1954

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The Legal Nature of the State Income Tax

By CHARLES R. LOCKYER

After the inadequacy of existing federal and state revenue-raising media became apparent in the early 1900's, both state and federal governmental units resorted to income taxation as significant revenue measures. Prior to this serious utilization of income taxes, various courts evolved an elaborate assemblage of law primarily concerned with three major types of taxes. According to Justice Field:

The power of taxation is necessarily limited to subjects within the jurisdiction of the taxing state. Those subjects are persons, property, and business. Whatever form taxation may assume it must relate to one of these subjects.¹

The grouping of Justice Field may be the basis for classifying taxes into a functional arrangement. Professor Cooley accordingly classified taxes as capitation or poll, property, and excise.² Legal provisions and technicalities applicable to the particular category were generally applicable to all taxes within a class. For example, a tax classified as a personal tax was subject to those provisions and limitations common to the personal tax class. Conversely, legal provisions properly applied to property and excise taxes were not generally applicable to a personal tax. The increased use of income taxes presented courts (particularly state courts) with the problem of ascertaining the nature and characteristics of the income tax.

The form of legislation plays a very significant role in passing upon the constitutionality of various income tax acts. Both federal and state governments apparently have the inherent power to impose income taxes; therefore no specific constitutional grant is necessary.³ Constitutional provisions generally limit rather

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¹ State Tax on Foreign Held Bonds, 15 Wall. 300, 82 U.S. 300 (1872).
³ Shaffer v. Carter, 252 U.S. 37, 40 S.Ct. 221, 64 L.Ed. 445 (1920); Reynolds Metal Co. et al. v. Martin et al., 269 Ky. 378, 107 S.W. 2d 251 (1937); Stanley v. Gates, 179 Ark. 886, 19 S.W. 2d 1000 (1929); and Featherstone v. Norman, 170 Ga. 370, 153 S.E. 58 (1930).
than expand this authority. In some instances, constitutional provisions may be necessary to avoid the application of limiting provisions to income taxes. Such provisions apparently are effective on both the federal and state levels. Determining whether an income tax statute is in agreement with a given constitution is largely a matter of constitutional interpretation. In the case of state constitutions, the state rather than the federal courts generally resolve this matter inasmuch as no federal question arises.

Perhaps the experience in death taxation partially accounts for the inclination of courts to explore the legal nature of income taxes. Jurisdiction of states to impose death taxes, as defined by courts in the past, created significant areas of possible multiple taxation. Federal court decisions dealing with state jurisdiction in the area of state death taxation relied heavily upon the nature of the death tax. As a consequence of such decisions, the United States Supreme Court, in effect, mitigated for a time much of the load of multiple taxation arising from overlapping jurisdiction among the states. Some writers speculated as to whether similar effects may be obtained as a result of federal decisions in the area of state income taxation. Up to the present time, no such effects have occurred in the area of income taxation. The fact that individual death tax cases generally involved large dollar tax liabilities, as compared with state income tax cases, may partially account for the lack of similar decisions. More important may be the fact that later decisions in the area of death taxation indicated a distinct reversal in the court's construction of the constitution which tended to ameliorate multiple taxation among states. As might be expected, in the light of later developments in decisions applicable to state jurisdiction to impose death taxes, courts handed down few, if any, decisions that tended to mitigate multiple taxation in the area of state income taxes.

In many states the problem of determining the legal nature

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5 For example, see Henry Rottschaefer, State Jurisdiction to Tax Income, 20 Iowa L. Rev. 292-312 (1937).
of the tax was squarely presented. Needless to say, the several state tribunals variously resolved the problem. In addition to differences in view, state constitutions and income tax statutes helped to account for the diversity in opinions among courts of different states. The drafting and later interpretation of the Kentucky statutes involved considerable use of the experience of other states. The comparatively late institution of an income tax in Kentucky facilitated the extensive use of that experience.

