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THE NATIONAL MUNICIPAL REVIEW has published an admirable study of "Constitutional Tax Exemption" by Edward S. Corwin, McCormick professor of jurisprudence, Princeton University.

Professor Corwin agrees with other estimators that there are between thirty and forty billions of privately held public securities in this country which are either partially or totally tax exempt. In particular, the income of these securities is exempt from the Federal Income Tax. The Ways and Means Committee of the House of Representatives has before it a brief prepared by Mr. A. W. Gregg, expert of the Treasury Department, advising the committee that Congress is without power under the 16th Amendment or otherwise to tax the income of state and municipal bonds. Professor Corwin presents a carefully reasoned argument to the effect that Congress has the power to tax the income of such bonds and advises that Congress shall exercise that power as to state and municipal bonds hereafter issued although the power extends to the taxation of the income of all such bonds now outstanding.

The essence of Professor Corwin's argument is that the Supreme Court has never regarded itself as bound by any remarks in previous decisions which were not essential to the case under determination, and he alleges that the Supreme Court has never had before it since the adoption of the 16th Amendment any case in which it was essential to the decision that the court should pass upon the power of Congress to tax the income of state and municipal bonds.

The issue now presented never had any great importance until after the enactment of the Constitutional Amendment No. 16 which provides that "Congress shall have power to lay and collect taxes on incomes from whatever source derived without apportionment among the several states and without regard to any census or enumeration."

The usual system of taxation by the several states was the imposition of an ad valorem tax on the capital value of all property including evidences of debt. The usual practice by the several states was to permit the taxation locally of bonds issued by or under the authority of other states. An attempt was made to tax bonds of the United States and the Supreme Court held, in effect, that such a tax impaired the sovereignty of the United States and was impliedly contrary to the Constitution of the United States although there was no express prohibition contained in the Constitution.

Professor Corwin points out that an ad valorem tax so low as 1 per cent on a bond bearing 4 per cent interest was the equivalent of an income tax of 25 per cent. As local tax rates often exceed 2 per cent a local tax might exceed an income tax of 50 per cent. Such income tax rates were undreamed of prior to the Great War. Later the Supreme Court held that under the Income Tax Law enacted during the Civil War it was beyond the power of Congress to tax the income of state bonds. When Congress enacted an income tax thirty years ago the Supreme Court held that a tax on income from real or personal property is a "direct tax" within the meaning of the Constitution, which prohibits the levying of direct taxes by Congress unless such direct taxes are apportioned to the several states in proportion to population. In that case Professor Corwin holds that it was not essential for the court to go further and declare that it was incompetent for Congress to tax the income of state bonds; and he points out that the decisions of the court in which the court has gone out of its way to make statements about the power of Congress to tax the income of state and municipal bonds have gradually built up a theory in the mind of the court and in the minds of others that there is an implied prohibition in the Constitution against any taxation by the United States of the income of state and municipal bonds, but that the Supreme Court has not settled this question by any clear decision on the precise point now at issue.

Then Professor Corwin says we had presented by Congress to the several states an amendment to the Constitution in which the words of importance to the ordinary reader were these: "The Congress shall have power to lay and collect taxes on incomes *from whatever source derived*" and he says to the ordinary man those words mean what they say and not something less than they say. How words could be chosen to make more inclusive the power of Congress to tax income from all possible sources than do these words would be very hard to understand. He points out further that they mean what they meant to Mr. Hughes, then governor of New York, who said in his message to the Legislature, "The comprehensive words, 'from whatever source derived,' taken in their natural sense would include not only incomes from real and personal property but also incomes derived from state and municipal securities."

He quotes further to show that other governors in presenting the amendment for ratification to their legislatures entertained the same opinion as did Governor Hughes. Governor Gilchrist of Florida said, "Congress could therefore tax income from state and municipal bonds." Governor Hadley of Massachusetts said, "It impresses me as a narrow or technical objection to oppose this amendment for the reason that it does not provide for an exemption of that portion of one's income derived from state and municipal bonds." Governor Burke of North Dakota said, "The income tax amendment to the Constitution is broad enough to include a tax from incomes derived from the ownership of state and municipal bonds.

While Mr. Hughes was governor of New York the Legislature of New York did not ratify the amendment. His successor, Governor Dix, said in his message to the Legislature of New York that "if the words 'from whatever source derived' would leave the amendment ambiguous as to its power to tax incomes from officials' salaries and from bonds of states and municipalities the amendment ought to be opposed by whoever adheres to the Democratic maxim of the equality of laws." He advised ratification because he agreed with Governor Hughes as to the meaning of the words, "from whatever source derived", and he disagreed with him as to the wisdom of conferring so broad a power upon Congress.

Professor Corwin makes it clear that the legislatures of the states generally, and the people believed that the 16th Amendment would do what the words mean in their ordinary sense, give Congress power to tax all incomes no matter by whom received or from what source derived.

When this amendment was under consideration probably very few persons entertained for a moment the thought that an income tax might be necessary to raise such an enormous sum as was made necessary by the war; and in consequence few persons dreamed of surtaxes running above 50 per cent. So long as all recipients of income pay the same rate, whether such bonds shall be exempt or taxed, is of minor consequence because all such bonds will sell on a lower interest basis because of the exemption and all persons will be treated alike. It would be a mode of, in effect, collecting taxes from every person who bought a tax-exempt bond because he would pay a higher price for the bond at a given rate of interest or would lend his money at a lower rate of interest on account of the exemption. When, however, the tax is graduated a totally different state of things results. To the man who pays an income tax of 6 per cent the exemption amounts to little and would have correspondingly little effect upon the price of the bond; but to those who pay an income tax of 20 per cent to 60 per cent the exemption is vital, of immense importance, with the result that a small class of persons are put by the law under a compelling necessity to invest a large part of their capital in such exempt securities thereby enhancing the price of the bonds and decreasing the interest return to the ordinary investor. This is a gross injustice to the ordinary person who wishes to secure a safe return of income and at the same time is actuated by the patriotic purpose of lending money to his city, to his state, or to the nation. The effect is concealed from him. He does not realize that the interest return is abnormally reduced to him because a heavy tax is imposed on someone else.

Again Professor Corwin shows how to some extent states and municipalities are encouraged to borrow money instead of paying out of current income because they can borrow at extraordinarily low interest; and, still worse, the government forces the building up of a favored class upon whom it makes a motion as though it would impose a tax at a very high rate upon their incomes because their incomes are large, when in fact it does not impose any such tax because it offers them an exempt investment.

It is hard to understand why at the end of his admirable review of the law Professor Corwin suggests that Congress will limit the tax to future issues of public securities, state and municipal. He presents no argument to show that anyone ever bought a state bond or a city bond under any contract express or implied that there should be no United States tax upon the income of such bond. As a matter of fact, the buyer of a New York bond knew that if he lived in Ohio he would be called upon to pay an ad valorem tax equal to more than a 25 per cent income tax; and the same would be true if he lived in almost any one of the forty-seven states other than New York.