

## Validity of the Unemployment Compensation Program

Chas. C. Steward Mach. Co. v. Davis, 301 U.S. 548 (1937)

- History:** Charles C. Steward Machine Co. ("employer") paid unemployment tax in accordance with the Social Security Act. The employer then filed for a refund from the Alabama Internal Revenue Commissioner ("Davis") and sued to recover its tax payment. The employer challenged the validity of the unemployment tax by alleging that there was a conflict between Alabama statute and the U.S. Constitution. The District Court dismissed the suit, and the Fifth Circuit affirmed. Because this decision resulted in a circuit split on the issue, and the issue involves a constitutional question, the Supreme Court granted certiorari and affirmed.
- Facts:** Section IX of the Social Security Act levied on employers (with some exceptions) an annual "excise tax, with respect to having individuals in his employ." Exceptions include, in part, employers with fewer than eight employees, "agricultural labor, domestic service in a private home, and some other smaller classes." The taxes collected are held in the Treasury of the United States and are not designated towards any particular expenditure. If an employer has paid into a state unemployment fund, it can claim up to a 90% credit with the federal government, as long as the state unemployment program has been certified by the Secretary of the Treasury as meeting certain minimum requirements.
- Issues:**
- 1A. Is the unemployment tax invalid because it taxes the employment relationship, which is considered a right rather than a privilege or luxury?
  - 1B. Is the unemployment tax a uniform excise tax throughout the United States?
  2. Are the defined exceptions in the Social Security Act "so many and arbitrary as to violate the Fifth Amendment"?
  3. Is the purpose of the Social Security Act "an unlawful invasion of the reserved powers of the states" in violation of the Tenth Amendment?
  4. By complying with the Social Security Act, does a state "yield[] to coercion and [abandon] governmental functions which [it is] not permitted to surrender"?
- Holdings:** 1A. No, the unemployment tax is not invalid. Historically, Parliament and the colonial government both passed excise taxes that taxed relationships such as marriages, births, burials, and employment of male servants. Additionally, the government is free to tax businesses, whether in whole or in part. Since employment is but a part of a business, the government is free to tax employment.

1B. Yes, the unemployment tax is a uniform excise tax throughout the United States. The Constitution states that "Congress shall have Power to lay and collect Taxes, Duties, Imposts and Excises." When the tax is not a direct tax, it must be uniform across the United States. Unemployment tax is not a direct tax on individuals. Because it is not a direct tax, it must be uniform across the States. The employment relationship exists because it was created by State law. Congress may impose a tax on the relationship.

2. No, the defined exceptions in the Social Security Act do not violate the Fifth Amendment. The Fifth Amendment does not contain an equal protection clause, like the Fourteenth Amendment. "But even the states, though subject to such a clause, are not confined to a formula of rigid uniformity in framing measures of taxation." For example, States are free to choose which properties are subject to taxation and at what rates, if subject to taxation at all. States may tax some business, but not others. And if States are free to be selective in levying taxes, then by even greater force of logic the United States government may be selective. The exemptions contained in the Social Security Act were chosen after considering policy and practicality. Therefore, they cannot be considered arbitrary. Additionally, such exemptions would survive an equal protection challenge under the Fourteenth Amendment, so they also survive a Fifth Amendment challenge. This issue was addressed at length in *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495.

3. No, the purpose of the Social Security Act does not unlawfully invade the powers reserved to the states. A state is free to enact its own unemployment laws and may revoke them at any time. The only caveat is that a state's unemployment scheme must be reviewed and approved by the Social Security Board. Approval by the Board does not prevent a state from revoking its unemployment laws. The state is not required to enter into an agreement with the federal government as to how to disperse the funds to the unemployed, or that the funds must be used only for specific purposes. A state does not relinquish any power by depositing its collected taxes with the federal government. A state may choose to deposit the funds with the federal government in order to reduce risk of loss or waste of the fund. When deposited with the federal government, the fund is backed by the security of the U.S. Treasury. The state is free to revoke its consensual participation in the federal unemployment program at any time, and to receive a refund of any funds it has deposited with the federal government.