The legal nature of the income tax is by no means of entirely academic interest; rather it sheds light on several aspects of practical importance. The nature of the tax is of much importance in the determination of the constitutionality of the act. It directly affects a state's jurisdiction to impose income taxes. It also plays an important role in ascertaining which items are properly includable in income as well as determining the appropriateness of a method for allocating the income that corporations derive from two or more states. An analysis of income taxes, as classified by the courts in Kentucky and other jurisdictions, precedes a consideration of the relationships between the legal nature of the act and the practical implications. Legislative intention as stated in the statute may in some instances be an important factor affecting the decision regarding the nature of the tax. The following discussion includes no analysis of the effect of such statements.

AS A PERSONAL TAX

Strictly speaking, a personal tax is "a tax on the person without reference to property as a capitation or poll tax..." Inasmuch as states impose income taxes on income and not on a per capita basis, most courts have refrained from classifying the income tax as a personal tax. This category is perhaps the least suitable among the three traditional classes to embrace the income tax. A few courts have considered the possibility of classifying the income tax as a personal tax but rejected such a classification. Other courts have suggested that the income tax is, in some im-

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important respects, personal in nature. At best, the income tax partakes of certain qualities peculiar to a personal tax. For example, some decisions relating to the state's jurisdiction to impose an income tax have suggested a similarity between income and personal taxes. In *Cook v. Tait*¹ the Supreme Court held a nonresident citizen liable for federal income tax on income earned from property located in Mexico. The opinion suggests that an income tax is similar to a personal tax because the court would probably not sustain a property or an excise tax under such circumstances. The fact that citizenship rather than domicile constituted the basis for the tax liability weakens the suggestion that the court in *Cook v. Tait* regarded the income tax as partaking of the nature of a personal tax. A personal tax liability generally attaches by virtue of domicile rather than citizenship. In *Lawrence et al. v. State Tax Commission of Mississippi*,,¹⁰ the Supreme Court sustained the Mississippi state income tax applied to a resident who earned his income in Tennessee. Although the Mississippi court had previously held the tax to be an excise, the Supreme Court held itself concerned "... only with the practical operation ..." of the tax.¹¹ The court declared that "Domicile itself establishes a basis for taxation."¹²

However in *Shaffer v. Carter* the United States Supreme Court sustained the Oklahoma income tax on a nonresident domiciled in Illinois. The court clearly rejected the contention that the state's jurisdiction to impose the income tax depended entirely upon domicile. Apparently the court did not regard the Oklahoma income tax as a personal tax.

In summary, classifying the income tax as a personal tax in the strict sense is an inadequate explanation of the tax. The income tax possesses many characteristics quite distinct from a personal tax. The state's jurisdiction to impose an individual income tax is remarkably similar to the state's jurisdiction to impose a personal tax as indicated by some court decisions. Aside from the legalistic connotation of a personal tax, in popular usage there is much to support the suggestion that the income tax is a personal tax.

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¹¹ *Id.*
¹² *Id.*
tax. For example, some early taxes such as the class taxes of the German states of Baden and Prussia were basically a personal tax. That is, in the early 1800's the states divided the population into a few groups and imposed taxes according to each class. In addition, the model individual income tax prepared by committees of the National Tax Association were likewise essentially personal taxes by nature.

AS A PROPERTY TAX

The tendency of some state courts to regard income taxes as property taxes may be traceable to the Pollock cases involving the constitutionality of the federal individual income tax of 1894. As indicated below, this interpretation of the Pollock cases appears questionable. The Pollock cases are also important inasmuch as they are among the few cases that contain a penetrating analysis of the nature of the income tax. Generally, state courts refrained from such analysis and based their decision on selected decisions that previously grouped income taxes into the property tax category. State court decisions, which classified income taxes as property taxes, fall into two distinct categories. That is, the property or subject of the tax is sometimes the income-producing property or the income itself. Although most states adhere to the former classification, Massachusetts and a few other states embrace the latter concept.

