CONSTITUTIONAL LAW-- Effect of overruling prior decision dealing with statutory construction on intermediate transactions.

11-13

October 21, 1933.

FILED 3

Honorable Forrest Smith,
State Auditor,
Jefferson City, Missouri.

Dear Sir:

On March 22, 1933 this department furnished you with an opinion holding, first: That income arising wholly from government patents is taxable in Missouri under the State Income Tax Law; second: That said incomes arising from government patents were not taxable under the Income Tax Law of Missouri until May 16, 1932.

You now furnish a memorandum suggesting that, for the years 1929, 1930 and 1931, perhaps, incomes arising from government patents might be assessed under the Income Tax Law of this state.

This department has examined your memorandum and the authorities cited therein and this opinion will attempt to analyze the problems raised in your memorandum and will be divided into the consideration of four questions. I. What barrier or barriers prevent the collection by Missouri of a tax on income from United States patents for the years 1929, 1930 and 1931.? II. Could such barrier or barriers be removed? III. Have such barrier or barriers been removed? IV. Would it now be too late to collect such taxes because of limitations?

I.

WHAT BARRIER OR BARRIERS PREVENT THE COLLECTION BY MISSOURI OF A TAX ON INCOME FROM UNITED STATES PATENTS FOR THE YEARS 1929, 1930 and 1931.

(A) Missouri Income Tax Law. Under the statutes of Missouri relating to taxation of incomes (R. S. Mo. 1929, Secs. 10115-10145) taxes are levied on incomes with certain deductions and exemptions among which deductions and exemptions no direct reference is made to incomes from patents. The only provision which might be argued to exempt such income would be the following:

> "The following incomes shall be exempt from the provisions of this article. * * * (6) Any income derived from any public utility performing functions of national government or those incident to the state or any political subdivision thereof, or from the exercise of any essential governmental function accruing to any state, territory or the District of Columbia." (Sec. 10119.)

It might be argued that since the basis of the exemption of income from patents from state income taxes was based on the theory that to allow such taxes would interfere with a government instrumentality and since the provision just quoted exempts income derived from the exercise of any essential govern-

mental function that this proviso would expressly exempt from the operation of the Missouri Income Tax Law income from patents, but the force of this argument is destroyed by the fact that the second half of the above provision only deals with governmental functions "accruing to any state, territory or the District of Columbia" and does not refer to the government of the United States while in the first part of the quoted provision which deals with public utilities the term "national government" is expressly included, so that whether by oversight or advertence the above quoted provision does not exempt income from patents from the operation of the state Income Tax Law, and if there were no constitutional provision either of the United States or of the State of Missouri involved, and the only law in force were the state Income Tax Law, income from patents would be taxable.

(B) Since the state Income Tax Law by construction applies to income from patents since there is no constitutional provision of Missouri prohibiting such application the only prohibition against taxing income from patents must be imposed by the United States, and in the case of Long v. Rockwood, 277 U. S. 142 (1928) it was held that the Constitution of the United States prohibited the imposition of any tax on income from patents by any state on the theory that to allow such a tax would allow a state to burden a government instrumentality of the United States. The constitutional prohibition against such a tax is not found in any express words of the Constitution of the United States but was deduced from the four corners of the Constitution of the United States by Mr. Chief Justice Marshall in the case of McCulloch v. Maryland, 4 Wheat. 316 (1819) who said:

> "There is no express provision for the case, but the claim has been sustained on a principle which so entirely pervades the Constitution, is so interwoven with the materials which compose it, so interwoven with its web, so blended with its texture, as to be incapable of being separated from it, without rending it into shreds.
>
> This great principle is, that the Constitution and the laws made in pursuance thereof are supreme; that they control the Constitution and laws of the respective states, and cannot be controlled by them. From this, which may be almost termed an axiom, other propositions are deduced as corollaries, on the truth or error of which, and on their application to this case, the cause has been supposed to depend. These are, 1st. That a power to create implies a power to preserve. 2d. That a power to destroy, if wielded by a different hand, is hostile to, and incompatible with, these powers to create and to preserve. 3d. That where this repugnancy exists, that authority which is supreme must control, not yield to that over which it is supreme."

