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THE CONTINUED RESTRICTION OF THE FEDERAL GOVERNMENT'S IMMUNITY FROM STATE TAXATION —*UNITED STATES V. COUNTY OF FRESNO*

Under the Supremacy Clause of the United States Constitution,[1] the states may not tax the properties, functions or instrumentalities of the federal government.[2] This federal immunity from state taxation was first announced in the landmark case of *McCulloch v. Maryland*,[3] which invalidated a state tax on federal bank notes because it interfered with the Act of Congress[4] creating the federal banks.[5] Chief Justice Marshall, in the majority opinion, ruled that the federal government was entitled to protection from state legislation because of the inherent threat of interference with federal government activities.[6] It was his conviction that:

> The States have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government.[7]

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1. U.S. CONST. art. VI, cl. 2:
   This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.
2. For recent discussion of governmental tax immunity, see McCormack, *Intergovernmental Immunity and the Eleventh Amendment*, 51 N.C.L. REV. 485 (1973).
3. 17 U.S. (4 Wheat.) 316 (1819). In *McCulloch v. Maryland*, the Court held that a state tax on the Bank of the United States violated the Supremacy Clause. Federal government immunity from state taxation was found to exist because of the lack of a political check against abuse:
   > The people of a State, therefore, give to their government a right of taxing themselves and their property, . . . resting confidently on the interest of the legislator, and on the influence of the constituents over their representative, to guard against its abuse . . . .

   Id. at 428.
   > 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.

   Id. at 435.
4. An Act to incorporate the subscribers to the Bank of the United States, Act of April 10, 1816, ch. 44, 3 Stat. 266.
5. 17 U.S. (4 Wheat.) at 427.
6. *Id.* at 436.
7. *Id.*

For over a century after *McCulloch,* the Supreme Court steadily expanded the federal government's immunity from state taxation.[8] This immunity had extended to third persons,[9] such as employees,[10] patentees,[11] and lessees,[12] having relationships with the federal government. The Court prohibited state taxation of these third parties because of the possibility that the tax could increase costs charged to the federal government, thus creating an economic burden.[13]

Supreme Court decisions in the 1930's, however, reversed earlier interpretations of federal immunity from state taxation.[14] Third parties engaged in business transactions with the federal government no longer

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8. G. GUNTHER & N. DOWLING, CASES AND MATERIALS ON CONSTITUTIONAL LAW 752-53 (8th ed. 1970). For the historical development, *see* Powell, *The Waning of Intergovernmental Tax Immunities,* 58 HARV. L. REV. 633 (1945); Powell, *The Remnant of Intergovernmental Tax Immunities,* 58 HARV. L. REV. 757 (1945).

9. Standard Oil Co. v. Johnson, 316 U.S. 481 (1942). Appellant, Standard Oil, sold gas to United States Post Exchanges in California and was required to pay a license tax for the privilege of distributing motor vehicle fuel. The Court concluded that post exchanges were arms of the government essential for the performance of governmental functions. As an integral part of the War Department, the Court said that they "partake of whatever immunities it [the federal government] may have under the Constitution and federal statutes." *Id.* at 485.

Similarly, in Graves v. Texas Co., 298 U.S. 393 (1936), the Court condemned a state gas tax upon the sale, distribution, storage and withdrawal of gas for sale to the United States for use by the Army or Tennessee Valley Authority. *See also* Panhandle Oil Co. v. Knox, 277 U.S. 218 (1928), where the Court again held a state sales tax could not be applied to sales made to the federal government.

10. Dobbins v. Erie County, 41 U.S. (16 Pet.) 435 (1842) (holding that a state could not tax a federal officer's salary) (subsequently overruled by implication in Graves v. New York *ex rel.* O'Keefe, 306 U.S. 466 (1939)).

11. Long v. Rockwood, 277 U.S. 142 (1928) (holding patent royalties free from state income taxes) (subsequently overruled by Fox Film Corp. v. Doyal, 286 U.S. 123 (1932)).

12. Gillespie v. Oklahoma, 257 U.S. 501 (1922) (holding lessees of Indian lands immune from state income taxes).

13. An economic burden would fall on the federal government when a state sales tax is imposed on a private party working for the government under a "cost plus" basis. Under the terms of the contract, the federal government would be required to pay all costs incurred by the private party plus an additional amount for labor and profit. The state tax assessed against the contractor would be an additional cost incurred causing the government to pay a higher total contract cost. Thus, for many years after *McCulloch v. Maryland,* the Court invalidated state taxes on federal government contractors "whenever the effect of the tax was or might be to increase the cost to the federal government of performing its functions." United States v. County of Fresno, 97 S. Ct. 699, 703 (1977). *See also* Panhandle Oil Co. v. Knox, 277 U.S. 218 (1928); Gillespie v. Oklahoma, 257 U.S. 501 (1922); Dobbins v. Erie County, 41 U.S. (16 Pet.) 435 (1842).

14. *See generally* Powell, *The Waning of Intergovernmental Tax Immunities,* 58 HARV. L. REV. 633 (1945); Comment, *Government Contract Privileges: A Fertile Ground for State Taxation,* 44 VA. L. REV. 1099 (1958).

were shielded from state taxation because the economic burden of the tax ultimately fell on the federal government.[15] Tax immunity was upheld only when the tax imposed an unreasonable burden on the functioning of the federal government or its instrumentalities,[16] or the legal incidence of a tax fell on the federal government.[17] The legal incidence

15. The leading case in this regard was James v. Dravo Contracting Co., 302 U.S. 134 (1937). In that case, the Court held that the proceeds from a contract with the federal government were not immune from a state occupation tax measured by gross receipts received under contract with the federal government. The Court declared the tax valid even though the cost of the tax was to be borne by the government via a higher contract price.

