount ($66,560,560.43) included bonds aggregating $21,970,560.43 representing interest accruing and remaining unpaid during first 14 years, payment of which under the Funding Agreement is extended over the last 48 years.

[e] The United States holds obligations in the principal amount of $289,898.78, which, together with accrued interest thereon, are to be canceled pursuant to agreement of Apr. 14, 1938, between the United States and the Republic of Nicaragua, ratified by the U. S. Senate on June 13, 1938.

[f] Division of German bonds between private awards and Government awards is an estimate based upon best information available at this time. When Mixed Claims Commission has completed its duties, a more accurate division may be made. Awards generally bear interest at 5 percent per annum. Bonds do not bear interest, but the aggregate face amount thereof will be sufficient to cover payment of the principal and interest due on the total awards finally entered by the Mixed Claims Commission. Bonds for private awards are held in trust, the proceeds thereof when received at maturity to be distributed by the Treasury to the claimants. Bonds mature on Mar. 31 and Sept. 30 of each year in the principal amount of RM20,400,000 each. No payments are to be made on Government awards until all private awards are paid in full.

[g] Cash on deposit with the Treasurer of the United States to the credit of all war emergency corporations having such deposits amounted to $584,177.67.

[h] Cash on deposit with the Treasurer of the United States to the credit of corporations included in this group having such deposits amounted to $188,410,239 14.

[i] Reconstruction Finance Corporation funds.

[j] Home Owners' Loan Corporation funds made available for capital stock subscriptions.

[k] Reconstruction Finance Corporation funds amounting to $20,000,000, and appropriated funds amounting to $1,000,000, set aside for capital stock subscriptions.

[l] Includes Reconstruction Finance Corporation funds amounting to $42,844,482.07.

## STATEMENT OF HENRY C. MURPHY, PRINCIPAL ECONOMIC ANALYST, TREASURY DEPARTMENT

Mr. MURPHY. The chart (exhibit 1) has two banks or sets of bars. The upper bank divides the total amount of tax-exempt securities outstanding by classes of securities, each bar being in turn subdivided by class of holder. The lower bank divides the amount of tax-exempt securities outstanding by classes of holders, each bar being in turn subdivided by class of security.

The estimates with respect to classes of holders other than individuals are subject to a small margin of error. The estimates with respect to individuals are obtained by subtracting the aggregate amounts held by the other classes of holders from the total amounts outstanding. The term "individuals" as used in the chart, includes fiduciaries and trusts.

At the point in Mr. Hanes' testimony where he introduced the chart, reference was made to the fact that more tax-exempt securities are outstanding than can be absorbed by individuals subject to high surtaxes. This is clearly shown by the chart. For example, commercial and private banks derive very little benefit from the tax-exemption privilege, and yet they hold almost as many tax-exempt securities as individuals.

Senator LOGAN. Can you tell us offhand the difference between the quantity of revenue that would be produced by the local and State securities as against those which are Federal?

Mr. MURPHY. Our revenue estimates, I believe, are broken down into the amount that would be derived by taxing State and local securities and the amount that would be derived by taxing Federal securities. I believe Dr. O'Donnell can give you this break-down.

Senator LOGAN. I think it would be well to have it stated in round numbers.

## STATEMENT OF DR. AL F. O'DONNELL, ASSISTANT DIRECTOR OF RESEARCH AND STATISTICS, TREASURY DEPARTMENT

Mr. O'DONNELL. You will recall, Senator Logan, that the Under Secretary presented a range of estimates of from $179,000,000 to $337,000,000 increase in income-tax receipts of the Federal Government in years following the refunding of all of the tax-exempt securities now outstanding, assuming that no future governmental issues of securities will contain the tax-exempt privilege.

Estimates of this character are presented in terms of a range rather than as one figure not only because business conditions will vary from year to year and therefore the effective rate of tax will vary, but also because of different assumptions as to the ownership of the taxable governmental debt at that time. Among the many assumptions which must be made, one important one is that relating to the increased yield which individuals with large incomes will achieve by investing in industrial enterprises instead of in tax-exempt securities as at present. A further assumption must be made as to the extent to which these taxpayers invest in such enterprises instead of in the new governmental securities which it is assumed will be issued to refund the present tax-exempt issues.

The $179,000,000 estimate combines all of the conservative assumptions and the $337,000,000 estimate combines the liberal assumptions as to the increased income-tax receipts which the Federal Government might expect to receive. Seventy-two million dollars of the $179,000,000 conservative estimate is expected to be derived from taxing the income from the securities of the Federal Government and its instrumentalities which are now tax-exempt, and $107,000,000 is expected to be yielded by taxing under the Federal income-tax laws income from the State and local governmental securities. The estimate of $337,000,000 may be correspondingly broken down into an estimate of $139,000,000 from taxing the income received from Federal securities and $198,000,000 from taxing the income received from State and local governmental securities. Of the $337,000,000 estimate, $69,000,000 are expected to come from corporations and $268,000,000 from individuals. Of the $179,000,000 estimate, corporation income taxes are expected to be increased by $48,000,000 while those of individuals will be increased by $131,000,000.

Senator AUSTIN. Have you figures corresponding to that with respect to salaries and income?

Mr. O'DONNELL. The Federal Government now taxes the salaries of Federal employees so that no additional revenue will accrue from that source. The $16,000,000 estimate which the Under Secretary gave you was the amount of Federal income tax expected to be realized from taxing State and local salaries on which Federal income tax is not now being paid.

We have no knowledge of how much the respective States under the existing State income-tax laws would derive by virtue of their ability to tax the salaries of Federal employees.

Senator LOGAN. It might depend upon the rate?

Mr. O'DONNELL. Depending upon the rate, and what jurisdiction each State would have over the Federal salary of any particular person.

The CHAIRMAN. Have you made a further break-down as to the ratio between Federal and State employees with respect to the recent decision in the *New York-New Jersey case* as to what income you would derive if you taxed all classes of State and municipal officers and employees whom you may tax under the authority of that recent decision?

Mr. O'DONNELL. There is some dispute about that. We just do not know who would be covered. That is a matter of controversy.

The CHAIRMAN. Do you have any further questions, Senator Logan?

Senator LOGAN. I do not care to ask anything now, but I assume that Mr. Hanes will be available if we desire to obtain additional information. I would like to study his statement, and, if there is anything I do not understand, I would like to ask if he can reappear.

Mr. HANES. That is entirely satisfactory. I can appear at any time.

The CHAIRMAN. Is there anyone else from the Treasury that you desire to have heard now?

Mr. HANES. I believe not. We are available at all times.

The CHAIRMAN. It is the plan of the committee that we should now hear from the Assistant Attorney General, Mr. James W. Morris, who has made a legal study respecting this question.

I think that it would be very well that the representatives of the Treasury Department be here while he testifies.

Mr. HANES. I asked that the Chief Counsel of the Bureau of Internal Revenue be here to make a statement, and he is desirous of being heard.

Mr. WENCHEL. It would be satisfactory to me for Mr. Morris to complete his statement.

The CHAIRMAN. We will now hear the statement of Mr. James W. Morris, Assistant Attorney General, who has made an exhaustive investigation of this question from a legal standpoint.

Before Mr. Morris begins his statement, I will state that the committee is agreeable to hearing from those who are in opposition on February 7, 1939, at 10 o'clock. It is our desire to hear the arguments to be presented by the Treasury Department and the Department of Justice and at the conclusion of that testimony we will adjourn to February 7 at 10 o'clock. So, I might say, if it is satisfactory to the committee, that we will try to finish this afternoon, and then we will adjourn until February 7 at 10 o'clock.

We will now hear from Mr. James W. Morris, Assistant Attorney General.

## STATEMENT OF HON. JAMES W. MORRIS, ASSISTANT ATTORNEY GENERAL

Mr. MORRIS. Mr. Chairman and members of the committee: Shortly after the President's message to Congress of April 25, 1938, the Department of Justice was requested by the Treasury Department to undertake to bring together for the convenience of the appropriate committees of the Congress, all relevant data on the legal problems affecting the legislation proposed in that message. This study was concluded and a report, together with six volumes of an appendix, transmitted to the Treasury Department on June 24, 1938. Copies of the study and appendix have also been furnished to this committee, to the Senate Finance Committee, the Ways and Means Committee of the House of Representatives, the Joint Committee on Taxation, and to several libraries. Printed copies of the study, without the appendix, have been rather generally distributed to those interested.

The legislation recommended by the President (1) would subject to the Federal income tax the interest paid on future issues of Federal, State, and municipal bonds, and the salaries of State and municipal officers and employees; and (2) would permit State taxation of the interest on future issues of Federal bonds and the salaries of Federal officers and employees within their taxing jurisdiction.

The study falls into two parts, the first relating to the decisions of the Supreme Court which bear on the pertinent tax immunity problems, irrespective of the sixteenth amendment, and the second exploring the interpretation of that amendment. I shall not, of course, undertake here to discuss these problems with the detail and particularity with which they are examined in the study. I can only hope to point out the various arguments which may be drawn from that study which seem to justify the enactment of the proposed legislation, and which should be urged upon the courts in any judicial examination of such legislation.

Quite apart, then, from the meaning and effect of the sixteenth amendment, it may be well to trace from its origin the doctrine of intergovernmental tax immunity. That doctrine stems from *McCulloch* v. *Maryland*. It was fashioned in order to protect an important Federal policy from complete frustration at the hands of dissident States. The Bank of the United States was established in 1816. Within 3 years eight States had enacted laws designed to penalize the bank or expel its branches from their territory. The State of Maryland enacted legislation which provided that if any bank established a branch office in the State without State authority (obviously aimed only at the Bank of the United States) it must issue notes only in specified denominations and only on stamped paper to be purchased at prescribed rates from the treasurer of the western shore; alternatively, the branch office could gain exemption from these requirements by the payment in advance of $15,000 a year. In an action against the cashier, the State court rendered judgment for the statutory penalties.

When the matter came before the Supreme Court, a distinguished array of counsel presented the cause. No one questioned Webster's emphatic insistence that the bank could be destroyed if the State were empowered to enact any tax. The Court unanimously declared the tax to be invalid. Chief Justice Marshall stated his famous apothegm that the power to tax involves the power to destroy. It is not conceivable that the result of that case could have been different. Although not pitched on the ground of discrimination, such destructive discrimination was obviously present. It is illuminating that the Chief Justice never departed from the proposition that the Constitution makes the Federal laws supreme. The argument was made that to sustain the right of the General Government to tax banks chartered by the States, equally sustains the right of the States to tax banks chartered by the General Government. To that argument Marshall said:

> But the two cases are not on the same reason. The people of all the States have created the General Government, and have conferred upon it the general power of taxation. The people of all the States, and the States themselves, are represented in Congress, and, by their representatives, exercise this power. When they tax the chartered institutions of the States, they tax their constituents; and these taxes must be uniform. But when a State taxes the operations of the Government of the United States, it acts upon institutions created, not by their own constituents, but by people over whom they claim no control. It acts upon the measures of a Government created by others as well as themselves, for the benefit of others in common with themselves. The difference is that which always exists, and always must exist, between the action of the whole on a part, and the action of a part on the whole—between the laws of a government declared to be supreme, and those of a government which, when in opposition to those laws, is not supreme.

In three cases during the next 50 years the Court had occasion to declare State taxes on Federal instrumentalities to be invalid. I shall not undertake to discuss *Osborn* v. *United States Bank*, *Weston* v. *City Council of Charleston*, and *Dobbins* v. *Commissioners of Erie County*. Suffice to say that the ground of each of these decisions was the constitutional supremacy of the Federal Government.

No Federal tax upon a State instrumentality was assailed until 1870 in the case of *Collector* v. *Day*. The Income Tax Acts of the Civil War period laid a tax upon the income derived from certain sources "and any other sources whatever." Judge Day, judge of the

Massachusetts Court of Probate and Insolvency, was subjected to the Federal income tax under that provision. Having paid the tax, he brought suit for refund, and the Supreme Court, making a sharp departure from the earlier cases, held that the tax immunity established in *McCulloch* v. *Maryland* was reciprocal in its nature. Justice Nelson, speaking for the Court, considered that the power of the Federal Government to tax an officer of a State government might "defeat all the ends of government." Justice Bradley dissented because the State officer was also a citizen of the United States and subject to the constitutionally supreme taxing power of the Central Government. *Collector* v. *Day* has never been expressly overruled. I shall presently discuss, however, more recent decisions of the Supreme Court which seem to take from that case much of its supporting reasoning.

The last of the Civil War income-tax acts was made to apply only for the years 1870 and 1871. The next income-tax act passed by the Congress was the act of 1894. The critical language of this act was similar to earlier income-tax provisions. It lay a tax on gains, profits, and income from certain enumerated specific sources and "all other gains, profits, and income derived from any source whatever." Out of deference to *Collector* v. *Day*, a proviso was made that "salaries due to State, county, or municipal officers shall be exempt from the income tax herein levied." There was no exemption of the interest from State and municipal bonds.

It was this situation that gave rise to the case of *Pollock* v. *Farmers' Loan & Trust Company*, decided by the Supreme Court in 1895. Although the Court had held in *Springer* v. *United States* in 1880, that the general income tax imposed by the act of 1864, as amended by the act of 1865 was "within the category of an excise or duty," that it was not a direct tax, and was not subject to the rule of apportionment, the contention was made in the *Pollock case* that the income tax there involved was a direct tax and therefore could not be laid unless apportioned, in accordance with clause 3 of section 1 of article I of the Constitution, "among the several States * * * according to their respective numbers," and clause 4 of section 9 of article I, which provides that no direct tax shall be laid "unless in proportion to the census or enumeration hereinbefore directed to be taken."

Rather sketchily, the facts in the *Pollock case* were these: Pollock, a citizen of Massachusetts, was a stockholder in the Trust Co., a New York corporation. He filed a bill for an injunction to prevent the Trust Co. from paying the income tax. The bill alleged that the Trust Co.'s capital was $5,000,000, of which $1,000,000 was invested in real estate, $2,000,000 in bonds issued by the city of New York, and $1,000,000 invested in corporate bonds. The total income for the year 1894 was alleged to be $300,000 of which $50,000 was derived from the real estate, and $60,000 from the municipal bonds. It was also alleged that the Trust Co. held as trust property real estate of the value of $5,000 000 from which it received trust income in the amount of $200,000 per annum. The defendants demurred, the demurrer was sustained and the bill dismissed.

Thereupon an appeal was allowed to the Supreme Court. Mr. Chief Justice Fuller wrote the majority opinion which was first handed down. In this it was held: (1) The tax on income from real estate was a direct tax on such realty and void for lack of apportion-

ment; and (2) the tax on income from State and municipal bonds was a tax on the power of the States and their instrumentalities to borrow money and consequently repugnant to the Constitution. The Court being equally divided on all other questions, they were left undecided. Mr. Justice Field delivered a specially concurring opinion. Mr. Justice White and Mr. Justice Harlan dissented on the first question decided, but agreed on the second.

A rehearing was granted in the case, and the opinion of the majority on rehearing, among other things stated:

> We are now permitted to broaden the field of inquiry, and to determine to which of the two great classes a tax upon a person's entire income, whether derived from rents, or products, or otherwise, of real estate, or from bonds, stocks, or other forms of personal property, belongs; and we are unable to conclude that * * * [it] is so different from a tax upon the property itself that it is not a direct, but an indirect tax, in the meaning of the Constitution.

The Chief Justice mentioned the argument (and rejected it) "that income is taxable irrespective of the source from whence it is derived." It will be observed that here there was not the difference made—I speak now of the last opinion in that case—between income from municipal bonds and income from other personal property. On the other hand, the opinion states:

> * * * it follows that if the revenue derived from municipal bonds cannot be taxed because the source cannot be, the same rule applies to revenue from any other source not subject to the tax; and the lack of power to levy any but an apportioned tax on real and personal property equally exists as to the revenue therefrom.

It will thus be seen, I think, rather clearly, that the *Pollock case* is grounded upon a refusal to recognize income, without regard to its source, as the subject matter of the tax. On the contrary, the burden of the tax was considered as falling upon the source. The Court clearly considered that income should be broken down into its constituent items and each traced to its source to determine the liability for income tax. It was not then recognized, as it has been since by the Supreme Court in the *Cohn case*, that the tax is "a necessary payment for the privilege of living in organized society" and "neither the privilege nor the burden is affected by the character of the source from which the income is derived. For that reason income is not necessarily clothed with the tax immunity enjoyed by its source." Nor, was it then recognized, as it has been since by the Supreme Court in the *Hale case*, that—

> * * * the tax complained of * * * is not laid upon the obligation to pay the principal or interest created by the bonds * * * [but] * * * is laid upon the net results of a bundle or aggregate of occupations and investments.

As I have said, *McCulloch* v. *Maryland* was not grounded upon the discriminatory nature of the tax there involved, although it was a discriminatory tax. Indeed, the Court sanctioned certain nondiscriminatory taxes on the land owned by the bank and shares of the bank owned by the citizens of Maryland. Subsequently, however, in *Dobbins* v. *Commissioner of Erie County*, the Court held a Pennsylvania State tax to be invalid when applied to a captain of a United States revenue cutter, even though the argument was made and not disputed that the tax there was nondiscriminatory. And, in *Bank of Commerce* v. *New York City*, the Court expressly rejected the argument that the earlier cases protected Federal instrumentalities only

from discrimination and not from general taxation. But in more recent cases the Court, in sustaining a tax against those who claimed immunity, has noted the absence of discrimination in the taxes involved. This was done in *Metcalf & Eddy* v. *Mitchell* in 1926, and in the *Schuylkill Trust Co. case* where the Court struck down a tax on the ground that it was discriminatory.

The CHAIRMAN. Mr. Morris, may I interrupt?

Mr. MORRIS. Yes, sir.

The CHAIRMAN. Before you get away from the *Pollock case.*

Mr. MORRIS. Yes, sir.

The CHAIRMAN. Which, of course, is one of the principal impediments.

Mr. MORRIS. The impediment case.

The CHAIRMAN. To a statute here. I understand that while there was a division as to the question of that part of the tax which could be said to be a tax on real estate, the Court was unanimous in its view that there could be no income tax upon the income from municipal and State bonds.

Mr. MORRIS. That is right.

The CHAIRMAN. There is not any question about that.

