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James W. Smith

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STATE TAXATION OF FEDERAL INSTRUMENTALITIES: APPLICATION TO FEDERAL LOAN & EQUITY PROGRAMS

I. Introduction

Although the Constitution does not expressly provide for intergovernmental immunities from taxation, the Supreme Court has implied such a doctrine relying on the Supremacy Clause. The Court has construed the Supremacy Clause to mean that a state may not tax the federal government or any of its instrumentalities. This Note discusses the attempts by states to tax entities which have a distinguishing connection to the federal government. Two competing interests are at stake. First, from the perspective of the federal government, such taxation by a state involves the power to destroy or at least the power to substantially interfere with the functions of federal law and thus subvert the operation of

1. State taxation of imports and exports was expressly prohibited in U.S. Const. art. I, § 10, cl. 2, which provides that: “No state shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws. . . .”

2. U.S. Const. art. VI, cl. 2 provides:
   This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

3. McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819). In Collector v. Day, 78 U.S. (11 Wall.) 113 (1870), the Court held that Congress may not impose a tax upon the salary of a judicial officer of a state. The Court stated: “[i]f the means and instrumentalities employed by [the federal] government to carry into operation the powers granted to it are, necessarily, and, for the sake of self-preservation, exempt from taxation by the States, why are not those of the States depending upon their reserve powers, for like reasons, equally exempt from Federal taxation?” Id. at 127. Subsequently, state immunity from federal taxation was restricted to governmental as opposed to proprietary activities of the state. Helvering v. Gerhardt, 304 U.S. 405 (1938). In New York v. United States, 326 U.S. 572 (1946), the federal government sought to tax a mineral water bottling plant operation of the state. The Court held such a tax would be valid if it was non-discriminatory and was not levied on those activities which were uniquely characteristic of a government. In a concurring opinion by Chief Justice Stone, the rest of the majority also rejected the government-proprietary test but noted that there might be a non-discriminatory tax which “would nevertheless impair the sovereign status of the State. . . .” Id. at 587. See McCormack, Intergovernmental Immunity and the Eleventh Amendment, 51 N.C.L. Rev. 485 (1973).

the Supremacy Clause. Second, because the taxing power is an essential instrument of every sovereign government, the judicial denial of a state's right to exercise this power would deprive it of a much needed source of revenue. This Note is specifically concerned with how these interests relate to state taxation of recipients of federal loan and equity financing and argues that in this particular area the judicial is not the proper forum for weighing these complex policy issues because Congress is in a better position to decide this question. Section II of this Note traces the constitutional history of the doctrine of federal immunity. Section III sets out the various tests which have been used to determine when a private entity may be considered a federal instrumentality for purposes of immunity from state taxation. Section IV discusses the doctrine as it presently exists in relation to loan and equity finance programs of the federal government. Section V suggests that Congress should take a more active role in determining which private entities should be granted instrumentality status.

II. Constitutional Background

A. *McCulloch v. Maryland*

In the landmark decision of *McCulloch v. Maryland*, Maryland sought to impose a tax on the bank notes issued by the Bank of the United States. The taxing statute required either that the bank print its notes on stamped paper sold by the state or pay an annual lump sum to the state in lieu of purchasing the paper. Chief Justice Marshall, speaking for a unanimous Court, held that the states could not tax or otherwise interfere with a federal instrumentality, stating "the states have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by congress to carry

7. The tax was discriminatory in that it was levied only upon banks operating within Maryland without the state's authority. The Bank of the United States was the only bank in this category. *Id.* at 320.
8. *Id.* at 321.
9. *Id.* at 328-31.
into execution the powers vested in the general government."  

The Court reasoned that, although the power to tax is an essential incident of sovereignty, a state cannot exercise this power over those entities to which its sovereignty does not extend, namely, the federal government. Because the power to tax necessarily involves the power to destroy, to permit a state to tax a federal instrumentality would result in the destruction by the state of an entity which it did not create.

It was the vulnerability of the federal government to states' abuse of the taxing power which compelled the Court to erect a per se rule against such taxation. Chief Justice Marshall stated that the structure of the government itself provides the only protection against abuse. The Court reasoned that a state's own citizens, unlike the federal government, were protected from "erroneous and oppressive taxation" by representation in the state's legislature. The federal government, lacking representation in the state, was left without security from abuse by a state. Thus, the federal government was in need of the protection of a per se rule which proscribed taxation of federal instrumentalities by a state.

10. Id. at 336.
11. "[T]he power of taxation is one of vital importance; that it is retained by the states; that it is not abridged by the grant of a similar power to the government of the Union; that it is to be concurrently exercised by the two governments—are truths which have never been denied." Id. at 425.
12. "The sovereignty of a state extends to every thing which exists by its own authority, or is introduced by its permission; but does it extend to those means which are employed by congress to carry into execution powers conferred on that body by the people of the United States? We think it demonstrable, that it does not." Id. at 429.
13. Id. at 427, 431.
14. "[W]hen a state taxes the operations of the government of the United States, it acts upon institutions created, not by their own constituents, but by people over whom they claim no control. It acts upon the measures of a government created by others as well as themselves for the benefit of others in common with themselves." Id. at 435.
15. Id. at 428-29.
16. Id. at 428.
17. "The people of a state, therefore, give to their government a right of taxing themselves and their property ... resting confidently on the interests of the legislator, and on the influence of the constituent over their representative, to guard them against its abuse." Id. at 428.
19. The Court stated: "In the legislature of the Union alone, are all represented. The legislature of the Union alone, therefore, can be trusted by the people with the power of controlling measures which concern all, in the confidence that it will not be abused." McCulloch v. Maryland, 17 U.S. (4 Wheat.) at 431. Maryland argued that a rule of reason
McCulloch established the principle that, absent affirmative Congressional consent to the contrary, the United States Government is immune from state taxation. The fact that a federal instrumentality is involved rather than the government itself does not alter the application of this doctrine. The Court did limit its holding, however, to permit a state to tax certain property of a federal entity. For example, Maryland could continue to tax the

should apply and that only those taxes which were exercised in an unreasonable and oppressive manner should be prohibited. Id. at 427. Justice Marshall, however, recognized the difficulty federal courts would have deciding whether the tax was reasonable and thus established an absolute immunity from state taxation of federal instrumentalities. The Court stated: "We are not driven to the perplexing inquiry, so unfit for the judicial department, what degree of taxation is the legitimate use, and what degree may amount [sic] to the abuse of the power." Id. at 430. The per se rule adopted by McCulloch has nevertheless resulted in the deep involvement of the federal courts in the determination of the validity of such state tax statutes. The relatively simple test that a state tax of a federal instrumentality is valid so long as it does not discriminate against the federal government was rejected.


The McCulloch Court held that any tax imposed by a state on the operations of the Union was itself an abuse "because it [was] the usurpation of a power which the people of a single state cannot give." Id. 17 U.S. (4 Wheat.) at 430. This rationale was followed in Weston v. Charleston, 27 U.S. (2 Pet.) 449 (1829) (a property tax assessed on government bonds).