The economic burden argument was again rejected in Graves v. New York *ex rel.* O'Keefe, 306 U.S. 466 (1939), *overruling* Dobbins v. Erie County, 41 U.S. (16 Pet.) 435 (1842). In this case, the Court sustained a nondiscriminatory state tax on the income of federal employees and said, "the theory which once won a qualified approval, that a tax on income is legally or economically a tax on its source, is no longer tenable . . . ." *Id.* at 480.

16. *See* Graves v. New York *ex rel.* O'Keefe, 306 U.S. 466 (1939). In *Graves,* the Court said that the only possible basis for implying a constitutional immunity from state taxation would be if "the economic burden of the tax is in some way passed on so as to impose a burden on the national government tantamount to an interference by one government with the other in the performance of its function." *Id.* at 481.

In applying this test to the facts in *Graves,* the Court found that the economic burden of the state income tax on the federal government was a "normal incident" to the coexisting operations of two sovereigns. *Id.* at 487. In addition, the Court found that the state tax did not unduly interfere with or obstruct the federal government's functioning. *Id.* at 484.

See also United States v. Boyd, 378 U.S. 39 (1964); Oklahoma Tax Comm'n v. Texas Co., 336 U.S. 342 (1949); Metcalf & Eddy v. Mitchell, 269 U.S. 514 (1926); Van Brocklin v. Tennessee, 117 U.S. 151 (1886); Union Pacific R.R. v. Peniston, 85 U.S. (18 Wall.) 5 (1873); Weston v. City Council of Charleston, 27 U.S. (2 Pet.) 449 (1829).

17. The legal incidence test was applied by the Supreme Court in Alabama v. King & Boozer, 314 U.S. 1 (1941), *overruling* Panhandle Oil Co. v. Knox, 277 U.S. 218 (1928). This case upheld a sales tax on a federal government contractor's purchases of materials to be used in constructing an army camp under a cost-plus-fixed-fee contract. The Court said a state could tax a private contractor even though the economic burden of the tax was ultimately passed to the federal government. *Id.* at 12. The fact that title to the purchased lumber passed to the government on delivery did not create an obligation between the government and the vendor that would make the government, as purchaser, directly liable for the tax. *Id.* at 13-14. Thus, the legal incidence of the tax did not fall on the federal government because the government was not the purchaser. In a similar case, Curry v. United States, 314 U.S. 14 (1941), the Supreme Court upheld an Alabama use tax on roofing purchased outside the State by a contractor for the federal government in a cost-plus contract. Again, the legal incidence of the tax was found to rest on the contractor, and the federal government was affected "only as the economic burden is shifted to it through operation of the contract." *Id.* at 18.

The only time a state sales tax was found to be unconstitutional in a cost-plus contract was a case in which the contractor was said to be the purchasing agent of the government. Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1954).

of a tax fell on the federal government whenever the state tax was assessed directly against the federal government or its property.[18]

In the recent Supreme Court decision of *United States v. County of Fresno*,[19] the Court upheld the right of two California counties to tax federal employees on their possessory interests[20] in tax-exempt housing owned by the federal government.[21] This Note will discuss the two-step process used in determining the constitutionality of the possessory interest tax. The issues to be examined are whether the federal government's immunity from state taxation protected the federal employees and, if not, whether the state tax was discriminatory in its application.

THE BACKGROUND OF *County of Fresno*

The California counties of Fresno and Tuolomne[22] were authorized to assess an annual property tax on non-owners' possessory interests in tax-exempt land or improvements.[23] The purpose of the tax[24] was to supple-

18. For example, a state law requiring that a sales tax be collected by the seller from the purchaser cannot be imposed on sales to the federal government. The requirement that the tax be passed on to the purchaser would place the legal incidence of the tax on the federal government.

19. 97 S. Ct. 699 (1977), *aff'g* 50 Cal. App.3d 633, 123 Cal. Rptr. 548 (1975).

20. A possessory interest tax is a tax imposed on the annual use of real property or improvements thereon and is assessed against the non-owner who has possession of, claim to, or right in such property. *See, e.g.*, CAL. REV. & TAX. CODE §107 (West 1970).

21. 97 S. Ct. at 699.

22. Due to the similarity of the Fresno and Tuolomne cases, Fresno, as used hereinafter, will refer to Tuolomne County as well.

23. CAL. CONST. art. 13, §1 states in part:

> All property in the State except as otherwise in this Constitution provided, not exempt under the laws of the United States, shall be taxed in proportion to its value, to be ascertained as provided by law, or as hereinafter provided.

24. Section 104 of the California Revenue and Taxation Code provides in part:

> "Real estate" or "real property" includes: (a) The possession of, claim to, ownership of, or right to the possession of land.

CAL. REV. & TAX. CODE §104 (West 1970). Section 107 of the California Revenue and Taxation Code provides in part:

> Possessory interests means the following: (a) Possession of, claim to, or right to the possession of land or improvements, except when coupled with ownership of the land or improvements in the same person.

CAL. REV. & TAX. CODE §107 (West 1970).

