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## THE POWER OF THE STATE TO TAX WHERE THE INCIDENCE FALLS UPON THE FEDERAL GOVERNMENT

WILLIAM G. CLARK

**I**N THE 1930's the Great Depression, with its widely endemic wake of unemployment, increased both the States' needs for additional funds, with which to alleviate the burdens of immediate poverty, and diminished the sources of revenue that would otherwise have provided these funds.

Therefore, during the early years of the fourth decade of the Twentieth Century, many States, including Illinois, imposed taxes measured by the gross receipts from the sales of personal property.

Because of the varying provisions of the constitutions of the several States which grant or limit the States' taxing power, because of the variant legal conceptions underlying State taxes, and, partly perhaps, because of the variant tastes on the part of the authors of the various State taxing acts, the juristic concepts uttered in these various State taxing laws differed in this respect: Some of the State taxing measures conceived the tax as being laid upon the ultimate consumer, the merchant being regarded as the State's taxing collector *in invitum*. Other State taxing measures conceived the tax as being laid in legal contemplation directly and ultimately upon the vendor, even though the economic burden of the tax fell upon the purchaser.

But regardless of whether the State tax was considered as being laid upon the ultimate purchaser, with the vendor being the State's tax collector, or directly upon the vendor, there arose a widespread practice of adding the approximate amount of the tax (*e.g.*, three cents per dollar) to the price of the merchandise.

Illinois' taxes measured by gross receipts from sales of merchandise exemplified each of these concepts. Illinois' Motor Fuel Tax Act<sup>1</sup> has always been regarded as being laid not upon the vendor of gasoline, but upon the purchaser for the privilege of driving upon public highways. The retail vendor, usually the proprietor of a filling station, is regarded not as a taxpayer, but as a tax collector, impressed into the

<sup>1</sup> ILL. REV. STAT. ch. 120, §§ 417-434 (1961).

State's service on the theory that if he desires to sell gasoline for use and consumption in driving over Illinois' highways, he must serve as the State's uncompensated tax gatherer.<sup>2</sup>

But the first Illinois Retailers' Occupation Tax Act was held unconstitutional in *Winter v. Barrett*<sup>3</sup> because it exempted from its reach farmers and truck gardeners who sold foodstuffs produced by them directly to the ultimate consumer at retail. The second Illinois Retailers' Occupation Tax Act, which was held constitutional in *Reif v. Barrett*<sup>4</sup> and is still in effect with numerous amendments, conceives the tax as being laid upon the retail merchant and not upon his consumer.<sup>5</sup>

The Illinois' Use Tax Act<sup>6</sup> which was held constitutional as complementing and implementing the Retailers' Occupation Tax Act, conceives the tax as being laid upon the purchaser, and in effect makes the merchant (at least where the goods are purchased in Illinois) the State's tax gatherer.<sup>7</sup>

This discussion is not concerned with the general scope, extent and reach of the States' power to impose taxes measured by a flat rate upon gross receipts in general. Rather, it is confined to the particular class of cases that arise where, although the tax is laid in juristic form upon the vendor, it is in economic reality borne by the Federal Government.

Prior to 1941 it was contended that at least in cases where the amount of the tax (*e.g.*, three cents per dollar) was in fiscal actuality borne by the Federal Government as a separate charge, the tax was in ultimate reality laid upon the Federal Government and was unconstitutional for that reason.

But in 1941 the Supreme Court of the United States held contra in *Alabama v. King & Boozer*.<sup>8</sup> There the defendant contended that an otherwise constitutional tax laid by Alabama on vendors of personal property and measured by gross receipts infringed federal sovereignty because the tax was levied on contractors who used the property in

<sup>2</sup> *People v. Deep Rock Oil Co.*, 343 Ill. 388, 175 N.E. 572 (1931).

<sup>3</sup> 352 Ill. 441, 186 N.E. 113 (1933).

<sup>4</sup> 355 Ill. 104, 188 N.E. 889 (1933).

<sup>5</sup> *People's Drug Shop, Inc. v. Moysey*, 384 Ill. 283, 51 N.E. 2d 144 (1943).

<sup>6</sup> ILL. REV. STAT. ch. 120, §§ 439.1-439.22 (1961).

<sup>7</sup> *Turner v. Wright*, 11 Ill. 2d 161, 142 N.E. 2d 84 (1957) (appeal dismissed for want of substantial federal question, 355 U.S. 65 [1957]).

<sup>8</sup> 314 U.S. 1 (1948).

the performance of contracts with the United States. The Court decided that the tax was constitutional, even though the United States absorbed and bore the economic burden of the tax under "cost-plus contracts."

From 1941 to the late 1950's the decisions of the Supreme Court appear to have recognized that the interplay of Federal and State taxation was based upon the right of the States to impose otherwise permissible taxes measured by gross receipts in cases where the Federal Government bore the actual economic burden of the tax. In *Phillips Chem. Co. v. Dumas School District*<sup>9</sup> the facts were these: Texas levied an *ad valorem* tax with respect to leasehold estates in lands. The tax was imposed annually upon the lessee but was measured by the value of the property, not to the lessee, but to the lessor. The statute fixed a lower tax base if the lessor was the State of Texas or one of its agencies. The United States had temporarily leased surplus land to Phillips Chemical Company, a private corporation organized and operated for profit. The Supreme Court of the United States held that even though Phillips Chemical Company might be taxed on the value of the property demised to the United States, the tax rate was higher than it would have been had the property been leased to the State of Texas: therefore the tax discriminated against the United States, infringed federal sovereignty and was unconstitutional.

