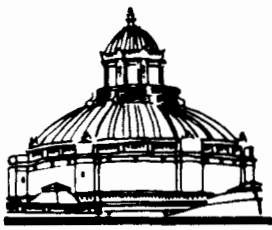
Report No. 83-150 A

COMMON LEGAL QUESTIONS AND ANSWERS CONCERNING CURRENCY, LEGAL TENDER AND MONEY

American Law Division



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July 5, 1983

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ABSTRACT

This report answers common legal questions relating to currency, legal tender, and money.

CONTENTS

COMMON LEGAL QUESTIONS AND ANSWERS CONCERNING
CURRENCY, LEGAL TENDER AND MONEY

The following are several of the more common questions and answers relating to United States currency, legal tender, and the constitutionality of paper money.

1. What is meant by the term "legal tender"?

Legal tender may be defined as the kind of coin or money which the law compels a creditor to accept in payment of his debt, when tendered in the right amount. Black's Law Dictionary 1637 (4th ed. 1968). In the United States, Congress has defined legal tender by statute in the following manner:

> United States coins and currency (including Federal reserve notes and circulating notes of Federal reserve banks and national banks) are legal tender for all debts, public charges, taxes and dues. Foreign gold or silver coins are not legal tender for debts. (31 U.S.C. § 5103).

This is not to say, of course, that parties may not contractually agree to payment in a form other than legal tender. Thus, for example parties may stipulate that payment is to be in foreign coins, or currency, or through an exchange of goods or services, and such contracts are fully enforceable. 60 Am. Jur.2d Payment § 26 (1972).

2. What is the "money of account" of the United States?

Prior to 1982, the United States Code contained a provision stating that the "money of account" of the United States shall be expressed in dollars, dimes, cents and mills. 31 U.S.C. § 371 (1976). This section was amended and recodified as 31 U.S.C. § 5101 by Public Law 97-258 (1982), so that it no longer contains the expression "money of account," but instead simply provides:

> United States money is expressed in dollars, dimes or tenths, cents or hundreths, and mills or thousandths. A dime is a tenth of a dollar, a cent is a hundreth of a dollar, and a mill is a thousandth of a dollar.

The omission of the phrase "money of account," as well as the historical background and meaning of that phrase, is discussed in the House report associated with the amendment, H.R. Rep. No. 97-651:

> The word "money" is substituted for "money of account" to eliminate unnecessary words. As far as can be determined, the phrase "money of account" has not been interpreted by any court or Government agency. The phrase was used by Alexander Hamilton in his "Report on the Establishment of the Mint" (1791). In that Report, Hamilton propounded 6 questions, including:
>
> > 1st. What ought to be the nature of the money unit of the United States?
>
> Thereafter, Hamilton uses the phrases "money unit of the United States" and "money of account" interchangeably and in the sense that the phrases are used to denote the monetary system for keeping financial accounts. In short, the phrases simply indicate that financial accounts are to be based on a decimal money system:
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> > . . ., and it is certain that nothing can be more simple and convenient than the decimal subdivisions. There is every reason to expect that the method will speedily grow into general use, when it shall be seconded by corresponding coins. On this plan the unit in the money of account will continue to be, as established by that resolution [of August 8, 1786], a dollar, and its multiples, dimes, cents, and mills, or tenths, hundreths, and thousands.
>
> Thus, the phrase "money of account" did not mean, by itself, that dollars or fractions of dollars must be equal to something having intrinsic or "substantive" value. This concept is supported by earlier writings of Thomas Jefferson in his "Notes on the Establishment of a Money Unit, and of a Coinage for the United States" (1784), and the 1782 report to the President of the Continental Congress on the coinage of the United States by the Superintendent of Finances, Robert Morris, which was apparently prepared by the Assistant Superintendent, Gouverneur Morris. See Paul L. Ford, *The Writings of Thomas Jefferson*, vol. III (G.P. Putnam's Sons, 1894) pp. 446-457; William G. Sumner, *The Financier and the Finances of the American Revolution*, vol. II (Burt Franklin, 1891, reprinted 1970) pp. 36-47; and George T. Curtis, *History of the Constitution, vol. I (Harper and Brothers, 1859) p. 443, n2. The words "or units" and "and all accounts in the public offices and all proceedings in the courts shall be kept and had in conformity to this regulation" are omitted as surplus.*

3. What are Federal Reserve notes?

Federal Reserve notes are notes issued by the Board of Governors of the Federal Reserve System to Federal Reserve banks, for eventual circulation as paper currency. Federal Reserve notes are statutorily defined as obligations of the United States, and as legal tender. 12 U.S.C. § 411, 31 U.S.C. § 5103. At present, nearly all of the circulating paper currency in the United States consists of these notes.

