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TAXATION - CONSTITUTIONALITY OF GRADUATED SALES TAXES

TAXATION — CONSTITUTIONALITY OF GRADUATED SALES TAXES — A Kentucky statute of 1930 levied a tax on gross retail sales at rates varying from 1/20 of one per cent on gross sales up to $400,000 per year, to one per cent on all gross sales over $1,000,000 annually. For the purpose of this tax all retail stores under the same ownership, operation or control, directly or indirectly, were treated as a unit; hence, the heavier rates of the tax fell upon the chain stores and large department stores. A group of chain and department stores sought to enjoin the collection of the tax, as contrary to the state and federal constitutions, and appealed from a state court decision upholding the tax. *Held*, that the statute is a denial of equal protection of the laws contrary to the Fourteenth Amendment, since it imposes taxes at varying rates upon identical sales, solely upon the basis of the volume of the sales annually, and hence is an unjust and unreasonable classification. *Stewart Dry Goods Co. v. Lewis*, (U. S. 1935) 55 Sup. Ct. 525.

The constitutionality of many selective sales taxes,[1] the flat rate retail sales tax,[2] and the general sales tax[3] has been widely upheld. Sales tax revenues have been found to be reasonably constant even under depression conditions, so that a large and rapidly increasing number of states make use of some type of sales taxation.[4] Furthermore, various exemption provisions excluding from the operation of such sales taxes certain articles of commerce such as agricultural products sold by those who had raised them,[5] or gasoline already subject to such tax[6] have been held not to deny equal protection of the law. Likewise, classification of the rates as applied to the gross sales of various sorts of producers has been upheld.[7] But the tax involved in the instant case was held to go beyond the

[1] This type of tax dates back to early colonial times; see National Industrial Conference Board, SALES TAXES—GENERAL, SELECTIVE AND RETAIL 48-57 (1932).

[2] National Industrial Conference Board, SALES TAXES—GENERAL, SELECTIVE AND RETAIL 58-63 (1932). See also HAIG, THE SALES TAX IN THE AMERICAN STATES (1934); an interesting history of the Kentucky situation which led to the tax concerned in the principal case is given on pp. 159-164.

[3] BUEHLER, GENERAL SALES TAXATION (1932); National Industrial Conference Board, SALES TAXES—GENERAL, SELECTIVE AND RETAIL 13-47, 64-79 (1932); HAIG, THE SALES TAX IN THE AMERICAN STATES (1934); Martin and Tolman, "Recent State Gross Sales Tax Legislation," 11 TAX MAG. 449 (Dec. 1933), 12 TAX MAG. 15 (1934).

[4] It would be difficult to say just how many are now in effect, because many of those passed since 1929 have been for a limited period only. During the legislative sessions of 1933, 17 states adopted one form or another of the general sales tax, bringing the total to 25; there are probably a good many more now. Martin and Tolman, "Recent State Gross Sales Tax Legislation," 11 TAX MAG. 449 at 452 (Dec. 1933).

[5] Knisely v. Cotterel, 196 Pa. 614, 46 Atl. 861, 50 L. R. A. 86 (1900). But *cf.* Winter v. Barrett, 352 Ill. 441, 186 N. E. 113, 89 A. L. R. 1398 (1933), which held an Illinois general sales tax contrary to the uniformity clause of the state constitution because of the exemption of sales of gasoline, and farmers' sales of their own products.

[6] Liggett Co. v. Lee, 288 U. S. 517, 53 Sup. Ct. 481, 85 A. L. R. 699 (1933).

[7] Knisely v. Cotterel, 196 Pa. 614, 46 Atl. 861, 50 L. R. A. 86 (1900); State

limits of reasonable classification. The particular type of graduated tax involved is one which bears most heavily upon the department and chain stores.[8] Efforts to tax chain stores more heavily than those independently owned and controlled have been common and have met with varying success.[9] In 1931 one of the most direct methods of reaching chain organizations, that of a license tax on each store, graduated according to the number of stores under unified ownership or control, was upheld by the United States Supreme Court in the case of *State Board of Tax Commissioners v. Jackson.*[10] That decision was based upon the general ground that the classification was a reasonable one for tax purposes, since chain stores possessed merchandising advantages as a result of their sales volume and organization which in general resulted in a greater percentage of net income, and hence a greater ability to pay taxes, than with the ordinary individual retailer.[11] However, the courts have held unreasonable a license tax imposing a higher rate per store on those owning over five stores, the higher rate including the first five stores;[12] likewise a license tax graduated according to the number of stores operated in each county.[13] The principal case represented an attempt to apply to the retail sales tax a distinction similar to that made in the graduated license tax. If the increased volume of business was the principal factor giving additional advantages to chain stores, such a graduation based on gross sales would seem to approximate ability to pay more closely than that based upon the number of stores operated. However, the graduated sales tax also hits the department stores, which cannot be said to secure all the chain store advantages, their merchandising being spread over numerous lines of goods.[14] Yet it should be

ex rel. Botkin v. Welsh, 61 S. D. 593, 251 N. W. 189 (1933); State ex rel. Stiner v. Yelle, 174 Wash. 402, 25 Pac. (2d) 91 (1933).

