BANKS & BANKING: State banks and trust companies, members of Federal Reserve System, not exempt from paying contributions under Unemployment Compensation Law.

March 10, 1938

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Honorable R. W. Holt
Commissioner of Finance
Jefferson City, Missouri

Dear Mr. Holt:

The Attorney-General acknowledges receipt of the letter from the Farmers and Merchants Bank and Trust Company of Hannibal, Missouri, in which the opinion of the Attorney-General is requested on the question submitted in your letter. You request our opinion on the question submitted by the above bank. The query is:

> Are Missouri state banks and trust companies, organized and existing under the laws of this State, which are members of the Federal Reserve System, liable and obligated to pay contributions under the Missouri Unemployment Compensation Act?

The Missouri Unemployment Compensation Law was enacted by the 59th General Assembly (Laws of Missouri, 1937, page 574) and sub-clause 5 of clause 6 of sub-division "i" of Section 3 of the Act reads as follows (p. 577):

> "The term 'employment' shall not include:
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> * * * * * *
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> "Service performed in the employ of any other state or its political sub-divisions, or of the United States government, or of an instrumentality of any other state or states or their political sub-divisions or of the United States."

Section 811, Title VIII, of the Federal Act, provides that:

> "The term 'employment' means any service, of whatever nature performed within the United States by an employe for his employer, except --
>
> "(6) Service performed in the employ of the United States Government or of an instrumentality of the United States;"

Section 907, Title IX (c):

> "(5) Service performed in the employ of the United States Government or of an instrumentality of the United States."

It will be noticed that the Missouri Unemployment Compensation Law follows somewhat the language used in the Federal Social Security Act, approved by the President August 14, 1935.

After quoting from the State and Federal acts, as above, we deem it necessary to quote the pertinent parts of the section of the Banking Laws of Missouri which authorizes Missouri banks to become members of the Federal Reserve System. By express legislation Missouri has consented that banking institutions may become members of the Federal Reserve System.

Section 5354, paragraph 3, R. S. Mo. 1929, Vol. 11, Mo. St. Ann. p. 7574 (Trust Companies - 5421 R. S. 1929, Sec. 13). Paragraph 3, supra, relating to banks, reads as follows:

> "3. To purchase and hold, for the purpose of becoming a member of a federal reserve bank, so much of the capital stock thereof as will qualify it for membership in such reserve bank pursuant to an act of congress, approved December twenty-three, nineteen hundred and thirteen, entitled the 'Federal reserve act' and any amendments thereto; to become a member of

> such federal reserve bank, and to have and exercise all powers, not in conflict with the laws of this state, which are conferred upon any such member bank by the 'Federal reserve act' and any amendments thereto. Such member bank and its directors, officers, and stockholders shall continue to be subject, however, to all liabilities and duties imposed upon them by any law of this state and to all the provisions of this chapter relating to banks."

If Missouri state banks and trust companies organized and doing business under the laws of Missouri, which are members of the Federal Reserve System, are instrumentalities of the United States, within the meaning of the Unemployment Compensation Law, then they are not subject to the payment of contributions under the Unemployment Compensation Law.

State banks and trust companies may become members of the Federal Reserve System by making application to the Federal Reserve Board for the privilege, and securing its approval, and by subscribing to a specified number of shares of stock in the Federal Reserve System which is located in the district of the applying bank or trust company, as the case may be.

There are other prequisites to membership in said Federal Reserve Bank, as set forth in the Federal Reserve Act. It will be seen that by appropriate legislation, as hereinabove set out, the State of Missouri has permitted state banking institutions to become members of the Federal Reserve System.

While paragraph 3 of Section 5354, supra, of the banking law permits state banking institutions to become members of the Federal Reserve System, however, this consent is subject to the limitation that the bank is to have all the powers of a member of the Federal Reserve Bank "not in conflict with the laws of this State," and to the further limitation that such member bank "shall continue to be subject, however, to all liabilities and duties imposed upon them by any law of this state and to all the provisions of this chapter relating to banks." The privilege and benefits of the relationship may be voluntarily acquired by the bank, 12 U. S. C. A., Section 321, and may be relinquished by giving notice, etc., 12 U. S. C. A., Section 328. It is permissive and not mandatory and it is a business arrangement that the bank may or may not enter into.