Although some may disagree, the constitutional authority of the Federal Government to issue circulating notes was upheld by the Supreme Court in the case of Juilliard v. Greenman, 110 U.S. 421 (1884). In this case the Court explained:

> . . . Under the power to borrow money on the credit of the United States, and to issue circulating notes for the money borrowed, its power to define the quality and force of those notes as currency is as broad as the like power over a metallic currency under the power to coin money and to regulate the value thereof. Under the two powers, taken together, Congress is authorized to establish a national currency, either in coin or in paper, and to make that currency lawful money for all purposes, as regards the national government or private parties. . . . [Emphasis added] (110 U.S. at 130).

Lower court decisions have specifically upheld the legality of the issuance of Federal Reserve notes and their use as legal tender. See, e.g., Milam v. United States, 524 F.2d 629 (9th Cir. 1974); United States v. Rifken, 577 F.2d 1111 (8th Cir. 1978); United States v. Wangrud, 533 F.2d 495 (9th Cir. 1976) cert. den. 429 U.S. 818 (1976).

4. What "backs" Federal Reserve notes?

Federal Reserve notes are collateralized by Federal Reserve bank holdings of Government securities, gold certificates, Special Drawing Rights certificates, obligations issued or guaranteed by an agency of the United States, and certain types of commercial paper. 12 U.S.C. § 412. Under section 105(b) of the Monetary

Control Act of 1980, Public Law 96-221, Federal Reserve banks may also collateralize notes with "obligations of, or fully guaranteed as to principal and interest by, a foreign government or agency thereof." This provision has been criticized as allowing the Federal Reserve System the authority to "monetize" foreign government debt. However, as explained in a recent House Banking Committee publication, this was neither the intent of the provision, nor the manner in which it is being carried out by the Federal Reserve System. Rather, the purpose of this provision is to allow Federal Reserve banks to invest foreign currencies, acquired through the normal course of business, in interest bearing investments, and additionally, to permit these assets to be used as collateral for Federal Reserve notes when demand for currency requires the use of additional collateral. See, Staff of the House Subcommittee on Domestic Monetary Policy, House Committee on Banking, Finance and Urban Affairs, The Use of Certain Provisions of the Federal Reserve Act, As Amended by Section 105(b)(2) of the Monetary Control Act of 1980, Comm. Print. No. 98-3 (1983).

5. What Can Federal Reserve Notes Be Redeemed For?

Pursuant to statute, Federal Reserve notes may be redeemed for "lawful money" on demand at the Treasury Department or at any Federal Reserve bank. 12 U.S.C. § 411. The term "lawful money" is not generally defined by statute. However, the courts have interpreted this term to be equivalent to "legal tender," which includes other Federal Reserve notes. For example, in United States v. Rickman, 638 F.2d 182 (10th Cir. 1980), the court stated at page 184:

> Defendant argues that the Federal Reserve notes in which he was paid were not lawful money within the meaning of Art. 1, § 8, United States Constitution. . . . We find no validity in the distinction which defendant draws between "lawful money" and "legal tender." Money is a medium of exchange. Legal tender is money which the law requires a creditor to receive in payment of an obligation. The aggregate of the powers granted to Congress by the

> Constitution includes broad and comprehensive authority over revenue, finance, and currency. . . . In the exercise of that power Congress has declared that Federal Reserve notes are legal tender and redeemable in lawful money. Defendant received Federal Reserve notes when he cashed his pay checks and used those notes to pay his personal expenses. He obtained and used lawful money.

Thus, Federal Reserve notes may be redeemed for other Federal Reserve notes, or for other notes or coins presently available and circulating as legal tender.

6. Isn't "Lawful Money" Defined at 12 U.S.C. § 152?

Section 152 of Title 12, United States Code provides for required reserves for so-called "gold banks," which were authorized pursuant to section 151 of that Title. Gold banks were banking associations organized for the purpose of issuing notes payable in gold, as well as United States notes redeemable in gold. Section 152 provides that such gold banks must keep at all times not less than 25 percent of their outstanding notes in gold and silver coin of the United States. This section goes on to state that "in applying the same to associations organized for issuing gold notes [gold banks'], the terms, "lawful money" and "lawful money of the United States" shall be construed to mean gold or silver coin of the United States. . ."

The Gold Reserve Act of 1934 provides that "no gold shall hereafter be coined, and no gold coin shall hereafter be paid out or delivered by the United States . . . All gold coins of the United States shall be withdrawn from circulation, and, together with all other gold owned by the United States, shall be formed into bars. . . ." 48 Stat. 340 (1934). This Act also states that, except to the extent permitted by the Secretary of the Treasury, "no currency of the United States shall be redeemed in gold. . . ." and that "No redemptions in gold shall be made except in gold bullion. . . ." 48 Stat. 340 (1934). Based on these provisions, it would appear that it is presently impossible to organize

a gold bank. And since 12 U.S.C. § 152 solely relates to gold banks organized under 12 U.S.C. § 151, its provisions would appear to be dormant. This would include the last sentence of 12 U.S.C. § 152, which defines the terms "lawful money" and "lawful money of the United States" for purposes of applying those terms to gold banks.