The constitutional principle laid down in McCulloch v. Maryland was the authority for the decision in Long v. Rockwood and in a long line of cases between those two. The principle enunciated therein has been laid down as being as much part of the Constitution of the United States as if it were found in the Constitution in express words because a construction of a statute is as much a part of the

statute as the words themselves and probably even more important. Thus the Constitution of the United States as interpreted in Long v. Rockwood was the sole obstacle to a collection of taxes on income from patents by the state of Missouri for the years 1929, 1930 and 1931.

II.

COULD SUCH BARRIER OR BARRIERS BE REMOVED?

Since it is the function of the Supreme Court of the United States to declare the meaning of the Constitution and also the effect of its own decisions, and since it acknowledges no limitation on its powers in these regards the Supreme Court of the United States could without any power competent to oppose it declare that the Constitution had always meant what it is declared to mean in Fox Film Corp. v. Doyal, 286 U. S. 123, and that the Constitution had never meant what the court of Long v. Rockwood, supra, held it to mean if it desired so to hold because there would be no higher power to prevent such a decision, nor would there be a lack of precedent for so holding.

(A) A change of judicial construction of a statute, i. e., where a court of last resort overrules a previous decision construing such statute and says that the statute which though unamended by legislative act had before been declared to mean one thing and now means another is not the same as an amendment of the statute by the Legislature to effect the same result. This is well illustrated by the case of Fleming v. Fleming, 264 U. S. 29, (1924) where the question was presented as to whether or not a change of judicial construction of a statute by a state supreme court constituted an impairment of the obligation of contracts (U. S. Constitution Article I, Sec. 10) which, of course, is prohibited to a state. Mr. Chief Justice Taft dealt with the problem in the following manner:

> "It is urged upon us that the impairment here is legislative, in that the case turned on the effect of Section 3376 of the Iowa Code, that the subsequent judicial construction of it became part of the statute, and gave it a new effect as a law. In other words, the contention is that the same statute was one law when first construed before the making of the contract, and has become a new and different act of the legislature by the later decision of the court. This is ingenious but unsound. It is the same law. The effect of the subsequent decisions is not to make a new law, but only to hold that the law always meant what the court now says it means. The court has power to construe a legislative act, but it has no power, by change in construction, to date its passage as a law from the time of the later decision. A statute in force when a contract was made cannot be made a subsequent statute through new interpretation by the courts. Any different view would be at variance with the many decisions of this court cited in the Flanagan Case. (264 U. S. 31, 32.)

The significance of the opinion just quoted is very great for the problem under

consideration. As was demonstrated above, the Supreme Court of the United States can give one of its own decisions any effect which seems fit, and the Supreme Court of the United States and its interpretation of the Constitution was the only barrier to the imposition by Missouri of a tax on income from patents. Now if the Supreme Court of the United States declares that a change of construction of the statute does not amount to the enactment of a new statute, as it did declare in the case last cited, then there has been no legislative action in Missouri on the subject in question since the original enactment of the Income Tax Law and, therefore, the problem cannot arise of whether or not the Legislature of Missouri has impaired the obligation of contracts or has attempted to pass a retrospective law as prohibited by the Constitution of Missouri, Article II, Sec. 15 which provides "that no * * * law * * retrospective in its operation * * * can be passed by the General Assembly." The Missouri constitutional provision just quoted by its terms applies solely to legislative action, and the Supreme Court of the United States says that a change of the construction of a statute is not a legislative action. Of course, it is not the function of the Supreme Court of the United States to construe a state constitutional provision, but the clear language of the above state constitutional provision confines its operation to acts of the Legislature.