The Supreme Judicial Court of Massachusetts in 1917 ruled that the income tax was essentially a property tax and that income was the subject of taxation. The court sustained the constitutionality of the 1916 income tax. It held that the differential rate structure was not in violation of uniformity provisions because the legislature based the rates on reasonable classification. Notwithstanding previous contrary decisions the court clearly differentiated between income and income-producing property and held the former to be the subject of the tax. The court stated that the somewhat unique decision agreed with the uniformity provision of the Massachusetts Constitution and also with the “ordinary and popular meaning” of income. The amendment ab-

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25 Id.
solved all possible doubt of the legislature regarding the power
to utilize income as the subject of the tax. With the subject of
taxation determined, the court indicated that the definition and
measurement of income was essential to the tax. The jurists noted
that a time interval was an essential element of income. They
also noted that income as the subject of taxation resulted in a
broader tax base than if the subject were the income-producing
property. Apparently, the court regarded the tax as a property
tax on income received during a specified period. The Mas-
sachusetts court also classified the income tax as a property tax
and the income-producing property as the subject of the tax both
before and after Trefry v. Putnam.\(^1\)

Courts of other states have likewise suggested that the income
tax was a property tax but that the income-producing property
was the subject of taxation. Two early Georgia and Missouri
decisions declared that an income tax was not a property tax.\(^1\)
In dissenting opinions the minority contended that income was
property and the subject of the tax. The tax, they contended,
was a property tax. These dissenting opinions were persuasive in
later cases in which courts held income taxes to be property taxes
and income the subject of taxation. The New Hampshire Su-
preme Court in an advisory opinion suggested that an income tax
imposed on income derived from property already subject to a
property tax would not constitute double taxation because income
was the subject of taxation of the income tax and different from
the income-producing property. The court held: “Money on
hands (sic) has been taxed as property in the hands of the owner
separate from the property producing it.”\(^8\) In the same case, the
dissenting opinion of Justice Robert J. Peaslee subsequently proved
influential in numerous state court decisions which differentiated
between income and property. This opinion materially aided in
the development of another concept of the nature of income
taxes. The Delaware Court of General Sessions held the income
tax to be a property tax and income the subject of the tax.\(^9\) The
Delaware court referred to the Georgia opinion as “very technical,

\(^{10}\) Opinion of the Justices, 220 Mass. 618, 108 N.E. 570 (1915) and Maguire
\(^{11}\) Ludlow-Saylor Wire Co. v. Wollbrink, 275 Mo. 399, 205 S.W. 196 (1918)
and The Mayor, Savannah v. Charles Hartridge, 8 Ga. 23 (1850).
\(^{12}\) In re Opinion of the Justices, 77 N.H. 611, 93 A. 311 (1915).
\(^{13}\) State v. Pinder, 30 Del. 416, 108 A. 43 (1919).
If not illogical for not regarding income as property and properly within the purview of the constitutional provisions applicable to property taxation. In State v. Pinder the court affirmed the constitutionality of the income tax. The court declared that exemptions allowed in the law were not repugnant to the constitutional mandates of reasonableness and uniformity.

The Alabama Court in 1920 provided a most complete statement to the effect that an income tax is a property tax and income the subject of taxation. Apparently the court based its decision on the following syllogistic reasoning:

To summarize: Money or any other thing of value, acquired as gain or profit from capital or labor, is property; in the aggregate these acquisitions constitute income; and, in accordance with the axiom that the whole includes all of its parts, income includes property and nothing but property, and therefore is itself property.

The confusion in logic stemmed from the fact that the court regarded the acquisition and the thing acquired as synonymous. However this reasoning proved quite persuasive for other courts confronted with a similar question. The Illinois Supreme Court in Bachrach v. Nelson reasoned that, "in accordance with the axiom that the whole includes all of its parts, income includes property, and nothing but property, and therefore is itself property." The court accordingly declared the Illinois income tax of 1929 unconstitutional because the proposed rate structure did not conform with the uniformity provision of the constitution applicable to property taxes.