7. Isn't the Dollar Defined in Terms of Gold?

As originally instituted, the United States currency system equated the dollar with specific weights of gold or silver. For example, the Coinage Act of 1792 provided that Eagles or $10 dollar coins were to contain 275 grains of standard gold and that $1 dollar coins were to contain 416 grains of standard silver. 1 Stat. 246, 248 (1792). Later enactments amended these provisions. For instance, the Gold Standard Act of 1900, 31 Stat. 45, provided that the dollar was to be defined as equal to 25.8 grains of gold. In 1934, acting under Thomas Amendment to the Agricultural Adjustment Act (48 Stat. 31), President Roosevelt set the gold value of the dollar at 13.7 grains of gold, equivalent to $35 dollars per ounce. In 1972, the Par Value Modification Act (Public Law 92-268) established the par value of the dollar at 1/38th ounce of gold. In 1973 this was changed to .829848 Special Drawing Rights or $42.22 per ounce of gold (Public Law 93-110). Finally, in 1976, the par value of the dollar was abolished (Public Law 94-564 § 6). However, even when the dollar had a par value expressed in terms of a quantity of gold, this did not mean that one could redeem dollars for gold, or that a dollar was "worth" a certain amount of gold for domestic purposes. Domestic redemption in gold was prohibited by the Gold Reserve Act of 1934, 48 Stat. 337, and the par value was basically a bookkeeping device used for settling international monetary balances. Therefore the par value of the dollar did not relate to the "worth" or "actual value" of the dollar, and attempts to so equate it (and thereby reduce income tax

liability) have been rejected by the courts. See, e.g., Birkenstock v. Commission of Internal Revenue, 646 F.2d 1185 (7th Cir. 1981); Mathes v. Commissioner of Internal Revenue, 576 F.2d 70 (5th Cir. 1978) cert. den. 440 U.S. 911 (1979).

8. Is Article I, Section 10 of the Constitution in effect in all of the States?

Article I, Section 10 is part of the United States Constitution. It is in effect in all of the 50 States.

9. Does Article I, Section 10 of the Constitution Require Gold or Silver Backing?

Article 1, Section 10 of the Constitution provides that "No state shall . . . make any Thing but gold or silver Coin a Tender in Payment of Debts. . . ." This provision has been consistently interpreted by the courts as limiting the power of the States, but not the Federal Government. For example, in Juilliard v. Greenman, 110 U.S. 421 (1884), the Supreme Court stated at page 446:

> By the Constitution of the United States, the several States are prohibited from coining money, emitting bills of credit, or making anything but gold or silver coin a tender in payment of debts. But no intention can be inferred from this to deny to Congress either or these powers. . . .

Thus, although the States may not make paper money legal tender, the Federal Government may do so, and pursuant to 31 U.S.C. § 5103, all United States coins and currencies, including Federal Reserve notes, are legal tender. The courts have also uniformly rejected the argument that States violate Article 1, Section 10 when they authorize or demand payment in Federal Reserve notes.[1/] For example, in Leitch v. Oregon, 519 P.2d 1045 (1974), the Court of Appeals for the State

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1/ In Hagar v. Land Reclamation District No. 108, 111 U.S. 701 (1884), the Supreme Court held that the Federal legal tender statute did not apply to State taxes. However, the statute was subsequently amended to include State taxes. See, Lowry v. Alaska, 655 P.2d 780 (1982).

of Oregon rejected the argument that the State could not demand that taxes be paid with Federal Reserve notes:

> U.S. Constitution, Art. 1, § 10, upon which the plaintiff relies, prohibits states from making "any Thing but gold and silver Coin a Tender in Payment of Debts * * *." Plaintiff has no cognizable complaint in this regard, for it is the federal government, and not the state, that has made "all coins and currencies of the United States * * * legal tender * * *." (519 P.2d at 1046).

Similarly, in Kauffman v. Citizens State Bank of Loyal, 307 N.W.2d 325 (1981), the Court of Appeals of Wisconsin held:

> Federal reserve notes are legal tender in Wisconsin, not by any law of this state, but because Congress has made them legal tender throughout these United States. Wisconsin has made no effort to declare that federal reserve notes are or are not, in the words of Art. I, sec. 10 of the United States Constitution, a "tender in payment of debts." (307 N.W.2d at 328)