20. The Court found that Congress had the power to create the bank. 17 U.S. (4 Wheat.) at 400-24. From this proposition it follows that Congress, by virtue of the Supremacy Clause, may determine which entities are to be immune from state taxation. "The legislature of the Union alone . . . can be trusted by the people with the power of controlling measures which concern all, in the confidence that it will not be abused." Id. at 431. See Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110, 122 (1954); Oklahoma v. Barnsdall Refineries, Inc., 296 U.S. 521, 525-26 (1936); Shaw v. Gibson-Zahniser Oil Corp., 276 U.S. 575, 581 (1928); Owensboro Nat'l Bank v. Owensboro, 173 U.S. 664, 668 (1899); Mercantile Bank v. New York, 121 U.S. 138 (1887); People v. Weaver, 100 U.S. 539, 543 (1879).


22. See Rohr Aircraft Corp. v. County of San Diego, 362 U.S. 628 (1960) (holding the Reconstruction Finance Corporation immune from state taxation because it was a federal instrumentality notwithstanding an agreement with a private lessee whereby the lessee would pay all such taxes); First Nat'l Bank v. Anderson, 269 U.S. 341, 347 (1926) (holding instrumentalities or "agencies of the United States created under its laws to promote its fiscal policies . . . cannot be taxed under state authority except as Congress consents and then only in conformity with the restrictions attached to its consent").
real property owned by the bank and to tax the interest which citizens of Maryland received from the bank on their deposits. The Court carved out this exception reasoning that the state should not be deprived of those resources which were "originally possessed" by it.

This distinction between a tax on the means or operations of the federal government and a tax on its property became important for private entities who claimed immunity. Real property owned by the federal government itself, however, was later held to be immune from state taxation.

B. The Legal Incidence Doctrine

In the years following the Supreme Court's decision in *McCulloch v. Maryland*, the doctrine of federal immunity from state taxation experienced its greatest expansion. During this period, federal courts applied the *per se* rule whenever there was a showing that the state tax would place an economic burden on the federal government. As a result, the Court employed this doctrine to prohibit, for example, state taxes on a federal officer's salary, sales made to the United States, royalties from United States' patents.

23. 17 U.S. (4 Wheat.) at 436. This distinction between a tax on federal property and a tax on the operations of the federal government was followed in Thompson v. Pacific R.R., 76 U.S. (9 Wall.) 579, 580 (1869).
25. See James v. Dravo Contracting Co., 302 U.S. 134 (1937) (In holding a state tax on a government contractor valid, the Court stated that no tax can be laid upon the operations of a federal instrumentality which exists for private gain; but its local property is subject to non-discriminating state taxation); cf., Clallam County v. United States, 263 U.S. 341 (1923) (The Court held that a state could not tax the property of a liquidating federal instrumentality. Where the sole purpose of the creation and use of the instrumentality was to perform a government function.).
27. See Waning of Tax Immunities, supra note 5; Remnant of Tax Immunities, supra note 5.
28. See United States v. County of Fresno, 429 U.S. 452, 460 (1977) (The Court noted that during this period state taxes on federal government contractors would be invalidated "whenever the effect of the tax was or might be to increase the cost to the Federal Government of performing its functions.").
The Supreme Court, however, refined the economic burden test in 1937 in *James v. Dravo Contracting Co.* In *Dravo*, West Virginia wished to impose a gross receipts tax on the income received by a construction company under contract with the federal government to build locks and dams. Under the rules developed in the decisions prior to *Dravo*, such a tax would have been unconstitutional because the contractor could have shifted the ultimate burden to the government. The *Dravo* Court redefined the economic burden test and held that where no direct burden is laid upon the federal government, the states could impose a nondiscriminatory tax which is collected from government contractors. The fact that imposition of the tax would increase the cost of government operations did not invalidate the tax.

Of particular importance to private entities claiming immunity from state taxation, the Court further noted that the "mode of constitution" of such entities could not be disregarded in deciding the question of tax exemption. The majority stated that

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33. 302 U.S. 134 (1937).
34. *Id.* at 137.
35. See notes 29-32 supra and accompanying text.
36. 302 U.S. at 149-50.
37. *Id.* at 160. The majority in *Dravo* recognized the distinction made in *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) at 436, between a tax on a federal instrumentality's property and a tax on its operations. Under the rule established in *McCulloch*, the property used by the contractor in performing its services for the federal government was not immune from taxation by the state. The *Dravo* Court found that a tax on the contractor's property was "closely analogous" to a tax on the income derived from the use of that property and thus a tax on such income was also constitutional. 302 U.S. at 153. The Court stated: "His [a contractor's] earnings flow from his work; his property is employed in securing them. In both cases, the taxes increase the cost of the work and diminish his profits." *Id.* The Court reaffirmed that a tax on property was proper and, from that proposition, established the principle that a tax on the income produced from the use of that property was also constitutional. Although payment by the contractor of both a property tax and an income tax resulted in an economic burden on the federal government because the cost of the tax would probably be shifted to the government, the *Dravo* Court found the government suffered no direct burden because the taxing statute itself did not impose the tax directly on the government or its contractor.
38. 302 U.S. at 157.
it was obvious that an agency might be of such a character or so intimately connected with the exercise of a power or the performance of a duty by the one government 'that any taxation of it by the other would be such a direct interference with the functions of government itself as to be plainly beyond the taxing power.'

By narrowing the economic burden test to prohibit state taxation only in cases where there was a direct burden on the federal government and by permitting state taxation of income derived from property used in performing services for the federal government, Dravo adjusted the balance of federal and state interests which had fallen so heavily in prior years in favor of immunizing the national government from state taxation. The Court sought a more practical construction in an effort to balance competing policy interests and to limit interference with the sovereign functions of both the state and federal governments.

Justice Roberts, dissenting in Dravo, concluded that “the United States may, in its discretion, erect corporations for private gain and employ them as its instrumentalities. No tax can be laid upon their franchises or operations, but their local property is subject to non-discriminating state taxation.”

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Justice Roberts further stated, however, that the bestowal of benefits or rights by federal law upon an individual or corporation does not, by itself, call for the application of the federal immunity doctrine.

39. *Id.* (quoting Metcalf & Eddy v. Mitchell, 269 U.S. 514, 523-24 (1926)).

40. The Court also cited language from Willcuts v. Bunn, 282 U.S. 216, 225 (1931). In Willcuts, the Court held that income received by owners upon the sale of government bonds was not immune from state taxation. The Willcuts Court stated:

> The power to tax is no less essential than the power to borrow money, and in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of non-discriminatory laws, and where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any influence upon the exercise of the functions of government.

302 U.S. at 150.

41. The Court illustrated this concern stating that the principles employed in achieving this delicate balance required the observance of “close distinctions” to insure “the essential freedom of government in performing its functions, without unduly limiting the taxing power which is equally essential to both Nation and State under our dual system.”