The Washington Supreme Court held the Washington income tax of 1933 to be a property tax. Inasmuch as the tax was graduated in relation to taxable income the court ruled that the law lacked constitutional uniformity and therefore declared it unconstitutional. In an overstatement, the court declared: "The overwhelming weight of judicial authority is that income is property and a tax upon income is a tax upon property." More recently,

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20 Id.
21 Eliasberg Brothers Mercantile Co. v. Grimes, 204 Ala. 492, 86 So. 56, 11 A.L.R. 300 (1920).
22 Id.
25 Id.
the court held the Corporation Excise Tax of 1951 to be an income tax which is a property tax "masquerading as an excise tax." The opinion is somewhat unique because the court held the law in violation of the uniformity provision of the constitution even though the tax rate was a flat 4 per cent. Lack of uniformity stemmed from the fact that the tax applied to corporations and competing co-partnerships and sole proprietorships did not incur tax liability.

To classify the income tax as a property tax and regard income as the subject of taxation suggests the application of a tax on income in lieu of the ad valorem tax on income when received and enjoyed. Implicit to the income concept is the time period. The flow of taxable wealth during a given taxable period constitutes the basis for an income tax. If the court classifies the income tax as a property tax, the realistic possibility of imposing two property taxes on certain items arises. Such double taxation is particularly troublesome in those states with constitutional prohibitions against double taxation. Notwithstanding the fact that double taxation may legally exist in certain states, the situation may be regarded as unsatisfactory.

Courts embracing the view that an income tax is a property tax on income may sometimes find exemptions of minimum income in violation of constitutional uniformity provisions. On the other hand, exemptions of all income of prescribed recipients such as educational institutions might be effective even though not specified by statute.

The imposition of a tax on income does not lend itself to the usual practice of placing the tax on property owned on a specified date. Courts frequently cited this difference as an objection to the classification of income taxes as property taxes. However the Alabama court saw no objection to the alleged difference and further held:

Nor is it of consequence that the money thus taxed has left the hands of its quondam owner, however speedily; for the state has the inherent power to tax property owned at any time during the tax year, though it has not seen fit to do so.27

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27 Eliasberg Brothers Mercantile Co. v. Grimes, 204 Ala. 492, 86 So. 56, 11 A.L.R. 300 (1920).
In the past most of the state courts placed considerable reliance upon the *Pollock* cases when they contended that income taxes are property taxes and income is the subject of the tax. These cases may at best support the contention that an income tax is a property tax even though the question presented in these cases was whether the income tax of 1894 came within the purview of a direct tax as used in the federal constitution. In the various cases in which state courts held income taxes to be a property tax on the income-producing property the fact that the federal court previously held a tax on rental income to be a tax on the land was persuasive. In the second *Pollock* case the court held the federal tax on income from personal property to be tantamount to a personal property tax. Professor Rottschaefer and others regard the reliance upon *Pollock* cases to sustain the tax as a property tax regardless of the subject of taxation as "exceedingly weak."

The view that income taxes are property taxes imposed on the income-producing property is somewhat more popular among states classifying the income tax as a property tax. Obviously, this concept of income taxes refers primarily to partial income taxes on income derived from property and not other types of income. Opinions suggesting that the income tax is a property tax generally fail to distinguish clearly between those imposed on the income itself or those imposed on the income-producing property. The distinction is important in operation of the tax. Application of legal provisions of a property tax are made with reference to the subject. If the income tax is classified as a property tax on income, the exemptions of minimum incomes are usually unauthorized. If it is a property tax on the income-producing property, exemptions may be allowed for income derived from sources other than property. If the income-producing property is the subject of taxation, jurisdiction to tax income is dependent upon the state's jurisdiction over the income-producing property. If income is the subject of taxation, the jurisdiction of the state to impose the tax is dependent upon the income rather

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than income-producing property. Such general principles are applicable only to the extent that the courts respect these differences. Some courts have rendered opinions in which there is a commingling of the subjects of the tax and consequently inconsistencies in areas of income tax application.

