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January 15, 1919.

OPINION NO. 786.

TAXATION: INCOME TAX: UNITED STATES BONDS:

The income derived as interest on United States Bonds Is not taxable by the Territory of Hawaii.

Honorable Delbert E. Metzger,  
Treasurer, Territory of Hawaii,  
Honolulu, Hawaii.

Dear Sir: I beg to acknowledge the receipt "of your

communication of the 14th, together with certain enclosures, all relating to the right of the Territory of Hawaii to tax the income accruing from United States bonds to the holders of such bonds resident in the Territory of Hawaii.

Your specific question is as follows: "Is the interest received from the so-called Liberty Bonds issued by the United States of America liable to assessment under our Income Tax laws?"

This inquiry must be answered in the negative. The principle involved in this inquiry was discussed at some length in Opinion No. 783. In addition to the authorities quoted in that opinion, the general rule relating to the non-taxability of the United States bonds is set forth in Cooley's *Constitutional Limitations* on pp. 680 to 692, from which I quote the following excerpts:

"\* \* \* One of the implied limitations is that which precludes the States from taxing the agencies whereby the general government performs its functions. The reason is that, if they possessed this authority, it would be within their power to impose taxation to an extent that might cripple, if not wholly defeat, the operations of the national authority within its proper and constitutional sphere of action. \* \* \* It follows as a logical result from this doctrine that if the Congress of the Union may constitutionally create a Bank of the United States, as an agency of the national government, in the accomplishment of its constitutional purposes, any power of the States to tax such bank, or its property, or the means of performing its functions, unless with the consent of the United States, is precluded by necessary implication. \* \* \* So the States may not impose taxes upon the obligations or evidences of debt issued by the general government upon the loans made to it, unless such taxation is permitted by law of Congress, and then only in the manner such law shall prescribe—any such tax being an impediment to the operations of the government in negotiating loans, and, in greater or less degree in proportion to its magnitude, tending to cripple and embarrass the national power. The tax upon the national securities

is a tax upon the exercise of the power of Congress 'to borrow money on the credit of the United States.' The exercise of this power is interfered with to the extent of the tax imposed under State authority; and the liability of the certificates of stock or other securities to taxation by a State, in the hands of individuals, would necessarily affect their value in market, and therefore affect the free and unrestrained exercise of the power. 'If the right to impose a tax exists, it is a right which, in its nature, acknowledges no limits. It may be carried to any extent within the jurisdiction of the State or corporation which imposes it, which the will of each State or corporation may prescribe.'"

The principles announced in the foregoing are sustained by the authorities. In *Weston vs City Council of Charleston*; 2 Peters (U. S.) 449, 7 L. Ed. 481 on p. 487, the Supreme Court of the United States said:

"Congress has power 'to borrow money on the credit of the United States.' The stock it issues is the evidence of a debt created by the exercise of this power. The tax in question is a tax upon the contract subsisting between the government and the individual. It bears directly upon that contract, while subsisting and in full force. The power operates upon the contract the instant it is framed, and must imply a right to affect that contract.

If the States and corporations throughout the Union, possess the power to tax a contract for the loan of money, what shall arrest this principle in its application to every other contract? What measure can government adopt which will not be exposed to its influence?

But it is unnecessary to pursue this principle through its diversified application to all the contracts, and to the various operations of government. No one can be selected which is of more vital interest to the community than this of borrowing money on the credit of the United States. No power has been conferred by the American people on their government, the free and unburdened exercise of which more deeply affects every member of our Republic. In war, when the honor, the safety, the "independence of the nation are to be defended, when all its resources are to be strained to the utmost, credit must be brought in aid of taxation, and the

abundant revenue of peace and prosperity must be anticipated to supply the exigencies, the urgent demands of the moment. The people, for objects the most important which can occur in the progress of nations, have empowered their government to make these anticipation, 'to borrow money on the credit of the United States.' Can anything be more dangerous, or more injurious, than the admission of a principle which authorizes every State, and every corporation in the Union which possesses the right of taxation, to burden the exercise of this power at their discretion?

If the right to impose the tax exists, it is a right which in its nature acknowledges no limits. It may be carried to any extent within the jurisdiction of the State or corporation which imposes it, which the will of each State and corporation may prescribe. A power which is given by the whole American people for their common good. which is to be exercised at the most critical periods for the most important purposes, on the free exercise of which the interests certainly, perhaps the liberty of the whole may depend; may be burdened, impeded, if not arrested, by any of the organized parts of the confederacy.

In a society formed like ours, with one supreme government for national purposes, and numerous State governments for other purposes; in many respects independent, and in the uncontrolled exercise of many important powers, occasional interferences ought not to surprise us. The power of taxation is one of the most essential to a State, and one of the most extensive in its operation. The attempt to maintain a rule which shall limit its exercise is undoubtedly among the most delicate and difficult duties which can devolve on those whose province it is to expound the supreme law of the land in its application to the cases of individuals. This duty has more than once devolved on this court. In the performance of it we have considered it as a necessary consequence from the supremacy of the government of the whole, that its action in the exercise of its legitimate powers should be free and unembarrassed by any conflicting powers in the possession of its parts: that the powers of a State cannot rightfully be so exercised as to impede and obstruct the free course of those measures which the government of the States united may rightfully adopt."

Numerous other authorities might be cited to support this principle, and the only exception to the general rule as here laid down, is made in favor of the right of a State to impose an estate or inheritance tax upon such bonds. The rule thus laid down becomes obviously of greater force when it is considered that all of those bonds were specifically and in terms, issued as being exempt from any State or other local taxation whatever.

Under these circumstances, it would be difficult to imagine a greater interference with the constitutional right of the United States to borrow money, than the one indicated in your inquiry. The United States, under its constitutional power to borrow money, issues these bonds as evidence of its indebtedness, and expressly contracts with those bond holders that the said bonds shall be free from all state or other local taxation. To allow a State or a Territory to tax such bonds under such circumstances would be a direct denial of the power of the United States to borrow money for national purposes upon such terms as it, the borrowing power, might be able to make.

I am of the opinion, therefore, and so advise you, that by the authority of the adjudicated cases, and under the provisions by which the United States issues them, the said bonds are exempt from taxation by the Territory, both as to principle and interest. I am,

Yours very truly,

HARRY IRWIN,  
Attorney General.