42. *Id.* at 163 (Roberts, J., dissenting).

43. According to Justice Roberts, a state tax upon such an entity is void if it falls upon an operation in which the government has an interest, or is an excise or privilege tax upon the contractor’s operations. *Id.* at 163-64.
Draho supports the proposition that federal sovereignty is not violated by a state tax which is neither discriminatory nor is laid directly upon the federal government.\textsuperscript{44} The Supreme Court, in later government contractor cases, expanded upon and further illustrated this notion.\textsuperscript{45}

In Alabama v. King & Boozer,\textsuperscript{46} the defendant furnished lumber to cost-plus-fixed-fee contractors who were constructing an army camp for the government.\textsuperscript{47} Alabama sought to impose a two percent sales tax on the sale of the lumber from the defendant to the government contractors.\textsuperscript{48} The defendant argued that it did not have to collect the tax from the contractors because it would be a violation of the federal immunity doctrine.\textsuperscript{49}

The Supreme Court rejected an economic impact test\textsuperscript{50} and upheld the Alabama statute stating that the legal incidence of the tax did not fall on a federal instrumentality. The Court found that the legal incidence did not fall on the government because it was not the purchaser who was legally obligated to pay the tax under the statute.\textsuperscript{51} Rather, the contractor was obligated to pay the tax under the statute. Only where the government itself is liable for payment

\textsuperscript{44} In sustaining a non-discriminatory state tax on the income of federal employees, the Court again rejected the economic burden test in Graves v. New York ex rel. O'Keefe, 306 U.S. 466 (1939) (overruling Dobbins v. Erie County, 41 U.S. (16 Pet.) 435 (1842)). The Graves Court stated that the tax would be invalid only if "the economic burden of the tax is in some way passed on so as to impose a burden on the national government tantamount to an interference by one government with the other in the performance of its function." 306 U.S. at 481.


\textsuperscript{46} 314 U.S. 1 (1941).

\textsuperscript{47} Id. at 6.

\textsuperscript{48} Id. at 7.

\textsuperscript{49} In its contract with the contractors, in addition to the payment of a fixed fee, the government promised to reimburse the contractors for their expenses including all state and local taxes. Id. at 10. Thus, presumably under the economic burden test the tax was void as unconstitutional.

\textsuperscript{50} Even the government wished to abandon the economic burden test. In its brief in King & Boozer, the government characterized such a test as "illusory and incapable of consistent application." United States v. Detroit, 355 U.S. 466, 473 n.4 (1958).

\textsuperscript{51} 314 U.S. at 7 ("the tax is laid on the seller, who is denominated the 'taxpayer'... it is made the duty of the seller 'to add to the sales price and collect from the purchaser the amount due by the taxpayer on account of said tax.'") Id. (citations omitted).
of the tax will the tax be struck down.

The Court also closely construed the terms of the contract and found that the incidence of the tax fell on the contractor even though the government maintained extensive control over the contractor and title to the purchased lumber ultimately vested in the United States.\(^5\)

Thus, the legal incidence doctrine as employed in *Alabama v. King & Boozer* was an *ad hoc* formula under which the Supreme Court analyzed the taxing statute to determine who was legally obligated to pay the tax.\(^6\) In contrast to its holding in *King*

52. The Court examined the amount of control that the federal government exercised over the private entity to determine whether there existed an agency relationship. The Court held that this right to control the contractors did not give to the contractors the status of agents. *Id.* at 13. See *United States v. Boyd*, 378 U.S. 39, 41 (1964) (holding that Union Carbide was not a federal instrumentality despite extensive entanglement with the Atomic Energy Commission); *United States v. Muskegon*, 355 U.S. 484, 486 (1958) (holding that a private corporation was not a federal instrumentality because it could not properly be called a servant of the United States in agency terms). Control is an essential element in an agency or master-servant relationship. "Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and *subject to his control*, and consent by the other so to act." (emphasis added) *Restatement (Second) of Agency* § 1 (1958). A servant is defined in the *Restatement (Second) of Agency* § 220 (1958) as "a person employed to perform service in the affairs of another and who with respect to the physical conduct in the performance of the services is *subject to the other's control or right to control.*" (emphasis added). See F. MECHEM, OUTLINES OF AGENCY §§ 413-416 (4th ed. 1952). *But see United States v. New Mexico*, 624 F.2d 111 (10th Cir. 1980), cert. granted, 49 U.S.L.W. 3617 (Feb. 24, 1981) (No. 80-702), where the court stated that "[a]lthough there is language in these Supreme Court opinions suggesting that the results turn on traditional agency principles . . . it seems evident that the Court is more concerned with preserving the delicate financial balance between our co-existing sovereignties than with rigid adherence to agency law terminology." *See also United States v. Forst*, 442 F. Supp. 920 (W.D. Va.), *aff'd per curiam*, 569 F.2d 811 (4th Cir. 1978).

53. *Alabama v. King & Boozer*, 314 U.S. at 13-14. The Court stated: "[t]he asserted right of the one [sovereign] to be free of taxation by the other does not spell immunity from paying the added costs, attributable to the taxation of [its contractors]." *Id.* at 9.

54. 314 U.S. 1 (1941).

55. *Id.* at 14. In the companion case of *Curry v. United States*, 314 U.S. 14 (1941), the Court used the same test in holding valid the imposition of a state use tax on a government contractor. The Court in *Curry*, as well as in *King & Boozer*, recognized that the tax affected the government only through operation of the contract. "If the state law lays the tax upon [the contractors] rather than the [government] with whom they enter into a cost-plus contract like the present one, then it affects the Government . . . only as the economic burden is shifted to it through operation of the contact." *Id.* at 18.

56. The fact that "Congress ha[d] declined to pass legislation immunizing from state taxation contractors under 'cost-plus' contracts for the construction of governmental projects," 314 U.S. at 8, may have been an important factor in the Court's decision.
& Boozer, the Court in Kern-Limerick, Inc. v. Scurlock held a similar tax to be unconstitutional. 57

In Kern-Limerick, Arkansas wished to impose a two percent gross receipts tax on income derived from the sale of tractors by Kern-Limerick to contractors building a naval ammunition depot. The Supreme Court held that pursuant to the terms of the contract between the Navy and the private contractor, the contractor was the purchasing agent of the government and therefore the "legal incidence" of the tax fell upon the United States. 58 Justice Reed, writing for the majority, stated that the doctrine of federal immunity from state taxation was so embedded in constitutional history that the Court could not subject the government to such taxation without a clear congressional mandate. 59 Absent a waiver of federal immunity by Congress "the form of contracts . . . may determine the effect of state taxation on federal agencies." 60

Kern-Limerick condoned the use of contract terms to allow the federal government to protect its instrumentalities from state taxation. Thus, in addition to analyzing the taxing statute to discover the "legal incidence" of a state tax, as prescribed in King & Boozer, the Kern-Limerick Court found it necessary to determine if the government had agreed to contract terms which would result in the conferral of immunity to the private entity. 61

