FEDERALISM AND INTERGOVERNMENTAL TAX IMMUNITY NOW REST IN PEACE: SOUTH CAROLINA V. BAKER

INTRODUCTION

Recently, the United States Supreme Court decided the case of South Carolina v. Baker. The State of South Carolina raised a constitutional challenge to a provision of the Internal Revenue Code of 1954 (the "Code"). The provision requires that the debt obligation of states, local governments and their instrumentalities be issued in full registered form (as opposed to bearer form) for the interest on such obligations to be exempt from federal income taxation.

The Court's holding that the federal income tax provision offended neither the tenth amendment nor the doctrine of intergovernmental tax immunity laid to rest one of the last vestiges of federalism. The purpose of this Note is to analyze and determine the propriety of the Court's holding by reviewing judicial precedent and congressional legislative history.

First, this Note examines whether the principles of federalism

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2. Id. at 1358.
3. Id. at 1356-57. Section 103(a) of the Internal Revenue Code of 1954, which exempted the interest earned on the obligations of any state from a taxpayer’s gross income, was amended by the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"). Pub. L. No. 97-248, 96 Stat. 324, 566-707 (1982). TEFRA requires that “registration required obligation[s]” be issued in registered form, rather than bearer form to qualify for the § 103(a) exemption. TEFRA, Pub. L. No. 97-248, § 310(j)(1) (1982). Failure to adhere to the requirement of § 103(j)(1) of the Code means that interest on nonregistered form obligations would be included in gross income. Id.
4. See infra notes 224-26 and accompanying text.
5. See infra notes 277-407 and accompanying text.
were offended by Congress when it enacted the statute in question.\(^6\) Second, this Note determines whether the Court was correct in holding that the tax provision did not offend the judicial doctrine of intergovernmental tax immunity.\(^7\) Finally, this Note analyzes the Court's interpretation of the relevant legislative history.\(^8\)

BACKGROUND

PRINCIPLES OF FEDERALISM:

In the Seventeenth Century, Alexis de Tocqueville envisioned the formidable issues which were encountered by the United States Supreme Court in *Baker*.\(^9\) He noted:

> The first question which awaited the Americans was intricate, and by no means easy of solution: the object was so to divide the authority of the different states which composed the Union that each of them should continue to govern itself in all that concerned its internal prosperity, whilst the entire nation, represented by the Union, should continue to form a compact body, and to provide for the general ex
gencies of the people. *It was as impossible to determine beforehand, with any degree of accuracy, the share of authority which each of two governments was to enjoy, as to foresee all the incidents in the existence of a nation.*\(^10\)

The theme of dual existence espoused by de Tocqueville was likewise reiterated by the Federalist Papers and incorporated in the United States Constitution.\(^11\) The Constitution envisioned the continued existence of state governments as vital to the formation of the Union of the states.\(^12\)

The Constitution recognized that the states have powers to make political decisions and it enumerated significant, specific constraints and duties to the states.\(^13\) Moreover, this same document that recognized the states as independent entities also formed a national government with its own political powers, composed with specific

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6. See *infra* notes 293-337 and accompanying text.
7. See *infra* notes 338-393 and accompanying text.
8. See *infra* notes 394-407 and accompanying text.
10. Id.
12. Id. No. 45, at 311 (emphasis added). See, e.g., U.S. CONST. art. VI, cl. 3 (recognizing the existence of the state legislative, executive, and judicial branches).
13. See U.S. CONST. art. I, § 2, cl. 1 (providing that states shall elect members of Congress); U.S. CONST. art. IV, § 1 (requiring states to give full faith and credit to state judicial proceedings).
restraints and obligations.\textsuperscript{14}

The Framers recognized the unavoidable conflict between two political decision-making units but were unable to resolve the conflict.\textsuperscript{15} But the Supreme Court, as interpreter of the Constitution, is required to resolve any discrepancies which may arise.\textsuperscript{16} This occurs, for example, when there is a valid national law conflicting with a valid state law.\textsuperscript{17} Because the Constitution provides that any valid federal law is supreme, the Court's narrow interpretation of the government's powers to enact laws has protected the states' role in the federal system of government.\textsuperscript{18} This narrow definition results from a lack of standards from which to construe the federal government's powers.\textsuperscript{19} The Court has attempted to define the respective dominions of the two sovereigns by resorting to an analysis of the tenth amendment.\textsuperscript{20}

\section*{The Tenth Amendment}

The tenth amendment to the United States Constitution specifically provides that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."\textsuperscript{21} This declaration was meant to establish the relationship between the federal and state governments.\textsuperscript{22} Although the Court has interpreted the tenth amendment as being a mere "truism,"\textsuperscript{23} it did invoke the amendment to protect the states from unwarranted federal interference and to pre-

\begin{itemize}
\item \textsuperscript{14} See U.S. CONST. art. I, II, III (providing for legislative, executive, and judicial branches of the national government). See also U.S. CONST. art. IV, § 4 (requiring the federal government to guarantee every state a republican form of government).
\item \textsuperscript{15} See McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 405 (1819) (stating that the "question respecting the extent of powers actually granted, is perpetually arising, and will probably continue to arise, as long as our system shall exist.").
\item \textsuperscript{16} Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177 (1803) (holding that the power to interpret the Constitution is vested in the judicial branch of the federal government).
\item \textsuperscript{17} See McCulloch, 17 U.S. at 317-18 (declaring unconstitutional a valid state law imposing a state tax on a federal bank).
\item \textsuperscript{18} U.S. CONST. art. IV, cl. 2 (stating that the laws of the federal government are supreme to those of the state government). See S.R.A., Inc. v. Minnesota, 327 U.S. 558, 561 (1946) (stating the supremacy of the federal government).
\item \textsuperscript{19} See McCulloch, 17 U.S. at 434 (stating that the government has an undefined power to tax).
\item \textsuperscript{20} See supra notes 21-48 and accompanying text.
\item \textsuperscript{21} U.S. CONST. amend. X.
\item \textsuperscript{22} See Corwin, The Passing of Dual Federalism, 36 VA. L. REV. 1, 16 (1950) (stating that the police power gives the states a "near monopoly of the right to realize the main objectives of government.") (emphasis in original).
\item \textsuperscript{23} United States v. Darby, 312 U.S. 100, 124 (1941).
\end{itemize}
serve the principles of federalism. This has, however, changed in recent history.

In the past fifty years, the Court has permitted, if not blessed, this transfer of power from the states to the nation. With the sole exception of one federal statute being found invalid in *National League of Cities v. Usery*, the state sovereignty concept has not been a significant restraint on Congress' power to regulate the states. Even more telling is that Congress has employed the states as its agent to administer and enforce many major regulatory and benefit programs without any judicial intervention.

In *National League of Cities*, the Court held that Congress had violated the principles of federalism inherent in the tenth amendment by enacting an amendment to the Fair Labor Standard Act ("FLSA") which exceeded Congress' power under the commerce clause. The Court's rationale was based on the premise that there are certain attributes of the sovereignty of state government that Congress should not impair. It concluded that the amendment to FLSA directly displaced the state's freedom to structure integral operations in areas traditionally under state control.

In subsequent decisions, the Court more clearly identified the rationale used in *National League of Cities*. It articulated three criteria that had to be satisfied to bring the tenth amendment into play: (1) the challenged congressional action must regulate the states as states; (2) it must touch "matters that are indisputably attributes of state's sovereignty;" and (3) it must impair the state's ability "to structure operations in areas of traditional state functions." If all three requirements were met, the federal and state interests were to

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28. See *La Pierre*, 80 NW. U.L. REV. at 580 n.9 (stating that in over 300 cases dealing with the tenth amendment, only a few courts have held the federal statute challenged unconstitutional).


30. Id. at 851-52.

31. Id. at 842-43.

32. Id. at 851-52.

33. See infra notes 35-36 and accompanying text.

be balanced to determine if the relevant federal interest justified the resulting impairment of state sovereignty. 35

However, the Court in Garcia v. San Antonio Metropolitan Transit Authority, 36 found this test to be unworkable. 37 The Court in a five-to-four decision ruled that the minimum wage, maximum hours amendment to FLSA shall apply to employees of a city-owned and operated mass transit system. 38 It determined that federal regulatory actions did not undermine the autonomy and independence of the states. 39 The majority pointed out that special restraints on federal powers over the states were inherent in the structure of a national government, and therefore concluded that no express prohibition on Congress' exercise of its enumerated powers need be carved out of the Constitution by the Court to accomplish this end. 40 In arriving at this decision, the Court expressly overruled National League of Cities and eliminated most of the substantive protection that the tenth amendment had earlier afforded the states. 41

The Garcia Court not only rejected the analysis used in National League of Cities, but also rejected the basic premise that the states need judicial protection from unwarranted federal intrusion. 42 The Court declared that this protection required a determination of what governmental functions were vital to a particular government. 43 The Court found that "state immunity from federal regulation" based on defining important government function is incompatible with the role of federalism in a democratic society. 44 It stated that the scheme

35. See EEOC v. Wyoming, 460 U.S. at 237-39 (upholding the extension of the Age Discrimination in Employment Act of 1967 to state and local governments because that act did not "directly impair" the states ability to structure integral operations in areas of traditional government functions); Virginia Mining, 452 U.S. at 288, n.29 (discussing the balancing requirement).