The Supreme Court cited the California Administrative Code, Title 18, 321 (b). This section, defining a taxable possessory interest and applying it to non-taxable publicly-owned real property, did not exist when the 1967 assessments were made. Thus, in 1967, possessory interests in *all* tax-exempt property were subject to the possessory interest tax. For further discussion of Section 21(b) see text accompanying notes 74-76 *infra*. For further discussion of the California possessory interest tax, see Goldman, *Administrative and Legal Aspects of Taxation by California of Possessory Interest in Realty*, 23 So. CAL. L. REV. 169 (1950).

ment real property taxes which supported public services[25] rendered to the county inhabitants.[26] The possessory interest tax was promulgated in an effort to equalize the county tax burdens between users of non-tax-exempt[27] and tax-exempt property.[28]

Possessory interest taxes for the 1967 calendar year were assessed against United States Forest Service employees who occupied government-owned quarters within Fresno and Tuolomne Counties. Pursuant to California statute,[29] the county tax assessors were required

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25. Examples of public services are education, road repairs and construction, and police and fire protection. *See* notes 26 & 28 *infra*.

26. *See* People v. Naglee, 1 Cal. 232 (1850). In this case, the California Attorney General brought a *quo warranto* proceeding. He sought the California Supreme Court's opinion as to the constitutionality of a law requiring foreigners to pay a monthly license fee of $20 for the privilege of working in the California gold mines. The court upheld the license fee, the proceeds of which were applied to state services, stating:

> Persons, whether citizens or foreigners, occupying mineral lands within the state, though such lands form a portion of the public domain, are, in respect to taxation, whether for the support of the State Government or for police or municipal purposes, subject to the legislative jurisdiction of the State.

Id. at 242-43.

See also People v. Shearer, 30 Cal. 645 (1866). In this case, the California Supreme Court found a taxable possessory interest existed in inchoate rights of homesteaders. Possession of public land and improvements put upon them were recognized as "valuable species of property in the possessor." *Id.* at 656. The court went on to say, "Why should it [the possessor of public property] not contribute its proper share, according to the value of the interest, whatever it may be, of the taxes necessary to sustain the State Government which recognizes and protects it?" *Id.* at 657-58.

The United States Supreme Court upheld the states' abilities to tax their citizens in return for the privileges enjoyed by them in New York *ex rel.* Cohn v. Graves, 300 U.S. 308 (1937). The Court said: "Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government." *Id.* at 313. *See generally* Holbrook & O'Neill, *California Property Tax Trends:* 1850-1950, 24 So. CAL. L. REV. 252 (1951).

27. Users or tenants of taxable land are not taxed directly but through the real property taxes their owners are required to pay. It is presumed but not required that the owner will pass the tax on to the tenant through higher rent and thus the renter pays the tax indirectly. 97 S. Ct. at 701 n.3.

28. The first case upholding a possessory interest tax in California was State v. Moore, 12 Cal. 56 (1859). At that time large tracts of land in the California frontier were in the public domain and beyond taxation. The gold rush brought thousands of miners who did not hold fee titles. Thus, the state could not assess real property taxes against them. The California Supreme Court upheld the tax on the miners' possessory interests in the lands so that the basic principle of equality of taxation would be satisfied. The concept of equality of taxation was similarly upheld in the recent California case of Board of Supervisors v. Archer, 18 Cal. App.3d 717, 96 Cal. Rptr. 379 (1971). The California court said: "The permitees should contribute their proper share, according to the value of the interest, for the possession and valuable use of the land." *Id.* at 725, 96 Cal. Rptr. at 385.

29. CAL. REV. & TAX. CODE §405 (West 1970). The main difference between the tax

to determine the value of Forest Service employees' possessory interests. This value was determined by ascertaining the rent of comparable dwellings in the private sector[30] and then discounting for those rooms used solely for official Forest Service purposes.[31] Adjustments also were made for inconveniences to the employees such as distances to the nearest communities and the absence of customary amenities in or near the government-owned housing units.[32] Once value was determined and all adjustments were made, the tax assessment was calculated.

The Forest Service employees paid these tax assessments under protest and, joined by the United States Government, filed for refunds or reductions of the assessments.[33] The Boards of Supervisors for both counties denied the claims.[34] However, the trial courts disagreed and found no possessory interests subject to the tax.[35] The California Court of Appeals reversed both decisions, finding that under California law the Forest Service employees did have taxable possessory interests in the government housing quarters assigned to them.[36] The Court also found that imposition of the tax did not violate the federal government's im-

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computations by the County of Fresno and the County of Tuolomne was that the former estimated the term of the possessory interest to be one year whereas the latter established the term of possession to be five years (the length of time estimated to be the average time Forest Service employees remained in the Forest Service houses). 97 S. Ct. at 701 n.4.

30. 97 S. Ct. at 701.

31. *Id.*

32. Such amenities considered were: paved streets and lighting, landscaping and area attractiveness, existence and reliability of public services (electricity, telephones, fuel), police and fire protection, existence of offensive noises and odors, and standards of maintenance. *Id.* at 701 n.2.

33. 97 S. Ct. at 701.

34. Appellant's Jurisdictional Statement at 7, United States v. County of Fresno, 97 S. Ct. 699 (1977). The Fresno County Superior Court concluded: (1) the interests of the plaintiffs did not constitute possessory interests; (2) the assessor violated the Supremacy Clause of the United States Constitution; (3) the assessor violated Section 3 of the Act for Admission of the State of California, 9 Stat. 452, by interfering with the primary disposition of public lands by the United States; (4) the assessment and collection created a double tax against governmental interests and discriminated against the United States Government and its employees; and (5) the issue of valuation was therefore moot. United States v. County of Fresno, No. 136452 (Cal. Super. Ct., filed January 8, 1973).

35. The Tuolomne County Superior Court concluded as a matter of law that the individual plaintiffs did not have possessory interests and were therefore entitled to a refund. This court did not address the remaining issues that were discussed by the Fresno Superior Court, finding them to be moot. United States v. County of Tuolomne, No. 11317 (Cal. Super. Ct., filed May 14, 1973).

