FEDERAL TAXATION:-- Missouri Training School at Boonville, being an
EXEMPTION OF AGENCY instrumentality or agency of the state in carry-
OF THE STATE: ing on a governmental function, cannot be required to pay the Federal Process tax.

12-11

November 10, 1933.

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Mr. Stephen B. Hunder,
Director, Penal Institutions,
Jefferson City, Missouri.

Dear Sir:

We are acknowledging receipt of your letter in which you inquire as follows:

> "The Collector of Internal Revenue at Kansas City says that the Missouri Training School at Boonville must pay processing tax on wheat raised by the Institution. All work done in producing this wheat was done by inmates, is my understanding, but the Revenue Collector says that sinceall the boys in the institution were not used in producing this wheat therefore we are compelled to pay the tax. It might be held that all the boys did participate in producing the wheat, as they all contributed in work to furnish shoes and other foods and other things that were necessary to those who did the actual work in the wheat. In fact, all the boys in the Training School at Boonville contribute something to each other in all the work they are doing. If the Traning School is required to pay this $1.30 per bbl. you can see it is quite an item during the year.
>
> Would be pleased to be advised by you whether you think there is anything that might be done to relieve us of this tax."

You inquire whether the Missouri Training School at Boonville may be required to pay the processing tax on wheat raised by the institution.

Process tax is levied by the Agricultural Adjustment Act of May 12, 1933, chapter 25, 48 Stat. Section 9, paragraph (a) of the Act provides:

> "To obtain revenue for extraordinary expenses incurred by reason of the national economic emergency, there shall be levied processing taxes as hereinafter provided. When the Secretary of Agriculture determines that rental or benefit payments are to be made with respect to any basic agricultural commodity, he shall proclaim such

determination, and a processing tax shall be in effect with respect to such commodity from the beginning of the marketing year therefor next following the date of such proclamation. The processing tax shall be levied, assessed, and collected upon the first demestic processing of the commodity, whether of domestic production or imported, and shall be paid by the processor. * *"

Paragraph (d) of said Section 9 provides as follows:

"(d) As used in part 2 of this title - -
(1) In case of wheat, rice, and corn, the term 'processing' means the milling or other processing (except cleaning and drying) of wheat, rice, or corn for market, including custom milling for toll as well as commercial milling, but shall not include the grinding or cracking thereof not in the form of flour for feed purposes only.
(2) In case of Cotton, the term 'processing' means the spinning, manufacturing, or other processing (except grinding) of cotton; and the term 'cotton' shall not include cotton linters.
(3) In case of tobacco, the term 'processing' means the manufacturing or other processing (except drying or converting into insecticides and fertilizers) of tobacco.
(4) In case of hogs, the term 'processing' means the slaughter of hogs for market.
(5) In the case of any other commodity, the term 'processing' means any manufacturing or other processing involving a change in the form of the commodity or its preparation for market, as defined by regulations of the Secretary of Agriculture; and in prescribing such regulations the Secretary shall give due weight to the customs of the industry."

Disregarding the statute, a process is generally accepted to mean a mode of treatment of certain materials to produce a given result. It is an act, or series of acts, performed upon the subject matter to be transformed or reduced to a different state or thing. According to Section 1 of paragraph (d) of the Act in the case of wheat, "processing" means the milling or other processing (except cleaning and drying) of wheat, including custom milling for toll as well as commercial milling, but shall not include the grinding or cracking thereof not in the form of flour for feed purposes only. Under Section 2, processing of cotton means spinning and manufacturing. Under Section 3, the case of tobacco processing means manufacturing of tobacco, and under Section 4 in the case of hogs, it means slaughter of hogs for the market. Under general Section 5, as applied to all other commodities, processing means"any manufacturing or other process involving a change in the form of the commodity, or its preparation for market."

As we interpret the above sections, processing does not

mean the production of the wheat from the soil. Under Section 1 above, it means milling (except cleaning and drying), and shall not include the grinding and cracking thereof in the form of flour for feed purposes only. We believe that the proper construction of the Act is that a processing tax is not applicable to wheat grown and harvested where no other process is applied to the wheat. That interpretation seems to be entirely consistent with the various definitions of processing, as contained in paragraph (d) of Section 9. It is not, under said paragraph, the raising of the hogs that lays the basis for the process tax, but the slaughtering of them. It is not the raising of the cotton, but the spinning and manufacturing.

Although your inquiry is silent as to any processing which your institution might do to the wheat, we have assumed that the wheat is raised by your institution and marketed in its original form, without any processing, as is defined in paragraph (d) of Section 9. If our assumption is correct then we are of the opinion that as a producer of wheat who does not change the form thereof and does nothing in the form of processing, that the institution would not be liable for the processing tax. On the other hand, if your institution so deals with the wheat, as milling it, etc., as to come within the basis upon which the process tax is levied, we are still of the opinion that your institution would not be subject to the processing tax, for the following reasons hereinafter set out.

