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INCOME TAX DEDUCTIONS AS A MEANS OF EFFECTUATING GOVERNMENTAL POLICIES

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As a means of social control, income tax deductions obviously represent but a small segment of a much larger problem which permeates not only the entire field of taxation, but also the entire field of law, of politics, and of economics as well. The regulation of individual conduct has been a necessary by-product of all organized society. The planning and supervision of activity and the adjustment of differences have always been important parts of community life. Compliance has been secured by the use of self-restraint, coercion and hope for reward; the extent and the complexity of the machinery required for this purpose has varied with the economic and political development of the state and with the objectives desired and the means used to obtain them.

Contemporary industrial civilization, with its division of labor, its intricate financial system, and its large-scale production and distribution of goods, has demanded careful planning and coordination. Although opinions differ as to the proper place which government should occupy in this vast organization, few fail to appreciate the growing importance of political regulation and control. The *Laissez-faire* philosophy of the nineteenth century is being rapidly replaced by a less individualistic attitude. Administrative tribunals and state ownership and operation of property reflect this fundamental change. The close interrelationship between "government" and "business" makes it inevitable that the policies and actions of each depend upon and tremendously affect those of the other.

In addition to the direct control exercised by the federal, state, and local governments over public and private industry, the power to tax and the power to spend are being used to an increasing extent to supplement the more direct forms of regulation. In many types of situations the taxing power is a peculiarly effective method of effectuating "non-fiscal" policies.¹ For many years it has been recognized that the

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¹ See Shoup, *Facing the Tax Problem* (1937) 129 et seq.

"Taxation for non-fiscal purposes is taxation not to produce revenue to carry on a given program of public expenditures but to produce directly certain eco-

collection of any tax necessarily affects social and economic institutions.² Even when laid solely for the purpose of raising revenue, a tax may influence the buying habits of the public and consequently change the nature and location of industry; it may have a direct effect upon savings and upon the accumulation and distribution of wealth. In short, the government cannot collect revenue without "inevitably affecting social relations."³ It is because of this inevitable effect that taxation assumes such great importance as a means of social control. "The only real issue," it has been said, "is whether this powerful instrument shall be wielded blindly or whether it shall be intelligently directed toward the attainment of consciously sought social objectives."⁴

Greater recognition is being given to the fact that all governmental activities interact upon one another and unless there is a careful analysis of the purposes to be achieved by each there is great danger that they will nullify rather than support the general policies of the governing authority.⁵ The taxing and spending powers are thus being used with increasing effectiveness in the redistribution of income and wealth, to subsidize industry through tax exemptions and direct payments, and to encourage or prohibit certain types of conduct through special forms of taxation.⁶ Inheritance taxes, processing taxes and farmer benefit payments, protective tariffs, special taxes on oleomargarine and state bank notes, exemptions from taxation, excess and undistributed profits taxes, taxes on liquor—these illustrate but a few ways in which the taxing and spending powers have been used to regulate the production, distribution, and consumption of goods and services.

However, in spite of the fact that federal, state, and local taxes

conomic or social effects irrespective of whether revenue is actually raised or not." Peck, *The Use of the Taxing Power for Non-Fiscal Purposes* (1936) 183 *Annals of The American Academy of Political and Social Science* 57.

²"Taxation . . . is the most pervasive and privileged exercise of the police power; with the enormous increase in taxes resulting from the war, along with its large effect on the margins for profit, it is becoming the most effective exercise of the police power. Even when not consciously intended to be regulative, taxes nevertheless regulate." Commons, *Instrumental Economics* (1934) 820.

³Seligman, *Essays in Taxation* (10th ed., 1925) 316; Preliminary Report of the Committee of the National Tax Association on Federal Taxation of Corporations (1938) 23, 24.

⁴Heer, *Taxation as an Instrument of Social Control* (1937) 42 *AM. J. of Sociology* 484.

⁵Shoup, *op. cit. supra*, note 1 at 129.

⁶See Bingham, *Economic Effects of the New Deal Tax Policy* (1937) 3 *So. Econ. J.* 270, 275, 276.

absorb more than one-fifth of the national income⁷ the wisdom of using the taxing power for non-fiscal purposes is still a subject of serious controversy.⁸ Although there has been no disagreement concerning the proposition that the collection of any tax necessarily affects business, there has been a sharp difference of opinion as to the proper method of treating this inevitable consequence of taxation. Many believe that the effect of taxation should be minimized as much as possible—that the principle of “neutrality” should be a fundamental tenet of public finance; if there must be social control, the control should be achieved by direct legislation enacted for that particular purpose. They emphasize the difficulty of constructing an equitable tax system under the most favorable circumstances and insist that, because of the scope and complexity of the revenue problem, any attempt to incorporate regulatory provisions into tax legislation makes it virtually impossible to secure a satisfactory answer to two questions which are said to be separate and distinct. The result of this failure to segregate taxation from regulation, it is argued, is inadequate revenue, ineffective control, or both.

This over-simplification of the problem, however, fails to take into consideration the fact that since all taxes affect the production, exchange, and consumption of goods and services, any attempt to “neutralize” this phenomenon is itself a method of social control. An insistence upon the maintenance of the *status quo* requires a careful consideration of the effects of taxation and involves exactly the same type of “non-fiscal” judgment that is required when a tax is imposed for the purpose of raising revenue in a manner which will also lead to changed conditions of a kind thought desirable by the taxing authority. If the “leave-them-as-you-find-them”⁹ principle of taxation does not involve the exercise of control, then its proponents are reduced to the absurd position of advocating the collection of a tax regardless of its effect. This, of course, is never done. Whether “consciously, unconsciously, blindly, ignorantly, by greed and camouflage, by demagogic plutocracy or demagogic democracy,”¹⁰ the effect of a tax plays an important part in the legislative process. It is much better to accept the

⁷See Moulton and others, *Capital, Expense, Employment, and Economic Stability* (1940) 271.