In the *Pollock* cases there was perhaps a closer endorsement of the idea that the subject of taxation is the income-producing property rather than the income itself in the light of the special consideration of income from land and income from personal property. Other early federal cases suggested that a tax on income was on the property from which it was derived. The Massachusetts court, upon occasion, held the income-producing property to be the subject of taxation. In *De Blois et al. v. Commissioner of Corporations and Taxation* the court held a tax on income derived from real estate to be a tax on the income-producing property. The court allowed abatement of income taxes paid on trust income from rents because the legislature did not express in words of "unmistakable purport" their intention to impose a double tax on real estate which otherwise would exist by virtue of the ad valorem tax and the income tax. That is, the ad valorem and income tax are two taxes both imposed on the real estate.

The New Hampshire Supreme Court suggested a similar concept of the income tax when it advised the legislature that rental income attributable to realty located outside the state could not incur an income tax liability. Compensation for the use of either real estate or tangible personal property with a situs outside the state would likewise incur no income tax liability. The court implied that the income-producing property was the subject of the tax.

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32 Id.

33 In re Opinion of the Justices, 80 N.H. 559, 149 A. 321 (1930).
The California Supreme Court held that the state may not tax income from property exempt from taxation because a "tax upon the income of property is, to all intents and purposes, a tax upon the property itself." The court also held that double taxation resulted if a given parcel of property was subject to a county property tax and a state income tax on income derived from the parcel of property. In Oregon the court ruled a partial income tax on income from money and credits to be a property tax and the income-producing property to be the subject of taxation.

The Supreme Court of Pennsylvania felt "hedged in by no artificial restrictions arising from a peculiar or narrow interpretation of the applicable portions of our constitutions in former cases" in passing upon the nature of the state individual income tax. Accordingly, the court allegedly ascertained the nature of the tax "along natural, and normal lines." The court held the general income tax to be a property tax and therefore unconstitutional because it violated the uniformity and exemption provisions of the constitution. It is clear that the court regarded the income-producing property as the subject of taxation with respect to income from real estate, stocks, bonds, and similar securities. The decision also served as a basis for ascertaining the nature of income taxes imposed by the city and county of Philadelphia.

Many other courts noted important differences between income and property taxes and rejected attempts to classify the income tax as a property tax. The dissenting opinion of Justice Robert J. Peaslee indicates the basic difference between income and property taxes. Several courts have relied upon this opinion to explain the questionable classification of income taxes as property taxes. The Justice stated:

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35 Redfield et al. v. Fisher et al., 135 Ore. 180, 292 P. 813, 73 A.L.R. 721 (1930). As in the case of several other income tax statutes the legislation associated the tax with one of the traditional classes.
37 Id.
It is important that at the outset the fundamental difference between income and property be stated; and then as we go on it will be more plainly seen how and why the attempt to treat the two things as one must necessarily fail. A man's property is the amount of wealth he possesses at a particular moment, while his income is the amount of wealth obtained during some specified period. The two are measured by different standards. One is measured by amount and present possession. The other is determined by receipts, and quantity and time are necessary elements of the measure employed. In the measure of property present ownership is an essential element, and lapse of time can have no place. In the measure of income lapse of time is an essential element, and present possession can have no place. Each is measurable, but a common measure cannot be applied to both. The two are as incommensurate as a line and an angle.\(^3\)

Income and property taxes differ in that the latter imposes a tax liability upon the existence of property owned while the income tax is effective only upon the receipt of income, and without reference to its continued existence.\(^4\) That is, the property tax generally imposes liability at recurrent intervals based upon property measured by the amount of present possessions and the income tax imposes a tax liability upon income received over a period of time and only once when the prescribed event (receipt of income) occurs. Another difference is that the same funds or property may sustain more than one income tax liability as they may constitute income to any number of individuals during the year.\(^5\)

AS AN EXCISE TAX

Of the three major types of taxes, the excise category is perhaps the most usual classification used by courts in grouping income taxes. A precise definition of an excise tax is lacking; however an act is the usual basis for excise taxes. In the case of income taxes, the acts of doing business or earning an income are possible bases for an excise tax. Income may be the measure of the tax. That is, an income tax may be based upon an act or privi-

\(^3\) In re Opinion of the Justices, 77 N.H. 618, 93 A. 314 (1915).