10. May a State Tax Federal Reserve Notes?

In general, States may not tax Federal obligations, such as United States bonds and Treasury notes. The basis for this exemption is that a tax upon the obligations of the United States is virtually a tax upon the credit of the Federal Government, and upon its power to raise money. The efficiency of the United States Government to carry out its functions in this manner cannot be impaired by a tax imposed by the States. McCulloch v. Maryland, 17 U.S. (4 Wheat) 316 (1819). However, in Hibernia Savings and Loan Society v. San Francisco, 200 U.S. 310 (1906), the Supreme Court explained:

> The principle, upon which this exemption is claimed, does not apply to obligations . . . intended for immediate use, and designed merely to stand in the place of money until presented at the Treasury, and the money actually drawn thereon. In such case the tax is virtually a tax upon the money . . . As was said by Mr. Justice Miller in First Nat. Bank v. Kentucky . . . "That limitation [upon the power to tax] is, that the agencies of the Federal government are only exempted from state legislation, so far as

> that legislation may interfere with, or impair their efficiency in performing the functions by which they are designed to serve that government." (200 U.S. at 314)

Thus, the exemption from State taxation does not apply to United States obligations which stand in for or are "money," such as Federal Reserve notes. Further, Congress, through legislation, also waived any claim of exemption, at 31 U.S.C. § 5154, which states:

> A State . . . may tax United States coins and currency (including Federal Reserve notes and circulating notes of Federal reserve banks and national banks) as money on hand or on deposit in the same way and at the same rate that the State taxes United States coins and currency circulating within its jurisdiction.

Finally, it should be noted that most State taxes are not taxes on the Federal Reserve notes but on underlying transactions. Thus, for example, a State income tax is a tax on the income received, which is measured in the number of dollars (Federal Reserve notes) transferred, but is not a tax on the notes themselves. Similarly, a State sales tax is a tax on business transactions (sales), the amount of the tax proportional to the number of dollars (Federal Reserve notes) involved, but again is not a tax on the notes themselves.

11. What is the Legal Status of the Coinage Act of 1792?

The Coinage or Mint Act of 1792, 1 Stat. 246 (1792), established the United States Mint in Philadelphia, and provided for the appointment of the Mint's Director and other officers. The Act directed that coins of prescribed weights of gold and silver be coined, ranging from ten dollar "eagles" to half-cents. Section 11 of the original Act provided that the "proportional value of gold to silver in all coins . . . shall be fifteen to one." In other words, every fifteen ounces of pure silver was to be considered of equal value

to one ounce of gold. Section 14 provided that it shall be lawful for every person to bring silver or gold to the Mint in the form of bullion, for purposes of striking the bullion into coins or for redemption in the form of previously minted coins. Section 16 provided that all gold and silver coins issued from the Mint shall be lawful tender in all payments whatsoever. Section 19 provided for criminal penalties for the debasement or embezzlement of coins struck at the Mint. And section 20 provided that the "money of account" of the United States shall be expressed in dollars, "dismes," cents and milles.

Under well-established principles of law, a later-passed enactment will repeal a prior provision of law which is inconsistent with the newer law.[1/] A total of 26 major coinage bills were enacted between 1792 and 1842, with a major revision in 1837.[2/] The 1792 Act was substantially revised again in 1873, and according to one commentator, effectively replaced.[3/] And legislation since that date has in effect totally rewritten the law of coinage as it existed in the 19th Century.[4/]

The modern laws relating to coins and minting may be found in Title 31 of the United States Code. Section 5111 of this Title (as recodified and enacted into positive law by Public Law 97-258 (1982)), provides that the Secretary of the Treasury shall mint and issue coins in amounts he determines

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1/ C. Sands, Sutherland's Statutes and Statutory Construction § 51.02 (4th ed. 1973); Posadas v. National City Bank, 296 U.S. 497 (1936).

2/ Act of Jan. 18, 1837, 5 Stat. 136 (1837); Ganz, Toward a Revision of the Minting and Coinage Laws of the United States, 26 Clev. St. L.R. 175, 188 (1977).

3/ See, Ganz, supra note 2.

4/ Id.

are necessary to meet the needs of the United States. Section 5112 provides that the Secretary may only issue coins in the denominations of: dollar, half dollar, quarter, dime, 5-cent piece, and one-cent coin. The dollar, half dollar, quarter dollar, and dime coins must be "clad coins" consisting of copper sandwiched between an alloy of nickel and copper. The 5-cent coin must be composed of an alloy or copper and zinc. The Secretary has the authority to mint a limited number of dollar and half dollar coins composed of an alloy of silver and copper. However, the authority to mint such coins is due to expire January 1, 1984.

Based on these newer provisions, it appears that the Mint no longer has the statutory authority to strike silver or gold coins as prescribed in the Coinage Act of 1792, and these provisions must be considered to have been repealed by implication. In addition, provisions relating to the right of citizens to bring gold or silver to the Mint for purposes of coinage must likewise be considered no longer in effect. Under current law, a person still has the right to bring gold or silver bullion to be cast into bars. See, 31 U.S.C. § 5121.