⁸For example, see Lutz, *Public Finance* (1936) 371 et seq.; Tuller, *The Taxing Power* (1937) 13 et seq.; Todd, *Taxation and the Redistribution of Wealth* (1937) 22 *Bulletin of the National Tax Association* 269. Cf. Johnson, *Vested Interests in Government Spending* (1938) 17 *Proceedings Academy of Political Science* 73, 74, 75.

⁹Buehler, *Public Finance* (2d ed., 1940) 658.

¹⁰Commons, *Instrumental Economics* (1934) 821.

fact that legislators do consider expected effects and openly and intelligently to adapt them so that they will implement the policies of the government, than to permit a secret opposition to a changing order impair the very real value of an important instrument of control under the guise of economic doctrine.

Whatever may be the merits of the opposition to the use of taxation as a means of regulation, it is clear that so far as the income tax is concerned, taxation is being used for non-fiscal purposes. Although the need for revenue played an important part in the enactment of income tax legislation, the post-Civil War acts grew out of the Populist movement.¹¹ The unrest and demand for social reform during the latter part of the nineteenth century contributed largely to the enactment of the tax declared unconstitutional in *Pollock v. Farmers' Loan & Trust Co.*¹² While the bitter denunciation of the Court which followed this decision gradually subsided,¹³ the movement for tax reform continued and resulted in the Corporation Franchise Act of 1909¹⁴ and the Sixteenth Amendment.

While the policy underlying the use of the graduated income tax has long been the subject of dispute,¹⁵ it is clear that regardless of whether its justification is found in the fact that it is the best measure of the taxpayer's "ability to pay" or that it is the most efficient means of "redistributing" income, the deduction provisions of the present federal statute are a necessary part of the successful operation of either policy. Since the taxpayer's *gross* income¹⁶ is brought within the scope of the statute and since two persons with the same gross income may have entirely different *net* incomes, neither the "ability" theory nor the "redistribution" theory will be followed unless the deduction section permits an accurate reflection of the prevailing concept of *income*.

In addition to the major function of determining income, the deduction section has been used for the purpose of effectuating other

¹¹See Blakey, the Federal Income Tax (1940) Ch. 1.

¹²157 U. S. 429, 15 S. Ct. 673 (1895); 158 U. S. 601, 15 S. Ct. 912 (1895). See Buehler, Regulatory Taxation (1939) 17 Harv. Bus. Rev. 138.

¹³For a reprint of editorials see Department of Justice, Taxation of Government Bondholders and Employees (1938) Appendix Vol. 1, No. 10.

¹⁴36 Stat. 11, 112.

¹⁵With Seligman, Progressive Taxation in Theory and Practice (1894), Part II, compare Simons, Personal Income Taxation (1938) 18 et seq.; Messages of President Roosevelt of June 19, 1935, March 3, 1936 and November 16, 1937; Hale, Economic Theory and the Statesman, in Tugwell, the Trend of Economics (1924) 189, 217 et seq.

¹⁶See Internal Revenue Code of 1939 § 22.

policies of the national government. The most obvious example is, of course, the deduction for charitable contributions.¹⁷ Largely in an effort to encourage private charitable institutions which perform a part of the activities of government, Congress has provided for a limited reduction in taxes for those who donate to such institutions.¹⁸ However, the deduction is not limited to charities. Contributions to federal, state, and local governments, and to war veteran and fraternal organizations are also encouraged. In an effort to "stimulate prospecting and exploration"¹⁹ special deduction provisions have been included in various revenue measures.²⁰ Deductions based on "discovery value" rather than cost and percentage depletion based on gross income have been used to encourage the development of the mining and oil and gas industries. Although the deduction of interest on indebtedness incurred to purchase or carry tax exempt securities is not permitted, an exception is made in the case of original subscribers who purchase *United States* obligations.²¹ Since banks and other financial institutions pay interest on much of their funds used for investment, this exception was made in order to protect the market for federal bonds.²² Finally, the deduction of travelling expense while away from home incurred in the pursuit of a trade or business, "including the entire amount expended for meals and lodging"²³ and the deduction of payments made to *irrevocable* employees' pension trusts²⁴ were included for the respective purposes of encouraging persons to enter business for themselves (l) ²⁵ and to prevent employees from being deprived of expected benefits which would result from a termination of revocable trusts.²⁶ Thus Congress has intentionally employed income tax deductions as a means of securing desired courses of conduct and in a very real sense much of this effort has been successful.²⁷

¹⁷Internal Revenue Code of 1939 § 23 (o), (q).

¹⁸E. g., see Committee Reports to this effect reprinted in 1939-1 (Part 2) C. B. 741, 742, 789, 795.

¹⁹1939-1 (Part 2) C. B. 121.

²⁰For the modified provisions see Internal Revenue Code of 1939 §§ 23 (m), 114 (b), (2), (3), (4).

²¹Internal Revenue Code of 1939 § 23 (b).

²²1939-1 (Part 2) C. B. 604.

²³Internal Revenue Code of 1939 § 23 (a) (1).

²⁴Internal Revenue Code of 1939 § 23 (p).

²⁵61 Cong. Rec. 5201.

²⁶1939-1 (Part 2) C. B. 761.