36. United States v. County of Fresno, 50 Cal. App.3d 633, 123 Cal. Rptr. 548 (1975). United States v. County of Tuolomne, No. 11317 (Cal. Ct. App., filed August 13, 1975) was not published in the official reports. Judgment was reversed for the same reasons as set forth in the *County of Fresno* opinion filed on the same day.

munity from taxation because the tax was on the employees, not the government.[37]

The California Supreme Court denied review of both cases,[38] but the United States Supreme Court noted probable jurisdiction[39] and later affirmed the California Court of Appeals.[40] In upholding the possessory interest, the Court found: (1) the federal government's immunity from state taxation did not bar the imposition of the possessory interest tax on federal employees;[41] and (2) the tax did not discriminate against federal employees.[42]

FEDERAL GOVERNMENT IMMUNITY FROM STATE TAXATION

The federal government's immunity would invalidate a state tax if the legal incidence of the tax fell directly on the federal government or the economic burden of the tax unduly interfered with federal functions.[43] The legal incidence of a tax is said to fall upon the federal government whenever the government is the party against whom the tax is legally imposed and liability ultimately rests.[44] In determining that the legal incidence of the Fresno tax did not fall on the federal government, the Supreme Court relied primarily on three landmark cases decided in 1958.[45] In all three cases, the Supreme Court found no invasion of the government's constitutional immunity from state taxation and considered of utmost importance the fact that the taxed property was in the possession or use of private citizens.[46] Similarly, in *County of Fresno,*

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37. According to the appellate court:

> A possessory interest assessment is not made against the government property; the assessment is against the private citizen, and it is the private citizen's usufructuary interest in the government land and improvements alone that is being taxed.

50 Cal. App.3d at 640, 123 Cal. Rptr. at 552.

38. United States v. County of Fresno, 5 Civil No. 2055 (Cal. Sup. Ct., filed October 9, 1975); United States v. County of Tuolomne, 5 Civil No. 2124 (Cal. Sup. Ct., filed October 9, 1975).

39. United States v. County of Fresno, 425 U.S. 970 (1976).

40. 97 S. Ct. at 699.

41. *Id.* at 705.

42. *Id.* at 706.

43. *Id.* at 705.

44. *See* note 17 *supra.*

45. United States v. City of Detroit, 355 U.S. 466 (1958); United States v. Township of Muskegon, 355 U.S. 484 (1958); City of Detroit v. Murray Corp., 355 U.S. 489 (1958). *See* 97 S. Ct. at 706-07.

46. In the first case, United States v. City of Detroit, 355 U.S. 466 (1958), the taxpayer, Borg-Warner Corporation, was a lessee of a government-owned industrial plant located in Michigan. Under the terms of its contract with the federal government, Borg-Warner was required to pay a stipulated annual rental fee to the government but could deduct

although the United States was the owner of the Forest Service property, it was "the possession or use by the private citizen that was being taxed."[47]

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from such rental charges any taxes assessed against it pursuant to performance of the contract. *Id.* at 468. Although the Michigan use or privilege tax decreased the rental income to the federal government, it was sustained by the Supreme Court because the legal incidence of the tax fell on the private lessee. *Id.* at 468-70. In addition, the Court said the Michigan privilege tax was not discriminatory because it applied to every party who used exempt property in Michigan in connection with profit-motivated businesses. *Id.* at 473. Justice Whittaker disagreed in his dissent, however, finding an invalid direct tax against the government. *Id.* at 477. Justice Whittaker premised his dissent on the fact that the tax was computed on the entire value of the federal property and not on the value of the lessee's leasehold interest. *Id.* at 477-78.

In United States v. Township of Muskegon, 355 U.S. 424 (1958), the Michigan tax statute was sustained as it applied to the use of an industrial plant furnished by the government to a private contractor, rent free, under a contract for production of military supplies. Continental Motors Corporation, the contractor, agreed that in the absence of rent, the price of the goods would not include any part of the cost of the facilities furnished by the government. The absence of a formal lease with the federal government and the fact that Continental was using the property in the performance of its contract with the government were not considered by the Court to be distinguishing factors compelling a decision different from *United States v. City of Detroit. Id.* at 486. The important factor, according to the Court, was Continental's use of government property. *Id.* Justice Whittaker, in his dissent, again found an invalid direct tax against the federal government. *Id.* at 488. Here, no leasehold estate, tenancy or other property interest was held by the lessee in the government-owned industrial plant. *Id.* Thus, "even under the majority's interpretation of the law . . . the tax here imposed by the State, however it may be viewed, is a direct tax against the Government and is, hence, invalid." *Id.* 477-78.

The final case, City of Detroit v. Murray Corp., 355 U.S. 489 (1958), involved a subcontractor's possession of parts and materials in which the United States Government had legal title. The Court refused to give weight to the tax description styled as a "personal property tax":

> In passing on the constitutionality of a state tax "we are concerned only with its practical operation not its definition or the precise form of descriptive words which may be applied to it." Lawrence v. State Tax Comm'n, 286 U.S. 276, 280, 52 S. Ct. 556, 557, 76 L.Ed. 1102. Consequently, in determining whether these taxes violate the Government's constitutional immunity we must look through form and behind labels to substance.

Id. at 492. Instead, the Court found the tax was again on a private person's privilege or use of government property for profit. *Id.* at 493.

For additional discussion of the Michigan cases, see Brown, *The Supreme Court, 1957 Term*, 72 HARV. L. REV. 97, 157 (1958).