The additional obligations and duties which are imposed upon a member bank of the Federal Reserve System and the benefits which it derives from the new relationship lend to the bank an additional degree of safety by being under governmental supervision in addition to being under state supervision. This, of course, inures to the benefit of the bank.

We do not find that the term "instrumentality," as used in the Missouri Unemployment Compensation Law, is defined in the Act itself, neither has the act received any judicial interpretation at this date. We must, therefore, search elsewhere as to the meaning of the word "instrumentality" as it appears in the books which might be applicable to the question before us:

Webster's Dictionary says "instrumentality" means: "quality or state of being instrumental; that which is instrumental; anything used as a means or an agency; means; medium; agency."

The Standard Dictionary says "instrumentality" means: "the quality or condition of being instrumental; subordinate agency."

After quoting from the applicable statutes and making the foregoing observations, we shall undertake to examine some of the cases which we think throw light on the question and point the way to a decision.

We are not unmindful of the importance of the question to the banking institutions involved, nor that there seems to be divergent views of the attorney-generals of the various states on this question, and also the apparent contrariety of the cases which might be considered applicable to the point in dispute.

While the question of whether the Federal government may tax a state instrumentality does not enter into this question directly, the Supreme Court of the United States in many cases has said that the immunity is equal and reciprocal and that each must be left free from undue interference from the other, as stated in Metcalf and Eddy v. Mitchell, 70 L. Ed. 391, 269 U. S. 514, l. c. 521-522 (1926), where the court said, speaking through Justice Stone:

"* * * the very nature of our constitutional system of dual sovereign governments is such as impliedly to prohibit the federal government from taxing the instrumentalities of a state government, and in a similar manner to limit the powers of the states to tax the instrumentalities of the federal government. * * *

"Just what instrumentalities of either a state or the federal government are exempt from taxation by the other cannot be stated in terms of universal application, but this Court has repeatedly held that those agencies through which either government immediately and directly exercises its sovereign powers, are immune from the taxing power of the other. * * *

"When, however, the question is approached from the other end of the scale, it is apparent that not every person who uses his property or derives a profit, in his dealings with the government, may clothe himself with immunity from taxation on the theory that either he or his property is an instrumentality of government within the meaning of the rule. * * *

"As cases arise, lying between the two extremes, it becomes necessary to draw the line which separates those activities having some relation to government, which are nevertheless subject to taxation, from those which are immune. Experience has shown that there is no formula by which that line may be plotted with precision in advance, but recourse may be had to the reason upon which the rule rests, and which must be the guiding principle to control its operation. Its origin was due to the essential requirement of our constitutional system that the federal government must exercise its authority within the territorial limits of the state;

> and it rests on the conviction that each government, in order that it may administer its affairs within its own sphere, must be left free from undue interference by the other."

In Cooley on Taxation, Vol. 2 (4 Ed.), Section 613, p. 1300, it is said:

> "A corporation cannot escape state taxation merely because it was created by the Federal Government nor because it was subsidized by it, nor because it is employed by the Federal Government, wholly or in part, unless it is really an agency or instrumentality for the exercise of the constitutional powers of the United States. (Cases cited)" (Underscoring ours.)

In the case of Thomson v. Pacific Railroad, 76 U. S. Reps. 9 Wall 579 (1869), it was held that although Congress may constitutionally make or authorize contracts with individuals or corporations for services to the government, may grant aids by money or land in the performance of such services and may make contracts and conditions and may exempt, in its discretion, the agencies employed in such service from any state taxation which will prevent or impede the performance of them, yet in the absence of legislation on the part of Congress to indicate that such an exemption is deemed by it as essential to full performance to the party's obligations to the government, the exemption cannot be applied to the case of a corporation deriving its existence from state law, exercising its franchises under such law, and holding its property within state jurisdiction and under state protection, only because of the employment of the corporation in the service of the government.