²⁷For a discussion of the extent to which the combined income tax and estate tax deductions encourage gifts to charity see Harriss, *Taxes and Philanthropy* (1940) 32 Columbia Univ. Q. 112. See also Magill, *Federal Regulation of Family*

However, as is usually the case with taxation, income tax deductions have produced consequences of both a favorable and unfavorable nature. For example, the deduction for interest is allowed even though not incurred in the production of income.²⁸ Since the rental value of his residence is not taxed to the home-owner, this deduction, coupled with a similar one for taxes,²⁹ encourages home ownership. In view of the exemption of building and loan associations from taxation³⁰ this result appears to be consistent with congressional policy. But since the deduction is also allowed to corporations and since there is a policy to tax corporate income both to the corporation and later to the taxpayer when received in the form of dividends, the interest deduction offers an opportunity to avoid the tax to the corporation; by issuing bonds instead of stock to its shareholders, it is thus possible for many corporations greatly to reduce their taxable profit by the simple expedient of paying dividends in the form of interest.³¹

Because of the deliberate use which Congress has made of income tax deductions in the past and because of the inevitable effect such deductions have on corporate policies and individual conduct,³² it is to be expected that this practice will become of increasing importance in the future. By adjusting deductions particularly important to selected types of income, by classifying and giving varying effect to certain expenditures, by providing for new and eliminating old deductions, it is possible to penalize or subsidize industries, occupations and trades, and to regulate through coercion and reward.³³ Unless the Constitution stands in the way, an absolute control over deductions offers another powerful weapon of social control.

Settlements (1937) 4 U. of Chi. L. Rev. 265, 278. See also Harriss, Philanthropy and Federal Tax Exemptions (1939) 47 J. Pol. Econ. 526, 541.

²⁸Internal Revenue Code of 1939 § 23 (b).

²⁹Id. § 23 (c).

³⁰Id. § 101 (4).

³¹Conrad, Some Suggestions for Changes in the Federal Income Tax (1939) 17 Taxes 713, 717, 718; Magill, Effects of Taxation on Corporate Policies (1938) 72 U. S. L. Rev. 637, 644.

³²Lay, Some Public and Business Policies Embodied in the Federal Income Tax (1938) 18 Southwestern Soc. Sci. Q. 322.

³³"The whole theory of 'incentive taxation' can by a simple twist of the tongue be transformed into 'penalty taxation,' if one wills to do so. The taxpayer who is allowed to deduct from his taxable income the amount of his charitable contributions during the year is favored over the taxpayer who, having made no such contributions, is 'penalized' for his failure to do so. The matter is one of draftsmanship. Since the two forms of statutes do not have different effects, it is submitted that they should not have different constitutional consequences." Gellhorn, Administrative Law (1940) 444, 445.

The Supreme Court of the United States has repeatedly expressed the view that federal income tax deductions are exclusively a matter of legislative concern; that they involve statutory and not constitutional problems.³⁴ Typical of the many statements found in the Board of Tax Appeals, lower federal court, and Supreme Court opinions is the one appearing in *Helvering v. Independent Life Insurance Company*: "Unquestionably Congress has power to condition, limit, or deny deductions from gross income in order to arrive at the net that it chooses to tax."³⁵

While the cases fully support the statement that Congress has the power to deny all deductions from gross income,³⁶ there is considerable doubt as to the power of Congress to condition such deductions. Taken literally it would, of course, give the national government tremendous power over matters heretofore considered to be exclusively within the control of the states. Because of the steeply graduated personal income tax rates³⁷ and because of the magnitude of corporate deductions when compared with net income,³⁸ the economic coercion resulting from a threat of disallowance would compel prompt compliance with many forms of regulation.

However, the broad generalizations of the type quoted above appear in cases dealing with interpretations of the Fifth and Sixteenth Amendments. The questions under discussion related solely to the constitutional rights of private persons and did not involve alleged encroachments by the national government upon the reserved powers of the states. Actually, the Supreme Court has not permitted Congress to exercise uncontrolled discretion over deductions. In 1921, Congress revised the income tax sections relating to life insurance companies for the purpose of providing a more equitable method of taxing their

³⁴See *White v. United States*, 305 U. S. 281, 292, 59 S. Ct. 179, 184 (1938); *Deputy v. DuPont*, 308 U. S. 488, 60 S. Ct. 363, 366 (1940); and *Helvering v. Winmill*, 305 U. S. 79, 84, 59 S. Ct. 45, 47 (1938).

³⁵292 U. S. 371, 381, 54 S. Ct. 758, 760 (1934).

³⁶More than a hundred cases have been found which support those cited in note 34 *supra*.

³⁷The refusal of a deduction to a taxpayer in the highest income bracket would result in an increase in the surtax of 75 per-cent of the deduction disallowed. See Internal Revenue Code of 1939, § 12.

³⁸Aggregate federal corporate tax returns for 1936 reported total receipts of \$132,722,602,000. Total deductions amounted to \$124,951,715,000. Although \$78,023,107,000 of this latter sum represented cost of goods sold, nevertheless even the balance amounted to almost six times the net corporate income. U. S. Treasury Department, *Statistics of Income for 1936*, Part 2, p. 24.

earnings. Of the various deductions permitted there was one for tax exempt interest and another for 4% of certain reserves less the amount of the aforementioned interest which had been previously deducted.³⁹ In *National Life Insurance Co. v. United States*⁴⁰ the Supreme Court declared the act unconstitutional. "Congress had no power purposely and directly to tax state obligations by refusing to their owners deductions allowed to others."⁴¹

In view of these conflicting statements, the extent to which Congress may use deductions from gross income as a means of attaining objectives which could not be reached by direct action is by no means clear. As Congress has made no attempt to use the deduction section to secure such objectives since the decision in *National Life Insurance Co. v. United States*, there are no additional Supreme Court cases directly in point. However, a number of important cases growing out of similar federal tax legislation and a rapidly changing political and economic panorama suggest a probable solution to the problem.

The growing importance of government in business, the immediate sensitiveness of a competitive economy to a relative change in prices and purchasing power, the impossibility of insulating the effects of direct regulation, taxation, and public expenditures—all obviously require coordinated and cooperative action on the part of private enterprise and the national, state, and local governments. Seriously divergent policies must inevitably result in chaos. In a sense it is thus unfortunate that the uncertainty as to the nature and extent of the powers of Congress and of the several state legislatures has often led to an artificial selection of the instruments of social control. Instead of selecting the most effective means of reaching a desired result it has often been necessary to select a cumbersome and even an unsatisfactory method of attaining a legislative objective.

