Michigan Law Review

Volume 37 | Issue 8

1939

TAXATION - AD VALOREM TAXES - TAX ON GROSS EARNINGS AS EVASION OF CONSTITUTIONAL PROHIBITION OF AD VALOREM TAXES

Ward P. Allen
University of Michigan Law School

TAXATION — AD VALOREM TAXES — TAX ON GROSS EARNINGS AS EVASION OF CONSTITUTIONAL PROHIBITION OF AD VALOREM TAXES — An Oklahoma statute [1] imposed a tax of four per cent of the gross earnings of all freight cars owned, rented, leased, or used by any freight line company within the state, giving the state tax commission power to raise or lower the rate so that the tax should be "as nearly as practicable, the equal of the amount of tax such . . . companies would pay if their cars were taxed on an ad valorem basis." *Held*, although purporting to be measured by gross earnings, the tax is neither a gross earnings tax, nor a specific property tax, but an ad valorem tax in disguise, and thus violative of that provision in the Oklahoma Constitution [2] which states that "No ad valorem tax shall be levied for State purposes." *Pacific Fruit Express Co. v. Oklahoma Tax Commission*, (D. C. Okla. 1939) 27 F. Supp. 279.

The blanket constitutional amendment prohibiting all ad valorem taxes for state purposes, a reversal of the historical attitude,[3] is a crystallization of the increasingly prevalent belief that there is little justification for such a method

[1] Okla. Laws (1937), c. 66, art. 8, Stat. (Supp. 1938), § 12468c.

[2] Okla. Const., art. 10, § 9, as amended in 1933. The previous provision permitted ad valorem taxation for state purposes, but limited it to three and a half mills. See Graham v. Childers, 114 Okla. 38, 241 P. 178 (1925).

[3] Most state constitutions contain a provision that property must be taxed upon an ad valorem basis. Cal. Const., art. 13, § 1 [see Rittersbacher v. Board of Supervisors of Los Angeles County, 220 Cal. 535, 32 P. (2d) 135 (1934), certiorari den. 293 U. S. 592, 55 S. Ct. 107 (1934)]; Ill. Const., art. IX, § 1 [see People ex rel. McDonough v. Grand Trunk Western Ry., 357 Ill. 493, 192 N. E. 645 (1934)].

of tax apportionment in our present economy; [4] that an attempted justification for ad valorem taxes on the ability-to-pay theory involves the non sequitur that he who possesses the more valuable property can afford a higher tax, and is based on the mistaken assumption that appraisers find the true value instead of resorting to arbitrary assessments; and that an attempted justification on the benefits-received theory,[5] or its variant, the cost-of-services theory,[6] is likewise weak. In line with this, several less drastic devices have been adopted by some states to relieve the harshness of ad valorem taxation: some of the constitutional provisions requiring property taxes to be ad valorem have limited the amount.[7] Alabama has exempted homesteads from the provisions of the statute; [8] and there is a discernible tendency to lay ad valorem taxes so that they reach only productive property.[9] It would seem that there is more merit to the arguments against such method of taxation when the tax is upon realty than when it is levied on personalty; yet the sweeping terms of the amendment involved in the principal case included both in its prohibition. In enacting the present statute, the legislature, feeling the restriction of the constitutional provision, was presented with a nice problem in draftsmanship. A simple gross earnings tax, never considered an ad valorem tax,[10] would of course have been the easiest method of escaping invalidation under the amendment. But, skirting the Scylla of the state constitutional prohibition by such a course would undoubtedly, as the court intimates, have resulted in a wreck upon the Charybdis of the federal constitutional prohibition against burdening interstate commerce,[11] since such a tax is not

[4] See GREEN, THEORY AND PRACTICE OF MODERN TAXATION 232-234 (1933).

[5] See, however, Spengler, "Is the Real Estate Tax a Benefit Tax?" REPORT OF NEW YORK STATE COMMISSION FOR REVISION OF TAX LAWS, part III, memorandum 5 (1932) (Leg. Doc. No. 77).

[6] See Bonbright, "The Valuation of Real Estate for Tax Purposes," 34 COL. L. REV. 1397 at 1400 (1934), where the author points out that this theory has two bases: (1) that the cost of governmental protection to a person's property increases with its amount, and (2) that likewise does the cost of protecting other persons against the misuse of the property taxed.

[7] La. Const., art. 10, § 3 [and see State ex rel. Porterie v. H. L. Hunt, Inc., 182 La. 1073, 162 So. 777 (1935)]; Mich. Const., art. 10, § 21 [and see School District of City of Pontiac v. City of Pontiac, 262 Mich. 338, 247 N. W. 474, 787 (1933)]; N. C. Const., art. 5, § 6, art. 7, § 7 [and see Glenn v. Commrs. of Durham, 201 N. C. 233, 159 S. E. 439 (1931)]; Okla. Const., art. 10, § 9 (before the 1933 amendment).

[8] Ala. Gen. Laws (Extra Sess. 1936-1937), act no. 107.

[9] See, for example, Ohio Gen. Code (1938), §§ 5323, 5638, taxing unproductive investments at a much lower rate.

[10] Western Union Telegraph Co. v. State Board of Assessment, 80 Ala. 273 at 279 (1885); Hurd v. Cook, 60 N. J. L. 70 at 71, 36 A. 892 (1897); North Jersey Street Ry. v. Jersey City, 73 N. J. L. 481, 63 A. 833 (1906).

