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Constitutional Law--License Taxes--Classification

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Morton v. *Dickson*,[7] the court said (p. 579) that it would be inequitable to allow the vendor the right of entry without considering the "value of the land, the improvements made upon it, or any other equitable right of the vendee." Similarly, in the principal case[8] the court says (p. 39) with reference to those cases where ejectment was not allowed:[9] "the sums paid were of such proportion as to constitute penalties if allowed to be ignored or retained by the vendor." Accordingly it would seem that the Kentucky court now looks upon an action of ejectment brought by the vendor as involving something more than the mere right of possession. In the *Morton* case by denying ejectment on the ground that there would be no consideration of equities which the vendee might have acquired, and in the instant case by referring to those cases in which the substantial amount paid by the purchaser would be forfeited if the action were allowed, the court apparently determines in an ejectment action not only the right of possession, but in addition, all other rights of the parties and the equitable title to the lands as between them.[10]

The determination of the equities of the two parties in ejectment is certainly a reasonable consequence of a rule which allows the action where the vendee has made no substantial payment on the purchase price, and refuses to allow it where by such payment a "substantial equitable title" has been acquired.

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CONSTITUTIONAL LAW—LICENSE TAXES—CLASSIFICATION.

The General Assembly imposed graduated license fees on retail merchants, the amount of tax to be paid by each owner being dependent upon the number of stores which he operated within the state.[1] Plain-

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both of those cases the action was denied (in the *Doty* case with no mention being made of the equity already acquired by the vendee, and in the *Day* case, where the vendee had paid $400 out of a contract price of $600).

[7] 90 Ky. 572, 12 Ky. L. Rep. 507, 14 S.W. 905 (1890).

[8] The court in Maschinot v. Moore states that there is no disposition to depart from the rule against allowing ejectment, but states (p. 38) that "it will be observed from an examination that in each case of its application [citing Morton v. Dickson, 90 Ky. 572, 12 Ky. L. Rep. 507, 14 S.W. 905 (1890), and Day v. Miles, 204 Ky. 711, 265 S.W. 282 (1924)], there had been definitely and surely, a transfer or conveyance to the vendee of a *substantial equitable title*—just short of the legal title."

[9] *Supra* note 6.

[10] More particularly, those rights adjudicated will include the right of the vendee to specific performance or to a recission, or his right to be relieved from a forfeiture (i.e., his right to recover part of the payments if time is not of the essence, or where time is of the essence, but his delay is not so serious that equity will not relieve him of his default). Corbin, *supra* note 5.

[1] Kentucky Statutes 1936, Section 4302a-17:

"Every merchant establishing, operating or maintaining one or more stores, stands or places of business within this State, shall pay annually the license fee hereinafter prescribed for the privilege of open-

tiff sued under the Declaratory Judgment Act asking that the statute be declared unconstitutional as imposing an unreasonable and arbitrary classification for the purpose of taxation, and appealed from an order sustaining a demurrer to its petition. In reversing the order with directions to overrule the demurrer, the court said that the classification made in the act "is not a natural one, but is unreasonable and arbitrary," and stated that the question as to whether the classification could be justified as an exercise of police power was not involved since the statute was purely a revenue measure. Two judges dissented from the majority opinion that the classification was unreasonable but concurred in overruling the demurrer. *Great Atlantic & Pacific Tea Co.* v. *Kentucky Tax Comm.*, 278 Ky. 367, 128 S.W. (2d) 581 (1939).

The decision in the foregoing case is based on the court's interpretation of the requirement of uniformity in taxation as expressed in the state constitution.[2] No question of due process or equal protection under the federal Constitution was involved in the decision.[3]

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ing, establishing, operating or maintaining such stores, stands or places of business. The license fees herein prescribed shall be as follows:

"(1) On one store the flat sum of two dollars ($2.00);

"(2) On all chains of more than one, but not more than five stores, two dollars ($2.00) plus twenty-five dollars ($25.00) for each said store in excess of one;

"(3) On all chains of more than five, but not more than ten stores, one hundred and two dollars ($102.00) plus fifty dollars ($50.00) for each said store in excess of five;

"(4) On all chains of more than ten, but not more than twenty stores, three hundred and fifty-two dollars ($352.00) plus one hundred dollars ($100.00) for each said store in excess of ten;

"(5) On all chains of more than twenty, but not more than fifty stores, one thousand three hundred and fifty-two dollars ($1,352.00) plus two hundred dollars ($200.00) for each store in excess of twenty;

"(6) On all chains of more than fifty, seven thousand three hundred and fifty-two dollars ($7,352.00) plus three hundred dollars ($300.00) for each said store in excess of fifty."