Since the power of Congress to "lay and collect taxes, duties, imposts and excises"⁴² is said to embrace "every conceivable power of taxation,"⁴³ and since taxation inevitably affects economic and social relations, it is not surprising that this fortuitous conjunction of political and economic power should be exercised with increasing frequency.

³⁹Revenue Act of 1921, § 245.

⁴⁰277 U. S. 508, 48 S. Ct. 591 (1928).

⁴¹277 U. S. 508, 522, 48 S. Ct. 591, 594. Cf. Revenue Act of 1928, § 117.

⁴²U. S. Const. Art I, § 8. "The Congress shall have the power to lay and collect taxes, duties, imposts and excises."

⁴³*Brushaber v. Union Pacific R. Co.*, 240 U. S. 1, 12, 36 S. Ct. 236, 239 (1916).

Aside from its superior effectiveness for many purposes, it has the obvious advantage of constitutional validity in many types of situations,⁴⁴ a validity which makes its use advisable from a political point of view even though the exercise of some other, but less extensive, grant of authority would be more advantageous from an economic standpoint. Thus constitutional considerations compel congressional use and misuse of the taxing power. Constitutional considerations likewise form the basis of attack upon the exercise of this power. Undoubtedly a large part of the opposition to the use of the national taxing power for non-fiscal purposes is based upon either an objection to an extension of the activities of Congress in general or an objection to specific regulations in particular rather than because of any fundamental disapproval of regulation by taxation. By insisting upon a different and, allegedly, more direct method of social control, it has been frequently possible to raise serious constitutional doubts as to its validity and thus discourage its enactment, or, if this fails, to argue that the legislation is not in substance a tax even though it is in form. Since *every* tax statute represents at least an ostensible attempt to raise revenue and necessarily operates as a method of control,⁴⁵ the Supreme Court has frequently been called upon to determine the permissible limits of this inherent power-to-regulate-through-taxation. Unless it is to be supposed that the taxing power of Congress is the Achilles heel of our dual system of government, some line must be drawn between permissible revenue measures and unconstitutional interference.⁴⁶ Yet the drawing of this line is extremely difficult. Running counter to the concept of states' rights is the powerful force of economic necessity. The development of transportation and communication has obliterated state boundaries for many practical purposes.⁴⁷ It has long been recognized that in many situations regulation must be nation-wide if it is to be effective. The internal affairs of the states are becoming increasingly subject to federal control.

⁴⁴See Hall, *Government and Business* (1939) 311-314.

⁴⁵"In the levying of every tax Congress must inevitably have a purpose other than the raising of revenue since it cannot escape the responsibility of controlling in the national interest the non-fiscal regulatory effects of the distribution of tax burdens. There can, in short, be no such thing as taxation for revenue only." Cushman, *Social and Economic Control through Taxation* (1934) 17 *Minn. L. Rev.* 757, 764.

⁴⁶"Congress is not empowered to tax for those purposes which are within the exclusive province of the states." Marshall, C. J., in *Gibbons v. Ogden*, 9 *Wheat.* 1, 199 (U. S. 1824). See also, Powell, *Child Labor, Congress, and the Constitution* (1922) 1 *N. C. L. Rev.* 61, 69; Rottschaefer, *Constitutional Law* (1939) 175 et seq.

⁴⁷E. g., the *Shreveport case*, *Houston, E. & W. Texas Ry. Co. v. United States*, 234 U. S. 342, 34 S. Ct. 833 (1914).

In addition to the current trend toward greater centralization, those who oppose the use of the taxing power for non-fiscal purposes have been faced with a long-continued course of legislative conduct to the contrary, conduct which has been sustained, moreover, by numerous Supreme Court decisions.

The framers of the Constitution were well aware of the regulatory aspects of taxation.⁴⁸ Colonial tariffs and the interstate barriers under the Articles of Confederation supplied ample training in the use of tax legislation for non-fiscal purposes.⁴⁹ This recognition was voiced from the floor of the Convention and is contained in the Constitution itself.⁵⁰ The requirement that direct taxes be apportioned is a lasting memorial to a keen appreciation of the possible effect of a national capitation tax upon the existence of slavery in the South.⁵¹

The second act of the new Congress,⁵² a tariff on imports "for the support of government . . . and the encouragement and protection of manufactures," eloquently describes the prevailing legislative opinion in 1789. Furthermore, this use of the taxing power to secure collateral results was not confined to import duties. In 1791 a tax was laid on domestic liquor;⁵³ although enacted primarily for the purpose of raising revenue, one of the reasons given for this particular exaction was that it would tend to discourage the consumption of alcoholic beverages. Thus, the virtually contemporaneous action of members of Con-

⁴⁸Brant, *Regulation by Taxation* (1935) 85 *New Republic* 98. Cf. Cushman, *The National Police Power under the Taxing Clause of the Constitution* (1920) 4 *Minn. L. Rev.* 247, 296 n. 34; Stocking, *The Development of American Institutions*, in Spahr and Others, *Economic Principles and Problems* (1940) 41, 49.

⁴⁹For numerous illustrations see *Opinion of the Justices*, 196 *Mass.* 603, 85 *N. E.* 545 (1908).

⁵⁰For example, see Madison, *Debates in the Federal Convention of 1787* (1920) 412.

⁵¹Paterson, J., a member of the Constitution Convention, said that "The provision was made in favor of the southern states. They possessed a large number of slaves; and had extensive tracts of territory, thinly settled, and not very productive. A majority of the states had but few slaves, and several of them a limited territory, well settled, and in a high state of cultivation. The southern states, if no provision had been introduced into the Constitution, would have been wholly at the mercy of the other states. Congress, in such case, might tax slaves, at discretion or arbitrarily, and land in every part of the Union at the same rate or measure: so much a head in the first instance, and so much an acre in the second. To guard them against imposition in these particulars, was the reason of introducing the clause in the Constitution, which directs that representatives and direct taxes shall be apportioned among the states, according to their respective numbers." *Hylton v. United States*, 3 *Dall.* 171, 177 (U. S. 1796).