37. Id. at 543-44.
38. Id. at 555-56.
39. Id. at 544-47.
40. Id. at 554. As support for its position that the national political process effectively preserves the state's interests, the Court pointed to the longstanding role of the national government in assisting states and local governments, particularly in the area of large federal subsidies given to the states. Id. at 552-54.
41. Id. at 550-54, 557.
42. Id. at 547-54.
43. Id. at 546-49.
44. Id. at 546-47. The Court in Garcia discussed the intergovernmental tax immunity cases in which earlier court's had attempted to "draw the line" between governmental and proprietary functions. Id. at 541-44. The Court noted that this distinction created such uncertainty and instability in the area of tax immunity that it was ultimately abandoned as untenable. Id. at 543. See also infra notes 78-180 and accompany-
the Framers of the Constitution created to protect the states was “one of process rather than one of result.” The states were represented in Congress, a law that would unduly burden the states would presumably not be enacted at all. Hence, the majority eliminated any judicial ad hoc appraisal of governmental functions and chose to rely on the political process as the most effective and best equipped means of protecting the states from the national government’s unwarranted intrusion.

THE GUARANTEE Clause

Justice O’Connor’s dissent in South Carolina v. Baker noted that the principles of federalism found in the tenth amendment that preserve the states’ autonomy can also be derived from the guarantee clause. The Guarantee Clause of the United States Constitution provides that “[t]he United States shall guarantee to every State in the Union a Republican Form of Government.” The statement ‘republican form of government’ has been described by John Adams as “so loose and indefinite that successive predominate functions will put gloss and construction upon it as different as light and darkness.” In spite of Adams’ pronouncement, there exists agreement among scholars that the core meaning of the republican form of government is one based on popular control.

Congress’ exercise of both its commerce power and its taxing powers concerns state immunity where federal action infringes too heavily on state sovereignty. Although these powers are doctrinally the same, they are interpreted differently. See United States v. California, 297 U.S. 175, 184-85 (1936) (stating that interpretation of tax immunity differs from the interpretation of the commerce clause). The difference is that the power to tax is exercised concurrently by both state and federal government. Van Brocklin v. Tennessee, 117 U.S. 151, 155 (1886). Therefore, the tax immunity implied in the federal system of government is equally restrictive on taxes imposed by either government. United States v. California, 297 U.S. at 184. Hence, tax immunity is implied from the nature of the federal system and the relationship of the federal and state governments within that system. Id. at 184. The taxing power of the federal government is construed narrowly in order to give each government reasonable scope for its taxing power. Id.

45. Garcia, 469 U.S. at 554.
46. Id. at 556.
47. Id. at 546.
49. U.S. Const. art. IV, § 4. The policy determination demanded by the guarantee clause is that the states should maintain a separate and independent existence. See Lane County v. Oregon, 74 U.S. (7 Wall.) 71, 76 (1869).
The Supreme Court first encountered a guarantee clause violation in *Luther v. Borden.* Martin Luther had filed a trespass action against Luther M. Borden and other members of the Rhode Island Military. Borden countered the charge by arguing that Luther was a member of an insurrection to overthrow the government and that the trespass was necessary in order to arrest him. Luther argued that he, rather than Borden, supported the only legitimate government in Rhode Island.

The Court started its analysis by noting that to resolve the controversy it had to determine which government was legitimate at the time of the trespass. The Court, however, quickly pointed out that although the United States had a duty to guarantee every state a republican form of government, the decision of which government was republican was vested not in the judiciary but in Congress. It held that such a claim was nonjusticiable, and that vindication of a claim based on the guarantee clause rests with Congress. The Court's rationale in *Luther* was that no standards of review existed which a court could utilize to adjudicate the guarantee clause claim. However, a close reading of the Court's holding indicates that it loathed to disturb the workings of a state government rather than resolve a controversy.

In two subsequent decisions, the Court stated that guarantee clause claims were not *per se* nonjusticiable. However, in *Colegrove v. Green,* the Court reinstated its holding in *Luther* that guarantee clause claims are non-justiciable. Yet, in the subsequent decision of *Baker v. Carr,* the Court sought to more clearly define the justiciability of guarantee clause claims.

In *Carr,* Charles Baker had filed a civil action challenging the


52. 48 U.S. (7 How.) 1 (1849).
53. Id. at 34.
54. Id.
55. Id. at 35.
56. Id.
57. Id. at 42.
58. Id.
59. Id. at 41-42.
60. Id. at 38-39.
61. See McPherson v. Blacker, 146 U.S. 1, 24 (1892) (stating that the validity of the guarantee clause was a judicial question); Pacific States Tel. & Tel. Co. v. Oregon, 223 U.S. 118, 149-50 (1912) (requiring a narrow interpretation of the Supreme Court's holding in *Luther*).
63. 369 U.S. 186 (1962). See infra notes 64-72 and accompanying text.
constitutionality of a Tennessee apportionment statute. Baker charged that the apportionment of Representatives and Senators in the state legislature denied him and those similarly situated the equal protection of the law by “debasement of their votes.”

The Court rejected the district court's holding that the apportionment challenge presented a political question or guarantee clause question and therefore it was nonjusticiable. Thereby retreating from the declaration that guarantee clause claims are always nonjusticiable. In Carr, the Court declared that “the political question barrier [in guarantee clause cases] was not absolute” and that guarantee clause complaints might be justiciable in “extreme” situations. The Court, however, stressed that a determination of justiciability demands a case-by-case inquiry into the facts of each controversy.

After reviewing a series of cases in which guarantee clause claims had been held nonjusticiable, the Court proposed six factors to aid in this inquiry. These factors are: (1) demonstration that the issue raised is delegated to Congress or the executive; (2) a lack of a judicial standard of review; (3) the resolution of the issue requires the judiciary to engage in a policy determination beyond its powers; (4) adjudication of the issue entails expressing lack of respect to Congress or the executive; (5) questioning decisions made by Congress and the executive; and (6) resolving that the issue has the possibility of leading to different pronouncement by the three branches of the federal government on the same issue. The Court would dismiss the case if one of these factors was found.

Two years later, the Court in Reynolds v. Sims suggested more explicitly that some guarantee clause claims are judicially reviewable. Lower courts have since proceeded to rely upon the holdings in Carr and Reynolds to conclude that some guarantee clause claims are justiciable, thereby eliminating a nonjusticiable per se rule and invoking the guarantee clause to protect the states from federal intrusion.

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64. Carr, 396 U.S. at 192-94.
65. Id. at 194.
66. Id. at 209.
67. Id. at 226, n.53.
68. Id. at 222, n.48.
69. Id. at 210-11.
70. Id. at 217.
71. Id.
72. Id.
73. 377 U.S. 533, 582 (1964).
INTERGOVERNMENTAL TAX IMMUNITY

Birth and Demise of the Judicial Doctrine

In determining the authority of either state or federal sovereignty in areas other than tax authority, the Court has grounded its rationale in the Constitution.\(^7\) This goal has been achieved by invoking the principles of federalism espoused in the tenth amendment.\(^7\) However, in the area of tax authority the Court has opted for the judicial doctrine of intergovernmental tax immunity.\(^7\)

The power to tax is a key incident of sovereignty.\(^7\) In a system of government that in theory recognizes the sovereignty of the states as well as the federation of those states, it is inevitable that conflicts will arise from attempted taxation of either government and its instrumentalities.\(^7\) The Constitution does not speak to such conflicts directly; however, the Constitution does expressly curtail state taxation of exports and imports.\(^8\) But, no provision of the Constitution prohibits either federal taxation of state instrumentalities or state taxation of federal instrumentalities; nor is there a provision which expressly preserves the power of either sovereign to tax the other.\(^8\) Intergovernmental tax immunity has nonetheless been implied by the federal courts.\(^8\)

The first immunity from taxation the Court espoused was federal immunity from state taxation.\(^8\) In *McCulloch v. Maryland*,\(^8\) the Bank of the United States, which was incorporated pursuant to an act of Congress, operated a branch office in the State of Maryland. At issue was the validity of a tax which Maryland sought to impose on all banks, including the Bank of the United States, that were operating in Maryland but were not chartered by its legislature.\(^7\) In an

\(^7\) See United States v. California, 297 U.S. at 184-85 (stating that interpretation of tax immunity differs from interpretation of the commerce clause).

\(^8\) National League of Cities, 426 U.S. at 842-43.

\(^7\) See Collector v. Day, 78 U.S. (11 Wall.) 113, 127 (1871) (stating that a state's exemption from taxation rests upon an implication in the Constitution that the federal government may not tax the means and instrumentalities of a state).

\(^8\) See *McCulloch*, 17 U.S. at 391 (stating that the power to tax is the power to destroy).

\(^7\) See id. at 430.

\(^8\) U.S. CONST. art. I, § 10, cl. 2.

\(^7\) Day, 78 U.S. (11 Wall.) at 127.


\(^8\) See infra notes 84-176 and accompanying text.

\(^8\) 17 U.S. (4 Wheat.) 316, 317-18 (1819).