The principles enunciated in Kern-Limerick are in derrogation of the principles underlying the federal immunity doctrine. The constitutional history of the federal immunity doctrine reveals a search for an equitable and efficient formula which would protect

58. Id. at 122-23.
59. Id. at 122.
60. Earlier in the opinion the Court also noted the "attention Congress has given in recent years to a proper adjustment of tax liabilities between the federal and state sovereignties." Id. at 116.
61. Id. at 122-23.
62. In his dissent, Justice Douglas criticized this formula because it allowed "any government functionary to draw the constitutional line by changing a few words in a contract." Id. at 126 (Douglas, J., dissenting). The Supreme Court later adopted this criticism in cases where state taxes were imposed upon private entities using federal property. In United States v. Muskegon, 355 U.S. 484 (1958), the Court states that "[c]onstitutional immunity from state taxation does not rest on such insubstantial formalities as whether the party using government property is formally designated a 'lessee.' Otherwise immunity could be conferred by a simple stroke of the draftman's pen." Id. at 486 (emphasis added).
the sovereign interests of both state and federal governments. To allow federal officials to arbitrarily designate private entities as tax-exempt by virtue of a contract would be to sweep aside this history and ignore the compelling policy interests of the state.63

III. When is a Private Entity Considered a Federal Instrumentality

If the legal incidence of a state tax does not fall directly on the government but rather falls on a private entity which for all intents and purposes is controlled by the federal government, one must then consider whether this entity, operating for a profit,64 may be considered a federal instrumentality for purposes of tax immunity.65

63. See United States v. Detroit, 355 U.S. 466 (1958) (separate opinion of Frankfurter, J.):

A principle with the uninterrupted historic longevity attributable to the immunity of government property from state taxation has a momentum of authority that reflects, if not a detailed exposition of considerations of policy demanded by our federal system, certainly a deep instinct that there are such considerations, and that the distinction between a tax on government property and a tax on a third person for the privilege of using such property is not an 'empty formalism.' The distinction embodies a considered judgment as to the minimum safeguard necessary for the National Government to carry on its essential functions without hindrance from the exercise of power by another sovereign within the same territory. That in a particular case there may in fact be no conflict in the exercise of the two governmental powers is not to the point. It is in avoiding the potentialities of friction and furthering the smooth operation of complicated governmental machinery that the constitutional doctrine of immunity finds its explanation and justification. Id. at 503-04.

64. But see United States v. County of Fresno, 429 U.S. 452 (1972) (holding that a state may tax property owned by the United States which is being used by a private citizen). Three companion decisions upheld a Michigan statute that provided that whenever tax-exempt property is leased or otherwise made available to a business user, such user is taxable as though he were the owner. United States v. Detroit, 355 U.S. 466 (1958); United States v. Muskegon, 355 U.S. 484 (1958); United States v. Murray Corp., 355 U.S. 489 (1958).

65. See Agricultural Bank v. Tax Comm’n, 392 U.S. 339 (1968) (Marshall, J., dissenting). In Agricultural Bank, the Supreme Judicial Court of Massachusetts held that national banks were not immune from taxes as federal instrumentalities because they received remuneration for performance of a federal function. The Supreme Court reversed, finding that the grant of tax immunity status by Congress mooted the issue. Justice Marshall's dissent, however, provides a useful overview of the various formulations which have been used to determine whether an institution or an individual is immune. Id. at 348-63 (Marshall, J., dissenting).
In *United States v. Boyd,* the Court held that a Tennessee use tax imposed on government property used by contractors in the performance of their contractual duty was constitutional. In *Boyd,* Union Carbide had a contract with the Atomic Energy Commission ("AEC") to maintain an atomic plant owned by the federal government. Although under the contract Union Carbide's efforts were closely tied to the efforts of the AEC, the Court found that Union Carbide obtained financial advantages of its own from the use of the plant. Thus, because of its own profit and gain from the use of the property, Union Carbide was not found to be an instrumentality of the federal government immune from state taxation.

In *Clallam County v. United States* the United States Spruce

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67. Id. at 41.
68. Id. at 43. See also *United States v. New Mexico,* 624 F.2d 111 (10th Cir. 1980), cert. granted, 49 U.S.L.W. 3617 (Feb. 24, 1981) (No. 80-702) (private corporations having management contracts with the Energy Research and Development Administration were subject to state's gross receipts tax); *United States v. Forst,* 442 F. Supp. 920 (W.D. Va. 1977), aff'd per curiam, 569 F.2d 811 (4th Cir. 1978) (holding a government contractor liable for a state tax, the court noted that title to purchased items and control over the contractor is not important. What is important is whose credit is bound.) Id. at 923-24.
70. See *United States v. Boyd,* 378 U.S. at 44-48. The Supreme Court recognized in *United States v. Allegheny,* 322 U.S. 174 (1944) that "[t]he distinction between taxation of private interests and taxation of governmental interests, although sometimes difficult to define, is fundamental in application of the immunity doctrine as developed in this country." Id. at 186. In *Allegheny,* a state sought to tax the value of machinery owned by the United States while it was being used by a government contractor. The Court held the tax to be an invalid tax on the government's property. The Court stated: "[t]he corporation] has some legal and beneficial interest in this property. . . . Whether such a right of possession and use . . . could be taxed by appropriate proceedings we do not decide." Id. But see L. TRIBE, *supra* note 18, at § 6-29 at 399 n.32, suggesting that *Allegheny* must now be regarded either as overruled by the Michigan property cases, United States v. Detroit, 355 U.S. 466 (1958); United States v. Muskegon, 355 U.S. 484 (1958); United States v. Murray Corp., 355 U.S. 489 (1958), or limited to the situation in which federal property is subject to a lien in event of non-payment of taxes by the private entity. See *United States v. County of Fresno,* 429 U.S. 452 (1977).
71. 263 U.S. 341 (1923).
Production Corporation was established by the federal government in order to manufacture airplanes for government use during World War I. The corporation was closely connected with the federal government, as illustrated by the fact that the United States owned all but seven shares of the corporation's stock. In addition, all the bonds issued by the corporation were held by the federal government. The State of Washington sought to tax land and property conveyed by the United States to the company.