⁵²1 *Stat.* 24 (1789).

⁵³1 *Stat.* 199 (1791).

gress, many of whom were members of the Constitutional Convention, indicates that the latter body saw no objection to taxation for regulatory purposes⁵⁴—at least so long as the statute was in the *form* of a revenue measure habitually employed for fiscal purpose. Congress was deliberately given very broad taxing powers; there was no intention to perpetuate the fundamental weaknesses of the Confederation. These powers were known to have regulatory consequences, yet there was no attempt to confine such consequences within the limits of the other delegated powers.

In view of the scope of the federal taxing power and the historical basis⁵⁵ for its use for non-fiscal purposes, it was to be expected that attempts to use it to burden and to prohibit would be sustained by the Supreme Court. And such has been the case. As long as the statute has been in the *form* of an *ordinary* revenue measure it has been invariably upheld. There has been no constitutional objection to a tax which “merely” handicaps or discourages a given course of conduct. Thus in *Veazie Bank v. Fenno*⁵⁶ the “tax” on state bank notes was sustained even though it was clear that the statute would not produce revenue. Although the Court did mention the fact that Congress had the power to regulate currency, the decision was based squarely upon the proposition that Congress had the power to tax such notes and having this power, the Court would not inquire into the amount of the tax or the purpose for which it was enacted.

The doctrine of the *Veazie Bank* case was reaffirmed in *McCray v. United States*.⁵⁷ Although it was argued that the federal tax on colored oleomargarine was so high that it would destroy the industry, the Court refused to inquire into the reason for its enactment. There being a power to tax, the rate was not a matter of judicial concern. Furthermore, even if there had been an abuse of power by Congress, the Court would not abuse its own power by disciplining another branch of the national government.⁵⁸ Other but less extreme cases indicated the same judicial attitude. An inheritance tax was sustained in *Knowl-*

⁵⁴See *J. W. Hampton, Jr., & Co. v. United States*, 276 U. S. 394, 412, 48 S. Ct. 348, 353 (1928).

⁵⁵“Since 1789 the Federal Government has used the taxing power to encourage or discourage, or even destroy, certain businesses, regulate others, and prevent still others from entering the field.” Anderson, *Taxation, Recovery, and Defense* (1940) 168.

⁵⁶8 Wall. 533 (U. S. 1869).

⁵⁷195 U. S. 27, 24 S. Ct. 769 (1904).

⁵⁸195 U. S. 27 at 54, 24 S. Ct. 769 at 776 (1904).

ton v. Moore⁵⁹ and a tax on foreign-built yachts in *Billings v. United States*;⁶⁰ the former tax received strong congressional support because it was admittedly a method of reducing large family fortunes while the latter tax was enacted as a measure to protect domestic ship-building. An attempt to regulate corporations⁶¹ and at the same time to avoid, in part, the decision in *Pollock v. Farmers' Loan & Trust Co.*⁶² was successful when the Corporation Excise Tax Act of 1909 was upheld in *Flint v. Stone-Tracy Co.*⁶³ The objection that a tax on corporations chartered by the states would enable Congress to destroy such institutions was said not to be a matter for the Court to decide. "The remedy for such wrongs, if such in fact exist, is in the ability of the people to choose their own representatives, and not in the exertion of unwarranted powers by courts of justice."⁶⁴

In addition to sustaining prohibitive sanctions in the bare form of tax legislation, the Supreme Court for a number of years indicated a willingness to sustain regulations which were incorporated in the statute for the ostensible purpose of aiding in the collection of the tax. In *Nicol v. Ames*⁶⁵ a federal "statute of frauds" for boards of trade was sustained as a legitimate part of a tax statute. While the act prescribed in detail the information to be contained in the memorandum of sale, it was justified on the ground that the provisions were simply "means of identifying the sale, and for collecting the tax by means of the required stamp." Again, in *Felsenheld v. United States*,⁶⁶ the Court upheld a section of the statute laying an excise tax on tobacco which prohibited the inclusion of "any article or thing whatsoever" on, in, or with the package containing the tobacco other than specified stamps and labels; even though the coupon in question was of inappreciable weight and in no way interfered with the collection of the tax, Congress could provide that the package bearing the revenue stamps "shall contain only the article which is subject to the tax."

A much more ambitious scheme to use the ancillary powers of taxation was sustained in *United States v. Doremus*.⁶⁷ In declaring the Har-

⁵⁹178 U. S. 41, 20 S. Ct. 747 (1900).

⁶⁰232 U. S. 261, 34 S. Ct. 421 (1914).

⁶¹"The first and only step thus far taken to place corporations, aside from railroads, under some form of government control." Bruce, *Taxation of Manufacturing and Mercantile Corporations* (1910) 3 *State and Local Taxation* 304.

⁶²157 U. S. 429, 15 S. Ct. 673 (1895); 158 U. S. 601, 15 S. Ct. 912 (1895).

⁶³220 U. S. 107, 31 S. Ct. 342 (1911).

⁶⁴220 U. S. 107, 169, 31 S. Ct. 342, 366 (1911).

⁶⁵173 U. S. 509, 19 S. Ct. 522 (1899).

⁶⁶186 U. S. 126, 22 S. Ct. 740 (1902).