(B) It is held by the Supreme Court of the United States that the impairment of the obligation of contracts clause of the United States Constitution does not apply to a change in ruling by a state Supreme Court, and that a state Supreme Court can give its decisions a retrospective effect without violating the Constitution of the United States. This principle is laid down in Great Northern R. Co. v. Sunburst Oil and Refining Co., 77 L. ed. 153 (1932) where the court, in dealing with the right of a state Supreme Court to make its decisions retroactive, said:

> "We think the Federal constitution has no voice upon the subject. A state in defining the limits of adherence to precedent may make a choice for itself between the principle of forward operation and that of relation backward. It may say that decisions of its highest court, though later overruled, are law none the less for intermediate transactions. Indeed there are cases intimating, too broadly (cf. Tidal Oil Co. v. Flanagan, 263 U. S. 444, 68 L. ed. 382, 44 S. Ct. 197, supra), that it must give them that effect; but never has doubt been expressed that it may so treat them if it pleases, whenever injustice or hardship will thereby be averted." * * * * * *
>
> "On the other hand, it may hold to the ancient dogma that the law declared by its courts had a Platonic or ideal existence before the act of declaration, in which event the discredited declaration will be viewed as if it had never been, and the reconsidered declaration as law from the beginning." * * * * * *
>
> "The alternative is the same whether the subject of the new decision is common law" * * or statute. * * * * *

> "The choice for any state may be determined by the juristic philosophy of the judges of her courts, their conceptions of law, its origin and nature. We review not the wisdom of their philosophies, but the legality of their acts. The State of Montana has told us by the voice of her highest court that with these alternative methods open to her, her preference is for the first. In making this choice, she is declaring common law for those within her borders. The common law as administered by her judges ascribes to the decisions of her highest court a power to bind and loose that is unextinguished, for intermediate transactions, by a decision overruling them. As applied to such transactions we may say of the earlier decision that it has not been overruled at all. It has been translated into a judgment of affirmance and recognized as law anew. Accompanying the recognition is a prophecy, which may or may not be realized in conduct, that transactions arising in the future will be governed by a different rule. If this is the common law doctrine of adherence to precedent as understood and enforced by the courts of Montana, we are not at liberty, for anything contained in the constitution of the United States, to thrust upon those courts a different conception either of the binding force of precedent or of the meaning of the judicial process."

To the same effect are Central Land Co. v. Laidley, 159 U. S. 103 (1895), Bacon v. Texas, 163 U. S. 207 (1896); Moore-Mansfield Construction Co. v. Electrical Installation Co., 234 U. S. 619 (1914), Tidal Oil Co. v. Flanagan, 263 U. S. 444 (1924), see Holmes, J., in Kuhn v. Fairmount Coal Co., 215 U. S. 348, 372 (1910). If there is no constitutional limitation to the right of a state Supreme Court, which is subject to the inhibitions of the contract clause of the United States Constitution to change an earlier holding so as to affect intervening rights then obviously there would be no obstacle in the way of the Supreme Court of the United States if it wished to declare one of its own decisions to be retroactive and to have the same effect as if an earlier decision which it overrules had never existed.

III.

HAVE SUCH BARRIER OR BARRIERS BEEN REMOVED?

The issue has thus narrowed down to a small focus so that the chief problem remaining is to decide whether or not the Supreme Court of the United States in the case of Fox Film Corp. v. Doyal, supra, which overruled Long v. Rockwood, supra, intended to give the latter decision a retroactive effect or to give it solely a prospective effect leaving all transactions entered into prior thereto intact and on the same footing as if Long v. Rockwood had not been overruled. The answer to this inquiry will depend upon whether the Supreme Court of the United States follows one or the other of two conflicting theories of jurisprudence which briefly expressed are (1) that the law is found not made and (2) that there is no such thing as the common law aside from the decisions of courts. The same problem is presented where a court of last resort holds that the Constitution prohibits a course of conduct which

it had been held was not prohibited by the Constitution as occurred when the Supreme Court of the United States in First National Bank of Boston v. Maine, 284 U. S. 312 (1932) overruled Blackstone v. Miller, 188 U. S. 189 (1903) and held that an inheritance tax on the stock of a corporation could only be imposed by the domicile of the decedent, so that the two problems will be treated as one.