\(^7\) Id.
opinion by Chief Justice Marshall, the Supreme Court held that Maryland's attempt to tax the Bank of the United States was unconstitutional because it undermined the supremacy status of the federal government.\textsuperscript{86}

In invalidating the statute, Chief Justice Marshall relied in part on the principle that the Constitution created two separate and distinct sovereignties which were independent of each other in their specific and reserved powers.\textsuperscript{87} Thus, the Chief Justice determined that there must always be subtracted from the powers granted in the Constitution to either the states or federal government the right of each sovereignty to function separately.\textsuperscript{88} Chief Justice Marshall stated that Maryland may not tax "those \textit{means} which are employed by Congress to carry into execution powers conferred on that body by the people of the United States."\textsuperscript{89} The \textit{McCulloch} case was the first step the Court took to develop what subsequently became known as the doctrine of intergovernmental tax immunity.\textsuperscript{90}

The Court developed the definition of "means" in \textit{Dobbins v. Commissioners of Erie County}.\textsuperscript{91} The Court in \textit{Dobbins} invalidated a county tax levied on the captain of a United States revenue cutter which was an armed vessel used primarily to enforce revenue laws.\textsuperscript{92} The Court noted that the office of the captain was the constitutional means by which the United States carried out its powers to lay and collect taxes.\textsuperscript{93} It then concluded that the county's tax provision unconstitutionally interfered with the exercise of those powers.\textsuperscript{94} The Court reasoned that the officer employed by the federal government was a means that effectuated the legitimate objectives of operating United States vessels; therefore, the officer's salary or emolument was not amenable to county taxes.\textsuperscript{95} Under this view, the Court only required that the means used be: (a) necessary to achieve a legitimate end; (b) must themselves be constitutional; and (c) must be executed for public good.\textsuperscript{96}

Twenty nine years after \textit{Dobbins}, the Supreme Court was faced with a similar question in \textit{Collector v. Day}.\textsuperscript{97} In \textit{Day}, a Massachusetts
probate judge paid a federal income tax assessment under protest.\textsuperscript{98} The judge asserted that his salary was immune from federal taxation.\textsuperscript{99}

The Supreme Court began its analysis of the issues by noting that the states are recognized by the Constitution and that their existence is necessary.\textsuperscript{100} The Court stated that the right of the states to establish and maintain a judicial department is an “original,” “inherent,” and “reserved,” power of the states.\textsuperscript{101} The Court reasoned that the states had never parted with this power, and with respect to it the supremacy of the national government did not exist.\textsuperscript{102} The Court stated that “in respect to the reserved powers, the state is as sovereign and independent as the general government.”\textsuperscript{103} The Court also stated that “the means and instrumentalities employed for carrying on the operations of [the states’] governments . . . should be left free and unimpaired.”\textsuperscript{104}

The Court in \textit{Day} thereby extended the concept of tax immunity to embrace any instrumentality of state or federal government used in the legitimate exercise of its constitutionally granted authority.\textsuperscript{105} The Court therefore ushered in the theory of reciprocal tax immunity, and also established a two strand test in order to invoke tax immunity.\textsuperscript{106} The challenged tax must be: (1) levied on a means or instrumentality of the government; and (2) it must interfere with functions which are essential to the maintenance of that government.\textsuperscript{107}

\textit{The Means or Instrumentality Strand}

The holding in \textit{Day} with respect to “means or instrumentality” was solidified almost a decade and a half later in \textit{Pollock v. Farmers’ Loan and Trust Co.}\textsuperscript{108} In that case, Pollock and other shareholders brought suit against the Farmers’ Loan and Trust Co. (the “company”) and its directors.\textsuperscript{109} The company’s assets were invested in

\begin{footnotes}
\footnote{\textit{Day}, 78 U.S. (11 Wall.) at 113-14.}
\footnote{\textit{Id.} at 114.}
\footnote{\textit{Id.} at 125.}
\footnote{\textit{Id.} at 126-27.}
\footnote{\textit{Id.} at 127.}
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\footnote{\textit{Id.} at 125-27.}
\footnote{\textit{Id.} at 127.}
\footnote{\textit{Id.} at 429 (1895).}
\footnote{\textit{Id.} at 430.}
\end{footnotes}
various real estate holdings and municipal bonds. The shareholders initiated suit because the company intended to pay a federal income tax on all company income including that income derived from the municipal bonds. This payment of the tax, the plaintiffs argued, would diminish the company's assets. In addition to directly challenging the constitutionality of the tax, the shareholders brought suit to enjoin the company from complying with the federal tax statute.

The Court stated that a municipal corporation is an instrumentality of the state, thus its property and revenues are immune from federal taxation. It then held that such tax immunity extended to interest on municipality issued bonds. The Court therefore concluded that a federal income tax imposed on municipal bond interest violated the doctrine of intergovernmental tax immunity because the tax would impair the state's power to borrow money, which was one of the primary means by which it financed its governmental functions.

The Supreme Court's broad interpretation of "instrumentalities" remained the law until 1937. In *James v. Dravo Contracting Co.*, the Court began to narrow the definition of "instrumentalities" as applied to intergovernmental tax immunity. It held in that case that independent contractors were not instrumentalities of the government with which they had contracted, and were not immune from taxation. In arriving at its ruling, the Court applied the general principles of agency law and concluded that a contractor was not an instrumentality of the government unless the tax "does in truth deprive [independent contractors] of power to serve the government."

The following year, the Court upheld the federal income taxation of various state appointees engaged in legitimate state endeavors

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110. *Id.*
111. *Id.* at 431-32.
112. *Id.* at 433.
113. *Id.* at 434.
114. *Id.* at 584.
115. *Id.* at 586.
116. *Id.* See also *Willcuts v. Bunn*, 282 U.S. 216, 234 (1931) (upholding the federal taxation of capital gains derived from the sale of municipal bonds); *Group No. 1 Oil Corp. v. Bass*, 283 U.S. 279, 283-84 (1931) (holding that profits derived from the sale of oil and gas leases was not immune from federal taxation because the leases were state instrumentalities).
117. See *infra* notes 118-21 and accompanying text.
118. 302 U.S. 343 (1937).
119. See *infra* note 111 and accompanying text.
120. *Dravo*, 302 U.S. at 149, 161.
121. *Id.* at 153-55.
in *Helvering v. Therrell.* It reasoned that although the state undertook such activities for what it perceived to be for the public benefit, those activities were not necessary to discharge the state's essential governmental duties. However, a vehement denunciation of the expansive reading of instrumentalities came a year later.

In *Graves v. New York ex rel. O'Keefe,* decided in 1939, the Supreme Court held that a state income tax laid on the salary of an employee of the federal government was constitutional. The Court, in rejecting that federal employees and officers are instrumentalities of the government, held that a tax imposed on the compensation of such individuals was neither legally nor economically a tax on its source.

Although the Court in *O'Keefe* found it significant that the employees, and not the government, incurred the actual tax burden, it did not preclude from immunity all situations in which the government is not the direct taxpayer. Rather, it noted that the doctrine of intergovernmental tax immunity may not be invoked merely because the expense of one government may be lessened if those with whom it transacts business with are exempt from taxation by the other government. The Court stated that the tax immunity may still be invoked if taxing the instrumentality would unduly obstruct the governmental function undertaken.

In more recent years, the Court has considered various cases involving state taxation of federal contractors. In these cases, it has...
emphasized the degree of proximity or control between the govern-
ment and the purported instrumentality, as well as where the legal
incident of the tax falls.\textsuperscript{132} Legal incident in this context does not re-
er to economic impact alone, but also refers to where the legal obli-
gation to pay the goods bearing the tax falls.\textsuperscript{133} As a result, when a
contract provides that the government, rather than the contractor, is
legally obligated to pay for the goods, the contractor is considered an
instrumentality of that government which is immune from taxation
by the other government.\textsuperscript{134} Thus, the government must bear the
legal, not simply the economic, burden of that tax in order to invoke
intergovernmental tax immunity.\textsuperscript{135}

\textbf{Essential Governmental Function Strand}

The "essential governmental function" concept has its origin in
\textit{McCulloch v. Maryland},\textsuperscript{136} wherein Chief Justice Marshall made his
often cited observation that "the power to tax involves the power to
destroy."\textsuperscript{137} Following \textit{McCulloch}, the Supreme Court continually
expanded the concept of essential governmental function under the
guse of Chief Justice Marshall's broad statement.\textsuperscript{138} The Court re-
sorted to examining the activities sought to be taxed to determine
whether they were essential to the government's continued
existence.\textsuperscript{139}

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\textsuperscript{132} New Mexico, 455 U.S. at 742, 743; Muskegon, 355 U.S. at 486-87.
\textsuperscript{133} See Alabama v. King \& Boozer, 314 U.S. 1, 12-14 (1941) (sustaining the constitutionality
of a state sales tax on lumber purchases by a contract in the performance of
a cost-plus-fixed-fee contract with the federal government because the legal incident
was not borne by federal government). See also Massachusetts v. United States, 435
U.S. 444, 469-70 (1978) (holding that a registration tax imposed upon state-owned
aircrafts does not violate the doctrine of intergovernmental tax immunity).
\textsuperscript{134} See United States v. Tax Comm'n of Mississippi, 421 U.S. 599, 610 (1975) (hold-
ing unconstitutional a state sales tax on liquor purchased by a United States military
installation because the legal incidence of the tax fell on United States).
\textsuperscript{135} See New Mexico, 455 U.S. at 735, n.11.
\textsuperscript{136} 17 U.S. (4 Wheat.) 316 (1819).
\textsuperscript{137} Id. at 431.
\textsuperscript{138} See Weston v. Charleston, 27 U.S. (2 Pet.) 449, 469 (1829) (invalidating state
taxation on the issuance of federal debt instruments); Dobbins v. Commissioners of
Erte County, 41 U.S. (16 Pet.) 435, 449-50 (1842) (invalidating a state tax on the salaries
of a federal officers).
\textsuperscript{139} See Flint v. Stone Tracy Co., 220 U.S. 107, 155 (1911) (holding that public service
companies that carry on private businesses are not immune from a corporate tax
imposed by Congress merely because they are incorporated under, and acting pursuant
to, state authority); South Carolina v. United States, 199 U.S. 437, 463 (1905) (holding
that persons who sell liquor as agents of a state which, in exercising its sovereign
power, has taken charge of liquor sales, are not relieved from liability for license tax
imposed by the federal government because they were acting in a proprietary capacity
rather than as an instrumentality).

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The Court in Helvering v. Therrell, however, recognized that it is not possible to ascertain what is an essential governmental function. The Court in Therrell determined that the states exemption from federal taxation depends on whether the activity was essential to the operation of the government. The Court further noted that such a determination must be made on a case-by-case basis after considering all relevant facts and circumstances. In its analysis, the Court reviewed earlier decisions in which activities such as a state operated liquor business, a state-owned railroad, and lease of state-owned lands were held not to be essential to the operation of the government.

