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TAXATION—CONSTITUTIONALITY OF AD VALOREM TAXES ON ANNUITIES ARISING OUT OF INSURANCE POLICIES IN KENTUCKY

The controversial issue of the taxability of annuities arising out of insurance as property was placed squarely before the Kentucky Court in *Button v. Hikes*.¹ There the deceased left a sum in money arising from an insurance policy, a minimum rate of interest and dividends on the principal payable to the taxpayer annually for life. Under the terms of the policy, the taxpayer could not commute, assign, alienate, anticipate or pledge the annual payments. The right of the taxpayer to the annual proceeds was assessed for taxation at a value based on life expectancy tables. The court held that the right to such payments was not taxable under constitutional and statutory provisions subjecting "all property" to assessment² and taxation³ at a specified rate.⁴

The Court placed great weight upon legislative and executive construction of existing and previous statutes and constitutional provisions. It was asserted that this construction of existing and similar provisions in previous constitutions and statutes was that the right to annual income arising from insurance policies was not property within the contemplation of the legislature and the drafters of the Constitution. The reasoning of the Court was that since the legislature and the drafters of the Constitution had known that the right to annuities arising from insurance had not been construed as property⁵ and had failed to expressly include it as such, that particular right was not intended to be included as property. The Court also gave prior legislative and executive construction of existing statutes and constitutional provisions considerable weight, thereby concluding that the right to annuities arising out of insurance policies was not property within the meaning of such constitutional and statutory provisions.

The rules applied by the Court are proper rules of statutory and constitutional construction. Their application, however, seems questionable in the principal case. It was held in *Martin v. High Splint Coal Company*⁶ that the legislature cannot exempt any property from *ad valorem* taxation aside from that expressly excluded by the Kentucky Constitution. Section 170 of the Kentucky Constitution is to the same effect. The right in question is not so exempt. It would seem, therefore, that the intention of the legislature not to include the right to annuities arising from insurance policies should have no effect as far as taxing statutes are con-

¹ 296 Ky. 163, 176 S. W. 2d 112 (1943).
² Ky. Const. sec. 172; Ky. R. S. 132.190 (3).
⁴ Ky. R. S. 132.010.
⁶ 288 Ky. 11, 103 S. W. 2d 711 (1931).
cerned. The construction of pertinent constitutional provisions should be controlling.

Executive and legislative construction need not be followed where clearly erroneous.7 Conceding for the purposes of discussion that the right to insurance annuities is a property right, that right would seem to fall within the express provisions of the Constitution pertaining to the taxation of property. Section 174 provides that "all property . . . shall be taxed in proportion to its value" while section 172 directs the assessment of all property "not exempted by this Constitution."8 It is further provided therein that all laws exempting property not exempted by the Constitution shall be void.9 These provisions are clear and explicit in their terms and evidence an intention to tax all personal property.10 If the right in question is a property right as determined by the courts, it would seem that legislative and executive construction of these constitutional provisions should be no basis for denying taxability in the face of the unequivocal terms of the Kentucky Constitution.

The Kentucky Court held in Commonwealth v. Travelers Insurance Machine Company2 that only rights enforceable by the courts are taxable as personal property. Thus it would seem that where the acquisition of the right is uncertain or based upon a contingency, it cannot be taxed as a property right. However, where the right is vested in the party, and is enforceable during his lifetime only, it is generally regarded as a property right subject to taxation.2 In spite of this general rule, two jurisdictions feel that such rights are contingent and not taxable as property.13 The exponents of this view point out that there is no immediate right which can be asserted and that the right is contingent upon the beneficiary's living. Therefore, there is no present right which can become the subject of taxation. This view is untenable. An annual income for life to which one has an enforceable right is taxed on the immediate right based on the present value. The right is existing at the time of assessment and certainly has some value. The contention that such a right is contingent and not taxable as property could

7 City of Fulton v. Shanklin, 275 Ky. 772, 122 S. W. 2d 733 (1939).
8 KY. CONST. sec. 174.
9 KY. CONST. sec. 172.
10 KY. CONST. sec. 170.
12 181 Ky. 596, 205 S. W. 561 (1918).
13 Guaranty Trust Co. v. Virginia, 305 U. S. 19 (1938); Evans v. Boyle County Board of Sup'rs, 296 Ky. 353, 177 S. W. 2d 137 (1944); Commonwealth ex rel. Martin v. Sutcliffe, 283 Ky. 274, 140 S. W. 2d 1028 (1940); second appeal in the name of Commonwealth ex rel Reeves v. Sutcliffe, 287 Ky. 809, 155 S. W. 2d 243 (1941); Commonwealth v. Nute, 115 Ky. 239, 72 S. W. 1090 (1903); Rowe v. Braden, 126 Ohio St. 533, 186 N. E. 392 (1933).
not stand in Kentucky in view of the decisions in Commonwealth ex rel. Martin v. Sutcliffe* and Evans v. Boyle County Board of Supervisors* where the court sustained a property tax on annuities arising out of a trust and a contract respectively. By analogy, an annuity arising out of an insurance contract, being an enforceable right to annual payments like rights to annuities arising out of trusts and other contracts, would seem to constitute property within the meaning of constitutional and statutory provisions applicable to taxable property.