In 1929, 1930 and 1931, the years for which taxes are in question, any taxpayer would have had a complete defense to an action for taxes on income from patents. Any attorney would have advised him that the tax could not constitutionally be assessed because the Supreme Court of the United States had so decreed and had said that the Constitution of the United States prohibited the imposition of such taxes. Since that time the Supreme Court of the United States has held that an unchanged constitution does not prohibit the imposition of such taxes. The Constitution of the United States only means what the Supreme Court says it means and, therefore, two elements are concerned in all constitutional questions (1) the language used in the Constitution and (2) the construction of such language by the Supreme Court, and when the court says that the language means a certain thing this meaning is as much the law as if words so defining this language were expressly inserted in the Constitution.

> "Whoever hath absolute authority to interpret any written or spoken laws, it is he who is truly the law-giver to all intents and purposes, and not the person who first wrote or spoke them." Gray, Nature and Sources of the Law, second edition, page 102.

Does the decision in Fox Film Corporation v. Doyal mean that the Constitution has always meant what it is in this case said to mean, or does it merely mean that the Constitution, now and in the future, allows and will allow the type of taxation therein upheld, but that in the past the Constitution meant something else? In other words, can there be successively two different and inconsistent interpretations of the due process clause which are successively the law, or was the former construction never the law but merely an erroneous conception of a fallible court? The solution of this question will involve a choice between the law as an ideal system of principles, the logical inconsistencies of which are due to imperfect powers of divination by certain courts, and the law as a system of decisions which, logical and consistent with each other or not, nevertheless are the sole standard to which men can look for guidance.

"The orthodox fiction that a rule of the common law is always at hand potentially to meet every case and that the judge does no more than discover it by logical process and apply it had broken down without any assistance from Germany. Austin long ago called it a childish fiction." Pound, The New Philosophies of Law, 27 Harv. L. Rev. 718, 733. With an ideal system of what the law should be a lawyer has no practical concern, for law must be regarded in the light of its effect on the conduct of men and not from the point of view of a moral or ethical standard which is not enforced by the

courts. However desirable the attainment of such a standard may be, it is frequently not enforced in the courts, and if a man without morals or ethics desires to enter into a transaction his sole inquiry need only be if the court would hold him subject to liability. "Take the fundamental question, What constitutes the law? You will find some text writers telling you that it is something different from what is decided by the courts of Massachusetts or England, that it is a system of reason, that it is a deduction from principles of ethics or admitted axioms, or what not, which may or may not coincide with the decisions. But if we take the view of our friend the bad man we shall find that he does not care two straws for the axioms or deductions, but that he does want to know what the Massachusetts or English courts are likely to do in fact. I am much of his mind. The prophecies of what the courts will do in fact, and nothing more pretentious, is what I mean by the law." Mr. Justice Holmes, The Path of the Law, 10 Harv. L. Rev. 457, 460.

Probably it would be better if the law could be an ideal system where every proposition could be solved by logic. Then it would be easy to say that Long v. Rockwood, supra, had never been really what the Constitution meant. But it certainly meant what the court there held at the time, for example, in 1931 when the Missouri Income Tax Law required a taxpayer to make his income tax return, and it meant this in the sense that the highest authority to which resort could be had had so decreed. The fact that some day Long v. Rockwood might be overruled would have been of little service even to a state official gifted with foresight if he had attempted to bring suit to collect a tax on income from patents. For all practical purposes, the decision of Long v. Rockwood was right when it was made, and was right until May 16, 1932, and the fact that it is now no longer right involves only a logical inconsistency for a theory which says that there can be only one right answer to a given problem according to the common law, no matter at what time the answer is sought. But inconsistent answers have been right, it is submitted, insofar as they have established a required line of conduct. Thus it would seem that logic cannot be used as a sole consideration in dealing with the law. "The fallacy to which I refer is the notion that the only force at work in the development of the law is logic. * * * I once heard a very eminent judge say that he never let a decision go until he was absolutely sure it was right. So judicial dissent is often blamed, as if it meant simply that one side or the other were not doing their sums right, and, if they would take more trouble, agreement inevitably would come."