\(^5\) Paine v. Oshkosh, 190 Wis. 69, 208 N.W. 790 (1926).
lege and measured by income. In light of federal usage of the term, the extent to which an excise tax is imposed as a *quid pro quo* is questionable. Rather, some legislation suggests a very broad use of the term and possibly includes most taxes otherwise unclassified. It is apparently quite clear that the federal corporation income tax of 1909 was basically an excise tax. The Supreme Court upheld its constitutionality on that ground.² The court held the tax to be imposed on the act of doing business rather than on the franchise. If the court had regarded the franchise as the tax base the tax probably would be a direct tax and therefore subject to the constitutional limitations of a direct tax existing at the time.

Courts on occasion have held state income taxes to be excise taxes. The Supreme Court held an English corporation liable for a New York income tax on the ground that the tax was an excise measured by allocated income rather than a direct tax upon income.³ The court upheld the tax based upon the privilege of doing business; however, it is questionable whether the court could sustain an income tax otherwise classified. In *Educational Films Corp. v. Ward* the Supreme Court affirmed the *Bass* case and sustained the New York tax even though the measure (income) included interest from both federal and state instrumentalities.⁴ The court reasoned that because the tax base was the privilege of doing business, the tax was not actually imposed on the federal instrumentalities and therefore constitutional.

Courts of Georgia and Missouri early classified income taxes as excise taxes.⁵ The Supreme Court of Mississippi rejected the property tax classification and held the income tax to be an excise tax.⁶ The Mississippi court reasoned that the production of income involved the joint efforts of the state and the recipient.

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⁶ *Hattiesburg Grocery Co. v. Robertson*, 126 Miss. 34, 88 So. 4, 25 A.L.R. 748 (1921).
Protection afforded by the state made the production and enjoyment of income possible. For this protection, the state may impose an income tax. The court further ruled that "While a tax on income includes some of the elements of a tax on property and of a tax on persons, it cannot be classified as strictly a tax on either, for it is generically and necessarily an excise..." In litigation in several other states, courts have held corporation income taxes to be excise taxes. Although the privilege or act conferred by the state to a natural person which might constitute the basis for an excise tax may become tenuous, some courts have held personal income taxes to be excise taxes. The grouping of the personal income tax as an excise raised some objections inasmuch as the right conferred by a state to an individual appears

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47 Id.
quite distant from the acts or privileges that usually constitute the basis for an excise.\textsuperscript{50} It is equally difficult to regard the receipt of income from out-of-state sources as an act or privilege, the basis for an excise tax, by the state of residence.

Classification of an income tax as an excise results in significant differences compared with the property tax class. Perhaps the most important difference is that the uniformity and double taxation provisions of the constitution applicable to property taxes are inapplicable to excise taxes. Characteristic of income taxes, particularly individual income taxes, is the graduated rate structures. In most jurisdictions a graduated rate is incompatible with uniformity provisions and therefore unconstitutional as a property tax. Inasmuch as the income tax if classified as an excise is not a tax on the income-producing property, possible prohibitions against double taxation do not arise.

Compared with the property tax classification, income taxes regarded as excise taxes may be subject to different rules with respect to the allocation of income.\textsuperscript{51} In the Bass case the Supreme Court indicated that the New York corporation income tax would be valid even though the operations of a foreign corporation conducted within the state "may have yielded no net income."\textsuperscript{52} The court apparently based this projection on the fact that the tax in question was an excise on the privilege of doing business based in part on net income. The fact that the tax was imposed in lieu of a property tax was also significant in the interpretation of the decision. Use of reasonable allocation formulas, regarded as an application of the unit rule of property taxation, generally meets with the approval of courts notwithstanding the fact that the tax is classified as an excise based on net income or a property tax on net income itself.\textsuperscript{53}

Whether the courts regard a state income tax as a property

\textsuperscript{50}The Indiana gross income tax, somewhat distinct from most income taxes, was held to be, with reference to individuals, based upon "the privilege of domicile" [Miles v. Department of Treasury, 193 N.E. 855, 97 A.L.R. 1474 (Ind. 1935)].