Mr. MORRIS. That a tax which discriminates against persons dealing with either the State or the Federal Governments does threaten the existence of the dual system is hardly open to question. It seems, however, more and more to be thought that, where the tax does not discriminate but simply makes for an equality of treatment, there is no threat to the existence of the State or, conversely, to the Federal Government. Indeed, there the reason for the immunity rule is absent. It would seem certain that this is particularly true where the legislation, as that here under consideration, not only addresses itself to transactions of the future so that those who might be thought to be immune will not suffer any burden of unexpected taxation, but which legislation, as well, provides that the States may have the right to tax that kind of income from Federal sources which, derived from State sources, is made subject to Federal taxation. Thus, all citizens, whether or not employed or having contractual relations with either the State or Federal Governments would be treated alike and each, being a citizen of both governments, would pay his proper share for the support of both.

The CHAIRMAN. Let me here ask: Is there any other existing situation where the Federal Government authorizes State taxation of a federally incorporated corporation than in the case of national banks?

Mr. MORRIS. I was going to answer national banks.

The CHAIRMAN. Do you mean you will cover national-bank taxation later?

Mr. MORRIS. No, but I do mention cases which show the imposition of State taxes and the validity of those taxes with respect to matters which might and would under the *Pollock case* have been considered to have been immune from such taxation. And I think that rather clearly points out that there is the right on the part of the Congress, and in fact it has been expressly so held that the Congress can waive immunity.

The CHAIRMAN. As they do in the case of national banks?

Mr. MORRIS. We believe so, and I think it is in *Van Allen* v. *The Assessors*, and I do mention that case in connection with the anal-

ogous points of the departure, or the points of departure in analogous fields from the *Pollock case.*

The CHAIRMAN. And if we go into this reciprocal arrangement, it could be, of course, done on the same basis that we authorize taxation by State authorities of national banks, in that they must be treated in the same manner that the State treats its own corporations.

Mr. MORRIS. Precisely. The discriminaion could not be permitted there. And I should like to emphasize even more than I did in the statement I made that there can be no question as to Congress waiving the immunity.

The CHAIRMAN. Further, in connection with that question, it would be helpful to me if you would tell us if there is any other instance where the Federal Government has authorized taxation by State authorities than in the case of national banks? How is it with respect to these federally chartered building and loan associations? Would you look into that and see whether they are taxed or not?

Mr. MORRIS. There are provisions with respect to those agencies that do permit certain taxation, and I will undertake to submit to the committee a more definite statement on that point.

The CHAIRMAN. I think it would be helpful to us to have all instances where the Government does authorize taxation by the State of its creatures.

Mr. MORRIS. I believe following my statement that Mr. Gardner, who worked with particular detail on this subject, might enlighten the committee further, and, supplementing what he says, I should be glad to give a statement on that precise point.

The CHAIRMAN. Yes.

Senator AUSTIN. I should think it would be well also, because I believe it falls in the same line of study, to consider those cases where there is a division of jurisdiction between State and Federal Government with respect to lands and structures on those lands.

Mr. MORRIS. Yes, sir.

Senator AUSTIN. In some cases the possession by the State has been greater than in others, the possession of jurisdiction by the State government.

Mr. MORRIS. In many cases it has been so.

Senator AUSTIN. And if you extend your study to take in those cases, I think it would help us somewhat.

Mr. MORRIS. All right, Senator.

The CHAIRMAN. You were on page 9.

Mr. MORRIS. Yes, sir. I was trying to bring the thought of what I just said in connection with that which follows: I was pointing out that the legislation considered particularly lacks anything which could be said to be discriminating, or of a discriminatory nature, in that it acts upon the future rather than the past, and therefore does not subject people who were thought to be immune when they entered into transactions to such taxation, and it extends to the States the right to tax similar income from Federal sources, so there would be no discrimination between those who might be looked upon as citizens of the State and those who were taxpayers of the Federal Government.

If we look at the action of the Court in somewhat analogous and related fields, we find that there has been wide departure from much upon which *Collector* v. *Day* and the *Pollock case* were grounded. In

*Flint* v. *Stone Tracy Co.* a tax was laid upon corporations measured by their income "from all sources during such year." This tax, incidentally, was enacted in 1909 by the same Congress which proposed the sixteenth amendment. In this case the corporation had received a substantial amount of income as interest derived from State and municipal bonds. Nevertheless, the Court there held, sustaining the tax, that such tax was in the nature of an excise tax and, therefore, was not "the legal equivalent of a direct tax on the" bonds.

The CHAIRMAN. That is a little cloudy to me, but just where does that differ from the ruling in the *Pollock case*? Perhaps I had better put it the other way, is seems to me diametrically opposite to the ruling in the *Pollock case*.

Mr. MORRIS. It seems to me so, too, Senator. But the way they arrived at it in the *Pollock case*, they said the income derived from this piece of property was tantamount to the property itself.

However, as you pointed out in your question, the members of the Court dissented from that in the first instance with respect to personal property, although sharing the thought that neither directly nor indirectly could a tax be laid upon income derived from State bonds or subdivisions. That being so, they came to that view because they looked at the source from which that income was derived, and holding that the source could not be taxed, held that the income could not.

Now, in the *Flint* v. *Stone Tracy Co.*, the reasoning was that Congress has a right to lay a tax on the operation of a corporation, the doing of business. They have a right, so the Court said, to measure that tax by the income which it receives, and even though part of that income comes from sources which cannot be taxed, that does not vitiate its being included as a measure of the tax. It is a bit of dialectic reasoning, and when the substance is looked at it seems to me, as it does to the Senator, that it is a wide departure from what was done in the *Pollock case*. But it is only one of such departures.

This decision has been reaffirmed and followed in *Educational Films Corporation* v. *Ward and Pacific Co. and Johnson*. I think that is inaccurate in its reference to the case, and it should be *Educational Films Corporation* v. *Ward and Pacific Co.* v. *Johnson*. The former case upheld a State franchise tax, measured by net income which included the then exempt copyright royalties. The latter case sustained a similar tax measured by income which included the interest on tax-exempt State bonds.

Again, in *Van Allen* v. *The Assessors*—that was the case I mentioned in response to your question a moment ago—the Court has held that the Congress may grant to the States the right to tax a stockholder of a corporation without deducting the full value of Government bonds held by such corporation. This decision was based in part upon the power of Congress to waive the immunity and in part upon the ground that a tax on the shares was not the equivalent to a tax upon capital. There has naturally been developed by the Court the exception to this rule that the tax must not discriminate against corporations holding United States securities. This was done in the *Schuylkill Trust Co. case*, to which I have referred.

In another analogous field, the Court has held that the New York inheritance tax could be imposed upon a bequest of United States bonds, and, conversely, in *Greiner* v. *Lewellyn*, the Court upheld the

Federal estate tax as applied to an estate including municipal bonds. It followed naturally, in *Wilcuts* v. *Bunn*, that the Federal income tax could be imposed with respect to the capital gain on the resale of municipal bonds.

It is difficult to see how the holder of Government bonds has any different relation to the Government from one who has any other kind of contract with the Government. The former pays money to the Government and receives in return a promise to pay the agreed interest and to repay the principal.

The CHAIRMAN. Take that sentence at the bottom of page 10 and the top of page 11: "In another analogous field, the Court has held that the New York inheritance tax could be imposed upon a bequest of United States bonds"—was there anything similar to what is now said in these bonds to the effect that they are taxable?

Mr. MORRIS. No, sir; it did not rest upon the provisions of the bonds. It rested upon this: That the Court there held that the tax exemption of the bonds would not render them immune or free from taxation as respects the passing of those bonds by death from the decedent to the person that received them at death.

In other words, the State, they said, had the right to control the matter of inheritance, and the State did, and the act of passing at death was an operation, an act which could be made the subject of a State tax, and that is the reasoning that conversely is applied when the Federal tax is imposed upon the passing of municipal or State bonds. It is an excise rather than a direct tax.

I will point out that it is difficult to differentiate between a bondholder and a contractor with the Government. The latter either transfers goods to the Government, or performs services for it, or both, in return for the promise of the Government to make the agreed payments. At the time of the *Pollock case*, it was established that the operations of the Government contractor could not be taxed, but subsequent decisions of the Court have now established beyond dispute that the Government contractor is fully subject to non-discriminatory taxation on his receipts from the Government. In *Metcalf & Eddy* v. *Mitchell*, the Federal income tax was sustained as applied to a firm which did consulting engineering work under contracts with States and municipalities. That case has been consistently followed, even to the point, in *James* v. *Dravo Contracting Co.*, decided at the last term of Court, that the State of West Virginia could lay a tax of 2 percent on the gross receipts realized within the State under a contract for the construction of locks and dams for the United States. The Court here emphasized that the tax was nondiscriminatory, and that it was valid even though it might result in added cost to the Government.

In *Gillespie* v. *Oklahoma* there was involved a net income tax imposed on the lessee of Indian oil lands. Following the *Pollock case*, the Court there reached the conclusion that the tax on the income was the equivalent of taxing the lease itself. It, therefore, held the tax to be invalid, and, in *Burnet* v. *Colorado Oil & Gas Co.*, the Court followed the *Pollock case* again, and again held such tax to be invalid. But, in *Helvering* v. *Mountain Producers Corporation*, also decided at the last term, the court expressly overruled both the *Gillespie case* and the *Coronado case*. There the Chief Justice, speaking for the Court, stressed the expanding need of the State and Federal Govern-

ments for revenues and the undesirability of exempting a private entrepreneur from nondiscriminatory taxes, holding that the net income tax upon the lessee had only an indirect and remote effect upon the Government lessor, not sufficient to invalidate the tax.

The CHAIRMAN. What year was the *Gillespie case* decided?

Mr. MORRIS. I have forgotten, but I can easily find out and let you know. It was 1921.

The CHAIRMAN. And the *Coronado case?*

Mr. MORRIS. In 1925.

The CHAIRMAN. And the *Helvering case* last year?

Mr. MORRIS. Last term.

The CHAIRMAN. 1937 or 1938?

Mr. MORRIS. That is right.

In the fields of interstate commerce and foreign exports there have been decisions which are incompatible with the *Pollock case.* In *United States Glue Co.* v. *Oak Creek*, the Court sustained a tax on the net income realized from interstate commerce, saying:

> * * * if there be no discrimination against interstate commerce * * * it constitutes one of the ordinary and general burdens of government * * *.

The Oak Creek decision has been consistently followed. The Constitution expressly provides that no tax or duty shall be laid on articles exported from any State. Yet it is settled that Congress may tax the net income realized in the business of exporting. The Court, in *Peck & Co.* v. *Lowe*, said:

> It [Revenue Act of 1913] is not laid on income from exportation because of its source, or in a discriminative way, but just as it is laid on other income. * * * At most, exportation is affected only indirectly and remotely.

And, finally, in this connection, it has been settled, even before the *Pollock case*, that the Constitution does not protect a State bondholder against taxation by another State. In *Bonaparte* v. *Tax Court* the Supreme Court said:

> It is true, if a State could protect its securities from taxation everywhere, it might succeed in borrowing money at reduced interest; but, inasmuch as it cannot secure such exemption outside of its own jurisdiction, it is compelled to go into the market as a borrower, subject to the same disabilities in this particular as individuals.

Of course, the classic reason for extending tax exemptions to a private person who has dealings with the Government is that, if he were taxed in this respect, the taxing government would have the power to prevent his entering into such transaction, and, accordingly, could destroy the pertinent function of the other government. It is this that has played such a part in the earlier decisions of the Court. It has never been, so far as I know, expressly rejected by a majority of the Court. It does appear, however, to have been recognized that there may exist a power to tax even though there be no power, by discriminatory taxation or otherwise, of destruction. Mr. Justice Holmes stated it well, in a dissenting opinion in the *Panhandle Oil Company case*, in which he was joined by Justices Brandeis, Sutherland, and Stone. Speaking of the earlier decisions, he said:

> In those days it was not recognized as it is today that most of the distinctions of law are distinctions of degree. If the States had any power it was assumed that they had all power, and that the necessary alternative was to deny it altogether. But this Court which so often has defeated the attempt to tax in certain ways can defeat an attempt to discriminate or otherwise go too

far without wholly abolishing the power to tax. The power to tax is not the power to destroy while this Court sits. The power to fix rates is the power to destroy if unlimited, but this Court, while it endeavors to prevent confiscation, does not prevent the fixing of rates.

The proposition that the power to tax is the power to destroy appears to be contradicted by half a hundred cases of the Supreme Court itself. In *Western Union Telegraph Company* v. *Massachusetts*, the Court sustained a State tax upon the capital stock of a corporation considered to be a governmental agency; that is an agency of the National Government. But the Court recognized that "the State could not interfere by any specific statute to prevent a corporation from placing its lines along these post roads, or stop the use of them after they were placed there."

From *Collector* v. *Day* down through the last term of Court the development has not been an extension of immunity but a restriction of it. First came the distinction between essential governmental functions and those that were not. In *Flint* v. *Stone Tracy Co.*, several times referred to, the contenton that certain moneys were received for services as trustees and guardians met with the answer that such income was not immune. In the *South Carolina case* it was held that a State engaging in the business of dispensing liquor could not claim sovereign immunity from taxation for that activity. More recently a manager of the Boston Elevated Railroad was denied immunity from Federal taxation. In the *Brush case* the superintendent of the water department of New York City was held to be immune from Federal income tax, but this decision apparently turned on the proposition that the Treasury Regulation treated him as not taxable, and the Government had not in that case attacked the validity of such regulation. The most recent and the most sweeping decision was that in the *Gerhardt case*, which involved employees of the New York Port Authority. That case was decided at the last term. There the Court did not base its decision on the proposition that the New York Port Authority was the creature of the State of New York and of the State of New Jersey, except as showing that the regulations, referred to in the *Brush case*, did not apply, but treated the question as one not having those peculiar circumstances. While *Collector* v. *Day* was distinguished rather than overruled, it certainly cannot be said that it was reaffirmed. In upholding the Federal income tax there, the Court said—I am speaking of the *Gerhardt case:*

The basis upon which constitutional tax immunity of a State has been supported is the protection which it affords to the continued existence of the State. To attain that end, it is not ordinarily necessary to confer on the State a competitive advantage over private persons in carrying on the operations of its government.

The CHAIRMAN. In *Collector* v. *Day*, that was the Massachusetts judgeship?

Mr. MORRIS. Yes, sir; in 1870. It seems that the Federal Government enjoys a somewhat different status with respect to tax immunities than do States, and the Court in the *Gerhardt case* continued, and quite noteworthy:

* * * Chief Justice Marshall * * * was careful to point out not only that the taxing power of the National Government is supreme, by reason of the

constitutional grant, but that in laying a Federal tax on State instrumentalities the people of the States, acting through their representatives, are laying a tax on their own institutions and consequently are subject to political restraints which can be counted on to prevent abuse. State taxation of national instrumentalities is subject to no such restraint, for the people outside the State have no representatives who participate in the legislation; and in a real sense, as to them, the taxation is without representation. The exercise of the national taxing power is thus subject to a safeguard which does not operate when a State undertakes to tax a national instrumentality.

And further it is stated in that opinion:

There are cogent reasons why any constitutional restriction upon the taxing power granted to Congress, so far as it can be properly raised by implication, should be narrowly limited. * * *

The CHAIRMAN. By statute or by judicial construction?

Mr. MORRIS. By judicial construction.

The CHAIRMAN. Before you leave the *Gerhardt case*, was that a unanimous decision?

Mr. MORRIS. The *Gerhardt case?*

The CHAIRMAN. Yes.

Mr. MORRIS. No. There was a dissenting opinion by two members, as I recall it.

The CHAIRMAN. Seven and two?

Mr. MORRIS. That is my recollection. Seven or six. Yes, there was one Justice who did concur and said *Collector* v. *Day* ought to be overruled, expressly.

The CHAIRMAN. Senator Austin says his recollection is there was one dissent and one Judge who did not participate.

Mr. MORRIS. I think there were two dissents.

Mr. GARDNER. Justices McReynolds and Butler.

The CHAIRMAN. Six, two, and one?

Mr. GARDNER. Neither Justice Cardozo nor Justice Reed participated in the decision.

The CHAIRMAN. You were at the bottom paragraph on 15.

Mr. MORRIS. Speaking of Australia and Canada, while, of course, not authoritative, it is interesting to note that in the somewhat comparable Federal systems of Canada and Australia the reciprocal immunity rule stated in our earlier cases were, at first, followed in both jurisdictions, and in both it has been completely altered. This is interesting, as I see it, only in that it shows that nondiscriminatory taxation of those who deal with the local and general governments does not, as a practical matter of experience, constitute a threat to the existence of either.

So, quite apart from what effect, if any, the sixteenth amendment has upon the authority of either the *Pollock case* or *Collector* v. *Day*, those cases seem to stand alone, and much weaker as authority than would be the case if the Supreme Court in analogous fields had followed the principles upon which those two cases rest.

The President in transmitting his message to the Congress, recommending the legislation under consideration, pointed out that the language of the sixteenth amendment would seem to authorize taxation of income derived from State and municipal, as well as Federal bonds, and also income derived from State and municipal, as well as Federal offices. He stated that expressions in recent judicial opinions lead to the hope that the Court itself would question the doctrines underlying the tax immunity of such income, and further

stated that it was not unreasonable to hope that judicial decision may find it possible to correct it.

The sixteenth amendment was proposed by the Congress on the 12th day of July 1909, and was declared in force by the Secretary of State on the 25th day of February 1913. The amendment reads as follows:

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

It would seem, standing alone, very clear that this was a grant of power to Congress to lay and collect taxes on income without regard to the source of such income, and without the requirement as to apportionment which sections 2 and 9 of article I require in the case of direct taxes. It is insisted, however, that this amendment should be construed, in the light of the power which Congress had to lay taxes prior to its adoption, and in the light of the situation produced by the decision in the *Pollock case* which had led to its adoption.

The Court has said in the *Brushaber case*, which followed the sixteenth amendment, Mr. Chief Justice White, speaking for the Court:

> Indeed in the light of the history which we have given and of the decision in the *Pollock case* and the ground upon which the ruling in that case was based, there is no escape from the conclusion that the amendment was drawn for the purpose of doing away for the future with the principle upon which the *Pollock case* was decided, that is, of determining whether a tax on income was direct not by a consideration of the burden placed on the taxed income upon which it directly operated, but by taking into view the burden which resulted on the property from which the income was derived, since in express terms the amendment provides that income taxes, from whatever source the income may be derived, shall not be subject to the regulation of apportionment.

He thus reasoned that the effect of the amendment was to make a tax on income no longer a direct tax which must be apportioned but an indirect tax which must be uniform. The contention in the *Brushaber case* was, in the main, that because there were certain classes of income not taxed, the tax that was imposed was not in conformity with the sixteenth amendment and must, therefore, be apportioned. There were other features in the case, however. The only argument of the Government was that the amendment was intended to do away with apportionment. That with respect to what I have just stated, the Court agreed with the Government, but seemed to narrow the effect of the amendment to only what the Government contended for in that case.