⁶⁷249 U. S. 86, 39 S. Ct. 214 (1919).

riation Narcotic Drug Act constitutional, the Court said that Congress was clearly authorized to select as a subject of taxation dispensers of narcotics; since the detailed provisions relating to their registration had the tendency to diminish the clandestine sale of narcotics without paying the tax,⁶⁸ "the legislation enacted has some reasonable relation to the exercise of the taxing authority conferred by the Constitution, it cannot be invalidated because of the supposed motives which induced it."⁶⁹

Thus, for the first one hundred and thirty years under the Constitution, the Court refused to make a distinction between taxes for fiscal and for non-fiscal purposes. Although federal taxes had been declared unconstitutional because they were said to violate the requirement of apportionment,⁷⁰ or were on exports,⁷¹ or were contrary to the doctrine of intergovernmental tax immunity,⁷² no tax statute had been held invalid because of its regulatory effect. The national government had a broad taxing power, and in the exercise of this power its discretion as to the amount to be exacted was not subject to judicial review. Taxation often acted as a deterrent and occasionally as a prohibition; the *motive* for such action was immaterial. The selection of the object of the tax *always* involved non-fiscal considerations.⁷³ Consequently when President Taft, in order to eradicate an occupational disease resulting from the handling of white phosphorus, recommended,⁷⁴ and Congress

⁶⁸The tax was "\$1. per annum."

⁶⁹249 U. S. 86, 93, 39 S. Ct. 214, 216 (1919).

⁷⁰Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 S. Ct. 673 (1895); Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189 (1920).

⁷¹Fairbank v. United States, 181 U. S. 283, 21 S. Ct. 648 (1901); United States v. Hvoslef, 237 U. S. 1, 35 S. Ct. 459 (1915); Thames & Mersey Marine Ins. Co. v. United States, 237 U. S. 19, 35 S. Ct. 496 (1915).

⁷²Collector v. Day, 11 Wall. 113 (U. S. 1871); United States v. Railroad Co., 17 Wall. 322 (U. S. 1873).

⁷³"It is a common but, as we think, erroneous opinion in some quarters that the legislative body enacting a taxing statute cannot with propriety take into consideration any other matters but the revenue sought to be obtained, and that if it has other purposes besides raising revenue in imposing the tax, or in prescribing a particular manner in which it shall be levied, the tax is invalid. When enacting a statute, it is not only the right but the duty of a legislative body in such cases to take into consideration the effect of the tax in an economic way on the people as a whole, and the beneficial or injurious effects as the case may be which will result from the manner in which the tax is levied. If this were not done, the result might be highly injurious to the public generally, and result in a condition of affairs which would arouse so much protest and objection that our institutions would be endangered." Green, J., in *F. Couthouli, Inc. v. United States*, 54 F. (2d) 158, 162, 163 (Ct. Cl., 1931).

⁷⁴Message of December 6, 1910.

enacted,⁷⁵ a prohibitive tax on the manufacture of white phosphorus matches, the constitutional power of the national government was not seriously questioned.⁷⁶

Because of the unbroken line of authority sustaining the taxing power it was only reasonable that, when an attempt to regulate child labor through the exercise of its power over commerce failed in *Hammer v. Dagenhart*,⁷⁷ Congress should immediately thereafter seek to reach the same result through taxation. However, in *Bailey v. Drexel Furniture Co.*⁷⁸ the Court refused to follow its earlier practice and declared invalid the tax on the net profits of a business knowingly employing child labor. While indicating a willingness to concede that the question of intent would not be considered when dealing with a prohibitory excise on "a commodity or other thing of value," Mr. Chief Justice Taft, speaking for the majority, insisted that a detailed course of conduct prescribed by the act presented a different problem; it was an attempt to regulate subjects not entrusted to Congress. Although the Court said that the provisions appearing on the face of the statute were not "naturally and reasonably adapted to the collection of the tax,"⁷⁹ and thus sought to distinguish it from the narcotics tax, it should be noted that the detailed specifications in the child labor statute, unlike those of the earlier legislation, were not enacted as an ostensible aid to collection. Instead, they were merely descriptive of the industries subject to the tax—just as "notes used for circulation," "oleomargarine which is yellow in color," and "white phosphorus matches" described, in part, the businesses subject to other federal excise taxes. It is difficult to see how an excise tax on a business employing child labor discloses a clearer intention to regulate matters within the control of the states than does an excise on matches containing white phosphorus; yet to Taft the President and Taft the Chief Justice (in both offices under oath to support the Constitution of the United States) the two were entirely different. If the classification was valid under the Fifth Amendment, the Tenth Amendment should not have stood in the way. As was illustrated by the state bank note, olemargarine, narcotics, inheritance, and corporation tax cases, the power to tax necessarily carried with it the power to interfere with local affairs. Yet in *Hill v. Wal-*

⁷⁵37 Stat. 8 (1912).

⁷⁶The Act was not litigated. Shoup, *Facing the Tax Problem* (1937) 192.

⁷⁷247 U. S. 251, 38 S. Ct. 529 (1918).

⁷⁸259 U. S. 20, 42 S. Ct. 449 (1922).

⁷⁹259 U. S. 20, 43, 42 S. Ct. 449, 453 (1922).

lace,⁸⁰ decided the same day, the Court again held a business tax invalid. A "tax" on the sale of grain at boards of trade other than those boards of trade which complied with the requirements of the statute was also said to be an attempt to regulate rather than to tax.