\textsuperscript{51}Joseph W. Huston, Allocation of Corporate Net Income for Purposes of Taxation, 26 Ill. L. Rev. 728 (1932).

\textsuperscript{52}Bass, Ratcliff and Gretton, Ltd. v. State Tax Commission, 266 U.S. 271, 45 S. Ct. 82, 69 L.Ed. 282 (1924).

tax or an excise tax is significant in determining the extent to which the tax base may include income from federal instrumentalities. In the *Educational Films* case the Supreme Court sustained the New York corporation income tax even though the tax base included income from federal instrumentalities.\textsuperscript{54} The Supreme Court recognized "a logical and practical distinction between a tax laid directly upon all of any class of governmental instrumentalities, which the Constitution impliedly forbids, and \ldots (an excise tax) \ldots such as the present."\textsuperscript{55} Indeed, the court expressed doubt as to the validity of the tax under similar circumstances if the tax were not an excise. In the light of more recent cases it appears that income taxes in the nature of property taxes are subject to stricter rules than excise taxes with reference to taxation of federal instrumentalities, the nature of the tax is apparently considerably less significant for purposes of determining the legality of income taxes applied to interest from other state instrumentalities.

Another possible implication stemming from the legal nature of the act concerns the jurisdiction of the state to impose the tax. Viewed as a property tax the state's jurisdiction to impose an income tax is in some respects narrower than if an excise tax. Situs of property is of paramount importance in ascertaining the state's jurisdiction to impose a property tax whereas the exercise of an act or privilege is determining for an excise. As an excise tax, the broadened jurisdiction enlarges the area of multiple taxation more than is otherwise effective as a property tax. As a legal argument against a tax liability, multiple taxation appears to be impotent.

\textbf{AS A DISTINCT CLASS OF TAX}

Courts and various other legal scholars have manifested dissatisfaction with the three traditional tax classes for purposes of classifying income taxes.\textsuperscript{56} The distinctive nature of the income tax is such that none of the three usual categories is suitable

\textsuperscript{54} *Educational Films Corp. v. Ward*, 282 U.S. 379, 51 S.Ct. 176, 75 L.Ed. 400 (1931).

\textsuperscript{55} *Id.*

for the income tax. The income tax may bear strong resemblance to other types of taxes; however the differences are of such significance that the three categories are inappropriate. Some courts have regarded the income tax as *sui generis*, that is, distinct and peculiar to itself. In some states certain constitutional provisions constitute an important factor contributing to the rejection of the traditional classification.

The Supreme Court of Wisconsin clearly rejected the three traditional types of taxes and insisted upon a separate classification for the income tax. In *State v. Frear* the court recognized the distinctive nature of an income tax. The wording of the constitution influenced the decision of the court which held the income tax to be unique in nature. In rejecting the *Pollock* cases the court stated:

> However philosophical the argument may be that taxation of rents received from property is in effect taxation of the property itself, the people of Wisconsin have said that 'property' means one thing, and 'income' means another; in other words, that income taxation is not property taxation, as the words are used in the Constitution of Wisconsin.

The Supreme Court of South Carolina also rejected the contention that general individual and corporate income taxes are property taxes. Although the court indicated that an income tax may not properly fall under the property, personal, or excise tax classes, it recognized distinct similarities between the income tax and other types of taxes. Constitutional provisions in California likewise suggest that the income tax is unique in nature.

Like several other state courts, the Kentucky Court of Appeals has held income taxes to be unique in nature. In *Reynolds Metal Co. v. Martin* the court was primarily concerned with the problem of determining whether the income tax was a property tax in order to ascertain the constitutionality of the law. The court held that the income tax was not a property tax rather in the nature of an excise, but added that "it is not necessary to call it