In *Stanton* v. *Baltic Mining Co.* the contention was somewhat similar, and Chief Justice White, again speaking for the Court, made a similar holding.

In *Peck & Co.* v. *Lowe* the effect of the sixteenth amendment was considered, and the Court, speaking through Mr. Justice Van Devanter, said:

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

And again, in *Eisner* v. *Macomber*, Mr. Justice Van Devanter stated:

> As repeatedly held, this did not extend the taxing power to new subjects but merely removed the necessity which otherwise might exist for an apportionment among the States of taxes laid on income.

In that case Mr. Justice Holmes dissented, as did also Mr. Justice Brandeis, with whom Mr. Justice Clarke concurred.

It was, however, in the case of *Evans* v. *Gore*——

The CHAIRMAN (interposing). Of course, those two cases tie into the *Pollock case;* and if that is the law, it would mean that we could not do what the President proposed in his message of last April.

Mr. MORRIS. If that view is taken; but I am speaking apart now from the argument that I have concluded before we took up the question of what the sixteenth amendment means, but only with respect to the meaning and effect of the sixteenth amendment, if the sixteenth amendment be construed as the intimations in those opinions that I have just stated there, that its only effect was to do away with the necessity of apportionment, and that it had no effect in reaching new or other fields than existed before the amendment, then the question is not helped by the construction of the sixteenth amendment.

The CHAIRMAN. Do you consider that the quoted statements that you make from the *Lowe case* and the *Macomber case* are dicta, or do you consider that that was the actual holding of the Court?

Mr. MORRIS. It is difficult for me to say, Senator, what are dicta.

I think that the principle that adheres to the view that it does not enlarge the power of taxation is stated in *Evans* v. *Gore*, which follows what was said in the other cases.

The CHAIRMAN. You were just coming to that.

Mr. MORRIS. I do think the conclusion could have been reached in *Evans* v. *Gore* independent of that construction.

The CHAIRMAN. Certainly.

Mr. MORRIS. Though it was unquestionably a part of the reasoning in which the Court indulged.

It was, however, held in the case of *Evans* v. *Gore*, in which Mr. Justice Van Devanter, speaking—and it will be noted that he wrote the opinions in these three cases that I have referred to—speaking for the Court, pointed out the reasons why he held to the view that the amendment did not reach income theretofore thought to be exempted. In that case the question was whether or not Judge Evans, a Federal judge, could be required to pay a Federal income tax on his official salary.

The CHAIRMAN. That was about 1923, was it not?

Mr. MORRIS. I again have not the date of that. I will get it for you and give it to you in the morning.

Mr. GARDNER. I do not know, but it is somewhere in that neighborhood, though.

Mr. MORRIS. Yes; it was about then, but I will give you the exact date of it.

The provisions of article III of the Constitution are that—

> The judges, both of the Supreme and inferior courts shall hold their office during good behavior and shall at stated times receive for their service, a compensation which shall not be diminished during their continuance in office.

It was conceded that if the tax amounted to a diminution the tax was invalid. Indeed, there the Government further stated that "it is not, in view of recent decisions, contended that this amendment, speaking of the sixteenth amendment, rendered taxable as income anything which was not so taxable before." Nevertheless, Mr. Justice Van Devanter, speaking for a majority of seven, entered into a dis-

cussion of the meaning of the sixteenth amendment. Reference is made to the congressional history beginning with the message of President Taft and continuing through the debate on the Borah resolution. Mr. Justice Van Devanter said:

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

To that opinion Mr. Justice Holmes, with Mr. Justice Brandeis, dissented. The dissent was placed on two grounds: First, the tax did not result in a diminution of the judge's compensation; and, second, even if it did, it was made lawful by the sixteenth amendment. As to the second ground, the Justice said—Justice Holmes speaking:

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

That concludes Justice Holmes' dissenting opinion. But here it should be noted that article III of the Constitution with respect to diminishing the compensation of judges is for the clear purpose of protecting the judges, the recipients of such income, rather than to protect the source of such income, which is the purpose of an immunity rule and which the language of the sixteenth amendment would seem to be addressed to.

These cases show substantially what has been said by the Supreme Court in connection with the effect of the sixteenth amendment in this connection. It is to be noted that only a part, and a small part of the history and contemporary setting of the sixteenth amendment has ever been submitted to, or as far as the opinions show, considered by the Court in this connection. If the amendment is not to be read according to the natural meaning of its language, but if such language is to be construed by what extrinsic matters indicate the intention is, we think it is proper that consideration be given to all of such extrinsic matters to determine whether or not the intention is different from such natural meaning.

To do this, one must look first at the history of income-tax legislation prior to the adoption of the amendment. As I have stated, the first income tax act was enacted by Congress in 1861. This act was followed by the act of 1862, the act of 1864, the act of 1865, amended in 1866, and the act of 1867, all containing the language which it was considered included all income, that is, from any source whatever. The act of 1870, made applicable to the years 1870 and 1871, did likewise. It was under those Civil War acts that the case of *Collector* v. *Day* arose. Clearly the words "from any source whatever" were intended, and were considered by the Court, to include the salary

received by Judge Day as a State judge. If that had not been so, the Court would not have reached the constitutional question as to whether or not Congress had the power, not the intent, to tax such salary. Following that decision, when the Income Tax Act of 1894 was passed, although substantially the same language was used, there was an express provision that it should not apply to the salary of State officers. There was no express exemption as to the interest on State or municipal bonds. Therefore, it was intended, and considered by the Court, to include such interest. Otherwise the Court would not have reached, in the *Pollock case*, the constitutional question as to the power of Congress, rather than its intention to tax as income the interest from such bonds.

Furthermore, when the corporation tax was enacted as part of the Tariff Act of 1909, by the very same Congress which proposed the sixteenth amendment, it was provided as I have heretofore said, that corporations should pay a tax measured by "the entire net income over and above $5,000 received by it from all sources during such year" and (while the sixteenth amendment was before the States for ratification, and before a sufficient number of such States had ratified it), the Supreme Court decided in *Flint* v. *Stone Tracy Co.* that such language included interest received by the corporation on municipal bonds owned by it.

With this background for the construction of the language which was inserted in the proposed sixteenth amendment while it was in the Finance Committee of the Senate, it is difficult to see why the words "from whatever source derived" should not be thought to include the income which those words, with immaterial difference in arrangement, had been repeatedly held to include.

It is true that the *Pollock case* gave rise to the movement for the sixteenth amendment. It must be remembered, however, that one of the principal questions involved in that case was the validity of an income tax on the interest from municipal bonds. It was there held that such tax was invalid because such income was traced to a source which itself could not be taxed. It was the source from which such income was derived that rendered it exempt. When, therefore, constitutional provision is made that income may be taxed from whatever source derived, it would seem to be clearly responsive to the admitted dissatisfaction with the principle that each segment of income should be traced to its source. Repeating what Mr. Justice Holmes said:

> But the only cause of that difficulty was an attempt to trace income to its source, and it seems to me that the amendment was intended to put an end to the cause and not merely to obviate a single result.

Another part of the background is the agitation that took place, following the *Pollock case*, for an income tax. One cannot study that period, and contemporary newspaper and magazine articles, public debates, and political convention platforms, without being very sure that the basic idea behind the movement was that the Federal revenue system being made up principally of consumption taxes was unfair and unjust in that it placed a burden of supporting the Government upon those least able to pay and permitted wealth to escape. The movement was as broad as its subject and the evils sought to be remedied. There was no exception, exemption, or limitation, express or implied.

The CHAIRMAN. Mr. Morris, is there a distinction, in your estimation, between the power to tax through the Federal Government State bonds and the power to tax through the Federal Government municipal bonds? Do you think they rest upon the same foundation?

Mr. MORRIS. As I understand the Senator's question, is there a distinction between the power of the Federal Government to tax State bonds and the power of the Federal Government to tax municipal bonds?

The CHAIRMAN. Yes.

Mr. MORRIS. Not at all. I think if one involves a distinction, the others do also.

The CHAIRMAN. You think the underlying situation is identical?

Mr. MORRIS. I do. I see no difference. Let me qualify that by saying there might conceivably be bonds used for purposes not essentially governmental by a municipality so that a different question might arise, but I am speaking now of bonds that are issued for strictly governmental purposes.

The CHAIRMAN. I was thinking, suppose that the New York Port Authority issued bonds—and it probably has—would there be any reason to think now, because of the attitude of the Court in the *Gerhardt case*, that we might tax the income from the bonds of the New York Port Authority?

Mr. MORRIS. While the *Gerhardt case* dealt with a situation which the Court pointed out was not of the same character as so essentially governmental as was the case of Judge Day in *Collector* v. *Day*, I am not at all persuaded that it pitched its decision upon that particular difference.

I should not like to say that I consider the *Gerhardt case* as authority for that with respect to the bonds of such an authority.

The CHAIRMAN. The groundwork of the base decision in the *Gerhardt case* was that the employees were not performing an essential governmental function.

Mr. MORRIS. I am inclined to think, Senator, that the case goes somewhat beyond that. As was pointed out, that is true.

The CHAIRMAN. If that is a fact, and it seems the same reason for the port authority to issue securities.

Mr. MORRIS. It might, but I should not like to express an opinion on that.

The CHAIRMAN. That is why I asked whether there was any distinction to tax certain bonds not of the State itself, but of corporations, and so on, created by the State.

Mr. MORRIS. I think there is no difference if the instrumentalities of the State are engaged in governmental functions. I think the distinction, if any, might lie here, and that would apply as well to the State as to an instrumentality of the State, if it was engaged in some activity, or the bonds were issued for the operation of some activity that was considered to be not essentially governmental, such, for instance, as the carrying on of the dispensing of liquor, as was held in the *South Carolina case*, which was by the State; and I think the distinction lies, if there be a distinction, in the activities, and not in whether or not it be the State or the subdivision or an instrumentality of it.

The CHAIRMAN. But it seems to me there is ground for reaching the conclusion that if the salaries of the employees of that subdivision or

authority created by the State may be taxed, that were is some ground for thinking that the bonds could be.

Mr. MORRIS. That the bonds could be taxed?

The CHAIRMAN. That the bonds could likewise be taxed.

Mr. MORRIS. I think so, too.

The CHAIRMAN. I think we better suspend until 2 o'clock, if that be satisfactory.

(Whereupon, at 12 o'clock noon, a recess was taken until 2 p. m. of the same day.)

AFTERNOON SESSION

The committee met pursuant to recess at 3 o'clock p. m.

Present: Senator Brown, chairman.

The CHAIRMAN. We will proceed, Mr. Morris.

## STATEMENT OF JAMES W. MORRIS, ASSISTANT ATTORNEY GENERAL—Resumed

Mr. MORRIS. Mr. Chairman, at the time of the committee's adjournment I had been discussing certain of the backgrounds of the sixteenth amendment; that it had been brought about, or an impetus had been given to it by the Pollock decision which had dealt with the question of source, and, it is reasonable to assume the sixteenth amendment was addressed to it; also the popular agitation for an income tax which seemed not to admit of any limitation or exception.

Now, as to the legislative history we think throughout the legislative history of the proposal of the amendment there does not appear affirmatively one thing, prior to its submission, which indicates that it was intended to be narrower than its full broad meaning. On the contrary, President Taft in his message stated that he had considered an amendment unnecessary to an "exercise of certain phases of this power," but upon "a mature consideration" he was satisfied that "an amendment is the only proper course for its establishment to its full extent."

The CHAIRMAN. I would like to keep these dates approximately in mind. That was in 1909?

Mr. MORRIS. It was submitted in 1909, and that message occurred then.

Senator Brown, of Nebraska, had offered a resolution proposing an amendment to read:

> The Congress shall have power to lay and collect taxes on incomes and inheritances.

Subsequently, Senator Brown introduced a second joint resolution proposing a constitutional amendment which read, and we think the omissions are rather significant. That is why I quote it in full:

> The Congress shall have power to lay and collect direct taxes on incomes without apportionment among the several States according to population.

This resolution was referred to the Committee on Finance, of which Senator Aldrich was chairman. Senator McLaurin made the suggestion that—

I think if the Senator from Nebraska will change his amendment to the Constitution so as to strike out the words "and direct taxes" in clause 3, section 2, of the Constitution—which obviously refers to

clause 3 of section 2 of article 1—and also to strike out the words "or other direct" in clause 4 of section 9 of the Constitution, he will accomplish all that his amendment proposes to accomplish and not make a constitutional amendment for the enacting of a single act of legislation.

This suggestion of Senator McLaurin brings into bold relief the nature of Senator Brown's proposal, but Senator McLaurin's suggestion, although subsequently renewed, was not adopted. On the other hand, on June 28 Senator Aldrich for the Committee on Finance reported the resolution back to the Senate in the following form:

ART. XVI. The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States and without regard to any census or enumeration.

It is to be observed that the Committee on Finance changed the resolution as offered by Senator Brown by striking out the word "direct" preceding the word "taxes," and inserting, after the word "incomes," the words "from whatever source derived." While the official record does not show it, these changes were made, according to a published letter from him, by Senator Knute Nelson, of Minnesota, who was a member of the Committee on the Judiciary. His letter to Mr. Harry Hubbard on May 7, 1920, and published in the Journal of the American Bar Association stated:

The record may not show it but I introduced the amendment and the facts are that at that time Mr. Aldrich was chairman of the Finance Committee and I discussed the matter with him and insisted on the amendment being inserted and he concurred with me and reported the bill with the phrase "from whatever source derived."

In a subsequent letter written by Senator Nelson to Mr. Hubbard, following the decision of the Supreme Court in *Evans* v. *Gore*, which letter was also published in the Journal of the American Bar Association, he stated:

I have been very sorry to see that the Supreme Court in its decision, has utterly ignored the phrase; in fact, treated the amendment as though this phrase were not a part of it.

At the time these letters were written and at the time they were published by Mr. Hubbard, Senator Nelson was chairman of the Senate Committee on the Judiciary.

Thus, it would seem that while the proposed amendment was before the Congress there was inserted this language, which by repeated judicial construction had been determined to include the very character of income that is now being considered as the subject of legislation.

And, finally, as to the views of those who ratified the amendment. Reference was made in *Evans* v. *Gore* to the message sent by Governor Hughes of New York to the legislature, recommending the rejection of the sixteenth amendment. Governor Hughes stated that he favored an income-tax amendment—

But the power to tax incomes should not be granted in such terms as to subject to Federal taxation the incomes derived from bonds issued by the State itself, or those issued by municipal governments organized under the State's authority * * *.

This proposal is that the Federal Government shall have the power to lay and collect taxes on incomes "from whatever source derived." * * *

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

There was also filed before the New York Legislature, by Mr. Choate, who was counsel in the *Pollock case*, and four other attorneys, a memorandum opposing the ratification of the proposed amendment. In this memorandum it is stated:

> If, in the face of these contentions on the part of the legislative and executive branches and of these adjudications by the Supreme Court, the people, who are sovereign, adopt an amendment expressly conferring the power to tax incomes in the broadest terms in our language, namely, "from whatever source derived," the courts, under settled rules of construction would, as it seems to us, be constrained to hold that the words "from whatever source derived" excluded any implied limitation theretofore existing, because otherwise the whole clause would have no meaning or force. We know of no rule that would warrant the courts in holding that the words "from whatever source derived," adopted under these circumstances, were wholly meaningless and ineffective.

Mr. Francis Lynde Stetson filed a specially concurring memorandum with the Legislature of New York in which it was stated:

> These words, adopted after and in view of the previous decisions of the Supreme Court denying the existence of such a power under the present Constitution, would, it seems to me, amount to a valid express delegation to the Federal Government of the power not previously exercisable by the Congress. Otherwise the four words are superfluous. That they are superfluous would seem to be the opinion of some constitutional lawyers of great ability and learning, including the junior Senator from New York and his eloquent colleague from Idaho.
>
> Such opinions seem to rest upon a consideration of the undoubted power of the Congress by due apportionment to impose a direct tax upon any and all property, and, consequently, upon all incomes except those affected by the needs of the States for their own sovereignty, and protected only by judicial decisions now imperiled.
>
> * * * * * * *
>
> But, the amendment now proposed does more. The four words "from whatever source derived," in connection with the grant of an express power to levy a tax upon incomes, almost certainly would be construed to set aside the judicially ascertained immunity of State agencies and instrumentalities necessary for State administration.

Mr. J. Hampden Dougherty, a supporter of the amendment, replied to the Choate memorandum. He conceded that the proposed amendment would empower the Congress to tax the interest from State and municipal bonds but argued that such a result was desirable.

Senator Root, of New York, on February 17, 1910, wrote to a member of the New York Senate on the subject. Mr. Root argued that:

> The effect of the amendment will be, in my view, the same as if it said, "The United States may lay a tax on incomes without apportioning the tax, and this shall be applicable whatever the source of the income, subjected to the tax," leaving the question, "What incomes are subject to national taxation?" to be determined by the same principles and rules which are now applicable to the determination of that question.

The New York State Senator to whom Senator Root wrote was not convinced and replied:

> Great classes of income, the income from real estate and from personal property, are now for the first time practically immune even in the direct national emergency, because of the source from which they are derived. The proposed amendment would restore to the Nation the power to reach these incomes and all others from whatever source derived, subject only to the restrictions, implicit or explicit, which are within the Constitution itself. It is in this intent that the significance of the words "from whatever source derived" clearly appears.

He also stated:

I think it will turn out to be pretty nearly the universal opinion of the economists and experts in practical finance that the Governor's fears are ill-grounded. No harm can come to the credit of State or municipal bonds through the levying of a general income tax.

On February 8, 1910, Senator Borah called the attention of the Senate to Governor Hughes' message and introduced a resolution instructing the Senate Committee on the Judiciary to report whether the contention of Governor Hughes was constitutionally sound. The resolution was placed on the table, subject to call, and on February 10, 1910, Senator Borah called it up for discussion. He pointed out that the objections of Governor Hughes to the general language of the proposed amendment were similar to those urged to the language of the Constitution itself when it was awaiting ratification of the 13 States. Both the Constitution and the sixteenth amendment in form provided for the plenary grants of power, but both were subject, according to Senator Borah, to the same implied limitations. He concluded that the amendment did not deal with the question of power, but rather with the manner of exercising that power; that the phrase "from whatever source derived" added nothing to the force or scope of the proposed amendment. Senator Brown seemed to agree with Senator Borah, but stated in this connection:

I am not so clear, Mr. President, but that the very fact that the proposed amendment makes no exception of any income does not commend it to the public approval. So that, conceding for the moment that this amendment would confer a power to reach State securities, nevertheless, the fact that every man's income shall be reached may become one of the reasons why the amendment should be adopted.