[8] Stewart Dry Goods Co. v. John B. Lewis, (U. S. 1935) 55 Sup. Ct. 525 at 526, n. 3 (statute set forth). For a good discussion of the graduated retail sales tax in general, see Martin and Tolman, "Recent State Gross Sales Tax Legislation," Part II, 12 TAX MAG. 15 (Jan. 1934). HAIG, THE SALES TAX IN THE AMERICAN STATES 159 at 164 (1934), discusses the Kentucky tax.

[9] For collections of the earlier cases, see 73 A. L. R. 1481 (1931), 85 A. L. R. 736 (1933).

[10] 283 U. S. 527, 51 Sup. Ct. 540, 73 A. L. R. 1464 (1931). See also Fox v. Standard Oil Co. of New Jersey, 294 U. S. 87, 55 Sup. Ct. 333 (1935); Liggett Co. v. Lee, 288 U. S. 517, 53 Sup. Ct. 481, 85 A. L. R. 699 (1933).

[11] Stewart Dry Goods Co. v. John B. Lewis, (U. S. 1935) 55 Sup. Ct. 525 at 535; State Bd. of Tax Com'rs v. Jackson, 283 U. S. 527 at 535, 51 Sup. Ct. 540, 73 A. L. R. 1464 (1931); Fox v. Standard Oil Co. of New Jersey, 294 U. S. 87 at 97, 98, 55 Sup. Ct. 333 (1935).

[12] Great Atlantic & Pacific Tea Co. v. Doughton, 196 N. C. 145, 144 S. E. 701 (1928).

[13] Liggett Co. v. Lee, 288 U. S. 517, 53 Sup. Ct. 481, 85 A. L. R. 699 (1933).

[14] Stewart Dry Goods Co. v. John B. Lewis, (U. S. 1935) 55 Sup. Ct. 525 at 535, n. 3; Liggett Co. v. Lee, 288 U. S. 517 at 532, 53 Sup. Ct. 481, 85 A. L. R. 699 (1933); State Bd. of Tax Com'rs v. Jackson, 283 U. S. 527 at 536, 51 Sup. Ct. 540, 73 A. L. R. 1464 (1931); Fox v. Standard Oil Co. of New Jersey, 294 U. S. 87 at 97, 55 Sup. Ct. 333 (1935); the latter case, upholding taxation of gasoline stations on the same basis as chain stores, pointed out that they need not

pointed out that failure to include department stores in the same category as the chain stores was an argument seriously urged against the validity of the graduated license tax.[15] However, the really fatal distinction seemed to the Court to lie in the form of the two types of taxes. The chain store license tax is based upon the privilege of doing business, and chain stores can be said to do business of a sort somewhat different from that of the independent store. (From the classification, it must also have been found that chains of two to five did business of a sort differing from those of five to ten stores.[16]) In the principal case, the tax was based upon sales of commodities. The Court indicated that a tax upon the act of making sales cannot be varied in amount merely on the basis of the number of times that the act is performed.[17] It is certainly arguable that this is as reasonable a classification as that made when one store is burdened with an annual license fee many times that of another exactly similar store, merely because it happens to be one of a number jointly owned. It seems difficult to escape the conclusion voiced by Mr. Justice Cardozo in his dissenting opinion in the principal case that, "In fine, there may be classification for the purpose of taxation according to the nature of the business. There may be classification according to size and the power and opportunity of which size is an exponent. Such has been the teaching of the lawbooks, at least until to-day." [18]

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possess all the business advantages of chain stores for the classification to be a reasonable one.

[15] State Bd. of Tax Com'rs v. Jackson, 283 U. S. 527 at 535, 536, 51 Sup. Ct. 540, 73 A. L. R. 1464 (1931); Liggett Co. v. Lee, 288 U. S. 517 at 532, 533, 53 Sup. Ct. 481, 85 A. L. R. 699 (1933).

[16] Great Atlantic & Pacific Tea Co. v. Doughton, 196 N. C. 145, 144 S. E. 701 (1928); *cf.* State Bd. of Tax Com'rs v. Jackson, 283 U. S. 527, 51 Sup. Ct. 540, 73 A. L. R. 1464 (1931). See also Clark v. Titusville, 184 U. S. 329, 22 Sup. Ct. 382 (1902), which upheld a license tax upon wholesale and retail merchants, at a rate which varied progressively with gross sales; Metropolis Theater Co. v. Chicago, 228 U. S. 61, 33 Sup. Ct. 441 (1913), upholding a tax upon theater operators proportioned to the cost of the tickets; Pacific American Fisheries v. Alaska, 269 U. S. 269, 46 Sup. Ct. 110 (1925), which upheld a tax the rate of which varied with the number of cases of salmon packed.

[17] Stewart Dry Goods Co. v. John B. Lewis, (U. S. 1935) 55 Sup. Ct. 525 at 532.

[18] Stewart Dry Goods Co. v. John B. Lewis, (U. S. 1935) 55 Sup. Ct. 525 at 538. In respect to the comparison made between the principal case and the cases of Jackson v. Indiana State Tax Comm. and Fox v. Standard Oil Co., cited note 10, supra, it is interesting to note the way the members of the court voted. In the Jackson and Fox cases, the dissent was by Justices Sutherland, McReynolds, Van Devanter, and Butler; in the principal case, Justices Cardozo, Brandeis, and Stone dissented.