"This mode of thinking is entirely natural. The training of lawyers is a training in logic. The processes of analogy, discrimination, and deduction are those in which they are most at home. The language of judicial decisions is mainly the language of logic. And the logical method and form flatter that longing for certainty and for repose which is in every human mind. But certainty generally is illusion, and repose is not the destiny of man. Behind the logical form lies a judgment as to the relative worth and importance of competing legislative grounds, often an inarticulate and unconscious judgment, it is true, and yet the very root and nerve of the whole proceeding. You can give any conclusion a logical form." Mr. Justice Holmes, The Path of the Law, 10 Harv. L. Rev. 457, 465.

The attitude of the Supreme Court of the United States on the effect of overruling a prior decision has been rather discreet in avoiding statements that the overruled decision had never been the law. Thus, in Fox Film Corporation v. Doyal, supra, the court said:

> "The affirmance of the judgment in the instant case cannot be reconciled with the decision in Long v. Rockwood, 277 U. S. 142, 72 L. ed. 824, 48 S. Ct. 463, upon which appellant relies, and in view of the conclusions now reached upon a reexamination of the question, that case is definitely overruled." (286 U. S. 131.)

Likewise, in Farmers Loan and Trust Co. v. Minnesota, 280 U. S. 204 (1930) the court said:

> "Blackstone v. Miller, 188 U. S. 189, no longer can be regarded as a correct exposition of existing law; and to prevent misunderstanding it is definitely overruled." (280 U. S. 209.)

The Supreme Court, speaking through Chief Justice Waite in Douglass v. Pike County, 11 Otto 677, 25 L. ed. 968 (1880) was more definite in its language when it was said:

> "The true rule is to give a change of judicial construction, in respect to a statute, the same effect in its operation on contracts and existing contract rights that would be given to a legislative enactment; that is to say, make it prospective but not retroactive. After a statute has been settled by judicial construction, the construction becomes, so far as contract rights acquired under it are concerned, as much a part of the statute as the text itself, and a change of decision is, to all intents and purposes, the same in its effect on contracts as an amendment of the law by means of a legislative enactment.
>
> So far as this case is concerned, we have no hesitation in saying that the rights of the parties are to be determined according to the law as it was judicially construed to be when the bonds in question were put on the market as commercial paper. We recognize fully, not only the right of a state court, but its duty to change its decisions whenever, in its judgment, the necessity arises. It may do this for new reasons, or because of a change of opinion in respect to old ones; and ordinarily we will follow them, except so far as they affect rights vested before the change was made. The rules which properly govern courts, in respect to their past adjudications, are well expressed in Boyd v. Alabama, 94 U. S. 645 (XXIV., 302), where we spoke through Mr. Justice Field. If the Township Aid Act had not been repealed by the new Constitution of 1875, art. 9, sec. 6, which took away from all municipalities the power of

> subscribing to the stock of railroads, the new decisions would be binding in respect to all issues of bonds after they were made; but we cannot give them a retroactive effect without impairing the obligation of contracts long before entered into. This we feel ourselves prohibited by the Constitution of the United States from doing."

A word must be added about the last quotation to make it clear that the case from which the above quotation was taken has not been overruled by the principles set out in Great Northern R. Co. v. Sunburst Oil and Refining Co., supra, which latter case held that a change of decision by a state court operating retroactively does not conflict with the Constitution of the United States. The rule set out in Douglass v. Pike County is only applicable to cases arising in the federal courts in which the federal court need not necessarily follow the construction of a state statute by a state Supreme Court. As is pointed out by the court in Brinkerhoff-Faris Trust & Savings Co. v. Hill, 281 U. S. 672 (1930):

> "The process of trial and error, of change of decision in order to conform with changing ideas and conditions, is traditional with courts administering the common law. Since it is for the state courts to interpret and declare the law of the state, it is for them to correct their errors and declare what the law has been as well as what it is. State courts, like this court, may ordinarily overrule their own decisions without offending constitutional guaranties, even though parties may have acted to their prejudice on the faith of the earlier decisions. The doctrine of Gelpcke v. Dubuque, 1 Wall. 175, 17 L. ed. 520, and Butz v. Muscatine, 8 Wall. 575, 19 L. ed. 490, like that of Swift v. Tyson, 16 Pet. 1, 10 L. ed. 865, is, if applied at all, confined strictly to cases arising in the Federal courts." (281 U. S. 681 n.)