Senator Brown again on February 23 agreed with Senator Borah's conclusions, but added—

There is also a somewhat enthusiastic sentiment abroad in our land that the burdens should be borne by everybody in proportion to their ability to bear them, without regard to whether these abilities accrue from investments in farmlands or railroad stocks or State bonds. As a matter of common equity and evenhanded justice to the entire citizenship of the country, to exempt one class of incomes and tax another is abhorrent. * * *

On its face the proposition does not commend itself. It does not square with the doctrine of equal rights. It is hateful to every sense of justice. It cannot be defended in principle nor can it be used successfully, in my judgment, to defeat this amendment.

I have not the time to go more at length into the expressions made during the period the amendment was before the States. Suffice it to say that the Legislature of New York, following the recommendation of Governor Hughes, rejected the amendment.

The CHAIRMAN. Because with the view expressed and that the amendment would cover income from State securities.

Mr. MORRIS. Presumably so, because it was upon that ground he founded his objection, and what followed would seem further to support that view.

Gov. John A. Dix, who was elected in November 1910, resubmitted the amendment, urging its ratification. In his message he agreed with Governor Hughes as to its meaning, but thought that this was a strong argument for its ratification. The legislature thereupon ratified the amendment.

It will be recalled that in that interval there had occurred a general election, and the complexion had undergone a change. The amendment had been spoken of in the campaign.

The CHAIRMAN. Was there anything in the platform of either political party that embraced that?

Mr. MORRIS. Governor Dix stated he was pledged to the support of that amendment, and had received his election on the basis of that pledge.

The CHAIRMAN. Did Governor Hughes go to the Supreme Court after that time?

Mr. MORRIS. I have forgotten exactly when Governor Hughes was appointed on the Supreme Court. It was following that—I think that it was in November 1910. There was an interval of time—just how much it was I am not certain.

This discussion was publicized and circulated throughout the country. It was referred to in many messages of governors submitting the amendment to their respective legislatures. Many of the governors agreed with the construction which Governor Hughes had placed upon the amendment. Some urged its ratification. Some urged its rejection. Newspaper comment throughout the country and magazine articles aroused a general public interest and understanding of the issues.

I might say in the appendix of this study we have undertaken to give much of this material I am alluding to.

Finally, one of the leading papers of the country put the matter as follows:

> The question regarding the constitutional amendment enabling the Federal Government to lay a tax on incomes "from whatever source derived" is not a question regarding the conflict of laws, or for the construction of an obscure statute, involving difficult question of principle. It is a question addressed to the man in the street regarding the adoption of a new policy as to which his views should and will prevail. It is a question without roots in the past, and looking wholly to the future. The Supreme Court perhaps might listen patiently to such an argument as Senator Root's, but the man in the street will pay no attention to it and should not.

If, therefore, the meaning of this amendment is to be determined not merely by the words used therein but by its history and the contemporary thought of those who proposed it and those who ratified it, it would seem necessary to make a full examination, not a partial one. In the study I have mentioned, and its appendix, we have undertaken to gather all material which we can to throw light on this phase of the question. We do not believe that such data shows a preponderating understanding contrary to the natural meaning of the words used in the amendment.

The CHAIRMAN. Mr. Morris, was anything said in the debates in the New York Assembly that related to this particular question?

Mr. MORRIS. I have not seen any excerpts from those debates that throw any light upon what was said with respect to the amendment because we had no expression in the Governor's message. Mr. Buck, who will later testify, might be able to throw some light on whether or not he came across any of that material.

The CHAIRMAN. As I recall it, most of the Governors in their messages said very little on the subject. A few of them did.

Mr. MORRIS. A few of them did; yes. We have that set forth in the appendix to our study. We have been unable to get excerpts

from all the journals showing the debates and what opinions were expressed on it.

The CHAIRMAN. I remember the Governor of my State (Michigan) just submitted it without comment whatsoever.

Mr. MORRIS. A number of them did.

Now, turning from the background and history of the amendment to what happened subsequent thereto, to find if we can a congressional interpretation that might throw light upon it, and, we think that is critical because certain action that was taken might be claimed to have certain congressional interpretation, I will undertake to show as well as I can what that action was.

As for the congressional interpretation of the amendment, it is to be noted that, in the first act thereunder, the act of 1913, there is expressly exempted the interest upon obligations of a State or any political subdivision thereof upon the obligations of the United States or its possessions, and the compensation of all officers and employees of a State or any political subdivision thereof, except when such compensation is paid by the United States Government. When this act was pending before the Congress an amendment to subject the salaries of State officers was proposed. When support appeared for this amendment, Mr. Cordell Hull, who was in charge of the bill in the House, explained that the exemption was granted to salaries of State and municipal officers:

> In view of the long line of court decisions to the effect that the Government has no more power to tax the instrumentalities of a State than a State has to tax the instrumentalities of the National Government. Now, while individually speaking, I, as well as each Member here, has his opinion as to what might or might not be done in that respect at this time. Still it was not the desire of those who have been taking the most interest in this measure to inject any more constitutional questions or controversies into the bill, especially for the sake of only a few thousand dollars in taxes, and it would only add a few thousand dollars if that clause was included.

It is clear, therefore, that this exemption was made not as a matter of congressional construction of the constitutional power, but to avoid controversy on account of a constitutional question and because of the small amount of revenue involved.

The acts of 1916 and 1917 continued the same exemptions. Another effort was made to deal with the problem in connection with the Revenue Act of 1918. As reported by the Committee on Ways and Means, section 213 (a) of the bill included, as taxable income, salaries of the President of the United States and all other officers and employees of the United States or any State. Section 213 (b) (4) of the bill, as reported by the committee, provided for an exemption of interest upon obligations of a State, Territory, or any political subdivision thereof, "issued on or prior to the date of this act." The committee, in explaining this, stated that, although there is doubt as to the constitutionality of including the interest on these obligations (namely, those issued subsequent to the act), justice requires that, at least in time of war, the holders of these securities should share the burdens equally with the holders of Liberty bonds. It also noted that there was some question as to whether or not the salaries of officers and employees of States could be subjected to such tax. However, the committee felt that, in all equity and justice, such officials should be subject to income taxes, and that, if necessary, this matter should be definitely decided by the courts.

There was much debate on the floor and several amendments to eliminate the tax on both salaries and interest from State sources were offered and rejected. The bill, as reported by the Senate Committee on Finance, had stricken from it the provisions with respect to a tax on the interest of State and municipal obligations and was silent as to the salaries of State and municipal officials.

The CHAIRMAN. Do I take it that the House passed the Ways and Means Committee bill?

Mr. MORRIS. The House passed the bill reported by the Ways and Means Committee, and it came to the Senate and in the Senate Finance Committee they made changes which it explains as follows:

> The committee amended 213a so as to require that any gains, profits, and income derived from salaries * * * be subject to income tax, leaving the constitutional question as to the authority of Congress to tax certain salaries to be settled by the courts in any case in which the question may be raised.
>
> * * * * * * *
>
> The provision subjecting the interest on new issues of State and municipal bonds to taxation as income was also stricken out. Apart from the constitutional question, it seemed unwise for Congress to attempt to impose this tax upon the obligations of States and municipalities as long as the States are not free to tax in a similar manner the obligations of the United States.

After debate in the Senate, it was finally passed as recommended by the Finance Committee. Thus the Revenue Act of 1918, as finally enacted, included taxation of Federal officials and employees, but said nothing expressly one way or the other about salaries of State and municipal officers and employees. The act expressly exempted interest on State and municipal obligations. The same provisions appear in the Revenue Acts of 1921, 1924, and 1926. In the act of 1928 reference to the salaries of the President and salaries of Federal judges is eliminated from the definition of gross income. The specific exemption of the interest from the obligations of States and municipalities is continued. In the 1932 act the salaries of Presidents and Federal judges taking office after the date of that act are taxable. The specific exemption with respect to the interest upon obligations of States and municipalities is continued. Subsequent acts are to the same effect.

On May 6, 1919, Mr. Attorney General Palmer, at the request of the Secretary of the Treasury, rendered an opinion as to the applicability of section 213 of the Revenue Act of 1918 to the compensation received by State and municipal officials and employees. The Attorney General concluded that, although the provisions neither expressly included nor excluded such compensation, it could not be assumed that it was to be included, because—

> there cannot be any doubt that such wages and salaries are beyond the taxing power of Congress.

The opinion is based upon decisions of the Supreme Court rendered prior to the adoption of the sixteenth amendment and, of course, long prior to the recent decisions to which I have alluded. The opinion does not consider the effect or the the meaning of the sixteenth amendment. There is no indication that the Attorney General then had before him the data which has been gathered together in the study recently made and its appendix. Since the debates with reference to the Revenue Act of 1918, and since the opinion of Mr.

Attorney General Palmer, it does not appear that Congress has attempted to deal with this problem by statutory enactment. Every President of the United States since 1920 has recommended to the Congress that action be taken effectively to terminate the exemption of income from the so-called immune sources. Various hearings have been had on joint resolutions for constitutional amendments, beginning in 1922, and as late as 1937. President Franklin D. Roosevelt in 1935 recommended that such exemptions be terminated and suggested the submission of a constitutional amendment. Subsequently, after a consideration of the contemporary evidence and in the light of the more recent decisions of the Supreme Court, the conclusion was reached that, fairly construed, the language of the amendment would seem to authorize the taxation of income from such sources, and that a second amendment should not be necessary.

These arguments seem to be strong ones, but even if there were greater doubt as to the final solution of these constitutional problems, the legislation recommended by the President would still be justified. For only by such legislation can the question be settled as to whether or not, under the Constitution as it now stands, such income can be taxed. The enactment of legislation under substantially similar circumstances was approved by the Supreme Court in *Evans* v. *Gore*, to which I have already alluded. There, in discussing the propriety of its consideration and determination of the question which affected the salary of judicial officers, the Court noted the expression of Members of the Congress who, notwithstanding strong doubts as to its constitutionality, had supported the legislation in order to secure a determination of such constitutional questions which could not otherwise be settled. That the Court sanctioned such a course cannot be doubted.

Now, may I conclude by saying, Senator——

The CHAIRMAN. Mr. Morris, according to the last paragraph of your statement, that would rather justify the President's action in the Guffey coal bill controversy.

Mr. MORRIS. I think it not only adequately but emphatically does.

The CHAIRMAN. All right; go ahead.

Mr. MORRIS. I could not hope in this statement to you to bring to the committee all of the matters that should be considered by the committee. I could only hope to point out certain of those things, and I have dealt with them more sketchily than we do in our study. So I trust the committee will not consider my statement as being in anywise in lieu of the study and appendix prepared for the committee and which I would ask that the committee accept as my statement of the legal situation.

The CHAIRMAN. I think it would be rather expensive to have that printed, but it will be constantly referred to by us. It has been studied by the chairman in the past several months.

Mr. MORRIS. I am not asking that it be printed, but that it be considered and by reference made a part of my statement.

The CHAIRMAN. It will be, and I thank you very much for your very clear statement.

## STATEMENT BY JOHN PHILIP WENCHEL, CHIEF COUNSEL, BUREAU OF INTERNAL REVENUE

Mr. WENCHEL. Senator, I have prepared a legal discussion. It is quite lengthy, around 40 pages, and it so closely parallels the statement of the Assistant Attorney General that I was wondering if you would not prefer me merely to file it, and let me make this short statement.

The CHAIRMAN. Yes.

Mr. WENCHEL. I will do whatever seems wisest to you.

The CHAIRMAN. You do not think it would add a great deal to what Mr. Morris has said in his statement? We will file it and if we think it should be printed later as part of the committee's hearings, we will do so.

Mr. WENCHEL. The only thought that I had, after reading Mr. Morris' statement was that this so closely parallels it that I wonder whether you want to be burdened with the reading of it.

The CHAIRMAN. I am not sure. I will look it over and we might possibly have in inserted in the record.

Mr. WENCHEL. It does show the Department's view as compared with the Office of the Attorney General.

The CHAIRMAN. On the legal question?

Mr. WENCHEL. Yes, sir.

The CHAIRMAN. I think you might file it now, and then we will determine whether we will publish it as part of the committee's hearings. Are you now going to give your statement which I have here?

(Subsequently the legal discussion referred to by Mr. Wenchel was ordered printed in the record. It will be found at the conclusion of Mr. Wenchel's testimony.)

Mr. WENCHEL. Yes.

The CHAIRMAN. Very well. Proceed.

Mr. WENCHEL. The growing evils of tax-exempt securities and salaries are well-known. The President has suggested a way by which the unfair consequences of these immunities can be eliminated without the necessity for a constitutional amendment.

The Department of Justice has made an exhaustive study of the doctrine of reciprocal immunity and the Sixteenth amendment. That study concludes that the enactment of a "short and simple statute," as recommended by the President in his message to Congress last April, to end tax-exemption privileges is justified.

In my opinion, also, the Congress has the power to abolish tax-exempt securities and salaries.

Everybody knows that there are inequities in the revenue laws. There is no point in enumerating them now. But lawyers know they exist and so do laymen.

Every year hundreds of suggestions pour into the Bureau of Internal Revenue from citizens throughout the country with ideas as to how to make the application of the income tax fairer. Sometimes one or two remedies are suggested and other times wholesale revision is urged. These suggestions are generally unsatisfactory for one reason or another.

But possibly there is no one single item which so irritates the taxpayer of modest means as the statutory exemption of Government bondholders and Government employees from the income tax.

It is not a very wholesome condition when the ordinary taxpayer does not feel that the others are bearing their fair share of the burdens of government. A paragraph from one of these letters reads:

I started to earn whatever small amount I have been able to earn at a time when income taxes were high, and they have remained high ever since. I believe I have paid out in income taxes to the Federal Government four or five times the amount that I am worth today. It irks me beyond measure to know that there is a large class of persons with inherited wealth or who have made large sums during the boom period, the bulk of whose fortunes is invested in a form of security which bears no share of the burden imposed by Federal income taxes.

The other day I received a letter in the mails from a person in not so fortunate a class, and he says this:

For many years to me the taxation of certain people and exemption from taxation of certain others has been a matter of much debate and much adverse criticism. There will never come a ruling by either the court of appeals for the State of Maryland or by the Supreme Court of the United States in favor of taxing officeholders, both Federal and State, until and unless a Congress takes some definite and positive action promptly indicating that the lawmaking body is in accord with President Roosevelt's recommendation, namely, that the income of every man and woman, no matter from what source that income shall have been derived, from the President of the United States down through the United States Senators and the Members of the House of Representatives, the judges of the United States Supreme Court, every judge of every United States court, State court and every State official—everybody—should pay a tax on his or her income.

Can anything be more unfair, not to say mentally dishonest, than for the lawmaking body to hesitate to support the President in this matter?

He sent a copy to Senators Tydings and Radcliffe.

The CHAIRMAN. Does Maryland have a State income tax?

Mr. WENCHELL. They submitted a referendum last year, and it was not approved.

The CHAIRMAN. Mr. Wenchel, could I interrupt a moment? I understood from an article that I read in the New York Times this morning, giving the probable method the President is to send up on this subject, that New York and Utah were now making some effort to tax Federal salaries.

Mr. WENCHEL. New York has filed a suit and it has appealed to the Supreme Court in the case of an officer of the H. O. L. C.

The CHAIRMAN. Yes; but that has been withdrawn, however, has it not?

Mr. WENCHEL. No; it has not.

The CHAIRMAN. Making a contention somewhat similar to the position the Government took?

Mr. WENCHEL. That is right.

The CHAIRMAN. As to State authorities in the New York Port Authority?

Mr. WENCHEL. That is right.

The CHAIRMAN. Utah has done something.

Mr. WENCHEL. I have not heard of Utah.

Mr. LEO DIAMOND (office of the Chief Counsel, Bureau of Internal Revenue). There is the suit of *Van Cott* v. *State Tax Commissioner of Utah* pending in the Supreme Court; certiorari was granted on January 3, 1939.

The CHAIRMAN. Does Utah have an income tax?

Mr. DIAMOND. Yes; a State income tax.

The taxpayer was the agency counsel for the Salt Lake City agency

of the Reconstruction Finance Corporation, and his salary was held exempt from the State income tax by the Utah Supreme Court.

The other case is *Graves* v. *O'Keefe*, also pending in the Supreme Court, certiorari having been granted December 13, 1938. The taxpayer was an attorney for the Federal Home Owners' Loan Corporation in New York, and in that case also his salary was held not subject to State income tax by the New York Court of Appeals.

Mr. WENCHEL. Letters like that lead to the conclusion that somehow there has come to be a lack of proper adjustment between the operation of the revenue laws and the needs of the national community.

The way to deal with maladjustments in internal revenue laws is by direct, thorough, and systematic action by Congress. It is not the kind of a job State legislatures or State conventions are best fitted to do.

The CHAIRMAN. I agree with you; if the thing can be done, it must be done by Federal action.

Mr. WENCHEL. That is right.

The CHAIRMAN. It seems to me that is the better way to do it than to attempt to do it in 48 different jurisdictions.

No one seriously fears the effect upon States and their instrumentalities of the exercise by the Congress of, to quote the sixteenth amendment, "power to lay and collect taxes on incomes, from whatever source derived." For, as Chief Justice Marshall pointed out in the great case of *McCulloch* v. *Maryland* ((1819), 4 Wheat. 316):

> The people of all the States, and the States themselves, are represented in Congress, and, by their representatives exercise this power.

No one questions the proposition that the Federal Government lacks the power to tax in a manner which would destroy the States or their agencies or even seriously interfere with the exercise of State and municipal functions. This is the basic constitutional principle upon which the existence of tax-exempt securities and tax-exempt salaries is supposed to rest.

It can safely be assumed the Congress would pass no law professing to tax private incomes which actually tends to destroy States' rights. And it can fairly be said that the proposal of the President for a nondiscriminatory net income tax on the interest of public securities hereafter issued and on the salaries of public employees is not of this nature. Nor would it have any such effect.

Such a statute merely requires such interest and salaries to be included in the gross income of a taxpayer. The deductions and credits otherwise permitted by law would then be taken. If a net income subject to tax remained, the private individual or the private corporation would pay the same tax upon the amount of that net income as his fellow citizens or other corporations would pay if they had that much income.