In the case of Union Pacific Railroad Co. v. Peniston, 18 Wall. 5 (1873), the court said:

> "Admitting, then, fully as we do, that the company (Union Pacific Railroad) is an agent of the general government, designed to be employed, and actually employed, in the legitimate service of the government, both military and

> postal, does it necessarily follow that its property is exempt from state taxation?"

The United States Supreme Court in answering the above question, on page 36, said the following:

> "It is, therefore, manifest that exemption of federal agencies from state taxation is dependent, not upon the nature of the agents, or upon the mode of their constitution, or upon the fact that they are agents, but upon the effect of the tax; that is, upon the question whether the tax does in truth deprive them of power to serve the government as they were intended to serve it, or does hinder the efficient exercise of their power?" (Underscoring ours.)

In Baltimore Shipbuilding and Dry Dock Company v. Baltimore, 195 U. S. 375, 49 L. Ed. 242, 25 Sup. Ct. 500 (1904), the Supreme Court said:

> "* * * it seems to us extravagant to say that an independent private corporation for gain, created by a state, is exempt from state taxation, either in its corporate person or its property, because it is employed by the United States, even if the work for which it is employed is important and takes much of its time."

In Fidelity and Deposit Co. v. Pennsylvania, 240 U. S. 319, 60 L. Ed. 664, 36 Sup. Ct. 298, it was held that a surety company did not by qualifying under the statutes of the United States to become surety on bonds required by the United States, act as a Federal instrumentality so as to be exempt from a state tax on the premiums received, exacted from foreign corporations for the privilege of doing business within the state.

And in the case of Federal Compress and Warehouse Co. v. McLean, 291 U. S. 23, 78 L. Ed., l. c. 627 (1934), the

Supreme Court, through Justice Stone, said:

> "The mere extention of control over a business by the National government does not withdraw it from a local tax which presents no obstacle to the execution of the National policy. Susquehanna Power Co. v. Tax Commission, 283 U. S. 291, 75 L. Ed. 1042, 51 Supreme Ct. 434 (1931); Broad River Power Co. v. Query, 288 U. S. 178-180, 77 L. Ed. 685-686, 53 Supreme Court 326(1933)."

In the case of Fox Film Corp. v. Doyal, 286 U. S. 128, 76 L. Ed. 1014 (1932), it is said:

> "The principle of the immunity from state taxation of instrumentalities of the Federal Government, and of the corresponding immunity of state instrumentalities from Federal taxation -- essential to the maintenance of our dual system - has its inherent limitations. It is aimed at the protection of the operations of government. (M'Culloch v. Maryland, 4 Wheat. 316, 436, 4 L. Ed. 579, 608), and the immunity does not extend 'to anything lying outside or beyond to governmental functions and their exertions.'"

In the case of Federal Land Bank of St. Louis v. Priddy, 295 U. S. 229, 76 L. Ed. 1412, 55 Sup. Ct. 705 (U. S. p. 234) (1935), the court said:

> "Joint Stock Land Banks are privately owned corporations organized for profit to their stockholders through the business of making loans on farm mortgages * * * There is nothing in their organization and powers to suggest that they are government instrumentalities."

In the case of Hiatt v. United States, 4 Fed. (2d) 374, l. c. 375, the court said:

> "The matter of affiliation between the Dickinson Trust Company and the Federal Reserve Bank, aside from the investment in stock, seems to present merely a business arrangement between the Federal Reserve Bank and the Trust Company, which was not made under compulsion, and was doubtless regarded as advantageous by both concerns. It was simply an arrangement made for the advancement and in the interest of business for which the Trust Company was chartered."