The doctrine of Gelpcke v. Dubuque referred to in the last quotation is the doctrine also of Douglass v. Pike County, and this doctrine merely states that while a state Supreme Court can give a change of decision a retroactive effect which will not be disturbed by the Supreme Court of the United States on a writ of certiorari, none the less, where a case originates in a federal court involving a statute of a state the construction of which the Supreme Court of the State has changed the Supreme Court of the United States on appeal or certiorari from the lower federal court need not adopt the changed construction of the state court.

Further adverting to the philosophy of the Supreme Court of the United States as to a change of decision is the following:

> "Stare decisis is ordinarily a wise rule of action. But it is not a universal, inexorable command. The instances in which the Court has disregarded its admonition are many. The existing jurisdiction rests, in large part, upon like action of the Court in The

> Genesee Chief, 12 How. 443, 456. In that case the Court overruled The Thomas Jefferson, 10 Wheat. 428 and The Steamboat Orleans v. Phoebus, 11 Pet. 175; and a doctrine declared by Mr. Justice Story with the concurrence of Chief Justice Marshall and approved by Chancellor Kent, was abandoned when found to be erroneous, although it had been acted on for twenty-six years." Mr. Justice Brandeis dissenting in Washington v. Dawson & Co., 264 U. S. 219, 228, 238-9 (1924).

From the above quotations it seems a fair interpretation of the philosophy of the Supreme Court of the United States that it does not regard its own changes of decision as retroactive.

Of course, the United States is not subject to any doctrine preventing impairing the obligation of contracts by a decision or otherwise, but the Supreme Court of the United States does have a regard for vested rights acquired on the basis of its decisions, and while immunity from taxation is not a vested right, an immunity so well established as that established in Long v. Rockwood closely approximates such.

Thus it is believed that Long v. Rockwood, supra, was law during 1929, 1930 and 1931 just as much as Fox Film Corporation v. Doyal is the law today, and for the purpose of recovering income taxes for those years Long v. Rockwood prohibited the collection of such taxes in those years to the same extent that such collection is not prohibited now, and no theory that the law is immutable and that there is only one answer for all time to every constitutional question would allow the recovery by the state of any of these taxes.

> "The common law is not a brooding omnipresence in the sky but the articulate voice of some sovereign or quasi-sovereign that can be identified." Mr. Justice Holmes in Southern Pacific R. Co. v. Jensen, 244 U. S. 205, 222 (1917).

IV.
WOULD IT NOW BE TOO LATE TO COLLECT SUCH TAXES BECAUSE OF LIMITATIONS?

Even if the above reasoning were not correct and taxes could be recovered which could have accrued prior to the decision of Fox Film Corporation v. Doyal, taxes for 1929 would probably be barred by limitation. By R. S. Mo. 1929, Sec.10136 the period of limitations for recovery of income taxes is fixed as the same as the period of limitations for recovering personal property taxes, which by Section 9940 is five years. However, Section 10145 provides for the destruction of income tax returns after three years from the date on which they become due provided they have been paid, which would seem to indicate a clear intent that no transactions where payment has been accepted by the state in full should be opened up more than three years after such taxes became due, and the 1929 taxes became due on May 1, 1930, so that the returns on taxes for 1929 which have been paid should now be destroyed.

In conclusion, it is our opinion that no income from patents prior to May 16, 1932 can be taxed by the State of Missouri.

Very truly yours,

EDWARD H. MILLER,

APPROVED: ASSISTANT ATTORNEY GENERAL.

ATTORNEY GENERAL.