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57 State v. Frear, 148 Wis. 456, 134 N.W. 673 (1912).
58 Id.
The court regarded the income tax as a contribution to government measured by the taxpayers' ability to pay based on income. The tax obligated those domiciled or doing business in the state to make the contribution. The protection of government and other rights enjoyed by those subject to the tax justified such a contribution. The opinion, like similar decisions in other states, did not involve an analysis regarding the precise nature of the income tax. The court relied upon selected previous decisions of other courts and the wording of the Kentucky Constitution in support of its conclusion. The Kentucky Constitution refers to property, excise, and income taxes in addition to other types of taxes. Reference to both excise and income taxes with different provisions suggesting that the authors of the Kentucky Constitution did not regard the two as synonymous. The court concluded that it would therefore be improper to subject the income tax to constitutional limitations of the property tax. Although the problem which confronted the court was that of determining whether the income tax was a property tax, it recognized the distinction between an income and an excise tax. An indication of the significance of this distinction to the corporate tax is apparent in light of the principle that a state may not tax income from federal instrumentalities, although it may levy a franchise tax measured partly by net income, including income from federal instrumentalities.

The nature of an income tax is a question for the various state courts to resolve in most instances. When classified as a property, personal, or excise tax, the limitations applicable thereto are "almost always sufficient to prevent the use of the peculiar characteristics of the income tax which are the chief virtues." The Court of Appeals of Kentucky avoided such limitations by ruling that the tax was unique and different from the three traditional classes of taxes.

The practical significance of the legal nature of the tax was evidenced by other decisions involving an interpretation of the

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62 Id.
63 Ky. Const. secs. 170-174 and 181.
Kentucky income tax. In *Martin, Com'r of Revenue v. Wolfford* the court relied upon the *Reynolds Metal* decision in which it had been held that the income tax was not a property tax. The court held that the tax was therefore applicable to the salary of a circuit judge and did not violate constitutional provisions prohibiting the reduction in salary of such an official while in office. After noting that the income tax was not a property tax, the court stated: "If this were a tax levied against the salary of a public official, there would be a diminution of his compensation and the tax would be violative of . . ." certain sections of the state constitution.

The legal nature of the Kentucky income tax played an important role in the *Martin, Commissioner of Revenue v. Gage*. The state tax administrators took the position that an individual domiciled within the state on the last day of the year would be subject to income tax liability on all income earned during the year including that earned outside the commonwealth prior to becoming domiciled in Kentucky. Although courts of last resort in other states had previously ruled that the state was without constitutional authority to tax a resident upon income received from sources outside the state before becoming a resident of the state, the fact that the other state courts previously held the taxes in question to be property taxes was of paramount importance. Counsel for the appellants contended that inasmuch as the Kentucky income tax was not a property tax, there were no such constitutional objections. The Kentucky court held that such income earned outside the state prior to becoming a Kentucky resident was not taxable in the light of legislative intention.

The legal nature of the income tax was important in the *Fidelity and Columbia Trust Co. v. Reeves, Commissioner of Revenue* decision. In this case the taxpayer secured certain property in April, 1935 and disposed of such property at a gain in

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6 Martin, Com'r. of Revenue v. Wolfford, 269 Ky. 411, 107 S.W. 2d 267 (1937).
6 Id.
7 Martin, Commissioner of Revenue et al. v. Gage, 281 Ky. 95, 134 S.W. 2d 966 (1939).
9 Fidelity and Columbia Trust Co. v. Reeves, Commissioner of Revenue, 287 Ky. 522, S.W. 2d 337 (1941).
February and May, 1936. The appellant contended that the capital gain should be measured by the difference in values between the effective date of the income tax law (January 1, 1936) and the date of disposition. The appellant argued that the state was without "the power to impose an income tax upon the increase in capital value of assets accruing . . . prior to the date the first Kentucky Income Tax law became effective. . . ."71 The appellant apparently based this contention upon the property tax concept of the income tax. That is, the income tax would be inapplicable to increments in asset value prior to the effective date of the income tax if the income tax were a property tax. The court held that the taxable event was the sale of the property resulting in a gain even though some of it represented enhanced value to the corporation before the adoption of the income tax. If the tax were a property tax, the court probably would not have sustained a tax liability on increment in the value of the property prior to the effective date of the law.

71 Id.