4. No, a state's compliance with the Social Security Act is not the result of coercion. The Social Security Act and a state's unemployment scheme work in concert to alleviate the common concern of unemployment. When unemployment soared during the Great Depression, the states were not able to

relieve the crisis on their own, so the states sought help from the federal government. The federal government agreed to help and enacted the Social Security Act in response. The federal government may offer tax credits to the states as temptations or inducements to participate, but each state is free to make its own choice as to whether it will participate in the unemployment program. When a state elects to participate, it enacts its own statutes to administer the unemployment program. Since the state's own statutes would be an expression of the will of the people of that state, the state's participation cannot be found to be the result of undue influence or duress. Furthermore, by accepting the assistance offered through the Social Security Act, a state is not abandoning its governmental functions. The state is accepting help from the federal government to improve the general welfare of the public. At all times, the state retains the right to withdraw its participation in the unemployment program.

**Carmichael v. Southern Coal & Coke Co., 301 U.S. 495 (1937)**

**History:** Southern Coal & Coke Co. and Gulf States Paper Corporation ("employers") filed suit in the Middle District of Alabama to prevent the State of Alabama from collecting unemployment taxes. The District Court found in favor of the employers. The State of Alabama appealed to the Supreme Court of the United States. The Supreme Court reversed.

**Facts:** Alabama's Unemployment Compensation Act ("Act") was enacted to apply to certain employers as defined by the Act. "These employers include all who employ eight or more persons for twenty or more weeks in the year...except those engaged in certain specified employments." Other employers were excluded from the tax. Employers that were subject to the Act were required to pay a percentage of their monthly payroll into the state Unemployment Compensation Fund. The Act met all criteria for the unemployment program as set out in the Social Security Act. Southern Coal & Coke Co. and Gulf States Paper Corporation were employers that were obligated to pay unemployment taxes under the Act.

**Issues:**

1. Does "the Unemployment Compensation Act of Alabama infringe[] the due process and equal protection clauses of the Fourteenth Amendment"?
2. Is the Unemployment Compensation Act of Alabama "invalid because its enactment was coerced by the action of the Federal Government in adopting the Social Security Act...and because it involves an unconstitutional surrender to the national government of the sovereign power of the state"?

**Holdings:** 1. No, Alabama's Unemployment Compensation Act does not infringe the due process and equal protection clauses of the Fourteenth Amendment. The tax imposed by the Act "is of a type traditional in the history of Anglo-American legislation, [and] it is within state taxing power..."

The state is free to designate which groups are subject to pay the tax and which groups are exempt. The state need only provide a rational basis for its designations. The state's rational basis may include such justifications as administrative convenience and expense, or public interest in promoting, restricting or suppressing certain industries. Similarly, the state is free to designate which groups may benefit from the tax, and which groups are excluded, subject to the same rational basis test.

A state's "taxing power can be exerted only to effect a public purpose and does not embrace the raising of revenue for private purposes." Expenditures for the state's general welfare have "long and consistently [been] recognized" as valid. Since unemployment causes both social and economic problems, a state's decision to use its power to grant relief from the burdens caused by unemployment is a valid public purpose.

2. No. The Social Security Act does not have a coercive effect. "The United States and the State of Alabama are not alien governments. They coexist within the same territory. Unemployment within it is their common concern." The Social Security Act and Alabama's Unemployment Compensation Act represent "a cooperative legislative effort by state and national governments for carrying out a public purpose common to both, which neither could fully achieve without the cooperation of the other." Such cooperation is not prohibited by the Constitution.

Alabama's unemployment program is administered by the state in accordance with state law. If it wishes to do so, the state's legislature may repeal the Act and withdraw its contributions to the federal Unemployment Trust Fund. The state is then free to use those funds for any public purpose it deems worthy.