The great advocate, Choate, arguing before the Supreme Court (in *Pollock* v. *Farmers Loan & Trust Co.* (1895), 157 U. S. 429, 158 U. S. 601), labeled the income tax as "communistic in its purposes and tendencies." Similarly, today special pleaders vow that tax-exempt privileges somehow are "inherent in our Federal system" of government or are necessary corollaries of a "fundamental doctrine of the Constitution." Such platitudinous expressions, though not very help-

ful in a scientific economic and legal examination of a serious problem of national fiscal policy, sometimes serve to lift to a loftier plane the argument of those who wish to see these special privileges retained.

The CHAIRMAN. They were talking about graduated-income tax?

Mr. WENCHEL. Yes, sir.

The CHAIRMAN. That is what he meant by communistic, I suppose?

Mr. WENCHEL. You are talking about Choate? No; I didn't understand your question correctly, Senator. Choate thought that the whole income tax set-up was communistic. He did not make any bones about it. I was just taking a short quotation.

The CHAIRMAN. All right.

Mr. WENCHEL. What basic constitutional concept of our Federal system would be violated by a nondiscriminatory net-income tax on the interest received by private holders of State and municipal securities and salaries received by private individuals in the employ of State and local governments?

In no other Federal system is any such immunity recognized. Earlier cases in Australia which held private income exempt from taxation have been expressly overruled (*Davoren* v. *Commonwealth Commissioner of Taxation* (1923), 32 C. L. R. 616). Likewise, in Canada no immunity is accorded income received from public obligations or public offices (*Caron* v. *The King* (1924), A. C. 999; *Forbes* v. *Attorney General* (1937), 1 D. L. R.).

As was pointed out by Mr. Morris, the earlier decisions followed the decisions in this Court, but latterly they have been overruled.

The CHAIRMAN. Is the Canadian income tax a Dominion tax or a provincial tax or both?

Mr. WENCHEL. There is a Dominion tax, and there are provincial taxes besides.

The CHAIRMAN. So their Dominion tax is similar in effect to our Federal tax?

Mr. WENCHEL. To our Federal tax, that is right.

The CHAIRMAN. And there are some Provinces levying an income tax?

Mr. WENCHEL. That is right. Now, whether all of them do or not, I am not advised.

The CHAIRMAN. I am quite interested in that situation. I did not know that until Mr. Morris brought it up today. But, as I get it, the Dominion of Canada at first, when it levied an income tax, exempted taxation upon the securities of the Provinces, and later, by a change in judicial interpretation—I have forgotten what they call their act up there, but it is an act of confederation of some kind.

Mr. WENCHEL. North American Act.

The CHAIRMAN. Yes, North American Act, and by judicial interpretation they later approved this type of taxation by the Federal Government, the Dominion, against the securities and salaries of the various Provinces. That is the situation up there?

Mr. WENCHEL. That is correct.

In this connection, Senator Brown, I would like to quote part of a letter which the Minister of Finance for Canada wrote to Senator Lonergan on July 13, 1937. He said:

> The Dominion issued bonds in the period 1916–18, exempt from Dominion income tax. The last of these issues matures in December 1937. About half of

this issue has already been refunded into taxable issues and all other tax-free obligations issued during the war have been converted into taxable securities. It was felt at the time these tax-free issues were floated that the Canadian investor, unfamiliar with bond investment on any large scale, required the tax-free feature in the bonds he purchased. It was imperative that the various issues be successful as cash requirements of the Dominion during the Great War were very heavy. There were some, even at that time, who believed that the funds would have been forthcoming without tax exemption and in recent years, with the aid of hindsight, the number of persons who hold this view has greatly increased. It should be borne in mind that while these issues were exempt from Dominion income tax, they were subject to income taxes levied by a number of Provinces.

I attach hereto a bulletin published by the Dominion Bureau of Statistics, giving the yields on Dominion and Province of Ontario bonds from 1919 and 1900, respectively.

I also attach statement showing the yield on July 8, 1937, of Dominion, Provincial, and industrial bonds, all of which are payable in Canada only. This shows the differentials in yields on these three classes of bonds. I think you will be able to draw your own conclusions from these data.

The tables referred to appear in the hearings before the subcommittee of the Senate Committee on the Judiciary, Seventy-fifth Congress, first session, on S. J. Res. 5 and S. J. Res. 154, at pages 69 to 74.

If you will look at those tables, Senator, referred to in the letter, you will see that the reciprocal and nondiscriminatory income taxation imposed by the Dominion of Canada and the Provinces which have an income tax has not encumbered the borrowing power of the Canadian Federal or Provincial Governments, which are able, without any tax exemption privileges, to market their obligations at lower yields that can be commanded by the highest grade industrial securities with which they compete in the money market.

The CHAIRMAN. That is very interesting.

You were at the last paragraph on page 4.

Mr. WENOHEL. Tax-exempt securities and salaries are peculiarly an American tax problem—and a wholly unnecessary problem at that.

The reciprocal rights and immunities of the National and a State Government may be safeguarded—

as Mr. Justice Roberts has so well said—

by the observance of two limitations upon their respective powers of taxation. These are that the exactions of the one must not discriminate against the means and instrumentalities of the other and must not directly burden the operations of that other (*Brush* v. *Commissioner* (1936) 300 U. S. 352, 375).

After all, *whose* income is going to be taxed? Clearly there is no thought in the President's proposal of taxing the property or the income of any State or municipality. There is no thought of taxing the interest on bonds owned by the State or municipal sinking or pension funds.

Public income now exempt will remain exempt. Nothing but *private* income will be taxed under the suggested statute.

"*Whose* income?" is not a new or strange test to apply in determining the constitutionality of ending the subsidy of wealthy taxpayers and tax-free Government employees. It is the test which the Supreme Court of the United States used in holding the salaries of employees of the Port of New York Authority subject to income tax (*Helvering* v. *Gerhardt* (1938), 304 U. S. 405, rehearing denied, 59 Sup. Ct. 57).

In that case the Supreme Court listened to the same cut-and-dried arguments about how the sovereignty of the State clothes with constitutional immunity the private income of private persons who are able to afford investing in public securities or who receive salaries from the public treasury.

Mr. Justice Stone directed this forceful language in reply to these appeals for special privileges which masqueraded as constitutional arguments:

> A non-discriminatory tax laid on their net income, in common with that of all other members of the community, could by no means or reasonable probability be considered to preclude the performance of the function which New York and New Jersey have undertaken or to obstruct it more than like private enterprises are obstructed by our taxing system. Even though, to some ascertainable extent, the tax deprives the States of the advantage of paying less than the standard rate for the services which they engage, it does not curtail any of those functions which have been thought hitherto to be essential to their continued existence as States. At most, it may be said to increase somewhat the cost of the State governments, because, in an interdependent economic society, the taxation of income tends to raise * * * the price of labor and materials. The effect of the immunity, if allowed, would be to relieve respondents of their duty of financial support to the National Government in order to secure to the State a theoretical advantage so speculative in its character and measurement as to be unsubstantial. A tax immunity devised for protection of the States as governmental entities cannot be pressed so far.

As a matter of fact, nothing in the Revenue Act of 1938 excludes from gross income the compensation received by State and municipal employees. Congress repealed such a provision in the Revenue Act of 1918.

Interest derived from State and municipal securities is still, however, excluded by the Revenue Act of 1938 from gross income and has been since the income-tax law of 1913.

Why is this *statutory* exemption needed?

Those who oppose the President's proposal to repeal this statutory exemption know full well that so long as it stays in the Revenue Act the Supreme Court will never have the opportunity of considering whether interest on State and municipal securities is taxable or tax-exempt under the Constitution. That is why this statutory exemption is needed.

No principle of constitutional law requires a specific statutory provision to make it effective. Every constitutional prohibition is self-executing.

Can it be that those who say there is a constitutional immunity have no confidence in their own position?

They know, for example, that the Supreme Court has held (in *Willcuts* v. *Bunn* (1931), 282 U. S. 216), that capital gains realized from the sale of State and municipal securities are subject to the Federal income tax, the income-tax law exempting only "interest" from taxation.

They know also, for example, that the Supreme Court in overruling two earlier reciprocal-tax immunity cases last year said that hereafter "regard must be had to substance and direct effects" and that the test in these cases will now be whether or not there is in fact a "direct and substantial interference" with the functions of government (*Helvering* v. *Mountain Producers Corporation* (1938), 303 U. S. 376, overruling *Burnet* v. *Coronado Oil & Gas Co.* (1932), 285 U. S. 393, and *Gillespie* v. *Oklahoma* (1921) 257 U. S. 501).

And they know that Chief Justice Hughes has said that the effort of the Supreme Court in this class of cases will be to apply "the practical criterion" (*James* v. *Dravo Contracting Co.* (1937) 302 U. S. 134).

Even before the ratification of the sixteenth amendment the Supreme Court (in the case of *Flint* v. *Stone Tracy Co.* (1910), 220 U. S. 107) had upheld a Federal excise tax on corporations measured by net income from all sources. The court not only held that the phrase "from all sources" included the income from State and municipal securities but that the doctrine of reciprocal immunity from taxation did not apply. And in one of the last opinions which he wrote, Mr. Justice Cardozo pointed out that "many, perhaps most, courts hold that a net income tax is to be classified as an excise," and that the decisions of the Supreme Court itself "now forbid us to stigmatize as unreasonable the classification of a tax upon net income as something different from a property tax, if not substantially an excise."

Like most questions of political science, the constitutional issue involved in the proposal to abolish tax-exemption privileges is a question of degree.

The message of the President recognizes this elementary principle. That is why it is limited to the suggestion that income received by a *private* individual or corporation should not be excluded from income simply because it is derived from a State or municipal bond, and that income received by a *private* individual should not be excluded from income simply because he is paid by a State or local government.

Nothing in the Constitution requires that the holder of tax-exempt securities obtain an advantage over the holder of taxable securities.

Nothing in the sixteenth amendment warrants the belief that the Congress is constitutionally helpless to frame an income law which taxes the incomes of all private persons alike.

I do not believe that the Supreme Court will find it inconsistent with the principles of a Federal democracy for Congress to end the issuance *in the future* of securities which, as the Under Secretary of the Treasury has demonstrated to this committee, are worth more to persons of great means than to persons of modest means.

In short, the Constitution does not by necessary or unavoidable implication establish a privileged class of public creditors and public employees.

The real question before this committee is the same which Governor Dix of New York had in mind when he urged the legislature of that State to ratify the sixteenth amendment. Like many others, Governor Dix thought "from whatever source derived" was plain English and hence included the income of Government bondholders and employees. So he said:

> It is impossible to conceive of any proposition more unfair and more antagonistic to the American idea of equality and democratic principle of opposition to privilege, than an income tax so levied that it would divide the people of the United States into two classes.

When it becomes possible through the passage of the proposed statute to present the question here involved to the Supreme Court any argument that the borrowing power of States and their instrumentalities will be unconstitutionally burdened is not likely to be well

received. The fundamental principles laid down by Mr. Justice Stone in the *Port of New York Authority case* do not lead to such a conclusion. He put the case in these simple terms:

> The State and National Governments must co-exist. Each must be supported by taxation of those who are citizens of both. The mere fact that the economic burden of such taxes may be passed on to a State government and thus increase to some extent, here wholly conjectural, the expense of its operation, infringes no constitutitonal immunity. Such burdens are but normal incidents of the organization within the same territory of two governments, each possessed of the taxing power.

Perhaps in taxation, more than any other field of law, it can be said that the law is not abstract. There are two important elements in every decision upon the constitutionality of a tax. One is the rule to be applied. The other is the economic situation to which that rule must be applied. Whatever the decision may be, it sets in motion a powerful force in the economic life of the Nation.

"A Constitution," Mr. Justice Holmes has reminded us, "is not intended to embody a particular economic theory." Now that the economic incidences of the progressive income tax are more clearly perceived, and the socially unjust operation of the tax-exemption privileges better understood, opportunity should be given to the Supreme Court to reconsider the whole doctrine of reciprocal immunity from taxation. It can safely be predicted, when this opportunity is afforded by the ending of statutory tax-exemption privileges, the Court will vindicate the judgment of Congress that such privileges menace our progressive income tax and are not needful for the existence of our Federal system.

In closing, I would like to call attention to a statement which appears in the Washington News of September 25, 1937, quoting Dr. Nicholas Murray Butler. He said in replying to the proposition which was at that time being urged that it was necessary to get a constitutional amendment in order to tax the salaries of State employees and income from the bonds of the State and municipalities that:

> There could be no more direct and unqualified grant of power to Congress to tax incomes from whatever source than is conveyed in the language of the sixteenth amendment.
>
> To adopt now another amendment definitely specifying that the Congress might tax income from sources which have been held exempt because of court decisions subsequent to the sixteenth amendment would be to make us the laughing stock of the world.
>
> That would be equivalent to saying that the words "from whatever source derived" do not mean what they appear to mean, but must be supplemented by a variety of specific designations of sources of income.

(The following study was offered for the record by Mr. Wenchel:)

LEGAL DISCUSSION BY JOHN PHILIP WENCHEL, CHIEF COUNSEL, BUREAU OF INTERNAL REVENUE, OF THE CONSTITUTIONALITY OF PROPOSED LEGISLATION FOR THE ELIMINATION OF TAX-EXEMPT SECURITIES AND SALARIES BEFORE THE SPECIAL COMMITTEE OF THE SENATE ON THE TAXATION OF GOVERNMENT SECURITIES AND SALARIES, JANUARY 18, 1939

For the reasons given by Mr. Hanes, the Under Secretary of the Treasury, we believe that there can be no serious doubt as to the desirability of removing the reciprocal tax exemptions which now exist, and we are prepared to present the view that the termination of these exemptions can be accomplished by act of Congress. We are fortified in this position by the excellent and exhaustive study prepared by the Department of Justice under the immediate direction of the Honorable James W. Morris, Assistant Attorney General, in which the conclusion was reached that there are no legal barriers to such a program.

It is true that occasionally heretofore the Executive Department has entertained the view that the elimination of such barriers could be accomplished with certainty only through the means of an amendment to the Constitution. A blind adherence to the doctrine of *stare decisis* might possibly dictate a continuation in that point of view. But in these times the Supreme Court itself is not content to rest its determination of constitutional questions simply on *stare decisis*. Recently a number of decisions have been announced which indicate that the court is ready to reexamine prior attitudes and pronouncements in such matters, as, for example, in *Helvering* v. *Mountain Producers Corporation* (1938), 303 U. S. 376, and again in *Erie Railroad Company* v. *Harry J. Tompkins* (1938), 304 U. S. 64, each of which rejected established constitutional precedents in favor of principles more consonant with a realistic interpretation of that fundamental law.

It cannot be said without qualification that there is no judicial doctrine standing in the way of a full acceptance by the courts of this proposed legislation. On the contrary, it is conceded that among the many decisions of the courts touching on the constitutional issues here involved there are to be found some statements which may seem discouraging to the hope that the proposed legislation will weather the storm. However, it is one of the virtues or vices of the judiciary, depending upon the point of view, that extraneous statements known as *obiter dicta* appear in decisions on which important national issues depend. The courts have from time to time admitted that their decisions contain statements which are not necessary to the adjudication of the issues involved. In the early days of the Supreme Court, Chief Justice Marshall voiced this warning:

"It is a maxim not to be disregarded, that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected but ought not to control the judgment in a subsequent suit when the very point is presented for decision. The reason for this maxim is obvious. The question actually before the court is investigated with care and considered in its full extent. Other principles which may serve to illustrate it are considered in their relation to the case decided, but their possible bearing on all other cases is seldom completely investigated (*Cohens* v. *Virginia*, 6 Wheat. 234, 399)."

Justice Sutherland, in writing the majority opinion in *Brush* v. *Commissioner* (1937) 300 U. S. 352, was confronted with statements in the cases of *South Carolina* v. *United States* (1905) 199 U. S. 437, and *Flint* v. *Stone Tracy* (1911) 220 U. S. 107), to the effect that supplying water to the public is not a governmental function. In disposing of the dicta in these two cases by stating that in neither case was that particular question an issue and therefore the statements were made by way of illustration and were not necessary to the disposition of the question at issue he said: "Expressions of that kind may be respected but do not control in a subsequent case when the precise point is presented for decision."

We are convinced that a close examination of the cases will show that many of the arguments against the constitutionality of this proposed bill will be based upon *obiter dicta* by the court; expressions which were not necessary to the decisions in the cases in which they were made and expressions which the Court therefore may dispose of without great difficulty.

Examination of the cases indicates that the Court feels no compunction about reversing either its actual holdings or its obiter observations. The Court plainly admits it is not infallible; plainly admits that judicial doctrines need overhauling from time to time as political, sociological, and economic trends change. As was said by Mr. Justice Brandeis in the dissenting opinion in *Jaybird Mining Company* v. *Weir* (1920) 271 U. S. 609, 619):

"It is a peculiar virtue of our system of law that the process of inclusion and exclusion, so often employed in developing a rule, is not allowed to end with its enunciation and that an expression in an opinion yields later to the impact of facts unforeseen. The attitude of the court in this respect has been especially helpful when called upon to adjust the respective powers of the States and the Nation in the field of taxation."

It is important to note carefully the inducements which have caused the Court to reexamine and overrule its prior decisions. In the past 8 years the Supreme Court has overruled 10 of its previous decisions containing at least 6 of its weighty doctrines.

In 1930, in deciding *Farmers Loan & Trust Co.* v. *Minnesota* (1930) 280 U. S. 264, the Court overruled its previous decisions in *Blackstone* v. *Miller* (1903) 188 U. S. 189, in spite of the fact that it had existed for 27 years.

*Fox Film Corp.* v. *Doyal* (1932) 286 U. S. 123 overruled *Long* v. *Rockwood* (1928) 277 U. S. 142, which had for 5 years been authority for the tax immunity of income derived from royalties on patent rights. *Chicago & E. I. R. Co.* v. *Commissioner* (1932) 284 U. S. 207 overruled *Erie Railroad* v. *Collins* (1920) 253 U. S. 77 and *Erie Railroad* v. *Szary* (1920) 253 U. S. 86, both of which were authority for a doctrine recognized by the Court for 12 years. *Funk* v. *United States* (1933) 290 U. S. 371 overruled *Hendrix* v. *United States* (1911) 219 U. S. 79 and *Jim Fuey Moy* v. *United States* (1920) 254 U. S. 189, which had been authority for a judicial doctrine of considerable importance supported by the Court for 22 years. In 1937 the Court held constitutional a State minimum wage law in its decision in *West Coast Hotel Co.* v. *Parrish* (1937) 300 U. S. 379, and in doing so overruled its decision made 15 years before in *Adkins* v. *Children's Hospital* (1923) 261 U. S. 525, which had held a similar minimum wage law unconstitutional.