The Court held that the state could not tax the property of a corporation which, though formed under state laws was established and operated by the United States purely as an instrument of war. The Court was influenced by the fact that the federal government furnished the property used by the corporation and owned most of its stock and bonds in concluding that the corporation was a federal instrumentality. The Court noted that while taxation of property is generally distinguished from taxation of operations, Clallam was an exception because, not only was the instrumentality created by the government, but all its property was acquired and used for the sole purpose of performing a federal function. The Court stated that "[t]his is not like the case of a

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72. Id. at 343.
73. Id.
74. Id.
75. Id. at 343-44.
76. Id. at 344-45.
77. Clallam County is of particular significance when a corporation which has participated in a federal loan or equity financing program seeks immunity from state taxation. See notes 111-37 infra and accompanying text.
78. 263 U.S. at 344.
79. See New Brunswick v. United States, 276 U.S. 547 (1928). In New Brunswick the Supreme Court held that land acquired by the United States Housing Corporation and directed to be sold with reservation of a first lien for unpaid purchase money was not subject to state taxation because the Corporation held title as an instrumentality of the federal government. After the purchasers had made payments entitling them to receive deeds to the lots, however, the Corporation ceased to hold title solely for the federal government. The lots were then taxable. Id. at 555. In United States v. Milwaukee, 140 F.2d 286 (7th Cir.), cert. denied, 322 U.S. 735 (1944), the Court held, following New Brunswick, that property acquired by the Federal Public Housing Authority was exempt from state taxation.
80. 263 U.S. at 345. National banks have always had a significant role in the performance of essential federal functions. Beginning with McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819), these banks have traditionally been considered federal instrumentalities and, as such, immune from federal taxation. See Owensboro Nat'l Bank v. Owensboro, 173 U.S. 664 (1899); Osborn v. United States, 22 U.S. (9 Wheat.) 738 (1824). As the roles of both
corporation having its own purposes as well as those of the United States and interested in profit on its own account." The Court declined to consider whether the mere ownership by the federal government of all the assets of the corporation taken by itself would be enough to find the corporation immune from state taxation. The Court implied, however, that where the corporation was created solely to perform a federal function it would be exempt from state taxation.

In 1941, the Supreme Court, in *Federal Land Bank v. Bismarck Lumber Co.*, held that because the land bank was organized to effectuate the specific government program of extending credit on liberal terms to farm borrowers, it was an instrumentality of the United States despite the fact that the land bank possessed many of the characteristics of a private business corporation. In 1942, the federal government and national banks have evolved, however, the status of national banks as federal instrumentalities has been increasingly criticized. In *NRLB v. Bank of America*, 130 F.2d 624 (9th Cir.), cert. denied, 318 U.S. 792 (1942) the Ninth Circuit held that the bank was not an instrumentality of the government. *Id.* at 626-27. The bank was found to be a privately owned and managed corporation operated in the interest of the stockholders. The majority stated that "the United States did not create it, but has merely enabled it to be created. . . . It is true . . . that national banks may at times be called upon as aids in carrying out the fiscal policies of the government, but their activities in these respects are occasional and incidental to the primary purpose of the individuals who organize them. *Id.* at 627. In *Agricultural Bank v. Tax Comm’n*, 392 U.S. 339 (1968), the Supreme Court reversed a ruling by the Supreme Judicial Court of Massachusetts that national banks were not immune from state taxation. The Court, however, based its reversal not upon the assertion that national banks are federal instrumentalities, but upon the fact that the state taxing statute was not among the four specified methods of taxation permitted by Congress. 12 U.S.C. § 548 (1969). See *District of Columbia Nat’l Bank v. District of Columbia*, 348 F.2d 808 (D.C. Cir. 1965) (holding that § 548 was necessary to permit state legislatures to tax national banks). Justice Marshall, dissenting in *Agricultural Bank*, insisted that a national bank cannot be considered immune from state taxation under any of the various rubrics previously employed by the Court to determine if an entity is a federal instrumentality. Justice Marshall stated: "[a national bank] is a privately owned corporation existing for the private profit of its shareholders. It performs no significant federal governmental function that is not performed equally by state-chartered banks. Government officials do not run its day-to-day operations nor does the Government have any ownership interest in a national bank." 392 U.S. at 354 (Marshall, J., dissenting).

82. *Id.*
83. 314 U.S. 95 (1941).
84. *Id.* at 101-02. The Supreme Court affirmed that the federal land banks were instrumentalities, see *Federal Land Bank v. Priddy*, 295 U.S. 229 (1935); *Smith v. Kansas City Title & Trust Co.* 255 U.S. 180 (1921). The Court in *Bismarck* also recognized that "Con-
the Court held in *Standard Oil Co. v. Johnson*\(^88\) that post exchanges on military bases were instrumentalities of the federal government for purposes of tax immunity. In reaching its decision, a unanimous Court found that the exchanges were "arms of the Government deemed by it essential for the performance of governmental functions."\(^86\) The Court noted that the exchanges were "integral parts" of the War Department and thus partook of the Department's immunity under the Constitution.\(^87\)

In *United States v. Muskegon*,\(^88\) one of the Michigan property cases,\(^88\) the Supreme Court considered the fact that the corporation was using federal property in connection with its own commercial activities, as dispositive in concluding that the corporation was subject to a state tax. Under the taxing statute, Michigan assessed the value of work in process in the possession of a subcontractor while he was working under a government contract. The United States held legal title under the terms of the subcontract to the property assessed.

Although dictum in *Muskegon* indicated that the decision might have been different had the federal government exercised greater control over the subcontractor,\(^88\) the majority held that, in fact, the

\[\text{gess has authority to prescribe tax immunity for activities connected with, or in furtherance of lending functions of federal credit agencies.}\] 314 U.S. at 103. The Court stated

\[\text{[t]he argument that the lending functions of the federal land banks are proprietary rather than governmental misconceives the nature of the federal government with respect to every function which it performs. The federal government is one of delegated powers, and from that it necessarily follows that any constitutional exercise of its delegated powers is governmental ... It also follows that, when Congress constitutionally creates a corporation through which the federal government lawfully acts, the activities of such corporation are governmental.}\]


85. 316 U.S. 481 (1942).

86. *Id.* at 485.

87. *Id.* The Court also considered the control government officials maintained over the operation of the exchanges. For example, the commanding officer had complete authority to establish and maintain the exchange. He designated a post exchange officer to manage its affairs. This officer and the commanding officers of various company units comprised a council which supervised exchange activities. *Id.* at 484.


subcontractor "was not so assimilated by the Government as to become one of its constituent parts. It was free within broad limits to use the property as it thought advantageous and convenient in performing its contracts and maximizing its profits from them."91 The New York Court of Appeals in Liberty National Bank & Trust Co. v. Buscaglia,92 held that a national bank was not entitled to a constitutionally implied immunity from state taxation as a federal instrumentality. The court distinguished prior case law93 by finding that contemporary national banks do not perform services for the federal government as essential as those rendered by the banks of the 1800's.94 The court stated that privately owned and operated businesses which perform services for the federal government are not per se immune from a state tax which does not interfere with the performance of their service to the government.95

The Red Cross in Department of Employment v. United States,96 was held to be an instrumentality of the United States. The Court stated that there was "no simple test" for ascertaining whether an institution is "so closely related to governmental activity as to become . . . [an] instrumentality."97 Significant factors considered in its decision were that the Red Cross was chartered by Congress, its principal officers were appointed by the President, it received substantial financial aid from the federal government and it performed functions indispensable to the workings of the government.98 The Red Cross was deemed to be an arm of the government and thus immune from state taxation.99