Beginning with the *Child Labor Tax Case*, the Court for more than a decade thereafter displayed a vacillating attitude with regard to the power of Congress to tax for non-fiscal purposes. For example, it refused to grant certiorari in two cases⁸¹ where lower federal courts sustained the federal tax on the sale of tickets away from the box office. Although the rate was so graduated that "the ticket speculator has no motive to sell for a premium of between 50 cents and \$1,"⁸² the lower courts did not consider this a direct interference with state activity. Perhaps the fact that the Supreme Court had previously held that the states themselves could not regulate the price of theatre tickets⁸³ justified the belief that this was not an "unauthorized exercise by Congress of police power."⁸⁴ Any doubt as to the availability of the taxing power for regulatory measures was put to rest by the Supreme Court in *J. W. Hampton, Jr., & Co. v. United States*.⁸⁵ "So long as the motive of Congress and the effects of its legislative action are to secure revenue for the benefit of the general government, the existence of other motives in the selection of the subjects of taxes cannot invalidate congressional action."⁸⁶ Yet in spite of this the Court in *United States v. Constantine*⁸⁷ declared invalid a special excise tax on persons carrying on a liquor business in violation of state law. Since the exaction in question was in addition to the regular tax, since it was highly exorbitant, and since the condition of its imposition was the commission of a crime, the

⁸⁰259 U. S. 44, 42 S. Ct. 453 (1922). See also *Trusler v. Crooks*, 269 U. S. 475, 46 S. Ct. 165 (1926).

⁸¹*McKenna v. Anderson*, 31 F. (2d) 1016 (C. C. A. 2d, 1929), cert. denied, 279 U. S. 869, 49 S. Ct. 482 (1929); *Couthoui v. United States*, 54 F. (2d) 158 (Ct. Cl., 1931) cert. denied, 285 U. S. 548, 52 S. Ct. 396 (1932). Accord: *Alexander Theatre Ticket Office, Inc. v. United States*, 23 F. (2d) 44 (C. C. A. 2d, 1927); *Apollo Operating Corp. v. Anderson*, 55 F. (2d) 66 (C. C. A. 2d, 1932).

⁸²*Alexander Theatre Ticket Office, Inc. v. United States*, 23 F. (2d) 44, 48 (C. C. A. 2d, 1927).

⁸³*Tyson & Bro. United Theatre Ticket Offices v. Banton*, 273 U. S. 418, 47 S. Ct. 426 (1927).

⁸⁴23 F. (2d) 44, 47 (C. C. A. 2d, 1927).

⁸⁵276 U. S. 394, 48 S. Ct. 348 (1928). Tariff Act of 1922, § 315, authorizing the President to regulate customs duties in order to equalize the costs of production in the United States and competing foreign countries held valid.

⁸⁶276 U. S. 394, 412, 48 S. Ct. 348, 353 (1928).

⁸⁷296 U. S. 287, 56 S. Ct. 223 (1935).

Court declared it to be a penalty, and being a penalty, it was an attempt to "usurp the police powers of the state." Mr. Justice Cardozo in his dissenting opinion pointed out, however, that the classification was a reasonable one, that the large profits of an illegal business, the expense and difficulty of tax collection, and the propriety of a higher tax on illegality all led to the conclusion that the statute was an appropriate means of raising revenue.

In *United States v. Butler*⁸⁸ the A. A. A. processing tax was held invalid since it was part of a scheme to regulate farm production. Since the statute under consideration contained detailed regulatory provisions relating neither to the description of the persons subject to the tax nor to the means of collecting it, it represented a departure from the earlier tax legislation. It was largely because of this departure that the act was declared unconstitutional. If the expenditure section of the statute had been carefully insulated from the tax section, under prior decisions⁸⁹ the taxpayer would have been in no position to object to the manner in which the proceeds were used. Standing alone, the processing tax was clearly a valid exercise of the federal taxing power.⁹⁰ Except as a lesson of doubtful value in the drafting of statutes, the *Butler* case has little bearing upon the question of regulatory taxation; and even the uncertainty created by the *Constantine* case has been largely dispelled.

The National Firearms Act⁹¹ providing for the registration and taxation of dealers, a tax of \$200 on each transfer of certain types of firearms, and for the identification of transferees was sustained in *Sonzinsky v. United States*.⁹² Even though it was argued that the statute was enacted for the purpose of regulating and suppressing traffic in firearms, the Court refused to limit the federal taxing power. It said:

"Every tax is in some measure regulatory. To some extent it interposes an economic impediment to the activity taxed. . . . But a tax is not any the less a tax because it has a regulatory effect, . . . and it has long been established that an Act of Congress which on its face purports to be an exercise of the taxing power is not any the less so because the tax is burdensome or tends to restrict or suppress the thing taxed. . . . Inquiry into the

⁸⁸297 U. S. 1, 56 S. Ct. 312 (1936). Also *Rickert Rice Mills v. Fortenot*, 297 U. S. 110, 56 S. Ct. 374 (1936).

⁸⁹*Massachusetts v. Mellon*, 262 U. S. 447, 43 S. Ct. 597 (1923).

⁹⁰*Cincinnati Soap Co. v. United States*, 301 U. S. 308, 57 S. Ct. 764 (1936).

⁹¹48 Stat. 1236 (1934).

⁹²300 U. S. 506, 57 S. Ct. 554 (1937).

hidden motives which may move Congress to exercise a power constitutionally conferred upon it is beyond the competency of courts."⁹³

Thus the Court reaffirmed the traditional view that a statute appearing on its face to be a revenue measure will be treated as an exercise of the taxing power. The fact that Congress intends to achieve some result in addition to an avowed purpose of seeking funds for public expenditure will not defeat the legislation; "objective constitutionality"⁹⁴ and not "the process of psychoanalysis"⁹⁵ determines its validity.

However, if the statute contains detailed regulations which do not facilitate the collection of revenue a much more serious question is raised. In *Carter v. Carter Coal Co.*⁹⁶ a tax of 15% on the sale price of bituminous coal with a 13½% drawback for those operators who complied with the Bituminous Coal Conservation Act was declared to be a penalty and not a tax. But in *Sunshine Anthracite Coal Co. v. Adkins*⁹⁷ the 19½% tax imposed by the Bituminous Coal Act of 1937 upon non-code members engaged in interstate commerce was sustained, the regulatory provisions being "clearly within the power of Congress under the commerce clause of the Constitution."⁹⁸ Since the tax question was not seriously argued in the *Carter* case it is difficult to evaluate this method of regulation when the federal taxing power alone is the basis for the local interference. A conditional tax or a conditional drawback may be declared invalid even though a classified tax which gives something of the same result may be valid. That is, a "tax" may be used to discourage or prohibit a certain course of conduct even though it may not be possible to secure *affirmative* action through a coercive exaction; situations requiring administrative flexibility may be beyond federal control even though the static aspect of the same problem may be effectively regulated.