After Therrell, the Court has consistently refused to extend the doctrine of intergovernmental tax immunity to ordinary business activities conducted by the state or its agents, because such activities were merely proprietary in nature. The constitutionality of a tax has often turned on whether the activity sought to be taxed had a governmental rather than a proprietary, function.

After the Court rejected the governmental-proprietary distinction in New York v. United States, it instituted a hybrid test in Helvering v. Gerhardt. This test combined the nature of the activity with the degree of impact on the government in determining whether the activity was so essential to the government as to warrant immunity from taxation by the other government. The Court adhered, however, to the principal purpose of constitutional immunity, which was to protect the continued existence of the sovereign government. Essential activity, therefore, required that the activity be of such a nature that any taxation would unduly interfere with the

140. Therrell, 303 U.S. at 223.
141. Id.
142. Id.
143. Id. at 224-25.
144. See Helvering v. Gerhardt, 304 U.S. 405, 418 (1938) (refusing to grant tax immunity to a state-owned port authority).
145. Id. at 419.
146. 326 U.S. 572, 580 (1946) (plurality opinion). The Court rejected the governmental-proprietary distinction as the sole determinant of whether an activity essential to the maintenance of the government in New York v. United States, 326 U.S. 572, 580 (1946) (plurality opinion). The Court recognized that to base the federal taxing power on what activities are “normally” conducted by private enterprise, as opposed to what are “usual” governmental functions, would create too many practical problems and inconsistencies. Id. at 580. The Justices adhered to the view that the governmental-proprietary distinction was no longer a valid means for determining whether an activity was an essential governmental function. Id. at 583-84, 586, 591.
147. 304 U.S. 405 (1938).
148. Id. at 419-20.
149. Id. at 421.
functions of the government itself.\textsuperscript{150}

The Court thereafter narrowed the scope of activities deemed necessary to the "continued existence" of the government in circumstances when the intergovernmental tax immunity was invoked for the benefit of a private citizen.\textsuperscript{151} The Court considered the advantage of tax immunity to the government too theoretical and speculative to justify immunity from taxation by the other government.\textsuperscript{152} Thus, it held that the imposition of a federal income tax on various taxpayers does not interfere with the essential governmental functions of a state when such taxation does not threaten the continued existence of the state.\textsuperscript{153}

The determination as to whether an activity constitutes an 'essential or integral governmental' function has historically played a significant role in the development of the doctrine of intergovernmental tax immunity.\textsuperscript{154} The Court, however, recently rejected any distinctions made on the basis of essential, traditional, or integral governmental functions.\textsuperscript{155}

In \textit{Garcia}, a case arising under the commerce clause, the Court upheld the application of the FLSA to employees of a city operated transportation authority.\textsuperscript{156} The Court rejected the argument that the regulation would trench on "traditional governmental functions."\textsuperscript{157}

In rejecting this standard in the context of the commerce clause, the Court acknowledged the difficulties that it had experienced in applying this standard to the doctrine of intergovernmental tax immunity.\textsuperscript{158} It then stated that an essential governmental function standard was beset with the same problems in the field of regulatory immunity with respect to the commerce clause.\textsuperscript{159}

Although the Court in \textit{Garcia} rejected the use of an essential governmental function distinction in evaluating state regulatory immunity, the holding pertained solely to the Congress' exercise of its commerce power.\textsuperscript{160} As such, the Court's discussion and apparent re-

\begin{footnotesize}
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\item[150.] \textit{Id.} at 424. See also \textit{Metcalf & Eddy v. Mitchell}, 269 U.S. 514, 523-24 (1926) (upholding federal income taxation of an independent contractor engaged by the state to perform services on water supply and sewage disposal projects).
\item[151.] \textit{Gerhardt}, 304 U.S. at 420-21.
\item[152.] \textit{Id.} at 420.
\item[153.] \textit{Id.}
\item[154.] \textit{See supra notes 84-116 and accompanying text.}
\item[155.] \textit{Garcia}, 469 U.S. at 546-47.
\item[156.] \textit{Id.} at 555-56.
\item[157.] \textit{Id.} at 546-47.
\item[158.] \textit{Id.} at 540-43.
\item[159.] \textit{Id.} at 543. \textit{See supra notes 42-47 and accompanying text.}
\item[160.] \textit{Garcia}, 469 U.S. at 557.
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jection of the application of the essential governmental function test to determine the constitutionality of a tax imposed by one government on another's activities\textsuperscript{161} was simply dicta.

The substance of the essential governmental function test denounced by the majority in Garcia, had met a similar attack in Justices Johnson's dissent in Weston v. Charleston.\textsuperscript{162} Justice Johnson suggested that state taxation could easily be kept within its legitimate use by the judiciary if the courts simply demanded that a state not tax federal instrumentalities discriminatorily.\textsuperscript{163}

Chief Justice Marshall, however, writing for the majority, did not state that the immunity of federal instrumentalities from state taxation was implicit in the congressional action in creating the instrumentalities.\textsuperscript{164} He saw the issue in terms of the clashing of two blind forces: federal law (in form of federal operations) and state law (in form of state tax laws).\textsuperscript{165} It was never, for the Chief Justice, a question of reconciling the two forces.\textsuperscript{166} Rather, it was simply a question of which one would prevail, and the supremacy clause of the United States Constitution easily resolved that question.\textsuperscript{167}

The nondiscrimination taxation principle which gave either government authority to tax the instrumentalities of the other government, did not disappear with the majority's victory in Weston.\textsuperscript{168} One hundred years later, Chief Justice Hughes resurrected the nondiscrimination principle and it became a cornerstone of tax immunity law.\textsuperscript{169} Once, however, the Court recognized it could practicably police state taxation, Chief Justice Marshall's words that the "power to tax involves the power to destroy"\textsuperscript{170} became "[t]he power to tax is not the power to destroy while this Court sits."\textsuperscript{171}

In Helvering v. Mountain Producers Corp.,\textsuperscript{172} the Court stated that denying the tax exemption to those with whom the government transacts business may place an economic burden on the government.\textsuperscript{173} The Court announced that an economic burden is not
enough to invoke tax immunity, even though the government may have to pay more money to compensate for the taxes the individual would have had to pay. The Supreme Court concluded if "one operating under a government contract or lease is subjected to a tax with respect to his profits on the same basis as others who are engaged in similar businesses, there is no sufficient ground for holding that the effect upon the government is other than indirect and remote." The fact that the expense of one government might be lessened if all those with whom it transacts business with are exempt from taxation was also found not to be a valid reason to grant tax immunity.

LEGISLATIVE HISTORY

The bulk of federal revenues for the first 120 years of the existence of the Union were derived from tariffs, taxes on land, and direct taxes. However, attempts were made during times of economic stress to tax the interest on state obligations or the salaries of state officers. Such attempts were struck down by the Supreme Court.

In 1895, the Court unanimously determined in Pollock v. Farmers' Loan & Trust Co., that a federal statute purporting to tax interest on the obligation of the states and their instrumentalities was repugnant to the Constitution. As a reaction to the pronouncement in Pollock, President Taft sought a constitutional amendment which would do away with the requirements of uniformity and apportionment. The amendment was to permit the taxation of income "from whatever source derived." Congress enacted the proposed amendment and submitted it to the states for ratification.

The taxation of the state's debt obligation was allegedly raised by the opponents of the amendment as an attempt to derail the ratification process. Proponents of the amendment reacted immediately,
especially in the Senate, and charged that the opponent's fears that the amendment would enable taxation of state debt instruments were unfounded. Senator Norris Brown, sponsor of the resolution, described the effect of the amendment as follows:

The amendment does not alter or modify the relation today existing between the [s]tates and the [f]ederal [g]overnment. That relation will remain the same under the amendment as it is to-day without the amendment. It is conceded by all that the Government cannot under the present Constitution tax state securities or state instrumentalities.

To the credit of the opponents, no member of the Congress supported the proposition that the amendment would permit the taxation of the interest on state debt obligations. The furor died down and the amendment was ratified as the Sixteenth Amendment to the Constitution.

Much congressional debate followed the enactment of the sixteenth amendment. In introducing the first income tax statute adopted pursuant to the amendment, Representative Cordell Hull noted that the statute provided that interest on state obligations was specifically excluded from the definition of income so as not to raise the constitutional question.

But as the interests and economic needs of the federal government grew, several unsuccessful attempts were made to legislate such taxation. Congress also tried and failed to pass a constitutional amendment which would have authorized prospective taxation of state debt instruments. The proposed amendment provided that, "Congress shall have power to lay and collect taxes on gains, profits, and incomes, from whatever source derived, which shall include gains, profits and income from securities created by the states and their subsidiary government, issued after the ratification of this article." Proposals to tax such interests were made several other

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186. Id. at 1694-98 (statements of Senators Borah and Root).
187. Id. at 2246.
188. Id.
189. 33 HARV. L. REV. at 810.
190. See infra notes 191-93 and accompanying text.
191. See H.R. 3321, 63rd Cong., 1st Sess. (1913) (discussing the Tariff-Income Tax Bill); see also 60 CONG. REC. 508 (1913); Brushaber v. Union Pacific R. R. Co., 240 U.S. 1, 18-19 (1916) (interpreting the sixteenth amendment).
192. 56 CONG. REC. 10,628-29 (1918) (statement of Senator Thomas). Examples of these attempts include the emergency revenue measures during World War I. Id. at 10,628.
193. See infra note 198 and accompanying text.
194. Hearings before the Comm. on Ways and Means, House of Representatives on Tax-Exempt Securities, H.R.J. Res. 102, 67th Cong., 1st Sess. 3 (1922) [hereinafter 1922 Hearings] (emphasis added).
times, and extensive hearings were held as to whether a constitutional question was involved. The consensus at such hearings was that a substantial constitutional impediment prohibited such taxation.