47. 97 S. Ct. at 704. In *County of Fresno,* the legal incidence of the tax was on those who had possessory rights in property owned by tax-exempt entities. There was no possibility that the federal government would be held accountable for such unpaid taxes because the government-owned property would not be subject to a lien for unpaid taxes. Instead, the unpaid taxes were to be transferred to the unsecured property tax rolls of the county and collected as a personal debt of the assessee. Brief for Appellee, County of Fresno at 4, 97 S. Ct. 699.

The appellant employees in *County of Fresno* contended that they were immune from the possessory interest tax because they were agents of the federal government and occupied the government housing units solely for the performance of Forest Service functions.[48] They claimed that they were using the property to the government's advantage and were subject to detailed limitations and restrictions.[49] There is some merit to this argument in the sense that the employees did not have exclusive use or possession of their housing units. The determination of occupancy assignments was made solely by the government and was based on its own needs and purposes.[50] In fact, according to the trial court, the United States Government retained full rights of access. Supervisors had master keys and could enter the dwellings on official business at any time.[51] Furthermore, the employees could install additional locks only with the consent of their supervisors. When official Forest Service facilities were closed, the public was encouraged to contact Forest Service employees at their dwelling units.[52]

The Supreme Court admitted that the use of government property by the Forest Service employee "*only* in performing his job" could not have been subject to the possessory interest tax.[53] However, the Court found that the government housing was a personal financial benefit to the employees and their families.[54] Any interferences or inconveniences to

48. Brief for Appellant at 12, 97 S. Ct. 699.

49. The California Court of Appeals noted in its decision, however, that the restrictions such as evicting the employees in time of emergency or bringing another employee to live in the residence previously assigned were "exercised sparingly." Although restrictions were placed on making structural changes in the units, this was said to be common in private tenancies as well. 50 Cal. App.3d at 639-40, 123 Cal. Rptr. at 551-52.

50. The government retained control over assigning the units to obtain optimal effectiveness and could temporarily evict or impose upon the occupants additional employees during emergency situations such as forest fires. *Id.* at 637, 123 Cal. Rptr. at 550.

51. United States v. County of Fresno, No. 136452 (Cal. Super. Ct., filed January 8, 1973).

52. *Id.*

53. 97 S. Ct. at 706 n.15. For example, the Court set forth the situation in which the Forest Service employee inhabited a fire tower in the daytime for the sole purpose of watching for forest fires. This employee would not put the tower to beneficial personal use and would occupy it only while performing his job duties.

54. *Id.* at 706-07. In so holding, the Court cited United States v. County of Allegheny, 322 U.S. 174 (1944), which was heavily relied upon by the appellants in *Fresno*. *Allegheny* held an ad valorem state property tax (tax based on the total value of a particular item) invalid. The tax was assessed against the use by a private corporation of government-owned property and was invalidated because "the State made no effort to segregate the corporation's interest and tax it." *Id.* at 187. However, the Court in *Allegheny* also said in dictum that any personal advantages arising out of possession or custody of government property "by way of salary, profit or beneficial personal use of the property may be taxed . . . ." *Id.* at 188.

the appellants were factors to be considered in valuation of the possessory interest.[55] Since the tax was assessed against the employees' personal use of government property, apart from their job performance, the legal incidence of the tax fell upon the employees.[56]

In addition, the Court in *Fresno* found no undue economic interference with federal government activities.[57] However, the Court did recognize that some economic interference could result if the federal government voluntarily increased its employees' salaries to compensate for the tax assessments.[58] Alternatively, the Court said that the federal government could lose an advantage it had in the employment market, namely, supplying housing at a rental value lower than that paid by private tenants.[59]

Contrary to the Court's opinion, the Forest Service employees were paying rents equal to the fair rental value of similar houses in the private sector.[60] However, the Forest Service did have an economic advantage

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55. 97 S. Ct. at 707. The California Appellate Court also rejected appellant's government function argument using an exclusive use test. 50 Cal. App.3d at 639, 123 Cal. Rptr. at 551. This test provides that the occupier must have some exclusive possession of the premises so that the occupancy or use "subserves an independent, private interest." *Id.* Thus, *any* personal use of property, regardless of the primary reason for the occupancy, would create a taxable possessory interest. Under the exclusive use test, aspects of nontransferability and the ability of the government to revoke at will did not prevent a taxable possessory interest from arising. *Id.*

The appellate court relied on McCaslin v. DeCamp, 248 Cal. App.2d 13, 18, 56 Cal. Rptr. 42, 43 (1967). In *McCaslin* the plaintiff alleged his month-to-month occupancy could be terminated at any time his employment ceased. Nevertheless, the California Court of Appeals found a possessory interest existed. *See also* Kaiser Co. v. Reid, 30 Cal.2d 610, 184 P.2d 879 (1947); Pacific Grove-Asilomar Operating Corp. v. County of Monterey, 43 Cal. App.3d 675, 117 Cal. Rptr. 874 (1974).

Similarly, the Court of Appeals for the Ninth Circuit rejected the government function argument in International Paper Co. v. County of Siskiyou, 515 F.2d 285 (9th Cir. 1974). The Court upheld a California possessory interest tax assessed against a timber company, which contracted with the federal government to remove standing timber in the national forests. Although the company was required to comply with federal regulations as to cutting timber and building roads with the forests, it was found to have a taxable beneficial interest in the use of the forest land. *Id.* at 288. The company was not an agent of the Government entitled to immunity from state taxation. *Id.*

56. 97 S. Ct. at 705-07.

57. *Id.* at 705.