[11] The statute included not only gross earnings on intrastate business, but a portion of the gross earnings on all interstate business passing through, into, or out of the state. Of course, a tax upon the earnings from intrastate business would not be violative of the commerce clause. Pacific Express Co. v. Seibert, 142 U. S. 339, 12 S. Ct. 250 (1892); People of State of N. Y. ex rel. Cornell Steamboat Co. v. Sohmer, 235 U. S. 549, 35 S. Ct. 162 (1915), affg. 206 N. Y. 651, 99 N. E. 1115 (1914). But it is beyond

considered one upon property.[12] What was desired, then, was a property tax, not ad valorem, yet based on some method of reflecting ability to pay. The use of gross earnings to measure a property tax is neither violative of the commerce clause of the Federal Constitution,[13] nor considered a sufficiently accurate measure of the true value of the property to make the tax "ad valorem" within the proper meaning of that term.[14] Hence, had the statute in question been drafted in such form it would, no doubt, have been sustained. But the legislature chose to add the provision empowering the tax commission, whenever hearing and testimony revealed a difference, to alter the rate to conform to a general ad valorem tax on freight cars if such a tax were imposed. There is apparently but little authority bearing upon the precise effect of such a provision. But in two decisions of the Oklahoma Supreme Court[15] involving a similar statute[16] imposing a tax upon the gross value of petroleum production, with a similar provision for alteration of the rate to conform to the general ad valorem tax, may be found

cavil that taxation of the interstate earnings would be. Fargo v. Michigan, 121 U. S. 230, 7 S. Ct. 857 (1887); Philadelphia & Southern Steamship Co. v. Pennsylvania, 122 U. S. 326, 7 S. Ct. 1118 (1887); Meyer v. Wells, Fargo & Co., 223 U. S. 298, 32 S. Ct. 218 (1912); see United States Express Co. v. Minnesota, 223 U. S. 335 at 343, 32 S. Ct. 211 (1911) (and cases cited). The theory is that taxation of commerce is regulation thereof—The Passenger Cases, 7 How. (48 U. S.) 283 (1849); that the state cannot regulate those subjects of interstate commerce that are national in character—Cooley v. Board of Wardens of Philadelphia, 12 How. (53 U. S.) 298 (1851); and that the exchange and transportation of commodities between the states are of such a character—Welton v. Missouri, 91 U. S. 275 at 280 (1875).

[12] Meyer v. Wells, Fargo & Co., 223 U. S. 298, 32 S. Ct. 218 (1912); Choctaw, Oklahoma & Gulf R. R. v. Harrison, 235 U. S. 292, 35 S. Ct. 27 (1914). But several state decisions have held the contrary with similar taxes. See State ex rel. Minces v. Schoenig, 72 Minn. 528, 75 N. W. 711 (1898) (to the effect that a tax of 2% on gross receipts from "gift, fire, and bankrupt sales" is a property tax, and violative of the ad valorem requirement); Parker v. North British & Mercantile Ins. Co., 42 La. Ann. 428, 7 So. 599 (1890) (to the same effect as to a tax on gross receipts from insurance businesses).

[13] Galveston, H. & S. A. Ry. v. Texas, 210 U. S. 217, 28 S. Ct. 638 (1908); Meyer v. Wells, Fargo & Co., 223 U. S. 298, 32 S. Ct. 218 (1912); Cooney v. Mountain States Tel. & Tel. Co., 294 U. S. 384, 55 S. Ct. 477 (1935). It would seem that, even though in form a tax on gross earnings, a statute would be held sufficiently a property tax not to violate the commerce clause if there be a provision that it "shall be in lieu of all taxes upon its property." See United States Express Co. v. Minnesota, 223 U. S. 335 at 347, 32 S. Ct. 211 (1911), quoting the language of Justice Peckham in McHenry v. Alford, 168 U. S. 651 at 671, 18 S. Ct. 242 (1898). Somewhat similar wording in the statute involved in the instant case is to the effect that the tax "shall be in lieu of ad valorem taxes upon such freight cars."

[14] See cases cited, supra, note 10.

[15] Large Oil Co. v. Howard, 63 Okla. 143, 163 P. 537 (1917), reversed as to taxation of the property involved, 248 U. S. 549, 39 S. Ct. 183 (1918); In re Skelton Lead & Zinc Company's Gross Production Tax for 1919, 81 Okla. 134, 197 P. 495 (1921). The issue in both cases was whether or not a person operating under a lease granted by the federal government could be subjected to the tax.

[16] Okla. Laws (1916), c. 39; Stat. (1931), § 12434.

statements, apparently inconsistent, dealing with the matter. In the *Large Oil Co.* case [17] the court, without mentioning the provision for alteration, said, "it is not, however, a tax levied on an ad valorem basis within the meaning . . . of the Constitution." In the *Skelton* case,[18] however, the statement was to the effect that, "From this [the provision for alteration of the rate], it is clear that the Legislature had no other object than to levy a 'property tax' upon the mining property according to its *fair cash value* . . . providing the means . . . for correcting any mistakes which might result from overvaluation or excessive rate." These unhelpful authorities aside, it would seem that, excepting the unlikely situation wherein the particular cars were completely unproductive, the resultant tax would really be levied according to true value. If the amount of the tax were greater, the companies could certainly be expected to petition for the readjustment; and if the amount were less, the state tax commission under its statutory authority would undoubtedly initiate the proceedings. And by the added statement that, "It is hereby declared to be the intention of the legislature that the tax herein imposed be, as nearly as practicable, the equal of the amount of tax such . . . companies . . . would pay if their cars were taxed on an ad valorem basis," the legislature put such a complexion upon the statute as would seem to warrant, if not perhaps to dictate, the conclusion that the tax was ad valorem within the meaning of the constitutional prohibition.

Ward P. Allen

[17] 63 Okla. 143 at 155, 163 P. 537 (1917).
[18] 81 Okla. 134 at 137, 197 P. 495 (1921).