INCOME TAX: Com[illegible]tion of counsel for Trustee in Bankruptcy not exempt.

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May 2, 1935.

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Hon. Forrest Smith,
State Auditor,
Jefferson City, Mo.

Dear Sir:

This department is in receipt of your letter of April 30 requesting an opinion as to the following state of facts:

> "I herewith submit a copy of a petition which was filed in this office by W.C. Scarritt, et al., wherein they request that certain attorney fees outlined in the attached petition be deducted from their gross income as reported on their State Income Tax Returns for the calendar year 1934, said amounts having been included in their respective State Income Tax Returns for said year. The basis for this request is clearly set out in the attached petition."

W.C. Scarritt, Elliott H. Jones, Edward S. North and A.D. Scarritt, hereinafter called the petitioners, in 1933 were appointed by the Federal Bankruptcy Court, sitting at Kansas City, as counsel for Herbert V. Jones, Trustee in Bankruptcy of the Fox Rocky Mountain Theatre Co. and the Fox Midland Theatre Company. During the year 1934 $17,500 was paid to the aforesaid petitioners as compensation for their services performed on behalf of said trustee. It is now sought by this petition that the aforesaid sum of $17,500 be deducted from the returns of said petitioners as and for their income tax for the calendar year 1934.

Section 10117, R.S. Mo. 1929 provides in part as follows:

> "Income shall include gains, profits, and earnings derived from salaries, wages or compensation for personal services of whatever kind and in whatever form paid; and from professions, vocations, businesses, trade, commerce, or sales or dealings in property, whether real or personal, growing out of the ownership or the use of any interest in real or personal property; ***"

As authority for the proposition that Federal income is not subject to the income tax of the State of Missouri, the petitioners cite the case of State ex rel. Thompson v. Truman, 319 Mo. 423, wherein it was held by the Supreme Court of Missouri that the compensation allowed a receiver appointed by a Federal Court was not subject to income taxation by the State of Missouri for the reason that a receiver is an instrumentality of the Federal Court whether he be considered an officer of the Federal Government or not. In the course of its opinion, the Court said (l.c. 431):

> "It is plain under these rulings and definitions by Federal courts that whether an officer appointed by such court is technically an officer of the Federal Government or not, he discharges a duty necessary in the exercise by the government of its sovereign functions. The court, as a department of government, appoints a receiver as a necessary agency in the administration of the court functions. The emoluments of his office are fixed by the court as the proper compensation for the service which he renders. For the State to tax it would be to reduce that compensation, and to that extent would be an interference with the operation of the Federal court."

To our mind, however, there is a distinction between a receiver or trustee and counsel appointed to aid such receiver or trustee. An attorney employed as counsel for a trustee or

receiver is employed by reason of his professional ability and for the reason that said trustee or receiver, in the course of his duties, may have need of professional advice in order that questions of law may be properly investigated and the authorities fully presented; however, said attorney acts, not as an arm of the Court (as does the receiver or trustee), but merely as an aid to said receiver or trustee, much in the same manner as might an expert accountant. While a trustee or receiver is absolutely indispensable to the court in the administration of the receivership or bankruptcy proceedings, it is not always necessary that counsel be appointed, and it is only where the necessity clearly rises that the court should provide for the employment of counsel by receiver or trustee. The fees for counsel employed by receiver or trustee are regarded as a part of the receivership expenses and are allowed, not to the attorney, but to the receiver as a proper expenditure made by him. Joost v. Bennet, 56 P. l.c. 44.

Similarly, in the case of Stuart v. Boulware, 133 U.S. l.c. 81, the Court said:

> "On the other hand it is argued, and in this we concur, that if it were proper for the receiver to employ counsel, the allowance of reasonable counsel fees is to the receiver and not directly to the counsel, and that such fees would constitute only one of the items in the receiver's account; that the counsel had no cause of action, but the allowance was in legal effect to the receiver to enable him to make compensation for professional services."

It may be seen from these citations that the allowance is not made to attorneys for their services as an arm of the government or of the court, but is made for the purpose of allowing the receiver or trustee to make compensation for professional services rendered in the same manner as would professional services have been rendered to any other client.