During hearings before both the House and Senate, it was found that the interest on securities of the state or their political subdivisions would not be taxable on constitutional grounds. In the House hearing, the Secretary of the Treasury stated that the sixteenth amendment did not permit the federal government to tax income derived from state and municipal securities. At a hearing before the Senate, the Chairman of the Federal Trade Commission noted that the income tax acts exempt from taxation the income on the obligations of the states and their political subdivisions. The Chairman’s report stated the Court’s position that the federal government does not have the power to tax the instrumentalities of the state government. He concluded that the sixteenth amendment did not extend the taxing power of Congress to include interest paid on state obligations.

Additional hearings resulted in the same conclusion, including one in response to a request made by President Franklin D. Roosevelt. However, after the Court’s decision in O'Keefe, where it held that state tax immunity was granted or withheld by the will of Congress, the tone of such hearings became less definitive as to whether a constitutional amendment was necessary. Nonetheless, Congress continued its reluctance to pass legislation to tax state obligations.

In 1954, Congress abandoned its quest for a constitutional amendment. It embarked upon a more subtle plan of attack on
the taxation of state debt instruments. 207 This plan was necessary because the Court had several times refused to find any merit in the contention that the sixteenth amendment granted Congress the power to tax state debt instruments. 208 The Code continued to give a "lip service" statutory exemption from federal taxation to the interest on state obligations but the same statute would continually limit the scope of the term "obligations." 209 This congressional action limited the exemption contained in the tax laws since the first tax statute of 1913 and also avoided the constitutional question. 210 This action also limited judicial review to taxpayers, thereby excluding the states and their instrumentalities from redress. 211

FACTS AND HOLDING

In South Carolina v. Regan, 212 the State of South Carolina filed a Motion for Leave to File Complaint against the Secretary of the Treasury of the United States under the Court's original jurisdiction. 213 The Court agreed with the secretary that although the Court should exercise its discretion sparingly in granting original jurisdiction, the argument of the State of South Carolina that "application of § 103(j)(1) will materially interfere with and infringe upon the authority of South Carolina to borrow funds" is a vitally important question to all of the states. 214 The Court concluded that it was appropriate under the circumstances to exercise discretion to hear the case. 215

South Carolina urged the Court to grant its motion despite the action being barred by the Anti-Injunctive Act ("Act"). 216 The

207. See supra note 3 and accompanying text.
209. See supra note 3 and accompanying text.
211. I.R.C. § 7478 (1978) provides for declaratory judgment regarding the status of government obligations. It was intended to remedy the lack of judicial redress for the affected governments. 1978 U.S. CODE CONG. & ADMIN. NEWS 6761.
212. 465 U.S. 367 (1984). (Baker replaced Regan as the defendant while the case was pending.)
213. Id. at 370. The U.S. Constitution states that "in all Cases in which a State shall be a Party, the Supreme Court shall have original Jurisdiction." U.S. Const. art. III, § 2. Because the State of South Carolina was the real party in interest, the requirements for requesting a Supreme Court hearing based on its original jurisdiction was satisfied. South Carolina v. Regan, 465 U.S. at 382.
214. Id. (quotation omitted). The Court supported its conclusion by noting that 24 states had filed an amicus brief in which they had urged the Court to grant the motion. Id. at 832.
215. Id.
216. Id. at 372. The full text of the Anti-Injunctive Act reads:

Except as provided in sections 6212(a) and (c), 6213(a), 6672(b), 6694(c), 7426(a) and (b)(1), and 7429(b), no suit for the purpose of restraining the as-
Court, in granting South Carolina's motion, reasoned that the Act was not applicable to any action where a party had no "alternative legal avenue" to challenge a tax statute.\textsuperscript{217} Moreover, the Court concluded that the application of the Act would bar South Carolina from challenging the tax statute because the state would not incur any tax liability.\textsuperscript{218}

The Court, in addition, rejected the Secretary's contention that South Carolina could bring its constitutional grievances through a third party.\textsuperscript{219} The Court stated that "[b]ecause it is by no means certain that the [s]tate would be able to convince a taxpayer to raise its claims, reliance on the remedy \textsuperscript{220} would create the risk that the Anti-Injunction Act would entirely deprive the [s]tate of any opportunity to obtain review of its claims."

The State of South Carolina also alleged in its motion, that the resulting effect of § 103(j)(1) forced it to issue debt obligations in registered form.\textsuperscript{221} It argued that this congressional requirement thereby took away any choice it had in issuing its obligations.\textsuperscript{222} The state reasoned that since the power to borrow has long been held to be a cornerstone of state sovereignty, the statutory section curtailed the exercise of its borrowing power and thereby violated the tenth amendment.\textsuperscript{223}

The Court proceeded to appoint a Special Master (the "Master") to conduct a hearing, take evidence and give a ruling recommendation on South Carolina's argument.\textsuperscript{224} The Master concluded the tax statute was constitutional and urged a ruling for the Secretary.\textsuperscript{225}

South Carolina and the National Governors' Association ("NGA") as intervenor and other amicus curiae filed exception to the Master's various factual findings and to his legal conclusions that the statute was constitutional.\textsuperscript{226} The Court, in upholding the Masters legal conclusions, announced that the tax statute neither offended

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\item \textsuperscript{217} Id. at 373.
\item \textsuperscript{218} Id. at 379-80.
\item \textsuperscript{219} Id. at 380.
\item \textsuperscript{220} Id. at 380-81.
\item \textsuperscript{221} Id. at 371.
\item \textsuperscript{222} Id. at 371-72.
\item \textsuperscript{223} Id. at 372.
\item \textsuperscript{224} Id. at 382.
\item \textsuperscript{226} Id. at 1359-60, 1361 n.6, 1336 n.12.
\end{enumerate}
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the tenth amendment nor the doctrine of intergovernmental tax immunity. On the tenth amendment issue, the Court held that under \textit{Garcia v. San Antonio Metropolitan Transit Authority}, the amendment only sets "structural, not substantive" limits on Congress' regulatory power. Therefore, the Court announced that "states must find their protection from congressional regulation through the national political process, not through judicial defined spheres of unregulable state activity." However, the Court stated that if "extraordinary defects in the national political process" are found then judicial review under the tenth amendment would be proper. Since South Carolina did not show or allege such an extraordinary defect, the Court ruled that tenth amendment review was foreclosed.

The NGA, however, contended that \textit{FERC v. Mississippi} left open the possibility that the tenth amendment can be invoked to set limits on Congress' power to compel states to regulate on Congress' behalf. The Court, in disagreeing with the NGA's proposition, found that the claim left open in \textit{FERC} was not present in \textit{South Carolina v. Baker} and that the statutes in both cases sought different ends. Moreover, the Court noted that to agree with NGA would not only overrule \textit{Garcia} but would curtail Congress' regulatory power to a greater degree than in \textit{National League of Cities v. Usery}.

South Carolina also contended that the tax statute was unconstitutional because it offended the doctrine of intergovernmental tax immunity as announced in \textit{Pollock v. Farmers' Loan & Trust Co.} In disagreeing with South Carolina, the Court reviewed the labyrinth path taken by the Court over the years in developing this judicial doctrine. In so doing it established that, "\textit{Pollock} did not represent a unique immunity limited to income derived from state bonds."
Rather, Pollock illustrated the general rule, which held that neither sovereign could tax an individual's income obtained from any contract with a government.\textsuperscript{240} The Court stated, "[t]his general rule was based on the rationale that any tax on income a party received under a contract with a government was a tax on the contract and thus a tax 'on' the government because it burdened the government's power to enter into the contract."\textsuperscript{241} The Court, however, pointed out that this burden theory had been rejected by modern case law.\textsuperscript{242}

The Court stated that modern intergovernmental tax immunity analysis focused on a nondiscriminatory principal.\textsuperscript{243} It explained that the tax was "constitutional even though part or all of the financial burden falls on the other government."\textsuperscript{244} Under this reasoning the Court concluded, interest on a state bond could be subjected to nondiscriminatory taxation.\textsuperscript{245} The Court held that the Constitution only forbids a direct tax on any government.\textsuperscript{246}

A direct tax, the Court explained, is one where the tax falls on the government, or on an instrumentality or agency of a government which is inseparable from the government.\textsuperscript{247} Moreover, the Court reasoned that in \textit{Memphis Bank & Trust Co. v. Garner},\textsuperscript{248} it had held that a nondiscriminatory tax could be levied on the interest of a federal bond.\textsuperscript{249} Therefore, the Court concluded that since the federal and state immunity were reciprocal in nature, the interest on state bonds could not be immune from a nondiscriminatory federal tax.\textsuperscript{250}

In addition, the Court held the federal tax was not a "tax" in terms of intergovernmental tax immunity.\textsuperscript{251} A tax is an enforced contribution to support a government.\textsuperscript{252} Since, the federal tax on state and municipal bond interest was not such a tax it was

\textsuperscript{240} Id.
\textsuperscript{241} Id.
\textsuperscript{242} Id. at 1365.
\textsuperscript{243} Id. at 1365, 1368. In defining a nondiscriminatory tax, the Court stated that when "the economic but not the legal incidence of the tax falls upon the [f]ederal [g]overnment, such a tax generally does not violate the constitutional immunity if it does not discriminate against holders of federal property or those with whom the [f]ederal [g]overnment deals." Id. at 1368 (quoting Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 397 (1983)).
\textsuperscript{244} Id. at 1365.
\textsuperscript{245} Id. at 1386.
\textsuperscript{246} Id. However, the Court stated that some state activity could be subjected to a federal tax. Id. at 1367 n.13.
\textsuperscript{247} Id. at 1386 (quoting United States v. New Mexico, 455 U.S. 720, 735 (1982)). \textit{See} Helvering v. Mountain Producers Corp., 303 U.S. 376, 386-87 (1938).
\textsuperscript{248} 459 U.S. 392 (1983).
\textsuperscript{249} \textit{Baker}, 108 S. Ct. at 1368.
\textsuperscript{250} Id.
\textsuperscript{251} Id. (citation omitted).
\textsuperscript{252} Id. (citing United States v. Mississippi Tax Comm'n, 427 U.S. 599, 606 (1975)).
Justice Stevens, concurring with the Court's holding, noted that the "outcome of this case was equally clear well before [Garcia] was decided." He, however, declared that neither his nor the Court's opinion expressed the "wisdom" of taxing the interest on state bonds.