Further evidence that the Court is currently not blind to changing social and economic conditions, which, after all, are what our theories of justice are historically based upon, is contained in the opinions recently rendered by the Court in *Helvering* v. *Mountain Producers Corp.* (1938) 58 S. Ct. 623, which overruled *Gillespie* v. *Oklahoma* (1922) 257 U. S. 501, and *Burnet* v. *Coronado Oil and Gas Co.* (1932) 285 U. S. 393; *Erie Railroad Co.* v. *Tompkins* (1938) 304 U. S. 64, overruling *Swift* v. *Tyson* (1842) 16 Peters, 1; and *Helvering* v. *Gerhardt* (1938) 304 U. S. 405; rehearing denied, 59 Sup. Ct. 57, which goes far toward restating the present problem.

The doctrine of *Swift* v. *Tyson* was 96 years old, and in relegating it to the limbo of outworn principle, Justice Brandeis stated:

"* * * Doubt was repeatedly expressed as to the correctness of the construction given section 34 * * * and as to the soundness of the rule which it introduced * * *. *But it was the more recent research of a competent scholar who examined the original document, which established that the construction given to it by the Court was erroneous;* * * *.

* * * * * * * *

"*Experience in applying the doctrine of* Swift *v.* Tyson *had revealed its defects, political and social; and the benefits expected to flow from the rule did not accrue.* Persistence of State courts in their own opinions on question of common law prevented uniformity; * * * and the *impossibility of discovering a satisfactory line of demarcation* between the province of general law and that of local law *developed a new web of uncertainties.* * * *

"*On the other hand, the mischievous results of the doctrine had become apparent.* * * * Swift *v.* Tyson *introduced grave discrimination by noncitizens against citizens.* * * * *Thus, the doctrine rendered impossible equal protection of the law. In attempting to promote uniformity of law throughout the United States, the doctrine had prevented uniformity in the administration of the law of the State.*

"* * * *If only a question of statutory construction were involved, we should not be prepared to abandon a doctrine so widely applied through nearly a century.* * * * *But the unconstitutionality of the course pursued has now been made clear and compels us to do so.*" [Italics supplied.]

An examination of the cases cited discloses an aggregate of the following considerations which induced the Court to overrule prior decisions:

1. "The importance of the question" (*West Coast Hotel Co.* v. *Parrish, supra*); "the expanding needs of the State and Nation" (*Helvering* v. *Mountain Producers Corp., supra*); and a "close decision" (*West Coast Hotel Co.* v. *Parrish, supra*) of the Court in previous cases involving the doctrine.

2. The intervening "economic conditions" requiring reexamination of the "reasonableness of the exercise of the protective power of the State" (*West Coast Hotel Co.* v. *Parrish, supra*).

3. The fact that prior decisions have become out of harmony with the trend of later decisions (*Fox Film* v. *Doyal*, etc.).

4. The doctrine tends to "disturb good relations among the States and produce the kind of discontent expected to subside after establishment of the Union" and that it "has been stoutly assailed on principle" (*Blackstone* v. *Miller, supra*).

5. Research by competent authorities has shown that the Court placed an erroneous construction on the original document used as the basis of the doctrine and that "experience in applying the doctrine" has "revealed its defects, political and social" (*Erie Railroad Co.* v. *Tompkins, supra*).

6. "The benefits expected to flow from the rule did not accrue" and "the impossibility of discovering a satisfactory line of demarcation" created a "new well of uncertainties" (*Erie Railroad Co.* v. *Tompkins, supra*).

7. The doctrine has "introduced grave discrimination," its "mischievous results have become apparent" (*Erie Railroad Co.* v. *Tompkins, supra*), and "the practical effect of it has been bad" (*Blackstone* v. *Miller, supra*).

8. The doctrine has "rendered impossible equal protection of the law" and "in attempting to promote uniformity of law throughout the United States" it "has prevented uniformity in the administration of the law" (*Erie Railroad Co.* v. *Tompkins, supra*).

9. The "distinctions" maintained with respect to the doctrine "have attenuated its teaching and raised grave doubt as to whether it should longer be supported" (*Helvering* v. *Mountain Producers Corp., supra*).

It seems to us that each and every one of these inducements are present and applicable to the doctrine of implied immunities in the field of taxation. Moreover, the difficulties inherent in connection with the application of the doctrine supply cogent reasons for reexamination. This is particularly true where the impact of Federal taxation upon State activities is involved. What tax burdens threaten the destruction of the States and are, therefore, constitutionally objectionable, and what definite rules there are which determine the difference between governmental and proprietary functions of States are still unanswered questions from an administrative standpoint.

For the present it seems sufficient to state our belief that it is presently propitious to inquire of the Court whether or not "the impossibility of discovering a satisfactory line of demarcation" in the immunities doctrine has not created such a deep "new well of uncertainties" as to make it advisable and necessary to reexamine the whole basis of the doctrine. But even apart from that consideration, it must be apparent to all who have studied the unfolding of the national panorama that we have experienced a gradual but nevertheless sure metamorphosis in the relations between the Federal Government and the States. The character of that movement has been such that at the present time it seems almost impossible to doubt that the Court will find ample inducements to justify a reexamination of any existing authority which tends to deny the power of Congress to impose the tax proposed.

But even greater evidence that the Court is willing and ready to reexamine the numerous implications of the doctrine of implied immunities upon proper presentation of the issues involved is contained in the decision rendered on May 23, 1938, in *Helvering* v. *Gerhardt, supra*, popularly referred to as the *Port of New York Authority case*. The case involved the validity of the Federal income tax as applied to the salaries of employees of the Port of New York Authority, a bi-State corporation created by a Congressionally approved compact between New York and New Jersey. The corporation built and operated bridges, tunnels, and freight terminals. The Court held that the Federal Government had the constitutional power to tax the salaries of these employees.

While one may limit the decision to the particular facts of the case, the implications in it arising from statements in the opinion are of great importance as being a definite indication that as cases arise, the doctrine of immunities in all its phases will be reexamined in the light of modern thinking. The majority did not find it necessary explicitly to overrule any of its prior decisions, but quite definitely veered away from any restricted or narrow interpretation of its previous dicta by indicating that when the proper issues are brought before the Court, definite, administratively workable new outlines of the immunities doctrine will be drawn. Mr. Justice Black, in a separate concurring opinion in this case, urged a complete reexamination of the whole intergovernmental immunities question in the light of the unequivocal language of the sixteenth amendment.

Viewed in the light of the Court's traditional attitude and more particularly its present-day critical attitude toward constitutional doctrine there are several grounds upon which the constitutionality of the proposed legislation may be supported, any one of which would appear to be sufficient. An obvious ground, as the President has stated, is a normal and natural application of the language of the sixteenth amendment. A brief résumé of the history of the amendment will demonstrate, I think, that there is no good reason why the language of the amendment cannot be held to mean no more or less than the dictionaries all say it means.

In 1894 Congress passed an income-tax law. It provided for an annual tax of 2 percent upon the gains, profits, and income of over $4,000 from any kind of

property, rents, interest, dividends, salaries or from any profession, trade, or employment. The tax attracted much popular interest and acute attention was given to a case which was brought to the Supreme Court to test its constitutionality. This case was *Pollock* v. *Farmers' Loan and Trust Co.* (1895) 157 U. S. 420, 158 U. S. 601. The case involved the validity of the income tax as applied to the defendant's income which was derived from real estate, municipal bonds, and corporate bonds and stock. It was charged that the tax was unconstitutional on several grounds. It was contended that a tax on income from property was a direct tax, and it was also contended that the Federal Government was without power to tax the income from bonds of a municipality of a State. The Court held that a tax upon income from property was in the nature of a direct tax and was in violation of the Constitution since it was not apportioned among the States. The Court also held that a tax on interest from municipal securities was a tax on the borrowing power of the States and their municipalities and was unconstitutional. In reaching this conclusion as to the immunity of income from municipal bonds, the Court relied upon *Collector* v. *Day* (1871) 11 Wall. 113, where it had been held that the Federal Government could not levy an income tax upon the salaries of judicial officers of a State.

The decision in the *Pollock case* was widely criticized. Probably no other case, with the exception of the *Dred Scott case* received so much unfavorable comment. Proponents of the income tax did not retire from the struggle but carried on the fight over the next two decades. In 1908 the platform of the Democratic Party urged the submission of "a constitutional amendment specifically authorizing Congress to levy and collect a tax upon individual and corporate incomes, to the end that wealth may bear its proportionate share of the burdens of the Federal Government." The next year President Taft recommended to Congress that there be submitted to the States a proposed amendment to the Constitution which would grant to the Federal Government adequate power of income taxation. "Although I have not," he wrote, "considered a constitutional amendment as necessary to the exercise of certain phases of this power [to tax incomes], a mature consideration has satisfied me that an amendment is the only proper course for its establishment to its full extent. * * *."

On April 27, 1907, Senator Brown, of Nebraska, proposed an amendment which would provide as follows: "The Congress shall have power to lay and collect taxes on incomes and inheritances" (44 Cong. Rec. 1548). On June 17 Senator Brown introduced a new amendment which would provide that "The Congress shall have power to lay and collect direct taxes on incomes without apportionment among the several States according to population" (44 Cong. Rec. 3377). This amendment was referred to the Committee on Finance, which on June 28 reported a joint resolution which struck from Senator Brown's proposal the word "direct" and inserted the more comprehensive words "from whatever source derived." Thus expanded the proposed amendment would provide that: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States and without regard to any census or enumeration" (44 Cong. Rec. 3900). No explanation was made of the change. The debate in the Senate was slight and on July 5 the joint resolution was passed by the Senate by a unanimous vote. A week later, and without extended debate, the House passed the joint resolution by the overwhelming vote of 318 to 14 (44 Cong. Rec. 4121, 4440).

In the following January, Governor Hughes sent a message to the legislature of New York objecting to ratification of the amendment. "I am," said Governor Hughes, "in favor of conferring upon the Federal Government the power to lay and collect an income tax without apportionment among the States according to population. * * * But the power to tax incomes should not be granted in such terms as to subject to Federal taxation the incomes derived from bonds issued by the State itself or those issued by municipal governments organized under the State's authority—you are called upon to deal with a specific proposal to amend the Constitution. This proposal is that the Federal Government shall have the power to lay and collect taxes on incomes 'from whatever source derived.'" And, said Governor Hughes, "It is to be borne in mind that this is not a mere statute to be construed in the light of constitutional restrictions, express or implied, but a proposed amendment to the Constitution itself which, if ratified, will be in effect a grant to the Federal Government of the power which it defines. The comprehensive words 'from whatever source derived,' if taken in their natural sense, would include not only incomes from real and personal property, but also incomes derived from State and municipal securities."

Other chief executives also were of the opinion that the proposed amendment would permit the taxation of incomes from official salaries and from securities of States and municipalities. Governor Gilchrist, of Florida, considered that the amendment would confer power to tax incomes from State and municipal bonds, but was confident that Congressmen and Senators, being necessarily residents of the States and generally of municipalities would not exercise the power in such manner as to destroy the credit of their own State or their own municipality. Governor Gilchrist emphasized that he favored the income-tax amendment notwithstanding Governor Hughes' objection. Governor Haskell, of Oklahoma, stated that he considered the language of the amendment was very broad and that Congress should be careful in the exercise of the authority conferred upon Congress by the amendment. Governor Burke of North Dakota expressed his opinion that the proposed amendment was broad enough to include a tax on incomes derived from the ownership of State and municipal bonds, and stated that he was opposed to the amendment.

Governor Dix, a successor to Governor Hughes as chief executive of New York, was also of the opinion that the amendment would confer this power upon Congress. Governor Dix, however, thought that Congress should possess this power. "Indeed, it seems to me," he said, "that if the words 'from whatever source derived' would leave the amendment ambiguous as to its power to tax incomes from official salaries and from bonds of States and municipalities, the amendment ought to be opposed by whoever adheres to the democratic maxim of equality of laws, equality of privileges, and equality of burdens. * * * It is impossible to conceive of any proposition more unfair and more antagonistic to the American idea of equality and the democratic principle of opposition to privilege, than an income tax so levied that it would divide the people of the United States into two classes."

"This proposed amendment," said Senator Edmunds, of Vermont, "of course, embraces the income from every species of property, whether National bonds, State bonds, municipal bonds, the income of churches and charitable institutions, as well as savings banks and all the other earnings of labor" (45 Cong. Rec. 2001). Senator Edmunds opposed the proposed amendment. On the other hand, Senators Borah, Bailey, Brown, and Root, who were in favor of the amendment, expressed the opinion that the amendment would not confer upon Congress power to tax income from State and municipal securities and State and municipal salaries (45 Cong. Rec. 1694, 1698, 2539).

The foregoing discussion indicates that one of the obstacles to income taxation was the immunity of income from State and local securities which the court had pronounced in the *Pollock case*. In stating this position the court had relied upon *Collector* v. *Day* which had extended a like immunity to the salary of a State official. Such immunity of State salaries and income from State securities stood in the way of the possession of power necessary for the full development of a system of income taxation. The *Pollock case* had held that a tax on income derived from property was subject to the requirement of apportionment.

To remove income taxation from the rule of apportionment was one of the main purposes in framing the sixteenth amendment. But it was not the sole purpose. Congress might at different periods consider that it was desirable not to tax income from State and local securities, or not to tax salaries of State and local officials, but the possession by Congress of power to tax such incomes was essential to the molding of a system of taxation in conformity with the principle of ability to pay. The amendment was intended to remove the obstacles to taxation of such income as well as to remove the requirement of apportionment. It is reasonable to assume that it was for this express purpose that the words "from whatever source derived" were inserted.

In this connection it is significant that the corporation tax law of 1909, which was enacted contemporaneously with the submission of the sixteenth amendment, provided that "every corporation * * * shall be subject to pay annually a special excise tax * * * upon the * * * net income * * * received by it *from all sources* * * *." [Italics supplied.] In *Flint* v. *Stone Tracy Co.* (1911) 220 U. S. 107, the Court gave full effect to the words as meaning what they plainly said—in computing the excise tax the measure of the tax shall be "net income * * * *from all sources*." As this language was broad enough to include all income, that from State and municipal bonds as well as all other, the Court considered that such income was within the meaning of the statute. In the same period when Congress wrote into the corporation tax law the words "from all sources," it wrote into the resolution for the sixteenth amendment the words "from whatever source derived."

The Court gave full effect to the plain words of the corporation tax law. It is reasonable to expect that if the question comes directly before the Court it will give similar effect to the plain words of the sixteenth amendment.

The proposed amendment entered the arduous road to ratification in July 1909. The process of ratification dragged along over a period of 3½ years before it was completed in 1913. Congress soon acted and the Tariff Act of October 3, 1913, provided for an income tax. This act was retroactive and, although enacted in October 1913, it fixed a first period embracing the time from March 1 to December 31, 1913.

In *Brushaber* v. *Union Pacific R. R. Co.* (1916) 240 U. S. 1, it was contended that income which had accrued since March 1, 1913, could not be reached retroactively by a tax enacted in October 1913. The contention was that the income had become capital prior to the passage of the act; and that the sixteenth amendment permitted only the taxation of income and not the taxation of capital. The Court sustained the limited retroactivity of the tax. In the course of his opinion in the *Brushaber case* Mr. Chief Justice White stated that "* * * the whole purpose of the amendment was to relieve all income taxes from apportionment from a consideration of the source whence the income was derived." And in *Battle Mining Co.* v. *Stanton* (1916) 240 U. S. 103, Mr. Chief Justice White referred to the *Brushaber case* as having "settled" the proposition that the amendment conferred no new power of taxation.

When this language is considered in relation to the problem which was before the Court, its meaning becomes evident and it is seen that the statement does not conflict with the view that the sixteenth amendment conferred upon Congress the power to tax income from State and municipal securities and salaries of State and municipal employees. The contention was that income which had accrued before the passage of the act was capital and not income and that the amendment did not authorize Congress to tax without apportionment anything except *income*. The Court permitted the retroactive taxation, as a tax on income but in order to clarify its position and make clear that the amendment authorized a tax on income and not on capital, Mr. Chief Justice White wrote the passage quoted above. When viewed in relation to the problem before the Court the passage takes on meaning.

The case of *Eisner* v. *Macomber* (1920) 252 U. S. 189, presented a somewhat similar question. The question was whether a stock dividend involved in that case constituted income. Referring to the sixteenth amendment, Mr. Justice Pitney remarked, "* * * this did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the States of taxes laid on income." Here again the question related to the nature of the item which it was contended was subject to the income tax. The court declared that it was not income and that the amendment only authorized the taxation of income. "* * * This [the sixteenth amendment] did not extend the taxing power to new subjects * * *." Here, as in the *Brushaber case*, the Court was asserting that the sixteenth amendment did not authorize Congress to tax without apportionment anything except incomes.

In the light of the questions which were before the Court in these cases, it is seen that the Court's expressions of opinion do not militate against an interpretation of the amendment as authorizing taxation of State and municipal salaries or income from State and municipal securities. Indeed, to interpret the statements as indicating that the sixteenth amendment still leaves limitations on Congress' power to tax income is to charge the Court with having "settled" by dictum an important question of constitutional power which was not remotely involved in the cases before it.

*Evans* v. *Gore* (1920) 253 U. S. 245, decided that by taxing the salary of a Federal judge as a part of his income, Congress was in effect reducing his salary and thus violating article III, section 1, of the Constitution, which provides that "the judges * * * shall, at stated times, receive for their services, a compensation, which shall not be diminished during their continuance in office." The decision was by a divided Court, Mr. Justice Holmes and Mr. Justice Brandeis dissenting. Speaking for the majority, Mr. Justice Van Devanter rejected the contention that the sixteenth amendment must be deemed to have authorized such taxation, notwithstanding the language of article III.

While the Court was of the opinion that the sixteenth amendment did not extend Congress' power to tax incomes to such extent that the salaries of judges, specifically protected by article III, could be subjected to income taxa-

tion, there are important aspects of the decision which indicate that the case does not stand in the way of a tax on State and municipal salaries or income from State and municipal securities. The decision in *Evans* v. *Gore* is based on a clause of the written Constitution. No such clause can be invoked in behalf of State and municipal salaries or income from State and municipal securities.

It is important to note that the Court did not assert that the judges' salaries were inherently exempt from taxation. Neither the important principle of the separation of powers nor the principle of judicial independence were regarded by the framers of the Constitution as sufficient to secure the exemption pronounced in *Evans* v. *Gore*. On the contrary, that exemption was stipulated for in the written instrument itself.