91. Id. (emphasis added).
93. See note 80 supra.
95. Id. at 366, 235 N.E.2d at 106, 288 N.Y.S.2d at 40. In another instance, a state court held that governmental immunity from taxation does not extend to corporations or individuals merely because their activities are useful to the federal government. Boeing Co. v. Omdahl, 169 N.W.2d 696 (N.D. 1969).
97. Id. at 358-59.
98. Id. at 359.
99. Id. at 359-60. See also Small Business Admin. v. McClellan, 364 U.S. 446 (1960). The SBA was deemed to be an integral part of the government not a separate legal entity. The Court distinguished Sloan Shipyards Corp. v. United States Fleet Corp., 258 U.S. 549 (1922), where the Court refused to treat the corporation as an agent of the United States,
In summary, although there is no single standard with which to determine when a private entity is a federal instrumentality immune from state taxation, a firm seeking such status must show an extraordinarily close relationship to the national government. The ad hoc determination of whether a corporation is so assimilated into the government so as to become a constituent part essentially depends on two factors. First, the corporation should perform a federal function. Whether it is enough that the firm performs this function in addition to achieving its own private goals has not been addressed by the Supreme Court. *Clallam County v. United States,* the Michigan property cases and *Department of Employment v. United States* indicate that the corporation should not obtain a private advantage or gain from the performance of its services for the federal government. However, despite having many of the characteristics of a private business, land and national banks have been held to be federal instrumentalities because they indirectly performed a federal function.

A second factor considered by courts in determining whether a private entity is a federal instrumentality for purposes of state taxation is the amount and form of financial assistance the corporation receives from the federal government. For example, in *Clallam* the federal government owned almost all the corporation's stock and in *Department of Employment,* the Red Cross received substantial federal aid. It has not yet been determined, however, whether close financial ties alone will be sufficient to grant federal immunity status.

IV. Federal Loan and Equity Finance Programs

It is clear that the availability of capital is a critical factor in a nation's economic development. Over the past decade, however, smaller firms have felt the effect of a shrinking capital supply.

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*because in Sloan, unlike in McClellan, Congress in establishing the corporation, had "contemplated a corporation in which private persons might be stockholders." 258 U.S. at 565.
100. See note 80 supra.
101. 263 U.S. 345 (1923).
104. See notes 111-37 infra.
105. Public Offerings of Securities Underwritten for Companies with Net Worths...
Although in recent years the situation has improved, there is still a need to correct the market imperfections which funnel capital away from areas where it is most needed, namely smaller firms with the potential to employ socially and economically disadvantaged citizens.

If the government chooses to intervene in the market to influence the allocation and pricing of capital it has three alternatives. First, it can regulate existing private financial intermediaries. Second, it can attempt to correct existing market disadvantages by offering small firms economic incentives to start and continue production. Third, the government can establish

OF $5 MILLION OR LESS, 1969-1975

(in millions of Dollars)

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107. The Small Business Administration ("SBA") has suggested several reasons why small businesses have an insufficient capital supply: 1) concentration of assets in institutions preferring larger investments; 2) investor movement out of equities generally; 3) high entry costs for a registered offering; 4) venture capital organizations financing large companies rather than new ventures; and 5) greater role of large banks at expense of small firms. DEVELOPMENT FINANCING, supra note 105, at 19.

108. See L. Litvak & B. Daniels, INNOVATIONS IN DEVELOPMENT FINANCE 2 (1979) [hereinafter cited as INNOVATIONS IN DEVELOPMENT FINANCE].

109. An example would be the development of rules governing asset holdings of government chartered institutions. See INNOVATIONS IN DEVELOPMENT FINANCE, supra note 108.

110. For example, a state may give tax abatements to small firms to facilitate their growth. See, e.g. N.Y. COM. LAW §§ 115-120 (McKinney Supp. 1977) (Urban Job Incentive
its own financial intermediaries to circumvent a market which does not maximize social utility.

The federal government created its own financial intermediary in the Small Business Administration ("SBA"). The function of the SBA is to provide, through the use of small business investment companies ("SBIC's") and minority enterprise small business investment companies ("MESBIC's"), long-term credit and equity capital to businesses whose full participation in the free enterprise system has been hindered by social or economic disadvantages. Congress empowered the SBA to purchase or guarantee debentures issued by small businesses and, in addition, Congress has empowered the SBA to purchase shares of non-voting preferred and cumulative stock. Equity financing of this kind is a boon to capital-starved firms.

There has been increasing pressure on Congress in recent years to expand the use of this relatively new financial tool. Although

Board).

113. 15 U.S.C. § 683(c) (1976). The term of the debentures must not exceed fifteen years. Where the combined private paid-in capital and paid-in surplus is less than $500,000, the amount of debentures purchased by the government must not exceed 200% of the corporation's combined private paid-in capital and paid-in surplus, less the amount of preferred stock purchased by the government. Where the combined private paid-in capital and paid-in surplus is more than $500,000, then the amount of debentures purchased may not exceed 300% of the corporation's combined private paid-in capital and paid-in surplus, less the amount of such preferred securities. Id.
114. The amount of purchased stock may not exceed the combined private paid-in capital and paid-in surplus. Id.
115. Equity financing provides the small business with needed capital and gives the government a share of the businesses' future income, albeit uncertain. In this way, recipient firms are able to employ their capital without degenerative debt-maintenance costs until the business begins producing income. See Innovations in Development Financing, supra note 108, at 5-6.
116. For example, a number of bills introduced in the 96th Congress included equity financing provisions. For instance, in the Leahy Rural Development Bank Legislation S. 372, 96th Cong., 2d Sess., 126 Cong. Rec. S1606 (Feb. 20, 1980), included a provision for joint venture equity co-sponsorship which would make available equity capital for rural businesses and economic development projects. The Addabbo Minority Bank Legislation, H.R. 6904, 96th Cong., 2d Sess., 126 Cong. Rec. H2190 (Mar. 25, 1980), sought to establish an annual $500 million program authorizing the Small Business Administration to buy non-voting stock in small, minority-operated businesses, with strong growth potential, located in areas where there is surplus labor or underemployment. In addition, it has been urged that an equity financing provision be included in legislation to establish a National Development Bank. H.R. 7902, 96th Cong., 2d Sess., 126 Cong. Rec. H6946 (July 31, 1980). The bill would
the SBA presently operates one of the few federal equity finance programs, a handful of states have also recognized the need for such assistance.\textsuperscript{117} The proposed and existing loan and equity finance programs present a delicate constitutional issue in the application of the federal immunity doctrine to private entities receiving such assistance. Although various tests have been formulated by federal courts to ascertain whether a private entity is also a federal instrumentality,\textsuperscript{118} at base, it must be determined

\begin{quote}

have enabled the bank to make and guarantee long-term loans at reasonable interest rates in order to achieve a full employment economy. These bills all lapsed with the close of the 96th Congress.