58. *Id.*

59. *Id.* at 705 n.12. The Court said:

> The Federal Government would otherwise have had the power—enjoyed by no other employer—of giving its employees housing on which no property tax is paid by them either directly or indirectly as rent paid to a landlord who himself paid a property tax.

60. Justice Stevens, in his dissent, pointed out that "the proof established that the Forest Service charged its employees the fair rental value of similar houses in the private

over the private landlord prior to the possessory interest tax assessments. This advantage was that the government landlord kept the entire rent whereas the private landlord was required to pay a real property tax to the state.

Thus, the actual effect of the possessory interest tax on the federal government would be a decrease in federal funds or, in the alternative, a disadvantage in the market place. For example, if the government decreased the rent charged to its employees or increased the salaries paid to the employees by an amount equal to the possessory interest taxes, it would suffer an economic loss. If the federal government failed to reduce rents or increase salaries paid to its employees, it would be difficult to attract employees because they would be required to pay rent for government-owned housing plus the possessory interest tax, whereas private tenants would only pay rent in the private sector.[61]

Yet these disadvantages accruing to the federal government as a result of the possessory interest tax were not considered by the Court to unduly cripple or obstruct any of the government's functions.[62] Failing to show that the legal incidence of the tax fell directly on the federal government or that the economic burden of the tax on the government substantially interfered with its functions, the only other constitutional challenge to the Fresno tax would be to show that its application resulted in unjust discrimination.[63]

Analysis of the Discrimination Issue

Justice White, in the *County of Fresno* majority opinion, stated that that the possessory interest tax did not discriminate against the Forest Service or other federal employees.[64] The Court, relying on *United States v. City of Detroit*,[65] said the possessory interest tax equalized the

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sector." *Id.* at 708 nn. 1, 3. Discounting the fair rental value of similar houses in the private sector was not done as partial compensation to the Forest Service employees. Instead, the rental value was discounted because of inconveniences the employees faced that the private tenants did not. The discounting brought the private and public rental charges further in line with each other. *See* text accompanying note 31 *supra*.

61. *See* text accompanying note 71 *infra*.

62. 97 S. Ct. at 705.

63. *Id.* at 705-06.

64. *Id.* at 706.

65. 355 U.S. 466 (1958). The Michigan privilege tax in issue in *United States v. City of Detroit*, as well as in *United States v. Township of Muskegon* and *City of Detroit v. Murray Corp.*, provided in part:

> An Act to provide for the taxation of lessees and users of tax-exempt property. Section 1. When any real property which for any reason is exempt from taxation is leased, loaned or otherwise made available to and used by a private individ-

tax burdens on users of exempt and non-exempt property.[66] Further, the Court said that the tax did not discriminate against the federal employees because they were "no worse off under California tax laws than those who worked for private employers and rented houses in the private sector."[67]

Justice Stevens, the sole dissenter, highlights questionable aspects of the Court's holding. Justice Stevens found the possessory interest tax to be discriminatory because it applied to federal employees, but not to private tenants,[68] users of private tax-exempt property,[69] or state employees.[70] Justice Stevens seems to be correct as to the existence of discrimination between the federal employees and the private tenants. The possessory interest tax did not equalize the tax burdens between the private tenants and the federal employees. The Forest Service employees were assessed a tax by the counties whereas the private tenants were not. Assuming that a portion of the private tenant's rent will be applied to the owner's real property tax,[71] the federal employee will ultimately pay more for the use of comparable private tenant's rent *plus* the posses-

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> ual, association or corporation in connection with a business conducted for profit . . . it shall be subject to taxation in the same amount and to the same extent as though the lessee or user were the owner of such property.

MICH. COMP. LAWS §211.181 (1976). For further discussion of Michigan taxation of federal property, see Comment, *When May a Private Contractor Claim Federal Sovereign Immunity from State Taxation? An Analysis of Michigan Taxation Involving Federal Property Under Private Control*, 36 U. DET. L.J. 323 (1959).

The Michigan privilege tax and the California possessory interest tax are similar because both taxes are assessed against users of tax-exempt property. The fact that the Michigan tax applied to private use of tax-exempt real property "in connection with a business conducted for profit" was considered by the Supreme Court in *County of Fresno* to be an "inconsequential" difference from the California tax. 97 S. Ct. at 707. The Court said:

> The only difference between *Township of Muskegon* . . . and this case is that there the property was being used by business for "profit" and here the property is being put to "beneficial personal use" . . . . This difference is inconsequential.

66. The Court stated:

> [T]he State of California imposes a property tax on owners of non-exempt property which is "passed on by them to their . . . lessees." Consequently, the appellants who rent from the Forest Service, are no worse off under California tax laws than those who work for private employers and rent houses in the private sector.

97 S. Ct. at 706, *quoting* United States v. City of Detroit, 355 U.S. at 473.

67. *Id.*

68. *Id.* at 708-09.

69. *Id.* at 709.

70. *Id.*

71. *See* note 27 *supra*. *See also* 97 S. Ct. at 701 n.3.

sory interest tax.[72]

To further illustrate this reasoning, assume that the private tenant is paying $200 for a four-room unit of which $20 is allotted by the owner towards his payment of a real estate tax. The Forest Service employee may reside in a five-room unit of which one room is reserved solely for government purposes. This room would not be considered by the federal government in determining rent or by the county in assessing the possessory interest tax. The federal government, in charging its employees a rent equal to the fair rental value of a comparable four-room residence,[73] would therefore charge $200. If the county assesses its possessory interest tax against the federal employee, the employee must now pay an amount in addition to the $200 being paid by the private tenant.