The exemption of State and municipal salaries and income from State and municipal securities rests only on implications. Implication was not sufficient to secure an exemption for judicial salaries; why should implication be supposed to suffice in securing exemption for State and municipal salaries or income from State and municipal securities?

Another important distinction between the problem in *Evans* v. *Gore* and the problem now being considered, should be noted. In the exemption of the salaries of judges the emphasis is on the status of the recipient. Judicial salaries are protected as such by article III of the Constitution. The emphasis is not on exemption because of the source of the judicial salary, but on exemption because of the status of the recipient as a judge protected by article III.

On the other hand, the supposed immunity of State and municipal salaries and income from State and municipal securities emphasizes the source of such incomes. Thus the latter income, from State and municipal salaries and securities is sought to be exempted despite its being income by considering its source. But consideration of source is what the sixteenth amendment forbids in the determination of Congress' power in taxing incomes. The sixteenth amendment, thus, had no bearing on the point decided in *Evans* v. *Gore*. This was because the criterion of source of income, which had previously limited Congress' power in income taxation, and which criterion was repealed by the amendment, was not a consideration in article III.

Thus the repeal of source of income as a criterion of power to tax income did not affect the exemption afforded by article III, since that exemption was not related to source of income. But the repeal of the criterion of source of income was the purpose of the sixteenth amendment, and its adoption opened the way for taxation of income over which Congress had previously had only a limited power of taxation. It follows that what was said in *Evans* v. *Gore* about the sixteenth amendment was purely dictum. See, generally, Corwin, Constitutional Tax Exemption ((1924), 18 Nat. Municipal Review 51.)

In *Peck* v. *Lowe* (1918) 247 U. S. 165, a corporation engaged in buying goods in the several States and shipping them to foreign countries questioned the right of the Government to levy an income tax on so much of its income as arose from shipping goods to foreign countries and there selling them. It was claimed that this was within the prohibition of the Constitution, that "No tax or duty shall be laid on articles exported from any State." It was held that the prohibition of an export duty on articles did not prohibit an income tax on the corporation in respect of the gains made in the business of exporting. The court did not need to consider whether, if the clause of the Constitution which prohibited an export tax would otherwise prohibit an income tax on net income, nevertheless an income tax could be supported by the sixteenth amendment acting as a repeal pro tanto of such export tax prohibition. "The sixteenth amendment," said Mr. Justice Van Devanter, "although referred to in argument, has no real bearing and may be put out of view." And he added, "As pointed out in recent decisions, it [the sixteenth amendment] does not extend the taxing power to new or excepted subjects * * *," citing the *Brushaber* and *Stanton cases*, above referred to. But *Peck* v. *Lowe* was decided, as the Court itself stated, on the ground that a tax on an exporter's income is not a "tax on exports." The reference to the scope of the sixteenth amendment was here also solely dictum.

We believe it is safe to say that the history of the sixteenth amendment indicates that one of its purposes was to empower Congress to tax income from State and municipal securities and State and municipal salaries if and when Congress deemed it wise to do so, and we accordingly believe that the court may properly so hold when a case is presented to it squarely raising the question.

At this point we wish to say that the validity of the proposed legislation is not dependent upon any departure from the holding of the court in the case of *McCulloch* v. *Maryland* ((1819) 4 Wheat. 316). In that case Chief Justice Marshall held unconstitutional a discriminatory tax levied by the State of Maryland on the issuance of any notes by banks not chartered by the State of Maryland. Thus the tax was applicable only to the Federal bank in that State, and such a discriminatory tax levied by either the State or Federal Government against the instrumentality of the other government would today be held invalid as readily as it was more than a hundred years ago.

Although the tax under consideration in that case was clearly invalid as a discriminatory one, Chief Justice Marshall chose the occasion to sound a warning against State taxation of Federal instrumentalities on the theory that "the power to tax is the power to destroy." What the Chief Justice envisioned in that theory is unmistakably revealed by the context of his opinion. Throughout the opinion he took numerous occasions to point out that in respect to the powers granted under the Constitution to the National Government, that Government is supreme, and the States must yield where the paramount rights of the National Government are involved. It seems never to have occurred to Marshall that his theory might be seized upon as a basis for denying the power of the National Government to tax the people and the institutions of the States. An excerpt from the opinion will serve to illustrate this point. In answer to the assertion that the power of taxation in the National Government and State governments is concurrent, giving to State governments a right to tax banks chartered by the National Government corresponding to the right of the National Government to tax State banks, the Chief Justice stated:

"But the two cases are not on the same reason. The people of all the States have created the General Government and have conferred upon it the general power of taxation. The people of all the States and the States themselves are represented in Congress, and, by their representatives, exercise this power. When they tax the chartered institutions of the States they tax their constituents; and these taxes must be uniform. But when a State taxes the operations of the Government of the United States it acts upon institutions created not by their own constituents but by people over whom they claim no control. It acts upon the measures of a Government created by others as well as themselves, for the benefit of others in common with themselves. The difference is that which always exists, and always must exist, between the action of the whole on a part and the action of a part on the whole—between the laws of a government declared to be supreme and those of a government which, when in opposition to those laws, is not supreme."

Moreover, the dangers of discrimination which induced Marshall to enunciate the doctrine that "the power to tax is the power to destroy" are now adequately checked by the fourteenth amendment, which would prevent discriminatory taxation against a Federal instrumentality by the States, or any taxation which tended to destroy it. Nevertheless, we do not seek to run athwart the doctrine of the *McCulloch case*, and for this reason the proposed legislation expressly consents to taxation by the States of Federal employees and to the taxation of all persons on their income from Federal securities.

Anyone reading the decision in *McCulloch* v. *Maryland* in 1819 could hardly have predicted the decision 51 years later in *Collector* v. *Day* (1870) 11 Wall. (U. S.) 113, holding that the Federal Government cannot levy an income tax upon the salaries of certain State officials. It is our view, just as it has been the view of most commentators, that the decision in *Collector* v. *Day* is not supported by *McCulloch* v. *Maryland*, but, rather, that the earlier decision is in direct opposition to it.

The almost universal flood of criticism that has been directed at the reasoning and the result reached in the case of *Collector* v. *Day* has consisted principally of a restatement of the concise reasoning in the dissenting opinion of Mr. Justice Bradley, who can almost be said to voice the words of Chief Justice Marshall in pointing out that the decision of the majority in that case exempting State officials from Federal tax is neither a logical nor a practical corollary of *McCulloch* v. *Maryland*. His dissent is in part as follows:

"I dissent from the opinion of the Court in this case because it seems to me that the General Government has the same power of taxing the income of officers of the State governments as it has of taxing that of its own officers. It is the common government of all alike; and every citizen is presumed to trust his own Government in the matter of taxation. No man ceases to be a citizen of the United States by being an officer under the State government. I

cannot accede to the doctrine that the General Government is to be regarded as in any sense foreign or antagonistic to the State governments, their officers or people; nor can I agree that a presumption can be admitted that the General Government will act in a manner hostile to the existence or functions of the State governments, which are constituent parts of the system or body politic, forming the basis on which the General Government is founded. The taxation by the State governments of the instruments employed by the General Government in the exercise of its powers is a very different thing. Such taxation involves an interference with the powers of a government in which other States and their citizens are equally interested with the State which imposes the taxation."

That *Collector* v. *Day* was not a necessary corollary of *McCulloch* v. *Maryland*, and that the full import of the *McCulloch case* may rest on a sounder foundation than *Collector* v. *Day*, is openly recognized in the opinion of the Court, speaking through Mr. Justice Stone, in the *Port of New York Authority case*. He said:

"In sustaining the immunity from State taxation, the opinion of the Court, by Chief Justice Marshall, recognized a clear distinction between the extent of the power of a State to tax national banks and that of the National Government to tax State instrumentalities. He was careful to point out not only that the taxing power of the National Government is supreme, by reason of the constitutional grant, but that in laying a Federal tax on Federal instrumentalities the people of the States, acting through their representatives, are laying a tax on their own institutions and consequently are subject to political restraints which can be counted on to prevent abuse. State taxation of national instrumentalities is subject to no such restraint, for the people outside the State have no representatives who participate in the legislation; and in a real sense, as to them, the taxation is without representation. The exercise of the national taxing power is thus subject to a safeguard which does not operate when a State undertakes to tax a national instrumentality. * * * There are cogent reasons why any constitutional restriction upon the taxing power granted to Congress, so far as it can be properly raised by implication, should be narrowly limited. One, as was pointed out by Chief Justice Marshall in *McCulloch* v. *Maryland*, *supra*, 435–436, and *Osborn* v. *Bank of the United States*, *supra*, 465–466, is that the people of all the States have created the National Government and are represented in Congress. Through that representation they exercise the national taxing power. The very fact that when they are exercising it they are taxing themselves serves to guard against its abuse through the possibility of resort to the usual processes of political action which provides a readier and more adaptable means than any which courts can afford for securing accommodation of the competing demands for national revenue, on the one hand, and for reasonable scope for the independence of State action on the other."

It is worthy of note here that *Collector* v. *Day* was mentioned frequently in the three opinions rendered in the recent decision in the case of *Helvering* v. *Gerhardt*, *supra*. Mr. Justice Stone, in the majority opinion, said that *Collector* v. *Day* was originally limited to officers of State functions without which no State "could long preserve its existence" and that the court has refused in the past to enlarge it beyond those limits. This majority opinion, however, did not by any means place a stamp of approval even on this stated limitation of the immunities doctrine stemming out of *Collector* v. *Day*.

On the other hand, Mr. Justice Black in a separate concurring opinion found even the majority opinion written by Mr. Justice Stone irreconcilable with *Collector* v. *Day* and concluded that the court "should review and reexamine the rule based upon *Collector* v. *Day*," although that course "would logically require the entire subject of intergovernmental tax immunity to be reviewed in the light of the effect of the sixteenth amendment authorizing Congress to levy a tax on incomes 'from whatever source derived'" which would in turn require a reexamination of "the decisions interpreting the amendment."

In addition, careful analysis discloses that the power to destroy by taxation and to discriminate between persons or subjects was not and is not possessed by the Federal Government. Accordingly, it must be concluded that the doctrine expounded by *McCulloch* v. *Maryland* does not support the conclusion reached in *Collector* v. *Day*.

Assuming this to be true and that the doctrine of reciprocal immunity enunciated in *Collector* v. *Day* may be challenged by the present Supreme Court, just as the Court has recently challenged other doctrines no longer justified, we are not depending upon such action by the Court to support the proposed legislation. Should the Court refuse to abandon the doctrine of that case, the question still

remains whether the power which the Court there found wanting has not since been supplied by that language of the sixteenth amendment authorizing a tax on income "from whatever source derived." But that is not all. Even if the power to levy such a tax were not granted by the broad terms of that amendment, it still seems probable that a net income tax which today has come to be recognized as the fairest method of taxation would not be regarded as a burden upon State Government when imposed without discrimination upon an employee of that Government in his capacity as a citizen of the United States.

As previously stated, the doctrine of immunities rests historically upon the epochal dictum of Chief Justice Marshall. *McCulloch* v. *Maryland, supra,* Since Marshall's famous opinion in that case, the Court has questioned both the premise and the conclusion of this bold syllogism. *Plummer* v. *Coler* (1900) 178 U. S. 115; *Greiner* v. *Lewellyn* (1922) 258 U. S. 384; *Metcalf & Eddy* v. *Mitchell* (1926) 269 U. S. 514, 523. *Willcuts* v. *Bunn* (1931) 282 U. S. 216; *Group #1 Oil Corp.* v. *Bass* (1931) 283 U. S. 279, 282. No statement in any opinion has been quite as frankly or as eloquently put in illustration of this fact as the statement of Mr. Justice Holmes in the dissenting opinion in *Panhandle Oil Co.* v. *Mississippi ex rel. Knox* (1928) 277 U. S. 218, in which he said that the power to tax is not the power to destroy "while this Court sits."

Despite the criticism which has been made of the rule, it has left an indelible although varying influence on the development and preservation of the immunities doctrine. The doctrine was developed by Marshall upon the background of the dual system of government in the United States—government by the State and government by the Nation being coexistent. It was to preserve the sovereign powers of the Federal Government and to prevent the States from limiting the exercise of the sovereign powers of the Federal Government by use of the power to tax, that the implied immunities doctrine arose. The rule was finally consolidated in the conclusion that a tax by one sovereign (either the State or the Nation) which placed a burden on the other sovereign was unconstitutional since it thereby tended to violate "the necessary protection of the independence of the National and State Governments within their respective spheres." *Helvering* v. *Powers* (1934), 293 U. S. 214. This idea has been more popularly referred to as the "burden theory" of immunities. It is aptly stated in the following excerpt from the opinion in *Metcalf & Eddy* v. *Mitchell, supra,* that:

"Experience has shown that there is no formula by which that line may be plotted with precision in advance. But recourse may be had to the reason upon which the rule rests, and which must be the guiding principle to control its operation. Its origin was due to the essential requirement of our constitutional system that the Federal Government must exercise its authority within the territorial limits of the States; and it rests on the conviction that each government, in order that it may administer its affairs within its own sphere, must be left free from *undue* interference by the other." [Italics supplied.]

In the more formative period of the law on this subject, statements appearing in decisions of the court indicate that any burden on a sovereign, no matter how slight, which arose by reason of a tax levied by the other sovereign was considered to be a partial destruction of and a hinderance on the other sovereign powers. *Weston* v. *Charleston* (1829) 2 Pet. 449; *Dobbins* v. *Erie County* (1842) 16 Pet. 435; *Collector* v. *Day* (1870) 11 Wall. 113.

Tax immunity became too all-inclusive as a result of the earlier decisions and the court soon became conscious of the fact that the doctrine of implied immunities had swelled itself to such proportions that the taxing powers of both the State and the Nation were in danger of becoming impotent. Thus Chief Justice Hughes in his opinion in *Willcuts* v. *Bunn* (1931) 282 U. S. 216, 225, found it necessary to say:

"The limitation of this principle to its appropriate applications is also important to the successful working of our governmental system. The power to tax is no less essential than the power to borrow money, and in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of nondiscriminatory laws, and where no direct burden is laid upon the Government instrumentality, and there is only a remote, if any, influence upon the exercise of the function of government. * * * Before the power of Congress to lay the excise tax in question can be denied in the view that it imposes a burden upon the States' borrowing power, it must appear that the burden is real, not imaginary; substantial, not negligible."

In numerous cases the court stressed that exemption would not be granted from nondiscriminatory taxation where the effect would be to cripple the power

to tax. *Metcalf & Eddy* v. *Mitchell, supra; Susquehanna Co.* v. *State Tax Commission (No. 1)* (1931) 283 U. S. 291, 294; *United States* v. *California* (1936) 297 U. S. 175, 184–185. Indeed, as previously pointed out, in *Helvering* v. *Mountain Producers Corp., supra,* the Court overruled its decisions in *Gillespie* v. *Oklahoma, supra,* and *Burnet* v. *Coronado Oil and Gas Co., supra,* because in considerable part, alongside of the principle of tax immunity was the correlative and "competing principle, buttressed by the most cogent considerations, that the power to tax should not be crippled" by undue extensions of constitutional exemption.

As the realization grew upon the court that the immunities doctrine created an unjust distribution of the tax burden, more severe tests were used in applying the "burden" theory and it was held that to hamper or threaten destruction of a sovereign, the burden involved must be "real, not imaginary; substantial, not negligible" (*Willcuts* v. *Bunn, supra*). The burden was required to be "immediate or direct" and not "remote" (*Tirrell* v. *Johnson* (1934) 293 U. S. 533), and a tax burden which interfered with another sovereign, had to interfere in a "substantial manner." (*James* v. *Dravo Contracting Co.* (1937) 302 U. S. 134.

Further qualifications of the doctrine were introduced, however, and as more and more qualifications were introduced, the more bottomless became the "well of uncertainties" surrounding the doctrine. Whereas in the early days of the doctrine a tax by one sovereign was a burden which threatened to destroy another if the tax indirectly added to the costs of and was therefore borne indirectly by the other, it became necessary to whittle this principle down because of its increasing effect on the power to tax.

The Court found in a large and varying group of circumstances that although a tax by one sovereign undeniably added to the cost of operation of the other, this was not such a burden as threatened to destroy the other sovereign. Although gross receipts, property taxes, sales taxes, or income taxes paid to one sovereign by an independent contractor with the other sovereign, undeniably add to the charges made by the contractor for the services performed, thus forcing the other sovereign actually to pay all or some portion of the taxes, such taxes, although indirectly paid by the sovereign, have been held not to incur the type of burden which threatens to destroy. *Railroad Co.* v. *Peniston* (1873) 18 Wall. 5; *Central Pacific Railroad* v. *California* (1898) 162 U. S. 91; *Baltimore Shipbuilding and Dry Dock Co.* v. *Baltimore* (1904) 195 U. S. 375; *Choctaw O. & G. R. R. Co.* v. *Mackey* (1921) 256 U. S. 531, *Taber* v. *Indian Territory Co.* (1937) 300 U. S. 1; *Gromer* v. *Standard Dredging Co.* (1912) 224 U. S. 362; *Trinityfarm Co.* v. *Grosjean* (1934) 291 U. S. 466; *Tirrell* v. *Johnson* (1935) 293 U. S. 533; *Metcalf & Eddy* v. *Mitchell* (1926) 269 U. S. 514, *General Construction Co.* v. *Fisher* (1935) 295 U. S. 715; *Alward* v. *Johnson* (1931) 282 U. S. 509.

The Court has on several occasions pointed out that the State or the Nation is, to a greater or lesser degree, affected by virtually every tax levied by the other. If we pursued the casual lines which flow from the imposition of almost any tax, or any regulatory measure, we would find that sooner or later it impinged upon the other government. Once we put behind us the tax which is imposed directly upon the sovereign, the question necessarily becomes one of degree. Thus, the Court in *Metcalf & Eddy* v. *Mitchell, supra,* said:

"In a broad sense, the taxing power of either government, even when exercised in a manner admittedly necessary and proper, unavoidably has some effect upon the other. The burden of Federal taxation necessarily set an economic limit to the practical operation of the taxing power of the States, and *vice versa.* Taxation by either the State or the Federal Government affects in some measure the cost of operation of the other."