\textsuperscript{117} The first state equity program was the Connecticut Product Development Corporation ("CPDC"). Conn. Gen. Stat. Ann. \textsuperscript{\textcopyright} § 32-32 (West Supp. 1980). The CPDC was established as a quasi-public corporation, in an effort to trigger sectorial growth in Connecticut's economy. The CPDC invests in technologically intensive projects of a corporation rather than the firm as a whole. Id. § 32-39. CPDC funding is limited to 60\% of product development costs to ensure that private funds are leveraged and that the state does not actually manage the enterprise. The constitutionality of the CPDC was upheld in Wilson v. Connecticut Product Corp., 167 Conn. 111, 355 A.2d 72 (1974). The Massachusetts Technology Development Corporation ("MTDC"), Mass. Ann. Laws ch. 40G, §§ 1-10 (Michie Supp. 1981), also seeks to invest in business using a significant amount of technology. The MTDC's initial investment limit is $500,000 and its lifetime investment limit is $1,000,000. Massachusetts has also established the Massachusetts Community Development Finance Corporation (CDFC), Mass. Ann. Laws ch. 40F, §§ 1-5 (Michie Supp. 1981), which seeks to provide equity capital to businesses in targeted economically depressed areas. The CDFC may not own more than 49\% of the voting stock in any small business. Id. § 5. The CDFC was held to be constitutional by the Supreme Judicial Court of Massachusetts in Opinion of the Justices to the Governor, 373 Mass. 904, 369 N.E.2d 447 (1977). In an effort to develop it's renewable resources so as to strengthen the self-sustaining sectors of the state economy, Alaska established the Alaska Renewable Resources Corporation ("ARRC"). Alaska Stat. tit. 37, ch. 12 (1978). The ARRC may not invest in more than 49\% of the outstanding corporate stock of any individual corporation unless the legislature has approved the investment by resolution. The ARRC may invest no more than five percent of its capital or $1.5 million, whichever is less, in a single project. Id. § 37.12.080. The ARRC is also specifically prohibited from assuming responsibility for management of any project in which it has invested and may not exercise voting rights for that purpose. \textit{Id.}

\textsuperscript{118} See United States v. Muskegon, 355 U.S. 484 (1958); Standard Oil Co. v. Johnson, 316 U.S. 481 (1942); Clallam County v. United States, 263 U.S. 341 (1923). \textit{See also} notes 100-04 supra and accompanying text. Although the question has not yet been raised, the Chrysler Corporation Loan Guarantee program, 15 U.S.C. §§ 1861-1875 (Supp. 1980), presents an interesting constitutional issue in light of the federal instrumentality doctrine. The Chrysler Corporation Loan Guarantee Board (the Board) pursuant to 15 U.S.C. § 1867 (Supp. 1980), may extend loan guarantees to the Chrysler Corporation (the Corporation) in an amount not to exceed $1,500,000,000. The Board is authorized to inspect and copy all accounts, books, records, memoranda, correspondence, and other documents and transactions of the Corporation. 15 U.S.C. § 1869(a) (Supp. 1980). The General Accounting Office has the authority to conduct audits of all accounts and books of the Corporation. 15 U.S.C.
whether or not the private corporation is so closely related to the federal government as to be immune from state taxation. Is the infusion of federal capital either in the form of loans or equity sufficient government-private sector interaction to shroud the private corporation in the protective veil of the immunity doctrine? No federal court has expressly decided whether a private corporation, operating for its own profit while simultaneously fulfilling a federal function, may be considered a federal instrumentality. Analogous cases indicate, however, that a close relationship between the government and the private entity will be required before the doctrine will be applied. 119

A close relationship between the government and the private entity has been found where, as in *Clallam County v. United

§ 1869(b) (Supp. 1980). In addition, the Board is empowered to investigate allegations of fraud, incompetence or irregularity in the management of the affairs of the Corporation which are material to the Corporation’s ability to repay the loans guaranteed. 15 U.S.C. § 1869(c) (Supp. 1980).

As a condition to the loan guarantees, the federal government requires certain corporate actions. For instance, the Corporation is required to divest itself of $300,000,000 in assets. 15 U.S.C. § 1863(c)(3) (Supp. 1980). The Corporation as a pre-condition to receiving the guarantees is required to modify collective bargaining agreements between the Corporation and its employees as well as obtain concessions from employees not represented by a union. 15 U.S.C. § 1865 (Supp. 1980). It is interesting to note that the federal government was able to have the president of the UAW, Douglas Fraser, appointed to the board of directors of Chrysler. Although the federal government has not taken an actual equity interest in Chrysler, the actions which the Board can require of Chrysler make the involvement and stake of the federal government in the corporation apparent. See 15 U.S.C. § 1870 (Supp. 1980) enumerating the actions which the Board may take to protect the federal government’s interest in Chrysler, 15 U.S.C. § 1873(a),(b) (Supp. 1980), requiring the Board to make semi-annual reports to Congress on its activities and on the long-term economic implications of the Chrysler loan guarantee program; 15 U.S.C. § 1873(c) (Supp. 1980), requiring the Secretary of Transportation to complete an assessment of the economic impact on the automobile industry of federal regulatory requirements upon request of the Board. The ability of the federal government to place an individual on Chrysler’s board of directors, to inspect and audit the books and accounts of the corporation, see Ochs v. Washington Heights Fed. S&L Ass’n, 17 N.Y.2d 82, 215 N.E.2d 485, 268 N.Y.S.2d 294 (1966) (recognizing a shareholder’s common-law rights to inspect corporate records), and to order divestiture of corporate assets are all indicia of control. See Berkey v. Third Ave. Ry., 244 N.Y. 84, 155 N.E. 58 (1926); Wormser, *The Genius of Common Law: Enemies at the Gate*, 12 Colum. L. Rev. 496 (1912). Given the substantial monetary stake and the almost symbiotic relationship between Chrysler and the federal government, Chrysler may be considered an instrumentality of the federal government at some point in the future. See Department of Employment v. United States, 385 U.S. 355 (1966); United States v. New Mexico, 624 F.2d 111 (10th Cir. 1980), cert. granted, 49 U.S.L.W. 3617 (Feb. 24, 1981) (No. 80-702).

119. See notes 100-04 supra.
States, the United States owned almost all of the corporate securities and the firm was established and operated solely to perform a federal function. In Clallam County, the federal function consisted of building airplanes for the government during World War I and the firm performed no function of its own. Indeed, the Court explicitly distinguished Clallam County from the case of a corporation existing for its own purposes as well as those of the government.

The federal function which the SBA performs is to contribute to a well-balanced national economy by facilitating ownership in small businesses by those who have been hampered because of social or economic disadvantages. Certain state programs are also specifically targeted to substandard or blighted areas. It is arguable that if the SBA were to target its loan and equity financing exclusively to economically depressed areas, recipient corporations would directly effectuate the goals of the SBA, thereby performing a federal function. On the other hand, if the SBA were to make its loan and equity financing programs widely available, it would be difficult for any one recipient corporation to argue that it performs a federal function.