As was said in the case of Helvering v. Therrell, handed down by the United States Supreme Court, February 28, 1938:

> "The Constitution contemplates a national government free to use its delegated powers; also state governments capable of exercising their essential reserved powers; both operate within the same territorial limits; * *"

And further in said opinion the court said:

> "By definition precisely to delimit 'delegated powers' or 'essential governmental duties' is not possible. Controversies involving these terms must be decided as they arise, upon consideration of all the relevant circumstances. Notwithstanding discordant views which have sometimes arisen because of varying emphasis given to one or another of such circumstances, it is now settled doctrine that the inferred exemption from federal taxation does not extend to every instrumentality which a State may see fit

> to employ. Exemption depends upon the nature of the undertaking; it is cabined by the reason which underlies the inference."

The real question is whether the banking institutions in question are such instrumentalities of the Federal government as to come within the doctrine of the exemption of instrumentalities of one of the two governments from undue burdens by the other, and also whether it was the intention of the Legislature to exempt the member banks from the payment of the contributions. The declaration in the statute that instrumentalities of the United States are exempt was merely a declaration of the fixed and established law for the reason that if the instrumentality was one of those agencies through which the United States government exercised directly and immediately its sovereign powers it would be immune from the taxing power of the state even without such declaration in the law. The tests seem to be whether the instrumentality is acting as such in furtherance of a governmental function or of a proprietary function, and also whether the laying of the tax on the instrumentality would be a direct interference with the functions of government itself?

In arriving at our conclusion in this matter we have not overlooked the fact that the Bureau of Internal Revenue has construed the Federal Unemployment Compensation Act to mean that state banks which are members of the Federal Reserve System are exempt from payment of these taxes under the Federal act and that state banks not members of the Federal Reserve System are not exempt. We must concede that that interpretation given the Federal Act is persuasive, and that a great many states have adopted the policy of following the interpretation given the Federal Act by the Bureau of Internal Revenue.

All of the state banks and trust companies are organized under the same banking laws, governed by the same state laws, pay taxes levied in the same way, and are under the jurisdiction and regulation of the State Finance Department, and because one has seen fit to make application to

become a member of the Federal Reserve System and has been accepted by it, which it voluntarily did for reasons best known to itself, we are unable to say, upon the authority of the cases, that these banking institutions, which are members of the Federal Reserve System, are exempt from paying the contributions under the Missouri Unemployment Compensation Law.

In the Helvering v. Therrell Case, supra, and the other Federal Income Tax cases handed down by the United States Supreme Court, February 28, 1938, and also the income tax cases, namely, Helvering v. Mountain Producers Corporation, and other cases decided by the United States Supreme Court, March 7, 1938, in which the Supreme Court overruled the conclusions reached in the case of Gillespie v. Oklahoma, 257 U. S. 501, and Burnett v. Coronado Oil and Gas Company, 285 U. S. 393, and while these cases are not in exact point with the matter under consideration, however, we note that the court "in the light of the expanding needs of state and nation" has shown a tendency toward widening the field of taxation with reference to instrumentalities of the government and the income of officers of such instrumentalities. We have also taken cognizance of the very recent case of the Supreme Court of Missouri, decided February 25, 1938, namely, The State of Missouri at the relation of Baumann, Collector of the City of St. Louis v. Bowles, No. 35,209, which, however, is now pending on motion for rehearing, in which the Supreme Court in a unanimous opinion held that an employe of the Farm Credit Administration of St. Louis, admittedly a Federal instrumentality created for a public purpose, was liable for the payment of an income tax due the State of Missouri.

From the above and foregoing, it is the opinion of the Attorney-General that membership by state banks and trust companies in the Federal Reserve System does not make them instrumentalities of the United States within the scope of the Missouri Unemployment Compensation Law, and the bank

in question must make the reports and pay the contributions as provided therein, assuming, of course, it has eight or more employes as provided by Section 3, clause "h", sub-clause 1.

Respectfully submitted,

COVELL R. HEWITT
Assistant Attorney-General

APPROVED:

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Attorney-General

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