Justice Scalia, while concurring in the judgment, agreed with the majority on its ruling on the intergovernmental tax immunity issue. As to the majority's holding on the tenth amendment, Justice Scalia was disturbed because in his view "the Court without cause, cast doubt upon FERC" and that the Court misinterpreted Garcia's holding. The Justice pointed out that Garcia disapproved that the "national political process" was the state's only guard against federal regulation and that only extraordinary defects in the political process could warrant judicial relief. Justice Scalia, however, concluded that prior cases did not demand an identification of the contours of the Constitution which would curtail federal regulation under the Commerce Clause. However, he did admit that the constitutional structure was not offended by the tax statute.

In concurring with the judgment of the Court, Chief Justice Rehnquist agreed with the Court's holding that intergovernmental tax immunity principles were not offended in this case. But, he quickly pointed out that the majority cast doubt on the protection afforded by the tenth amendment. The Chief Justice stated that since the effect of the tax statute had only a de minimis impact on the state's borrowing ability, this conclusion should have terminated the tenth amendment inquiry. Moreover, he noted that even under the National League of Cities "expansive conception" of the tenth amendment the tax statute at issue would have been declared constitutional. Therefore, he found the Court lacked a reason for discussing deficiencies in the national political process or the federalism concerns espoused in FERC.

253. Id.
254. Id. at 1369 (Stevens, J., concurring).
255. Id.
256. Id. (Scalia, J., concurring in part and concurring in the judgment).
257. Id.
258. Id.
259. Id. (citing Garcia, 469 U.S. at 556 (1985)).
260. Id.
261. Id. (Rehnquist, C.J., concurring).
262. Id. at 1370.
263. Id.
264. Id.
265. Id. See supra notes 133-35 and accompanying text.
Justice O'Connor, in her strong dissent, accused the majority of negating the constitutional immunity that declared that the interest paid on state and local bonds was immune from federal taxation.266 Thus, the Justice concluded, impinged on the states' sovereignty.267 She announced that either the tenth amendment or the guarantee clause prohibited the taxation of the interest on state bonds.268 Justice O'Connor also accused the Court of not inquiring whether the federal tax violated the Constitution rather than the doctrine of intergovernmental tax immunity.269

Despite giving the Court deference to its intergovernmental tax immunity inquiry, Justice O'Connor was unsatisfied with its rationale that the doctrine of intergovernmental tax immunity had declined in this century.270 To this charge, she announced “constitutional principles do not depend upon the rise or fall of particular legal doctrines.”271

Also, Justice O'Connor pointed to the fact that state and municipal governments greatly depend upon borrowed funds to perform governmental functions.272 She reasoned that these functions would be jeopardized by the tax statute because the state and local governments would be required to raise interest rates, thereby increasing their cost of raising capital.273 In addition, Justice O'Connor stated that the limitation on intergovernmental tax immunity was only applied when the tax did not “substantially affect government operations.”274 The only deviation from this rule was when the tax burden was so uncertain that no benefit to the state would result from curtailing the federal taxing power.275 Justice O'Connor thereby disagreed with the Court for not protecting the states against this “crushing taxation.”276

ANALYSIS

The Court's announcement in Garcia v. San Antonio Metropolitan Transit Authority,277 established that the states protection from
undue federal regulation was by political process rather than by judicial result, and thus spelled the end of any tax immunity based on the tenth amendment.\textsuperscript{278} The \textit{Garcia} Court noted that the structure of the federal system of government includes “built-in restraints” which give to the states an input into the federal legislative process.\textsuperscript{279} This political process input ensures that laws that unduly burden the states will not be enacted.\textsuperscript{280} Justice Blackmun, writing for the majority, emphasized that unless there was some “affirmative limit” in the Constitution, the states had no special protection from federal regulation.\textsuperscript{281}

The Court, however, left open the possibility that if some federal law destroyed state sovereignty, it would be invalidated.\textsuperscript{282} But, a federal law which merely made it more expensive for the state to exercise their powers does not destroy state sovereignty.\textsuperscript{283} The tax statute involved in \textit{South Carolina v. Baker},\textsuperscript{284} was of the latter type of federal law and the Court had to uphold it because otherwise it would have overruled \textit{Garcia}.\textsuperscript{285}

In \textit{Baker}, the Court, in dicta, ventured into what might reach the threshold of an extraordinary defect in the political process.\textsuperscript{286} It stated, that the lack of “any right to participate” in the political process or being left “politically isolated and powerless” would invoke judicial review.\textsuperscript{287} Even the author of the now overruled \textit{National League of Cities v. Usery},\textsuperscript{288} Chief Justice Rehnquist stated that South Carolina had no tenth amendment protection from the federal tax statute, since the statute had only a \textit{de minimis} impact on the state’s borrowing ability.\textsuperscript{289}

The Court’s holding that in \textit{Baker} the tenth amendment is not implicated when Congress regulates the states arguably leaves open the possibility that Congress’ power to regulate the state may be limited by other provisions of the Constitution.\textsuperscript{290} Justice O’Connor in her dissent offered the guarantee clause as an example.\textsuperscript{291} Although the clause has not been frequently used to guard against unwar-
ranted federal regulation of the states, its principles could be so applied.292

PRINCIPLES OF FEDERALISM
The Tenth Amendment

*National League of Cities* breathed new life into the position favoring the constitutional exception from federal taxation of state and municipal obligations.293 For it was the first time since the Court Packing Plan that the Court had resurrected the tenth amendment and used it to overturn a federal law.294 One commentator noted,

The language and reasoning of the majority opinion in *National League of Cities* bolstered the pre-1937 case law supporting tax immunity for state and municipal bonds. Just as a federal law mandating overtime pay for state and city employees imposes substantial costs on the states and cities, so does a federal income tax on the interest earned from state and local bonds increase the borrowing cost of states and municipalities.295

The Court in *National League of Cities*, in dicta, also noted the power to borrow must be one of the "undoubted attribute[s] of state sovereignty."296 Some of the strong supporters of *National League of Cities* on the Court, later regarded as "serious" the argument of South Carolina in *South Carolina v. Regan*297 in support of a broad constitutional right of the states to issue tax exempt bonds unfettered by federal regulation.298

The case law immediately following *National League of Cities* did, however, undercut this view.299 Moreover, the Court never invalidated any federal law under *National League of Cities* guidelines.300 In subsequent cases, the Court upheld each challenged congressional act.301 However, in the lower courts much confusion was present and there seemed to be no emerging cohesive principle

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292. See infra notes 313-37 and accompanying text.
293. See supra notes 30-35 and accompanying text.
294. See supra note 35.
298. Id. at 401 (O'Connor, J., concurring in judgment).
299. See supra note 28 and accompanying text.
300. See supra note 28 and accompanying text.
from the cases, a fact which supported Justice Brennan's earlier prediction that the National League of Cities test was simply "unworkable."\textsuperscript{302}

The rationale of Garcia finally spelled the end of any constitutional based tax immunity grounded in the tenth amendment.\textsuperscript{303} The Garcia Court, in dicta, had noted that since no "affirmative limit" existed in the Constitution restraining the federal taxing power over state and municipal bonds judicial review was inappropriate.\textsuperscript{304} Moreover, the federal taxation of interest income from state and municipal bonds is not destructive of state autonomy,\textsuperscript{305} but merely makes it more expensive for states and municipalities to borrow money.\textsuperscript{306} The Court held that this increase in cost may be more or less than the increase in cost from the application of federal overtime laws to state and city employees.\textsuperscript{307} It all depends on how much borrowing and how much overtime the state requires and this is not a constitutional issue which involves the tenth amendment.\textsuperscript{308}

The South Carolina v. Baker Court turned Garcia's dicta into law by holding that the political process will set the limit of congressional taxing power, rather than the tenth amendment.\textsuperscript{309} The Baker Court makes it difficult, if not impossible, for the states to make a traditional intergovernmental tax immunity argument grounded on the tenth amendment because such an argument would require "extraordinary defects in the political process."\textsuperscript{310} However, the Court

\textsuperscript{302} National League of Cities, 426 U.S. at 223 (Brennan, J., dissenting). In the nine years of the reign of National League of Cities, eight of the nine Justices at one time thought later cases were simply inconsistent with National League of Cities. See 1 R. Rotunda, J. Nowak & J. Young, Treatise on Constitutional Law: Substance and Procedure § 4.10(d), at 318-19 (1986).

\textsuperscript{303} See supra note 42 and accompanying text.

\textsuperscript{304} Garcia, 469 U.S. at 555-56.

\textsuperscript{305} Baker, 108 S. Ct. at 1367, n. 4.

\textsuperscript{306} Regan, 465 U.S. at 415, n.16 (Stevens, J., concurring in part and dissenting in part).

\textsuperscript{307} National League of Cities, 426 U.S. at 846.