In 37 C. J. 883, it is said:

> "Congress possesses no power to lay taxes which would obstruct or interfere with the legitimate and efficient workings of the state governments, or of the agencies or instrumentalities employed by them."

The above principle is further expressed in the case of Metcalf v. Mitchell, 70 L. Ed. 384. The court says at page 391:

> "We pass to the more difficult question, whether Congress had the constitutional power to impose the tax in question and this must be answered in ascertaining whether its effect is such as to bring it within the purview of those decisions holding that 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 power 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. Thus, the employment of officers who are agents to administer its laws (Collector v. Day, supra; Dobbins v. Erie County, 16 Pet. 435, 10 L. ed. 1022), its obligations sold to raise public funds (Weston v. Charleston, 2 Pet. 449, 467 L. ed. 481, 487; Pollock v. Farmers' Loan & T. Co. 157 U. S. 429, 585, 586, 39 L. ed. 759, 820, 821, 15 Sup. Ct. Rep. 673), its investments of public funds in the securities of private corporations, for publid purposes (United States v. Baltimore & O. R. Co. 17 Wall. 322, 21 L. ed. 597), surety bonds exacted by it in the exercise of its police power (Ambrosini v. United States, 187 U. S. 1, 47 L. ed. 49, 23 Sup. Ct. Rep. 1, 13 Am. Crim. Rep. 699), are all so intimately connected with the necessary functions of government, as to fall within the established exemption; and when the instrumentality is of that character, the immunity extends not only to the instrumentality itself but to income derived from it (Pollock v. Farmers' Loan & T. Co. and Gillespie v. Oklahoma, supra) and forbids an occupation tax imposed on its use (Choctaw, O. & G. R. Co. v. Harrison, 235 U. S. 292, 59 L. ed. 234, 35 Sup. Ct. Rep. 27; and see Dobbins v. Erie County, supra)."

"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 states; 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."

"While it is evident that in one aspect the extent of the exemption must finally depend upon the effect of the tax upon the functions of the government alleged to be affected by it, still the nature of the governmental agencies or the mode of their constitution may not be disregarded in passing on the question of tax exemption; for it is obvious that an agency may 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."

"It is on this principle that, as we have seen, any taxation by one government of the salary of an officer of the other, or the public securities of the other, or an agency created and controlled by the other, exclusively to enable it to perform a governmental function is prohibited."

There can be no question but that the State of Missouri,

in the operation of its penal institutions, is performing a governmental function. It is just as much a part of the governmental function to apprehend and incarcerate criminals for the protection of itself and its citizens as it is to provide agencies for the protection of its own property and the property and rights of its citizens. As a matter of fact, it is only by the apprehending and incarcerating of the criminals that it can protect its own property and the property and rights of its citizens. These penal institutions, as an arm of the State in carrying out its governmental functions, are generally supported by taxation and by revenue from the various institutions. The amount of taxation necessary for the support of such penal institutions varies in so far as the institutions are capable of producing income for their own support. Revenue raised by taxation is an income of the State. Money derived from products produced and sold by the various penal institutions are also an income of the State. No one would contend that the Federal government would have a right to levy any sort of tax against the general revenue raised by the State of Missouri, and as we view it, they would have no more right to levy any sort of tax against products or incomes derived in the management of its penal institutions.

This principle is not new and has been generally recognized in the exempting from Federal income taxes, salaries of state officials. The salary of a state officer, however, at the time that it would be subject to income tax, is the personal property of the officer, and has ceased to be property of the state. Wheat raised by the Reformatory, however, never ceases to be income of the state, when in its original state or represented by money which it brings upon the market. If the Federal government cannot tax incomes of the state officials because it would be a burden upon the state, then it is hard to understand by what theory the Federal government could tax the income resulting from state property and the operation of state institutions. If it had a right to tax the income derived from the properties of the State of Missouri, then, by the same token, it would have a right to tax the physical property of the State. This it certainly cannot do. The Federal government has no right to tax the revenue derived by the State, and yet, to permit a tax on the income or products derived from state properties would be in effect a tax on a portion of that revenue.

It is therefore the opinion of this Department that the Missouri Training School at Boonville is an agency or instrumentality of the State of Missouri, created and controlled by it exclusively to enable it to perform a governmental function; that the Federal government would have no authority to levy any tax on such instrumentality or agency. In view of that holding this institution would not be liable for any processing tax, whether or not the facts are such as would bring it within the purview of the Federal statutes above quoted.

Very truly yours,

APPROVED:

Franklin V. Sayers
Assistant Attorney General.

Attorney General.