In *United States v. Livingston*<sup>10</sup> a three judge district court held that where property owned by the DuPont Corporation was leased to the United States for one dollar a year and was exploited without profit to DuPont for important defense research, a tax upon this property during this period was in reality a tax on the United States, even though it was imposed upon DuPont, where the Federal Government reimbursed DuPont *ad item* for this tax. The tax was therefore held invalid.

Thereupon the United States asserted, at least sporadically, that *any* state tax measured by gross receipts was unconstitutional where the full burden of the tax was borne in economic reality, if not in immediate form, by the Federal Government.<sup>11</sup>

In 1953, the General Assembly of Illinois amended Section 2 of the

<sup>9</sup> 361 U.S. 376 (1960).

<sup>10</sup> 179 F. Supp. 9 (E.D.S.C. 1959), *aff'd*, 364 U.S. 281 (1960).

<sup>11</sup> *Ibid.*

Illinois Retailers' Occupation Tax Act<sup>12</sup> to exempt from the measure of the tax:

The proceeds of such sales to the State of Illinois, any county, political subdivision or municipality thereof, or to any instrumentality or institution of any of the governmental units aforesaid, and excluding the proceeds of such sales to any corporation, society, association, foundation, or institution organized and operated exclusively for charitable, religious or educational purposes.<sup>13</sup>

After the effective date of this 1953 Amendment, July 1, 1953, Illinois continued to impose and the retailers continued to pay Illinois Retailers' Occupation Taxes that would otherwise be due, including taxes on sales made to the United States Government under contracts in which the contractors were specifically reimbursed *ad item* for the Illinois Retailers' Occupation Taxes computed and paid by Illinois vendors.

However on August 29, 1960, the United States and Olin Mathieson Chemical Corporation, a private corporate *entrepreneur* organized under the laws of the State of Virginia, filed suit in the United States District Court for the Northern District of Illinois relying upon the decisions in *Phillips Chem. Co. v. Dumas School District*<sup>14</sup> and *Livingston v. United States*.<sup>15</sup> Plaintiffs contended that inasmuch as Illinois exempted from its tax sales to the State, its instrumentalities, municipal corporations and charities, the continued exaction of the tax from Illinois retailers who sell to the United States and parties who have contracts with the United States discriminated against the Federal Government and infringed federal sovereignty.

A bench of three judges sitting *en banc*, under section 1253 of the Judicial Code,<sup>16</sup> held in *United States v. Department of Revenue*<sup>17</sup> that Illinois' 1953 exemptive provisions<sup>18</sup> invidiously discriminated against the Federal Government. Thereafter the United States and Olin Mathieson Company amended their complaint to assert a categorical immunity from the Illinois Retailers' Occupation Tax with respect to all sales to the Federal Government or its contractors.

<sup>12</sup> ILL. REV. STAT. ch. 120, § 441 (1953).

<sup>13</sup> ILL. REV. STAT. ch. 120, § 441 (1959).

<sup>14</sup> 361 U.S. 376 (1960).

<sup>15</sup> 179 F. Supp. 9 (E.D.S.C. 1959), *aff'd*, 364 U.S. 281 (1960).

<sup>16</sup> 28 U.S.C. § 1253 (1948).

<sup>17</sup> 191 F. Supp. 723 (N.D. Ill. 1960).

<sup>18</sup> ILL. REV. STAT. ch. 120, § 441 (1953).

Confronted by this pronouncement by the District Court, the Supreme Court of Illinois held in the *People ex rel. Holland Coal Co. v. Isaacs*,<sup>19</sup> that the 1953 Amendment to the Illinois Retailers' Occupation Tax Act which exempted from the reach of the tax sales to Illinois, its counties, municipalities and other agencies, was an unconstitutional discrimination against the Federal Government; that the General Assembly would not have enacted that Amendment if it had been aware that it discriminated against national sovereignty; and that it was therefore void. But the Court also held that the exemption of private charities did not discriminate against the Federal Government.

In the light of the decision of the Illinois Supreme Court in *Holland Coal Company*, the Supreme Court of the United States vacated the District Court's judgment in *United States v. Department of Revenue*<sup>20</sup> noted above, and remanded the case for further proceedings.<sup>21</sup>

On remand the District Court acceded to the holding of the Illinois Supreme Court in *Holland Coal Company*, and held that Illinois may continue to levy otherwise permissible Retailers' Occupation Taxes against Illinois vendors, even though the amounts of those taxes are borne specifically *ad item* by the Federal Government, so long as Illinois does not exempt similar sales to itself, its instrumentalities or municipal corporations, although it does exempt sales to private charities.<sup>22</sup>

Since the Supreme Court of the United States affirmed the District Court without opinion,<sup>23</sup> this note seems appropriate as an explanation of the actual holding in *United States v. Department of Revenue*<sup>24</sup> where the Court held that *Alabama v. King & Boozer*,<sup>25</sup> is still the law of the land and the several States may continue to replenish their revenues by otherwise permissible taxes laid in terms upon vendors even though the amounts of such taxes are borne specifically and *ad item* by the Federal Government, so long as the State does not exempt from the reach of the tax similar sales made to itself or its public instrumentalities.

<sup>19</sup> 22 Ill. 2d 477, 176 N.E. 2d 889 (1961).

<sup>20</sup> 191 F. Supp. 723 (N.D. Ill. 1960).

<sup>21</sup> *Department of Revenue v. United States*, 368 U.S. 30 (1960).

<sup>22</sup> *United States v. Department of Revenue*, 202 F. Supp. 757 (N.D. Ill. 1962) (one judge dissenting).

<sup>23</sup> 371 U.S. 21 (1962).

<sup>24</sup> 202 F. Supp. 757 (N.D. Ill. 1962).

<sup>25</sup> 314 U.S. 1 (1948).

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