\textsuperscript{308} Baker, 108 S. Ct. at 1361, n.6. Whether it costs the states more to raise capital by registering bonds will not trigger a tenth amendment analysis because the operation of the national political process cannot be implicated by a higher cost. See id. at 1362.

\textsuperscript{309} Id. at 1360-61 (citing Garcia, 469 U.S. at 556 (1985)).

\textsuperscript{310} Id. This "extraordinary defect requirement," however, is embraced by only four Justices (Brennan, White, Marshall and Blackmun). Id. at 1355-56. Justice Stevens adhered to his rational in Regan, when he stated that a tenth amendment violation "is inconsistent with the plain language of the Constitution itself." Regan, 465 U.S. at 418. He went on to quote the constitutional provision which grants Congress the taxing power that is limited in scope only by the sixteenth amendment. Id.

Justice Scalia dissented on the need for an extraordinary defect to invoke judicial review. Baker, 108 S. Ct. at 1369 (Scalia, J., concurring in part and concurring in the judgment). Chief Justice Rehnquist believed that because the impact of § 310(b)(1) was negligible to the states, there could be no tenth amendment inquiry. Id. at 1370
declined to identify what would amount to an extraordinary defect, but the majority in dicta indicated that either a deprivation of an opportunity to participate in the political process or political isolation may amount to an extraordinary defect. Notwithstanding Justice O'Connor's strong dissent, the majority of the Court is content to leave the question of intergovernmental tax immunity to be decided through and by the political system.

THE GUARANTEE CLAUSE

The Court's sweeping statement in Luther v. Borden, which was reiterated a hundred years later in Colegrove v. Green, that the guarantee clause issue could not be challenged in the courts, is not in accord with the Court's precedent and policy considerations. Nor does it foreclose a judicial review under the guarantee clause.

In Baker v. Carr the Court held that the guarantee clause does not include any demonstration that the issue is delegated to either Congress or the Executive "arising under the clause." Rather, the clause declares that every state is guaranteed a republican form of government by the United States. This reference to the United States plainly encompasses the Judicial branch, as well as the Executive and Legislative branches of the national government. The location of the guarantee clause in article IV of the Constitution, moreover, strengthens the conclusion that the Framers did not intend enforcement of the clause to be the exclusive province of Congress or the executive branch. If the Framers had intended that result, they would have incorporated the clause into the articles detailing the powers of those bodies.

(Rehnquist, C.J., concurring). Justice O'Connor, in her dissent, held fast to the belief that the tenth amendment was outrightly offended, a view that lead to her previous dissent in Garcia. Id. at 1371 (O'Connor, J., dissenting).

311. Id. at 1361. Two observations must be noted about this view. First, although its common in other constitutional areas such as equal protection, it is novel in a case involving federalism questions. United States v. Carolene Prods. Co., 304 U.S. 144, 152, n.4. Second, only four Justices agree with it. See supra note 310.

312. See supra note 230 and accompanying text.

313. 48 U.S. (7 How.) 1, 42 (1849).


315. Id. at 556. See infra notes 317-37 and accompanying text.

316. See infra notes 317-37 and accompanying text.


318. Id. at 217.


320. See Carr, 369 U.S. at 297 (Frankfurter J., dissenting) (stating that the guarantee clause is not committed by express terms to Congress).


322. Id.
Nor does the guarantee clause necessarily lack judicially manageable standards. The Supreme Court itself has declared that such a standard exists. Enforcing the fundamentals of republican governments provides a judicial standard at least as manageable as the malleable standards supplied by the equal protection or due process clauses.

Judicial enforcement of the guarantee clause does not require "an initial policy determination of a kind clearly for nonjudicial discretion." The only policy determination demanded is that the states should maintain a separate and independent existence. That decision, however, has already been made by the Constitution and is embedded in our constitutional history.

Protection of state autonomy, of course, may require the courts to invalidate some federal legislation. The act of invalidating the legislation, however, does not rise to the level of expressing lack of the respect due coordinate branches of government. Courts have a constitutional obligation to review the validity of both state and federal statutes. Furthermore, neither does the potentiality of embarrassment from multifarious pronouncement by various departments on the same question pose an obstacle to judicial review of federal action under the guarantee clause. The Court has held that it is the responsibility of the Court to act as the ultimate interpreter of the Constitution. Hence, if the Court invalidates a federal law because it denies the states a republican form of government, it has merely fulfilled its role of enforcing the Constitution.

Moreover, judicial enforcement of the guarantee clause is particularly appropriate because the political process announced in *Garcia* cannot guard against all federal actions that would infringe on republican government in the state. Clearly, the guarantee clause can be utilized by the courts to afford the states a constitutional safe-

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323. See Carr, 369 U.S. at 218.
324. See supra notes 75-76 and accompanying text.
327. See supra note 50.
331. Id.
332. See infra notes 333-34 and accompanying text.
333. See supra note 16 and accompanying text.
334. See supra note 16 and accompanying text.
335. See *Garcia*, 469 U.S. at 587-88 (O'Connor, J., dissenting).
guard from federal regulation.\textsuperscript{336} Therefore, the guarantee clause question raised by Justice O'Connor has merit and it should have been addressed by the Court.\textsuperscript{337}

**INTERGOVERNMENTAL TAX IMMUNITY**

Chief Justice Marshall established a doctrine of absolute federal tax immunity.\textsuperscript{338} Over the years, the Court has narrowed the immunity, particularly in cases involving federal taxation of states rather than state taxation of the federal government.\textsuperscript{339} The rationale for the Court to define the scope of federal taxation more narrowly is that the federal government levies taxes pursuant to a specific constitutional power which is, by express provision of the Constitution, supreme.\textsuperscript{340}

The Court has consistently recognized that federal immunity from state taxation is based on the declared supremacy of the federal government.\textsuperscript{341} On the other hand federal taxation of state instrumentalities is said to be subject to greater legislative controls.\textsuperscript{342} In *Helvering v. Gerhardt*,\textsuperscript{343} the Court emphasized that the people of the states have created the federal government, where they, and the states themselves, are represented in Congress.\textsuperscript{344} Thus, when Congress exercises its general power of taxation, it is taxing its constituents.\textsuperscript{345} When the state taxes the operation of the federal government, however, that state is not taxing its own constituents.\textsuperscript{346} Rather, it is taxing those over whom it has no control, namely, the citizens of the United States.\textsuperscript{347} Although the people of each state enjoy representation in the national government, the people of the United States enjoy no like representation in each state government.\textsuperscript{348}

Although in the abstract the Court has recognized the difficulty

\begin{itemize}
\item \textsuperscript{336} See supra notes 313-35 and accompanying text.
\item \textsuperscript{337} See supra notes 288-89 and accompanying text.
\item \textsuperscript{338} See supra notes 147-55 and accompanying text.
\item \textsuperscript{339} See supra notes 147-55 and accompanying text.
\item \textsuperscript{340} See U.S. Const. art. 1, § 8, cl. 7. The taxing clause of the Constitution, an enumerated power of Congress, provides that "Congress shall have Power To lay and collect Taxes, Duties, Impost and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States." Id. See supra note 18 and accompanying text.
\item \textsuperscript{341} See supra note 18 and accompanying text.
\item \textsuperscript{342} See supra notes 83-89, 146-53 and accompanying text.
\item \textsuperscript{343} 304 U.S. 405 (1938).
\item \textsuperscript{344} Id. at 412.
\item \textsuperscript{345} Id.
\item \textsuperscript{346} Id. at 412 n.2.
\item \textsuperscript{347} Id. at 412.
\item \textsuperscript{348} Id.
\end{itemize}
in determining where to draw the line for tax immunity, it has acknowledged that tax immunity is firmly based on the premise that each government "must be left free from undue interference by the other" to administer its own affairs within its own sphere.\textsuperscript{349} Thus, the Court stated in \textit{Metcalf & Eddy v. Mitchell},\textsuperscript{350} that the limitation on the taxing power of each government must function to ensure that neither government destroys the other nor substantially limits the exercise of the other's power.\textsuperscript{351}

In \textit{Metcalf & Eddy}, the Court set the limits to the doctrine of intergovernmental tax immunity.\textsuperscript{352} The Court noted that a determination that an activity involved does have some relation to the government sought to be taxed, is not of itself, sufficient to warrant tax immunity.\textsuperscript{353} The Court must determine whether that activity is of such a nature as to require immunity from taxation by the other government.\textsuperscript{354}

In distinguishing between these activities, the Court has considered two factors: (1) the nature of the government instrumentality employed; and (2) the effect of the challenged tax on government functions.\textsuperscript{355} These two factors have been interpreted to mean that in order for tax immunity to apply, the challenged tax must be levied on a means or instrumentality of the government, and the activity or operation sought to be taxed must be a governmental function essential to the maintenance of that government.\textsuperscript{356}

The Court thereafter recognized that it is not possible to delimit essential government function and adopted a nondiscriminatory test in \textit{James v. Dravo Constructing Co.}\textsuperscript{357} In announcing the new test, the Court in \textit{Dravo} held that earlier decisions had become increasingly divorced from their constitutional foundation.\textsuperscript{358} Since \textit{Dravo}, the Court has consistently held that a nondiscriminatory tax on the government is not sufficient in itself to invoke the doctrine of intergovernmental tax immunity.\textsuperscript{359} As the Court stated in \textit{Graves v. New York ex rel O'Keefe},\textsuperscript{360} the purpose of the tax immunity is not to confer a benefit on the government or to give the government a bargain-

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  \item \textsuperscript{349} See supra note 150 and accompanying text.
  \item \textsuperscript{350} 269 U.S. 514 (1926).
  \item \textsuperscript{351} \textit{Id.} at 523-24.
  \item \textsuperscript{352} \textit{Id.}
  \item \textsuperscript{353} \textit{Id.} at 522-23.
  \item \textsuperscript{354} \textit{Id.} at 524.
  \item \textsuperscript{355} \textit{Id.}
  \item \textsuperscript{356} \textit{Id.}
  \item \textsuperscript{357} 302 U.S. 134, 157 (1937). See supra notes 122-24 and accompanying text.
  \item \textsuperscript{358} \textit{Id.} at 134, 160.
  \item \textsuperscript{359} See supra notes 146-54 and accompanying text.
  \item \textsuperscript{360} 306 U.S. 465 (1939).
\end{itemize}
The adoption of the nondiscrimination principle in the areas of immunity from non-incident state taxation, state immunity from federal taxation, and commerce clause limitations on state taxation of interstate commerce attests to its success as a tool for accommodating state and federal interests. Since the test would merely prohibit unequal tax treatment of state instrumentalities, it can only operate to bar the federal government from abusing its taxing power. In *Massachusetts v. United States*, the Court observed that the nondiscriminatory character of the challenged federal tax served to "minimize, if not eliminate entirely, the basis for a conclusion that [the tax] might be an abusive exercise of the taxing power." Hence, the principle could adequately protect state interests.