However, any implied limitations upon the federal taxing power must be carefully examined. The relatively few cases declaring federal tax statutes unconstitutional are being carefully reconsidered by the Supreme Court. The restriction against the taxation of the salaries of

⁹³300 U. S. 506, 513-514, 57 S. Ct. 554, 555, 556 (1937).

⁹⁴Cushman, Social and Economic Control Through Federal Taxation (1934) 18 Minn. L. Rev. 757, 774 et seq.

⁹⁵From the opinion of Cardozo, J., dissenting in *United States v. Constantine*, 296 U. S. 287, 299, 56 S. Ct. 223, 228 (1935).

⁹⁶298 U. S. 238, 56 S. Ct. 855 (1936).

⁹⁷310 U. S. 381, 60 S. Ct. 907 (1940).

⁹⁸310 U. S. 381, 393, 60 S. Ct. 907, 912 (1940).

federal judges has disappeared.⁹⁹ There is increasing reluctance to strike down retroactive taxes¹⁰⁰ and there is a tendency to narrow the direct tax concept so that it includes only capitation taxes and assessments upon real property.¹⁰¹ The doctrine of intergovernmental tax immunity is rapidly disappearing,¹⁰² and it is even possible that the Court will revert to the view advanced by Chief Justice Marshall in *McCulloch v. Maryland*¹⁰³ that state institutions are protected from the national taxing power only by the uniformity and apportionment clauses of the Constitution and by the locally elected members of Congress. In fact, the Court has sustained the use of "economic coercion" on the states in order to compel them to enact legislation thought desirable by Congress. The 80% credit against the federal estate tax for amounts paid to state governments under similar statutes was sustained over the objection of the State of Florida.¹⁰⁴ And in *Chas. C. Steward Machine Co. v. Davis*¹⁰⁵ a federal tax on employers with a 90% credit for contributions made by such employers to state unemployment funds established in compliance with federal regulations was held valid. Compared with the possible implications of the *Davis* and state employee tax case,¹⁰⁶ the interference with local affairs objected to in *United States v. Constantine* appears mild indeed; and even if the *Constantine* decision has not been immunized by *Sonzinsky v. United States*,¹⁰⁷ the strong dissent in the earlier case and the present attitude of the Court give it very doubtful authority.

The other cases holding federal tax statutes invalid because of their non-fiscal character are of small solace to opponents of federal regulation. *United States v. Butler* never amounted to more than a "lesson in legislative draftsmanship,"¹⁰⁸ and the rapidly expanding power over commerce has largely nullified the effects of the remaining cases. Four months after *Hill v. Wallace* Congress enacted a similar statute which

⁹⁹See *O'Malley v. Woodrough*, 307 U. S. 277, 59 S. Ct. 838 (1939). Public Salary Tax Act of 1939, § 3.

¹⁰⁰E. g., see *United States v. Hudson*, 299 U. S. 498, 57 S. Ct. 309 (1937).

¹⁰¹See *New York ex rel. Cohn v. Graves*, 300 U. S. 308, 57 S. Ct. 466 (1937).

¹⁰²*Graves v. O'Keefe*, 306 U. S. 466, 480, 59 S. Ct. 595, 598 (1939).

¹⁰³4 Wheat. 316, 435, 436 (U. S. 1819).

¹⁰⁴*Florida v. Mellon*, 273 U. S. 12, 47 S. Ct. 265 (1927).

¹⁰⁵301 U. S. 548, 57 S. Ct. 883 (1937). See also *Helvering v. Davis*, 301 U. S. 619, 57 S. Ct. 904 (1937).

¹⁰⁶*Helvering v. Gerhardt*, 304 U. S. 405, 58 S. Ct. 969 (1938).

¹⁰⁷300 U. S. 506, 57 S. Ct. 554 (1937).

¹⁰⁸*Powell*, *The Processing Tax and the Social Security Act* (1936) 5 Brooklyn L. Rev. 125, 130.

was sustained in *Chicago Board of Trade v. Olsen*.¹⁰⁹ The regulation of the bituminous coal industry which was declared invalid in *Carter v. Carter Coal Co.* was redrafted and upheld in *Sunshine Anthracite Coal Co. v. Adkins*. Even *Bailey v. Drexel Furniture Co.* has been effectively circumscribed by the implications of *National Labor Relations Board v. Jones & Laughlin Steel Corporation*,¹¹⁰ by the specific provisions of the Fair Labor Standards Act of 1938,¹¹¹ and by *United States v. F. W. Darby Lumber Co.*¹¹²

The refurbishing of the taxing power, the broadening of the concept of interstate commerce and of the doctrine which permits national regulation of matters which "directly affect" such commerce, the control over foreign trade and banking and currency, the exclusive management of the postal service, and the power to enact bankruptcy measures—all combine to give tremendous power to the national government. In view of the multiple powers which may be exercised by Congress and the unsympathetic manner in which the Supreme Court has recently cited those tax decisions which overrode important national legislation, it may be reasonably supposed that future attempts to use the taxing power either as an independent source of authority for regulation or as an aid to some other delegated power will meet with little constitutional restraint.

¹⁰⁹262 U. S. 1, 43 S. Ct. 470 (1923).

¹¹⁰301 U. S. 1, 57 S. Ct. 615 (1937).

¹¹¹52 Stat. 1060 (1938) §§ 1 (l), 12.

¹¹²61 S. Ct. 451 (1941), overruling *Hammer v. Dagenhart*, 247 U. S. 251, 38 S. Ct. 529 (1918).