High, in his work on "Receivers", 4th Ed., at page 954, says:

> "Receivers are entitled in the settlement of their accounts, to payments made on account of legal services and counsel fees. And such fees, when paid by the receiver in good faith in collecting moneys

> to which he is entitled, the disbursements being necessary and beneficial to the parties ultimately entitled to the fund, should be paid from such fund in the settlement of the receiver's accounts. The allowance of counsel fees is regarded as being made to the receiver as an item in his account, and not directly to counsel, the allowance being made in his accounts in order that he may make compensation for such services."

While the distinction we have heretofore set out between the nature of employment and compensation incident thereto between a receiver or trustee and counsel for said receiver or trustee would seem to settle the question now here before us, nevertheless, consideration must be had to the proposition that an agency may be of such character or so intimately connected with the exercise of a power, or the performance of a duty, by one government that any taxation by the other would be such a direct interference with the functions of government itself as to be plainly beyond the taxing power. Necessarily, the same prohibitions apply to an attempt by the Federal government to tax an agency of the State government as apply to efforts by the State government to tax instrumentalities of our Federal government.

Perhaps the leading case on this question is the case of Metcalf & Eddy v. Mitchell, 269 U.S. 514. The question considered in that case was the liability to income tax of amounts received by consulting engineers as compensation for their services under contract with various states, municipalities, water or sewage districts created by state statute. The court held that since the engineers held no official positions - were free to accept other employment, and did not show that their duties were defined or prescribed by statute, they were not officers or employees of the state within the meaning of the statutory exemption, and that there was no constitutional prohibition against taxing them. In the course of the opinion the court said (l.c. 522, 524-525):

> "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.
> * * * *
> 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, (Gillespie v. Oklahoma, supra,) is prohibited. But here the tax is imposed on the income of one who is neither an officer nor an employee of government and whose only relation to it is that of contract, under which there is an obligation to furnish service, for practical purposes not unlike a contract to sell and deliver a commodity. The tax is imposed without discrimination upon income whether derived from services rendered to the state or services rendered to private individuals. In such a situation it cannot be said that the tax is imposed upon an agency of government in any technical sense, and the tax itself cannot be deemed to be an interference with government, or an impairment of the efficiency of its agencies in any substantial way."

In the case of Blair v. Byers, 35 F. (2d) 326 it was held that a lawyer practicing his profession while employed as a counsel for municipal water works trustees was not a city officer or employee within the statute exempting compensation from Federal income taxes. The Court said: (l.c. 328)

> "Nowhere in the record is it revealed to what extent, if at all, his services were subject to the control of the board of trustees. Furthermore, we are of opinion that an attorney who is engaged in this manner, who has not contracted to give to such a client his entire and exclusive services, does not thereby become an officer or employee in the sense of this statute. It is our judgment that

> Mr. Byers did not become such an employee of this political subdivision of the state of Iowa, and that the compensation which he received for services was therefore not exempt from income taxes."

And in the case of Elam v. Commissioner of Internal Revenue, 45 F. (2d) 337, the Circuit Court of Appeals held that attorneys for state court receivers are not 'officers or employees of state or political subdivision' within income tax exemption of the Federal Revenue Act. The Court said (l.c. 338):

> "Attorneys fees. That attorneys representing state court receivers are not officers of a 'state or political subdivision thereof' is definitely settled by the decision of Metcalf & Eddy v. Mitchell, 269 U.S. 514, 520, 46 S. Ct. 172, 70 L. Ed. 384."

CONCLUSION

While it may be difficult with respect to the problem of taxation by the state, to draw the line between agencies receiving compensation incidental to employment directly or indirectly from the Federal government, nevertheless, that difficulty is hardly an argument against making the distinction. As Mr. Justice Holmes has said: "Neither are we troubled by the question where to draw the line. That is the question in pretty much everything worth arguing in the law." Irvin v. Gavit, 268 U.S. 161.

Nevertheless, it seems clear in the instant case that the exemption here sought for by petitioners as to the compensation received by them as counsel for a trustee in bankruptcy should not be allowed, and this for the following reasons: (1) The allowance of counsel fees is to be regarded as being made to the receiver as an item in his account and not directly to counsel, the allowance being made in his accounts in order that he may make compensation for such services; (2) the effect of the income tax in the instant case does not impair in any substantial manner the ability of petitioners to discharge their obligations to the trustee in bankruptcy or to the Federal government; (3) the tax is not imposed upon an agency of government in any technical sense and the tax itself cannot be deemed to be an interference with government or the impairment of the

efficiency of its agencies in any substantial way. Metcalf & Eddy v. Mitchell, supra.

Respectfully submitted,

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APPROVED:

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