A second discriminatory aspect of the tax discussed in Justice Stevens' dissent was that the tax applied "only to publicly owned real property."[74] He stated that the possessory interest tax discriminated between public and private users of tax-exempt property because the tax did not apply to residential use of real estate owned by private hospitals, schools or religious organizations.[75]

Technically, this statement is incorrect. In 1967, when the possessory interest taxes were assessed, Section 21(b) of Title 18 of the California Administrative Code, limiting possessory interest tax assessments to publicly owned tax-exempt property, did not exist.[76] The 1967 posses-

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72. *See* notes 30 & 31 and accompanying text *supra*. The following chart illustrates the effect of the possessory interest tax:

	Private Owner		Federal Government
	$ 20	Real Estate Tax	IMMUNITY
LANDLORD	$180	Costs-Profit	$200
	$200	Rent	$200
TENANT		Possessory	
	0	Interest Tax	$ 20
		Tenant's	
	$200	Cost	$220

73. *Id.*

74. 97 S. Ct. at 709.

75. *Id.*

76. The California Administrative Code provides in part:

> Taxable possessory interest means a possessory interest in non-taxable publicly owned real property, as sucl. property is defined in Section 104 of the Revenue and Taxation Code . . . .

18 CAL. ADMIN. CODE §21(b) (West 1970).

sory interest assessments were applicable to all users of tax-exempt real property, including private hospitals, schools and religious organizations. Thus, on its face, the possessory interest tax was not discriminatory as to the private and public possessors. However, the tax may have been discriminatory in its application if in practice it was assessed only against public users of tax-exempt property. Nevertheless, this fact was neither alleged nor proved by the appellants, nor was it discussed in the majority or dissenting opinions.

Finally, Justice Stevens' dissent argued that the possessory interest tax discriminated between state and federal government employees.[77] His sole rationale was that the State of California and its political subdivisions could shift the economic burden of the possessory interest tax from the state employees to the state governmental entities by decreas-

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77. 97 S. Ct. at 709. Appellants raised the issue of discrimination between the federal and state governments on appeal at the state appellate court and supreme court levels. 50 Cal. App.3d at 641-43, 123 Cal. Rptr. at 550-51; Appellant's Jurisdictional Statement at 13-14, 97 S. Ct. 699. They alleged the California tax was not imposed upon possessory interests existing in state forests. *Id.* However, this claim was abandoned in their Supreme Court brief because of a lack of facts to support a finding of discrimination. 97 S. Ct. at 706 n.13; Brief for Appellants at 15 n.6, 97 S. Ct. 699.

Appellant's argument was based on three factors: (1) lack of possessory interest assessments against state employees; (2) in-lieu-of-tax payments by California to its counties pursuant to Section 4654 of the California Public Resources Code; and (3) in-lieu-of-tax payments by the federal government to the state pursuant to 16 U.S.C. §500 (1970). Jurisdictional Statement at 13-14, 97 S. Ct. at 699; 50 Cal. App.3d at 641-43, 123 Cal. Rptr. at 550-51.

This argument failed at the California appellate level and would have failed at the Supreme Court level for three reasons. First, though not mentioned by the Fifth Circuit Court of Appeals, possessory interest taxes have been assessed against state employees. *See* Kaiser Co. v. Reid, 30 Cal.2d 610, 618, 184 P.2d 879, 884 (1947); Outer Harbor Dock & Wharf Co. v. City of Los Angeles, 49 Cal. App. 120, 193 P.137 (1920); San Pedro, L.A. & S. L. R.R. v. City of Los Angeles, 180 Cal. 18, 179 P. 393 (1919). *See also* Goldman, *Administrative and Legal Aspects of Taxation by California of Possessory Interests in Realty*, 23 So. CAL. L. REV. 169, 174 (1950). Second, the in-lieu-of-tax payments made by the State of California to its counties relative to state forests were not in lieu of the possessory interest tax. They were in lieu of real property taxes assessed against private owners of "similar land similarly situated." CAL. PUB. RES. CODE §4654 (West 1970). Furthermore, the in-lieu-of-taxes were paid only with regard to lands used for "the purpose of continuous *commercial* production." *Id.* (Emphasis added). Thus, the payments did not apply to state forest lands occupied by state employees in their performance of state functions. The third and final fallacy with appellant's argument was that payments made pursuant to 16 U.S.C. §500 (1970) were not in-lieu-of-tax payments. 50 Cal. App.3d at 641, 123 Cal. Rptr. at 553. This statute provided that the federal government pay 25% of all monies received during any fiscal year from each national forest to the State treasury for the benefit of public schools and roads. 16 U.S.C. §500. The appellate court refused to consider the payments made pursuant to 16 U.S.C. §500 as in-lieu-of-taxes because the statute did not specifically mention this. 50 Cal. App.3d at 641, 123 Cal. Rptr. at 553.

ing the rents collected from state-owned houses or increasing the employees' compensation by the amount of the tax.[78] The overall effect of such schemes would be to eliminate the tax burden on the state employees and as Justice Stevens contends, "thereby cause the tax to have a significant impact on federal employees and no one else."[79]

If the state indirectly uses its powers to relieve its employees of their tax burdens, taxing only federal employees, the resulting discrimination is obvious. But a tax such as the possessory interest tax in *County of Fresno* remains valid because, on its face and as applied, both federal and state employees are legally liable for the tax assessments.