A possible objection to the taxation of a non-assignable annuity is that its value is not capable of being determined in the manner provided by the Kentucky Constitution, that is "at its fair cash value, estimated at the price it would bring at a fair voluntary sale." This objection was upheld where constitutions in other jurisdictions provided that the legislatures should devise methods of assessment and the legislatures failed to do so.* Since the Kentucky Constitution does not so provide, the use of life expectancy tables has been resorted to in aiding the assessment of annuities. This method of assessment was upheld by the Kentucky Court in an early decision* and has been approved in recent cases.* The Court, in Evans v. Boyle County Board of Supervisors,* held that the constitutional provision as to the manner of assessment was not mandatory, but rather that it provides the figure at which the property interest must be assessed, thus leaving the proper methods of assessment, so as to reach that figure, to the discretion of the courts. In situations where property interests are incumbered as to power of sale, assignment, etc., the rule is that the figure at which such property should be assessed is at the value it would bring at a free voluntary sale if it were free of incumbrances.* The above construction of the constitutional provision as to assessment seems reasonable since it is not to be assumed that the drafters of the constitution intended that property interests should not be taxed merely because their value cannot be ascertained in the manner provided in view of their peculiar nature or incumbrances.

It has been asserted that property tax on the right to annuities

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*283 Ky. 274, 140 S. W. 2d 1028 (1940); second appeal in the name of Commonwealth ex rel. Reeves v. Sutcliffe, 283 Ky. 274, 140 S. W. 2d 1028 (1940).
*296 Ky. 353, 177 S. W. 2d 137 (1944).
*3 Ky. Const. sec. 172.
*State Board of Tax Commissioners v. Holliday, 150 Ind. 216, 49 N. E. 14 (1898).
*Commonwealth v. Nute, 115 Ky. 239, 72 S. W. 1090 (1903).
*County Board of Tax Sup'rs of Jefferson County v. Helm, 297 Ky. 803, 181 S. W. 2d 452 (1944); Commonwealth ex rel. Martin v. Sutcliffe, 283 Ky. 274, 140 S. W. 2d 1028 (1940); second appeal in the name of Commonwealth ex rel. Reeves v. Sutcliffe, 287 Ky. 809, 155 S. W. 2d 243 (1941).
*Supra note 16.
*Commonwealth v. Nute, 115 Ky. 239, 72 S. W. 1090 (1903).
is double taxation and contravenes the Fourteenth Amendment of the United States Constitution in that it is the taking of property without due process of law.\(^2\) Double taxation is repugnant to public policy in Kentucky, where an \textit{ad valorem} tax is levied upon the same property for the same period by the same jurisdiction.\(^3\) The solution necessarily turns upon whether or not the tax in question is a tax on the source from which the income is derived since a property tax on the source is void where the situs is without the state\(^6\) and a property tax on the source which has its situs within the state and has already been taxed by the state for the same period is against public policy.\(^7\) A tax on an annuity is a tax on the property right belonging to the annuitant and the situs of that right is at the residence of the annuitant.\(^7\) The right to the proceeds is a distinct property interest in itself and a tax on that interest can hardly be regarded as a tax on the source from which the annual payments are to be derived. It has been so held as to rights to annual income arising out of trust,\(^8\) contract,\(^9\) and insurance.\(^9\)

The necessary conclusion is that annuities arising out of insurance policies which prohibit assignment, etc. of the proceeds should be taxable in Kentucky as a property right. The interest of the annuitant is clearly property under recent decisions taxing similar rights and in view of the express language of the Kentucky Constitution and statutes should become taxable as such. The use of life expectancy tables in assessing value is proper, and since the tax is on a property right distinct and independent in itself, the tax does not subject the owner to double taxation. Such a result seems socially undesirable in that the source is diminished while at the same time a burden is being placed upon the income, thus giving the effect of double taxation. The proper remedy is a constitutional amendment or suitable legislation.

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\(^{23}\) Brown, \textit{The Taxation of Trust Property} (1935) 23 KY. L. J. 403.\(^4\)
\(^{24}\) Livingston v. City of Paducah, 80 Ky. 656 (1883).\(^4\)
\(^{25}\) Safe Deposit and Trust Co. of Baltimore v. Commonwealth of Virginia, 280 U.S. 63 (1929).\(^4\)
\(^{26}\) Livingston v. City of Paducah, 80 Ky. 656 (1883).\(^4\)
\(^{27}\) Commonwealth ex rel. Martin v. Sutcliffe, 283 Ky. 274, 140 S. W. 2d 1028 (1940).\(^4\)
\(^{28}\) Commonwealth ex rel. Martin v. Sutcliff, 283 Ky. 274, 140 S. W. 2d 1028 (1940); second appeal in the name of Commonwealth ex rel. Reeves v. Sutcliffe, 287 Ky. 809, 155 S. W. 2d 243 (1941); Hunt v. Perry, 163 Mass. 287, 43 N. E. 103 (1896); Rowe v. Braden, 126 Ohio St. 533, 186 N. E. 392 (1933).\(^4\)
\(^{29}\) Evans v. Boyle County Board of Sup'r's, 296 Ky. 353, 177 S. W. 2d 137 (1944); Commonwealth v. Nute, 115 Ky. 239, 72 S. W. 1090 (1903); Wetmore v. State, 18 Ohio 77 (1849).\(^4\)
\(^{30}\) County Board of Tax Sup'r's of Jefferson County v. Helm, 297 Ky. 803, 181 S. W. 2d 452 (1944).\(^4\)

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