Another factor considered by the Clallam Court in determining the closeness of the relationship between the corporation and the government was the fact that the United States owned almost all of the corporation’s common shares. In equity financing programs where the government, qua stockholder, is an owner of the corporation sharing in both the gains and loses of the business, these ties are most pronounced. In order to gain the status of a federal instrumentality, however, the government would have to own a significant amount of the firm’s shares. If the government was enti-

120. 263 U.S. 341 (1923).
121. Id. at 343.
122. Id. at 345.
123. Compare Federal Land Bank of St. Paul v. Bismarck Lumber Co., 314 U.S. 95, 102 (1941) ("[w]hen Congress constitutionally creates a corporation through which the federal government lawfully acts, the activities of such a corporation are governmental") with NRLB v. Bank of America, 130 F.2d at 627 (a national bank was not an instrumentality because Congress did not create the bank but merely enabled it to be created). See note 80 supra.
tied to voting rights, its influence in the corporation would be even greater.

Although generally there are limits to the amount of loan and equity capital the federal government may invest in private corporations which are tied to the amount of paid-in capital, it is arguable that a firm which receives the maximum investment should be considered a federal instrumentality because of the corporation's close relation with the government and its performance of a federal function. Thus, a firm which receives a relatively small amount of federal financing may still have a close connection with the federal government where the overall private paid-in capital is also small.

As the Court stated in Department of Employment v. United States, there is "no simple test" to determine when a private entity is so close to the government as to become an instrumentality. Yet it is evident that a private entity must first overcome arduous judicial barriers before the Supreme Court will deem it a federal instrumentality. Corporations participating in loan or equity finance programs do maintain a close relationship with their creditor or stockholder, the government. In light of Clallam, the SBA may only purchase shares of non voting stock. 15 U.S.C. § 683(c)(1) (1976).

In addition to capital, participants in loan or equity financing programs may also receive technical assistance from the government. For instance, a bill proposing the establishment of a National Development Bank, states that "[t]he Bank may provide to borrowers whatever assistance, technical or otherwise, it considers necessary to protect its investment and to carry out the purpose of this Act." H.R. 7902, 96th Cong., 2d Sess. § 16(1) (1980). The influence of the Bank in the affairs of the recipient corporation is illustrated by the loan conditions that: 1) borrowers agree to fill a specified number of job openings to be determined by the Bank with previously unemployed or underemployed people; and 2) borrowers agree to conduct training sessions for such people. Id. § 14.

See notes 113-14 supra.

See Department of Employment v. United States, 385 U.S. at 359-60 (test for federal instrumentality whether entity is an "arm of the government"); United States v. Muskegon, 355 U.S. at 486 (in determining whether entity was a federal instrumentality court asked whether corporation was "so assimilated by the Government as to become one of its constituent parts?"); Standard Oil Co. v. Johnson, 316 U.S. at 485 (test whether firm is an "integral part" of a government department). An entity participating in an SBA equity program may be able to satisfy the above criteria.

See generally 13 C.F.R. §§ 101-31 (1980) (getting out the many regulations private entities must comply with to receive S.B.A. funds).
Muskegon\textsuperscript{134} and Department of Employment,\textsuperscript{135} however, the mere assertion that participation in a federal finance program would trigger the operation of the immunity doctrine is doubtful. The modern trend has been toward a restrictive view of the federal immunity doctrine.\textsuperscript{136} Even in cases where the doctrine has been applied to private corporations, the facts indicate a uniquely close government-corporate relationship.\textsuperscript{137}

V. The Role of Congress

Congress has the power to grant immunity from state taxes and has done so in Carson v. Roane-Anderson Co.\textsuperscript{138} where the Court held the Atomic Energy Commission immune by virtue of a congressional statute.\textsuperscript{139} In Cleveland v. United States,\textsuperscript{140} the Court stated that congressional power to grant immunities as deemed necessary "is settled by such an array of authority that citation would seem unnecessary."\textsuperscript{141} Moreover, a congressional waiver of immunity must be clear, express and affirmative and will be strictly construed.\textsuperscript{142}

There is a need for a clear congressional statement\textsuperscript{143} in this area

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134. 263 U.S. 341 (1923).
136. See generally The Waning of Tax Immunities, supra note 5; The Remnant of Tax Immunities, supra note 5.
137. National and land banks, which possess characteristics of private businesses have been held to be a federal instrumentality immune from state taxation because of the function they perform. The granting of this status has been criticized because of the changed roles of modern national banks. See First Agricultural Nat'l Bank v. State Tax Comm'n, 392 U.S. 339 (1968); NLRB v. Bank of America, 130 F.2d 624 (9th Cir. 1942), cert. denied, 318 U.S. 791 (1943); Liberty Nat'l Bank and Trust Co. v. Buscaglia, 21 N.Y.2d 357, 235 N.E.2d 101, 288 N.Y.S.2d 33 (1967). The Supreme Court decisions, however, which have granted immunity to national and land banks are precedent for a determination that firms receiving equity capital from the United States government who also perform an important federal function may also be immune from state taxation.
139. Id. at 236.
140. 323 U.S. 329 (1945).
141. Id. at 333.
142. United States v. City of Adair, 539 F.2d 1185 (8th Cir. 1976), cert. denied, 429 U.S. 1121 (1977). See L. Tribe, supra note 18, § 8-28 at 391 ("In those rare cases where Congress has expressly granted or withheld regulatory or tax immunity to certain of its instrumentalities, agents, or contractors, the validity or invalidity of state action is definitively settled by such federal legislation.").
143. The rationale for limiting judicial interference in the operation of other branches of
because of the rigid and restrictive tests applied by the Supreme Court to determine when a corporate entity will be considered a federal instrumentality for tax immunity purposes. The tests indicated a desire by the Supreme Court to restrict the application of the federal immunity doctrine. The decision of whether to restrict this doctrine, however, has wide-ranging economic and political ramifications. Because Congress is representative of both national and state interests, it is best able to balance the competing policy interests involved.\footnote{144}

In fact, as far back as \textit{McCulloch v. Maryland},\footnote{144} the judiciary itself recognized its own limitations in this field. The Court in \textit{McCulloch} stated, "[w]e are not driven to the perplexing inquiry, so unfit for the Judicial department, what degree of taxation is the legitimate use, and what degree may amount to the abuse of the power."\footnote{148} In \textit{Oklahoma Tax Comm'n v. Texas Co.},\footnote{147} the Court stated that "the question whether immunity shall be extended . . . is essentially legislative in character."\footnote{148} Precisely on point is the statement from the majority opinion in \textit{United States v. Detroit} expanding upon the idea enunciated in \textit{McCulloch}: "[w]ise and flexible adjustment of inter-governmental tax immunity calls for political and economic considerations of the greatest difficulty and delicacy. Such complex problems are ones which Congress is best qualified to resolve."\footnote{150}

While the federal government wishes to perform and carry on its
functions and activities free from state interference, states seek much needed revenue from a traditional source—taxation of private corporations. For the most part, judicial standards have been inadequate, because their rigid formulistic approach is correctly devoid of political consideration. It is critical that Congress, especially in the emerging loan and equity finance programs, confront these difficult issues as it alone is best suited to do.

James W. Smith