Justice Stevens felt that the states' taxing power exercised in such a manner would require the "Federal Government to surrender its own tax exemption in order to protect its employees from a discriminatory tax."[80] For example, the federal government may want to increase its employees' salaries or decrease the rents to avoid the disadvantage in the marketplace discussed previously.[81] However, this rationale would be better suited to a governmental immunity argument rather than the discrimination context in which Justice Stevens raises it. Perhaps Justice Stevens used the discrimination argument because the Court's trend has been to invalidate a tax on the discrimination issue rather than the immunity issue.[82] Nevertheless, by raising this argument in an unusual context, the discrimination aspect becomes weaker. For as Justice Stevens states:

> Potentially . . . the tax may have a practical effect on the Federal Government and its employees which is different from its effect on the owners or users of any other tax-exempt property in the State.[83]

But potential discrimination is not discrimination in fact and, thus, Justice Stevens' argument as to discrimination between federal and state employees would fail.

IMPACT OF *County of Fresno*

The Supreme Court in *United States v. County of Fresno* again has denied a private party's claim of immunity from state taxation on the basis of a relationship with the United States Government. Prior to

78. Implicit in Justice Stevens' reasoning is the recognition of other state action, such as a tax credit, which would produce the same leveling effect.

79. 97 S. Ct. at 708.

80. *Id.* at 709.

81. *See* text accompanying note 61 *supra.*

82. *See* note 85 and accompanying text *infra.*

83. 97 S. Ct. at 709.

County of Fresno, the most recent Supreme Court decisions on tax immunity dealt primarily with use of government-owned facilities and materials by private entrepreneurs for profit.[84] In all but one case,[85] the Court upheld the state taxes assessed against the private contractors' use of government property. The single case invalidating the state tax was decided not on the immunity issue but on the fact that the tax was discriminatory.[86]

In 1964, Justice Harlan suggested that a full-scale re-evaluation of the principles governing immunity might be in order.[87] *County of Fresno* has re-examined the tax immunity issue and reaffirmed the states' powers to tax federal government property "so long as it is the possession or use by the private citizen that is being taxed."[88] Additionally, in upholding the state tax on possessory interests, *County of Fresno* has extended the states' powers of taxation to personal not-for-profit use of government property.[89]

The Court has continued to use a two-step process for determining the constitutionality of a state tax statute challenged by a private party dealing with the federal government. If the Court initially determines that the federal government's immunity from state taxation does not extend to the private party, the Court then will determine whether the tax is discriminatory. It is the discrimination issue that the Court continually has found controlling.

The purpose of the federal government's immunity was not to confer an advantage on federal employees or the federal government.[90] Rather,

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84. *See* cases discussed in note 46 *supra.* Subsequently, the Court decided Phillips Chemical Co. v. Dumas School Dist., 361 U.S. 376 (1960) (invalidating a state tax on a commercial manufacturer on discrimination grounds); Rohr Aircraft Corp. v. San Diego Co., 362 U.S. 628 (1960) (upholding a state tax on land and leased by the government to a private corporation); and United States v. Boyd, 378 U.S. 39 (1964) (upholding sales and use taxes on government contractors).

85. Phillips Chemical Co. v. Dumas School Dist., 361 U.S. 376 (1960).

86. The tax was discriminatory because it imposed a lesser burden on users of exempt property owned by the state. *Id.* at 387.

87. United States v. Boyd, 378 U.S. at 51 (concurring opinion).

88. 97 S. Ct. at 704.

89. *Id.* at 707.

90. Quoting from Graves v. New York *ex rel.* O'Keefe, 306 U.S. 466, the Court said:

> [T]he purpose of the immunity was not to confer benefits on the employees by relieving them from contributing their share of the financial support of the other government, whose benefits they enjoy, or to give an advantage to that government by enabling it to engage employees at salaries lower than those paid for like services by other employers, public or private, but to prevent undue interference with the one government by imposing on it the tax burdens of the other. *Id.,* at 483-84, 59 S. Ct. at 600.

97 S. Ct. at 704 n.9.

immunity was recognized "to prevent undue interference with one government by imposing on it the tax burdens of the other."[91] Justice White, writing for the majority in *County of Fresno*, stated that the California possessory interest tax did not cripple or obstruct the federal government's functioning.[92] However, the burden of the Fresno tax was being imposed on the federal government[93] since the federal government had no alternative but to surrender its own tax exemption[94] in order to maintain a competitive position in the employment market. Thus, the tax upheld in *United States v. County of Fresno* creates friction between the two sovereigns, the very problem that the doctrine of constitutional immunity was intended to prevent.

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91. 97 S. Ct. at 704, *quoting* Graves v. New York *ex rel.* O'Keefe, 306 U.S. at 483-84.

92. 97 S. Ct. at 705.

93. Although relatively small amounts of money were involved in *County of Fresno*, ranging from $3.03 to $91.31, Brief for Appellants at 9 n.5, 97 S. Ct. 699, the impact is not only monetary but administrative. Justice Stevens' dissent recognized this administrative burden on the federal government which would have to determine whether the tax assessments were made correctly. 97 S. Ct. at 709 n.5. This burden is especially great in the area of possessory interest taxes because each residency has a unique occupancy date, spatial possession and physical surrounding. In addition, other states could adopt similar possessory interest taxes on Forest Service employees working within their boundaries. Varying methods of assessment would create the need for additional correction checks that would be time consuming and costly. Furthermore, the impact of the case could be far reaching because the United States has employees occupying government facilities in virtually all of the fifty states and various territories. Appellee, County of Fresno, agreed that the present case had a significant effect because in California alone about half of the land located within its boundaries was in the public domain. Brief for Appellee County of Fresno at 14, 97 S. Ct. at 699.

94. The federal government's surrender of its tax-exempt status is the practical effect of assuming the economic burden of the Fresno tax. However, the legal incidence of the tax does not fall on the federal government so the government's immunity under *McCulloch* theoretically remains in force.