What then is the nature of the "burden" which tends to defeat a government in carrying out its sovereign powers? The burden of additional cost alone is not sufficient to bring about tax immunity. Both the Supreme Court and the lower Federal courts have emphatically indicated this. *Trinityfarm Co.* v. *Grosjean, supra; Tirrell* v. *Johnston, supra: Wheeler Lumber Co.* v. *United States, supra; Alward* v. *Johnson, supra; Helvering* v. *Mountain Producers Corp., supra; Liggett & Myers Co.* v. *United States, supra; Helvering* v. *Gerhardt, supra; James* v. *Dravo Construction Co., supra.*

The *Dravo case* involved the right of the State of West Virginia to levy a tax on the gross receipts of the Dravo Contracting Co., which had contracted with the United States to build certain locks and dams in navigable rivers bordering on and flowing in the State of West Virginia. The court recognized the fact that the contractor might under certain circumstances absorb some of the tax but indicated that whether or not this was so made no difference.

It was recognized that the contractor's expenses were increased by reason of the tax and that under ordinary principles of cost accounting the tax would be considered in bidding on the contract with the Government, the tax thereby actually increasing the cost to the Government.

If then additional cost is not such a burden as to amount to an interference with a sovereign sufficient to threaten our dual system of government, and this seems adequately admitted by the court, what other burden is placed upon the States or upon the Federal Government by the legislation proposed?

Competition exists among investors in Government securities as well as among individuals in the search for governmental employment. For this reason it is wholly speculative and uncertain as to what part, if any, of the burden of a tax on income from such sources may be passed on to the States or what amount such employees and investors may absorb themselves. Assuming, however, that there is a speculative burden which may be passed on to the States by reason of this legislation, is such a burden on the States sufficient to give rise to immunity? The answer seems definitely to be "No," and is furnished by the majority opinion of the Supreme Court in the very recent *Port of New York Authority* case to which I have referred.

Again let us inquire what burden, then, is placed upon the States by the legislation here proposed that has not already been labeled by the Court as insufficient to give rise to immunity.

The mere taxation of a government employee is not sufficient to make applicable the immunity doctrine since out of that fact in itself there arises no assumption of a burden upon the Government which would threaten to destroy the dual system of government. *Helvering* v. *Gerhardt, supra; Smith* v. *Northern Trust Co.* (1911) 220 U. S. 107; *Helvering* v. *Powers, supra; Helvering* v. *Therrell* (1938) 303 U. S. 218. Since the indirect reflection of a tax in another sovereign's treasury is not in itself a test of a forbidden interference with the dual system of government, and since it is indicated by the *Therrell case* that a tax on an individual though he be a government employee, cannot possibly be a threat to that dual system when the tax does not result in added cost to the Government, what, then, is the line of demarcation between a tax which does threaten that system and one which does not? The Court, by its decisions, has confined the burden theory so that the only tax which is inhibited is one which actually threatens to destroy, namely, a discriminatory tax or one which is regulatory or prohibitory in its effect.

The States have throughout the years continuously broadened their fields of activity to enterprises which have long been in the hands of private business and thus subject to taxation. The court has recognized that by this means the States might eventually cramp the taxing power of the Federal Government until it became almost impotent. It seems almost unnecessary to cite statistics to demonstrate the dependence of the Federal Government and of many State governments upon the revenues obtained from the income tax on individuals. In recognition of this dependency and the drying-up of the source of such revenues due to the combination of the immunities doctrine and the increasing activity of the State and Nation in fields which have long been occupied by private enterprise, the court in *Helvering* v. *Powers, supra*, at p. 225, said:

"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. The fact that the State has power to undertake such enterprises, and that they are undertaken for what the State conceives to be the public benefit, does not establish immunity. * * *"

In *Helvering* v. *Gerhardt, supra*, Mr. Justice Stone commented on this point, saying that an allowance of immunity for the protection of State sovereignty is at the expense of the sovereign power of the Nation to tax and that any enlargement of the former involves a diminution of the latter. He said, "When enlargement proceeds beyond the necessity of protecting the State, the burden of the immunity is thrown upon the National Government with benefit only to a privileged class of taxpayers" and that unlimited State immunity "would become a ready means for striking down the taxing power of the Nation."

The most recent decision in which the Court recognized the potential destructiveness of the immunities doctrine to the Federal taxing power is *Allen* v. *Regents of University System of Georgia* (1938) 304 U. S. 439. Here the regents attempted to enjoin collection of a Federal tax on admissions to football

games at the State universities on the basis that this was imposing an unconstitutional burden on education which is a recognized essential governmental function. The Court reversed the circuit court of appeals, which had held the injunction valid. In the opinion of the majority, written by Mr. Justice Roberts, the Court assumed as true the fact that public education was a governmental function and that athletic programs were a part of the program of education, that the activity does not cease to be governmental because it produces income, and that the tax is imposed directly on the State activity and directly burdens that activity. The Court said that the question was "whether, by electing to support a governmental activity through the conduct of a business comparable in all essentials to those usually conducted by private owners, a State may withdraw the business from the field of taxation." It held that though education might be just as essential a governmental function as the maintenance of the executive, legislative, and judicial branches, "it does not follow that if a State elects to provide funds for any of these purposes by conducting a business, the application of the avails-in-aid of necessary governmental functions withdraws the business from the field of taxation."

In *South Carolina* v. *United States*, *supra*, and *Helvering* v. *Powers*, *supra*, the court not only considered the effect of exemptions on Federal revenues but apparently made this the basis of its decisions as to the asserted governmental character of the activity involved. In *South Carolina* v. *United States*, *supra*, at page 455 the court summarized its earlier analysis by saying, "Indeed, if all the States should concur in exercising their powers to the full extent, it would be almost impossible for the Nation to collect any revenues." And in *Helvering* v. *Powers*, *supra*, at page 225, the court defined a limitation upon the doctrine of intergovernmental tax immunity as the principle 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." (See also *United States* v. *California*, *supra*, at p. 184.)

Unfortunately a governmental function is not a constant product. What may be a usual governmental function today may be taken over by private business tomorrow and thus fall into the "proprietary" class when a government engages in it. What may be a proprietary function today may in the future become such a "usual," "ordinary," or "essential" governmental enterprise that it may be classed as a "governmental" function instead of a "proprietary" function. There will be, and have been constant changes in the fields of enterprise which we as a people properly look to the various State governments and the Federal Government to administer.

In conclusion I would like to summarize the principal points to which my discussion has been directed. First, I have given you the view that the Supreme Court has shown every evidence of a willingness and readiness to reexamine arguments and precedents in cases where important constitutional issues are involved, and I have illustrated this attitude on the part of the Court with respect to the field of taxation by several very recent decisions. Next, I presented to you the view that when the Court is requested to reexamine arguments and precedents in connection with the problem of intergovernmental immunities in taxation there will be at least two very persuasive, if not conclusive, grounds which will impel the Court to sustain the constitutionality of that legislation for which we are contending. The first of these is the language of the sixteenth amendment properly construed in the light of the events which led to its adoption, while the second is the broader but now equally well established proposition that any implied constitutional immunities from Federal taxation which may be enjoyed by the States do not extend to a nondiscriminatory income tax upon the salaries of State employees or the interest received by holders of State obligations when such a tax imposes no unreasonable burden upon the States.

The CHAIRMAN. Thank you, Mr. Wenchel.

Now, is there someone from your office ready to testify or someone from the Attorney General's office?

Mr. WENCHEL. Mr. Gardner, of the Department of Justice.

The CHAIRMAN. You are through, are you?

Mr. WENCHEL. I am through. All right, Mr. Gardner.

Mr. MORRIS. We have Mr. Gardner from the Attorney General's staff, if there is no one else from Mr. Wenchel's staff.

## STATEMENT OF WARNER W. GARDNER, SPECIAL ASSISTANT TO THE ATTORNEY GENERAL, DEPARTMENT OF JUSTICE

Mr. GARDNER. I have only a very few general comments to offer, Senator, and a few specific things that have been raised in the course of the discussion.

Among the general comments there are only two of importance, and I would like to emphasize a little bit one factor. Mr. Morris has discussed and our study takes up in great detail the fact that the *Pollock case* and *Collector* v. *Day*, which are the only two cases which definitely bar this legislation, have no authority at the present time, measured by the customary legal tests. Their reasoning has been rejected, the results of the decisions are to a greater or a lesser degree incompatible with the decisions in other fields. The other reasons which have been offered from time to time by the Supreme Court for tax immunity are either inapplicable or have in later decisions been rejected by the Court. These are in a sense legal dialectics breaking down the opinions into their reasons, attempting to square them with other decisions. Out of that stuff the law is made, of course. However, they do not necessarily reach into the living life of the Court. If in addition to breaking them down in that fashion we measured them against the current trends in tax immunity, we get a result which is more authoritative, I think, that can be gained by merely an abstract legal analysis of the opinions and their present authority.

In the last term the Court opened up with the *Dravo case*, in which the gross-receipts tax on a Government contractor was sustained. The Government argued for that result but was unable to distinguish three earlier cases, the sales-tax cases. The Court did not distinguish those cases but merely confined them to their facts and said that is not the situation here. So far as I know, no one ever offered a distinction between selling goods and selling a combination of goods and services, which is the contractor's function.

The CHAIRMAN. Is that a specific tax?

Mr. GARDNER. It is a gross-receipts tax.

The CHAIRMAN. That applies only to Government contracts?

Mr. GARDNER. Oh, heavens; no. Generally, any tax involved by the Federal or State Government which was directed only at people who deal with other governments, would be, of course, invalid under the implications of our Federal system.

The next decision was the *Therrell case*, which pushed the solution of tax immunity just a little further. In that case the bank liquidators and persons employed in banking departments and engaged in the liquidation of banks and insurance companies were held subject to the Federal income taxes.

The CHAIRMAN. That is the State banks?

Mr. GARDNER. That is the State banks; yes.

The CHAIRMAN. And the State trust companies, and so on?

Mr. GARDNER. The opinion is not particularly illuminating, so we can extract very little from it.

After this decision, the next decision which the Court took up dealt with immunity from income taxes which was claimed by lessees of State school lands. They had been held exempt from the Federal income tax in the *Coronado case*, which in turn followed the *Gillespie*

*case*, dealing with the converse situation of a State tax upon Federal lessees. Those two cases were expressly overruled.

Next in the order of delivery was the case of *Allen* v. *The Regents*, in which the Court assumed that education was an essential governmental function of the State. But it held that the receipts realized from holding football contests could be subjected to Federal taxation even though it formed a part of the educational curriculum, because the Court said it was analogous in almost every respect to commercial exhibits.

Finally, there was the *Gerhardt case*, which has been sufficiently discussed this morning, I think. Comparing this uniform record of extending taxation and contracting immunity, which the Court made last term, with the analysis of Assistant Attorney General Morris, and which our study explains, the conclusion emerges with considerable clarity that although the *Pollock* and *Day cases* stand unreversed, they have not the authority which ordinarily attaches to an unreversed decision in the Supreme Court.

The CHAIRMAN. I did not hear you say anything about *Evans* v. *Gore*. It seems to me that that case should be included with the *Collector* v. *Day* and the *Pollock case*, because while the Court could have decided it on the basis of the provision in the original Constitution it did use the other ground in that case.

Mr. GARDNER. I did not mention Evans and Gore for the reason that I am directing my remarks only to the tax-immunity problem, distinguished from the effect of the sixteenth amendment. I am unfortunately not sufficiently familiar with the sixteenth-amendement problem to be able to lend a great deal of enlightenment to the committee. And they considered the express provision of the Constitution that the salary of the judge should not be diminished during his term of office.

The second general comment grows out of this trend of decisions which has apparently been inaugurated by the Supreme Court during this past term.

With respect to the taxation of employees, both Federal and State, there is bound to be a continuing stream of litigation. If the trend of the Court is continued, the decisions more probably than not will be in favor of taxing employees and officers, who formerly, and I think with good cause under the existing decisions, had considered themselves to be immune from taxation.

The problems of retroactivity which are thus raised need little amplification except it is a danger which every employee of the State now faces, if we press the Gerhardt decision as far as seems likely, and which will perhaps have some bearing upon many Federal employees, if, indeed, not all of them.

The specific questions which were raised during the testimony of Mr. Morris, and to some extent Mr. Wenchel, include, first, the extent to which there has been a waiver of Federal taxation.

There was prepared a few months ago a compilation of such statutes of the last two and a half Congresses, the sessions which have appeared in printed form in the regular Statutes at Large, gathered by thumbing through the pages, and they number some 37 or so. Broken down there are about a dozen in which Congress has stated that the specific Federal instrumentality under question shall be exempt from all taxation.

There are nine, according to the count that I have here, in which Congress expressly waived immunity from taxation.

The CHAIRMAN. What are they? Do you happen to have them there?

Mr. GARDNER. I could give them to you by going through them.

The Federal Savings Loan Association is the first one to which I come. The provision of section 5 (h) of that act is that these associations, including their franchise, reserves, and surplus shall be taxable.

The CHAIRMAN. I was on the House committee and I remember that provision.

Mr. GARDNER. It is analogous to the national bank provision.

The next one deals with liquidators, referees, trustees, and other officers appointed by the United States.

Another one is with respect to national mortgage associations authorized to be established by the National Housing Act. I do not have them conveniently gathered here, but that perhaps will serve as a random sample.

The CHAIRMAN. I really would like to know what they are.

Mr. GARDNER. They are from the Seventy-third and Seventy-fourth and the first half of the Seventy-fifth sessions.

The CHAIRMAN. All right. You say there are nine?

Mr. GARDNER. There are nine in which they have waived all tax exemption. There are another seven in which they provide some tax exemption and some waiver of tax exemption and then there are another seven which provide for payments by the Federal Government or its instrumentalities to the States in lieu of taxes, an amount which I take it is estimated as the probable tax yield had they been subject to taxation.

This shows a consistent effort of the Congress, I submit, to deal with this difficult problem, it shows very plainly the extent to which it should be a problem for Congress rather than the courts, who can deal only in terms of black and white. Congress on the other hand can make quantitative as well as qualitative estimates.

There was one part during Mr. Morris' testimony where the Senator questioned the degree to which the *Flint* v. *Stone Tracy Co. case* can be reconciled with the *Pollock case*, and we of course believe that it cannot be so reconciled. I am pointing out here the dissenting opinion of Justice Brandeis in the *National Life Insurance case*, joined by Justices Holmes and Stone, who said they thought since *Flint* against *Stone Tracy*, the *Pollock case* in that part had been overruled.

I am responsible, Senator, for three mistakes in the dates of cases which were given you this morning. I thought I remembered them. In checking I discovered I did not. If you would like to have the correct dates of the *Coronado case*, the *Gillespie case*, the *Evans and Gore case*, I can give them to you.

The CHAIRMAN. All right.

Mr. GARDNER. The *Coronado case* was not, as I said, in 1925, but 1932; it was reported in volume 285.

The CHAIRMAN. And the *Gillespie case?*

Mr. GARDNER. The *Gillespie case* was decided in 1922, or the 1921 term in the spring.

And *Evans* v. *Gore*, which we speculated, was decided in 1923, was in fact decided in 1920.

That concludes all the things which I have in my mind to say, and I should be very happy to answer any questions which you might have.

The CHAIRMAN. I do not think I have any now, because it seems to me we will want to ask representatives of the Department questions which will be based upon what we learn from the opposition when they appear.

Mr. GARDNER. Yes.

The CHAIRMAN. And at that time I suppose the committee will want to ask quite a few questions.

Is there anyone else from the Attorney General's Department?

Mr. MORRIS. There is no one else here now.

The CHAIRMAN. Is there anyone else from the Treasury?

Mr. WENCHEL. No, sir; no further statement.

The CHAIRMAN. I thought I followed Mr. Hanes fairly closely this morning, but I do not know as there was a clear-cut discussion of this situation, and I really believe we ought to have something on it; that is, that if we pass and the courts approve of legislation such as the President has advocated, that there will be very little present effect upon either the revenues, or very little adverse effect upon the States. Did Mr. Hanes go into that question?

Mr. WENCHEL. I think he gave some figures. I think they amounted to something like $16,000,000, was it not?

The CHAIRMAN. That $16,000,000, as I remember it, was the amount of taxes that Government employees paid now.

Mr. WENCHEL. The increase, was it not?

The CHAIRMAN. The amount they would pay; yes, my point being that until new bond issues were made there would be very little that could be taxed by the Federal Government.

Mr. WENCHEL. Mr. Hanes stated:

> It is clear that in the next few years neither the additional tax revenue nor the additional interest cost will be considerable.

The CHAIRMAN. Perhaps that is what I had in mind. He did cover it.

Mr. WENCHEL. There is another place where he said something to the effect that it would not wash itself out in 50 years, some sort of expression like that.

The CHAIRMAN. As I remember it—and perhaps you would know—we shifted last year to what was known as the partition between long-time and short-time Government securities, which I believe the Treasury wanted to eliminate altogether. Was not that it? And we shifted that up so that there are now authorizations, as I recall it, for 30 billion in long-term securities and a total of 45 billion in securities of the Federal Government. Does anyone here know?

Mr. WENCHEL. I think your figures are correct.

The CHAIRMAN. I think so. I know I objected when the original matter was presented, and we did refuse to move the bars entirely because of this impending legislation.

Mr. WENCHEL. We can supply the exact figures, Senator, if you wish.

The CHAIRMAN. What I want to get at is—I think we should have, for the benefit of the States, an analysis of the outstanding Federal issues, so that we would know what were short term and what were

long term, and particulars and details as to how long those bonds run, and as to how soon the States could, in the event Congress authorizes this reciprocal taxation, expect the tax through their income taxes as to Federal securities. I do not thing that is in the case here, is it?

Mr. WENCHEL. No.

The CHAIRMAN. Can we have that?

Mr. WENCHEL. Yes, indeed.

The CHAIRMAN. And will you supply us with an analysis so we can have it in the record, and present it to the State representatives, who will be here on February 7?

Mr. WENCHEL. We will be glad to.

(For data and material requested, see tables VII and VIII and exhibit 2, at the conclusion of Mr. Hanes' testimony.)

The CHAIRMAN. Is there anything else?

Mr. Morris, I think, in view of the fact that the Departments have presented a very excellent case, we could have Mr. Buck appear after February 7.

Mr. MORRIS. All right, Senator. I will advise him of that. I know he will be glad to be here whenever it is convenient.

The CHAIRMAN. You can get in touch with him today?

Mr. MORRIS. I can phone him; yes.

The CHAIRMAN. Then, if there is nothing further, we can, I think, adjourn until February 7.

Is Mr. Seidman here? He asked to be heard early, and I would be willing to hear him now if he is here. He represents the New York Board of Trade.

Then, very well, we will hear him after February 7, and I thank you gentlemen for your attendance. The committee will now adjourn.

(Thereupon, at 3:20 p. m., the committee was adjourned until February 7, 1939, at 10 a. m.)