The federal courts have applied the nondiscrimination principle for over forty years in assessing the constitutionality of state taxes indirectly burdening the federal government and over thirty years in the area of state immunity from federal taxation. The adoption of the nondiscrimination test relinquishes to the proper branch of the government the task of weighing the competing interests at stake in the intergovernmental tax immunity area. Therefore, the standard is simple and eminently suited to judicial use thereby only a tool for judicial policing of taxation, from either sovereign, that is necessarily hostile to the other government's interest.

Under the modern principle of intergovernmental tax immunity, interest on state and municipal obligation can not logically be exempted from a nondiscriminatory federal tax which is not directly on the government (state or federal). Moreover, the State of South Carolina could not have raised a defensible argument that the federal tax was a direct tax.

The *South Carolina v. Baker* Court adhered to this principal in dicta. Because the tax was found by the Court to be nondiscriminatory, the Court had to hold that "subsequent case law has overruled the holding in *Pollock* that state bond interest is immune from..."
a nondiscriminatory federal tax." Therefore, in South Carolina v. Baker, as the Chief Justice surmised, "the principles of intergovernmental tax immunity are not threatened."374

The actual issuance of a debt obligation by a government has been held to be immune from taxation.375 The rationale employed being that the debt obligation is an instrumentality of the issuing government.376 Yet it does not follow that the bond remains an instrumentality in the hands of the purchaser because the municipal bond interest accrues to, and is taxed in the hands of, the purchaser.377 Thus, the legal incidence of the tax falls directly on the purchaser rather than the issuing government.378

Although a tax on such interest may indirectly impose an economic burden on the government, the government is not being taxed directly.379 As the Court held in O'Keefe, a tax on income is not a tax on its source.380 The fact that the tax imposes an indirect economic burden on the state is not, of itself, a sufficient reason to invoke tax immunity.381

In Pollock v. Farmers’ Loan & Trust Co.,382 the Court implied that the government retained an interest in its debt obligation because the relationship between the borrower and lender did not dissolve when the bond was issued; rather, that relationship continued to exist while the debt was outstanding.383 The rationale was that, in issuing municipal obligations, the state’s interest is in the exercise of its borrowing power.384 Hence, its interest remains the same regardless of who owns the instrument because the state is liable to the person holding title according to the terms of the instrument.385

Although the state’s interest in its debt obligations remains substantial even after the debt instrument is in the hands of the purchaser, it is clear that this obligation cannot remain an instrumentality of the state in the hands of a purchaser.386 If the

373. Id. at 1387.
374. Id. at 1389 (Rehnquist, C.J., concurring).
375. See supra notes 114-16 and accompanying text.
376. See supra notes 114-16 and accompanying text.
377. See supra notes 117-35 and accompanying text.
378. See supra notes 131-35 and accompanying text.
379. See supra notes 123-30 and accompanying text.
380. See supra note 126 and accompanying text.
381. See supra note 128 and accompanying text.
382. 157 U.S. 429 (1895).
383. See supra note 116 and accompanying text. See also Weston v. Charleston, 27 U.S. (2 Pet.) 449, 468 (1829) (noting that when land is purchased from the government the connection between the purchaser and the government is dissolved).
384. See supra note 116 and accompanying text.
385. See supra note 116 and accompanying text.
state's interest in the bond has completely passed to the purchaser, then any income earned by the private owner thereon may be subject to taxation by either government. $^{387}$

The Baker case adhered to the position that an instrumentality of a government is not immune from a nondiscriminatory tax. $^{388}$ Therefore, even if the state's interest in its debt obligation qualifies as an instrumentality of the state, there can be no shield from a nondiscriminatory tax. $^{389}$ Furthermore, a state cannot argue that the federal tax is a direct tax. $^{390}$ Consequently, a tax on the interest on state bonds is neither on the state nor its closely connected instrumentality. $^{391}$

Since a government or its instrumentality cannot invoke tax immunity when the tax is nondiscriminatory, Pollock can no longer be good law. $^{392}$ Therefore, the Court's holding in South Carolina v. Baker that tax on interest on state bonds does not offend the doctrine of intergovernmental tax immunity is supported by precedent. $^{393}$

**LEGISLATIVE HISTORY**

The South Carolina v. Baker Court correctly identified that the "sole purpose of the [s]ixteenth [a]mendment was to remove the apportionment requirement for whichever incomes were otherwise taxable." $^{394}$ However, the Court's holding that the legislative history merely shows that the words "from whatever source derived" of the sixteenth amendment were not affirmatively intended to authorize Congress to tax bond interest is defective. $^{395}$

The legislative history indicates that the sixteenth amendment proposed by President Taft was in reaction to Pollock, in which the Court announced that a federal tax on the interest of bonds issued by the state or their instrumentalities was invalid. $^{396}$ This clearly indicates that the amendment was aimed partly to overrule Pollock. $^{397}$ Moreover, Senator Brown, the sponsor of the amendment, was aware of the concern of the opponents of the amendment when he declared that the relationship existing between the two governments will re-

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387. Id.
389. Id.
390. Id. at 1366.
391. Id.
392. See supra notes 114-16 and accompanying text.
393. See supra notes 68-176, 254-57 and accompanying text.
395. Id. See supra notes 177-211 and accompanying text.
396. See supra notes 180-84 and accompanying text.
397. See supra note 182 and accompanying text.
main unchanged by the amendment. He concluded by noting that "[i]t is conceded by all that the government cannot under the present Constitution tax state securities or state instrumentalities."

After the adoption of the sixteenth amendment, the legislative history also indicates that Congress held the belief that only a constitutional amendment would allow for a tax on the interest on state and municipal bonds. Hence, the legislative history expressly indicates that the sixteenth amendment would not extend federal taxation to state obligations. This position enabled the amendment to be enacted by Congress and ratified by the states. The Congress' long held belief that only a constitutional amendment would eliminate the tax immunity on interest on state bonds, started to change after O'Keefe. By 1954, Congress by legislation, rather than a constitutional amendment, embarked on the task of eliminating the state tax immunity. For over thirty years, Congress has limited the states constitutional tax immunity by numerous legislations. Therefore, the tax statute in South Carolina v. Baker, is a part of a well orchestrated plan to extinguish state immunity from federal taxation. Congress thereby achieved its long sought goal to tax interest on state bonds by legislation which it once believed was denied by the Constitution. The majority in South Carolina v. Baker lends support to a dangerous proposition that constitutional doctrines can be overturned by legislative action rather than a judicial adjudication.

CONCLUSION

The municipal bond interest exemption is a benefit the states have enjoyed for many years. Early courts found the exemption to be mandated by the Constitution based on the implied doctrine of intergovernmental tax immunity. Since the exception has been codified for many years, the Court has not had to reconsider its position on whether the exemption is, in fact, constitutionally mandated.

As the Court developed the doctrine of intergovernmental tax immunity, it established two criteria necessary to successfully invoke tax immunity — first, the tax must be levied on a means or instru-

398. See supra note 187 and accompanying text.
400. See supra note 206 and accompanying text.
401. See supra notes 177-205 and accompanying text.
402. See supra note 204 and accompanying text.
403. See supra notes 206-11 and accompanying text.
404. See supra note 209 and accompanying text.
405. See supra notes 206-11 and accompanying text.
406. See supra notes 206-11 and accompanying text.
407. See supra note 271 and accompanying text.
mentality of the government; and second, the activity sought to be taxed must be a function essential to the continued existence of that government. In *Garcia*, the Court undermined the second foundational element of intergovernmental tax immunity, by rejecting any distinction “of activity” based on essential or integral governmental function. It is arguable that the doctrine of intergovernmental tax immunity never survived *Garcia*, of which *South Carolina v. Baker* answered in the affirmative.

*Garcia*’s elimination of the second requirement of the tax immunity by shifting that review to Congress, meant that a new approach had to be applied in deciding tax immunity issues. The Court in *Baker* by case synthesis announced a bipartite test. Under the test, if the tax is not imposed directly on, nor does not discriminate against, the government, then it does not offer intergovernmental tax immunity.

Given the modern development of the doctrine of intergovernmental tax immunity, *Baker* was an easy case for the Court. After *Baker*, states immunity from federal taxation can now only be reviewed judicially under a novel approach, if at all.

The Court correctly decided *Baker* under the principles of federalism and the judicial doctrine of intergovernmental tax immunity. However, the Court failed to address the intriguing question of whether the Constitution rather than a judicial doctrine or the principles of federalism can anchor intergovernmental tax immunity.

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