[2] Only two sections of the Constitution of Kentucky were regarded as having a particular bearing on the tax act in question. The pertinent provision in Section 171 is to the effect that "Taxes shall be levied and collected for public purposes only and shall be uniform upon all property of the same class subject to taxation within the territorial limits of the authority levying the tax; and all taxes shall be levied and collected by general laws." It will be observed that the language is "shall be uniform upon all *property*." As the tax here involved was not a tax on property, this provision has no applicability in the present decision. Section 181 states that "The general assembly may, by general laws only, provide for the payment of license fees on franchises, stock used for breeding purposes, the various trades, occupations, and professions, or a special or excise tax . . ."

[3] Had the classification in the instant case been considered in light of the equal protection clause, it appears certain that it would have been sustained. In State Tax Comrs. v. Jackson, 283 U.S. 527, 51 S. Ct. 540 (1931), the Supreme Court upheld a graduated license tax on chain stores. The tax was much the same in its operation as that in the principal case. The fact that the act in the *Jackson* case created only five classes for graduating the tax instead of six as in the instant case could hardly be said to affect the reasonableness of the classifica-

By a series of opinions the court has read into Section 181 of the state constitution the requirement of uniformity and freedom from arbitrary discrimination.[4] As the decision in the instant case is based on an application of Section 181, the court was at liberty to reach its own interpretation, without adopting that of the United States Supreme Court on the equal protection clause, so long as it saw fit to apply a standard as high as that required by the Supreme Court. According to the Kentucky court in *Williams* v. *City of Bowling Green*,[5] however, "There is no provision in our Constitution that fixes a different standard from that prescribed by the equal protection clause of the Fourteenth amendment to the Federal Constitution."[6] If this be true, the decided weight of authority is against the holding in the instant case.[7] Graduated license taxes similar to the one imposed by the Kentucky act have been held valid in many jurisdictions in recent years.[8]

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tion. A license tax graduated through six classes of stores was upheld in State ex rel. Lane Drug Stores v. Simpson, 122 Fla. 582, 166 So. 227 (1935); through nine classes in Fox v. Standard Oil Co., 294 U.S. 87, 55 S. Ct. 333 (1935); and through sixteen classes in Great Atlantic & Pacific Tea Co. v. Grosjean, 301 U.S. 412, 57 S. Ct. 772 (1937).

[4] City of Covington v. Dalheim, 126 Ky. 26, 102 S.W. 829 (1907); Hager v. Walker, 128 Ky. 1, 107 S.W. 254 (1908); City of Danville v. Quaker Maid, 211 Ky. 677, 278 S.W. 98 (1926); Trimble, *Excise Taxes and the Uniformity Clause of the Constitution of Kentucky*, 25 Ky. L.J. 342, 354 (1937).

However, uniformity does not prevent a classification; it only requires that the classification be reasonable. See Hager v. Walker, 128 Ky. 1, 11, 107 S.W. 254, 257; City of Danville v. Quaker Maid, 211 Ky. 677, 678, 278 S.W. 98 (1926).

In the instant case the court stated, pp. 378-9, that "While the provisions of Section 171 of our constitution, requiring taxes to be equal and uniform, apply *in their fullness* only to direct taxation of property, yet the principle of equality and uniformity must be observed in imposing license and occupation taxes . . . the tax must be uniform on all subjects within the class to which it is applied, and the classification must be made according to natural and well-recognized lines of distinction . . . The principle of equality and uniformity in taxation is one of the cornerstones of our Constitution . . ." (Italics added). It may well be asked how any principle can be a cornerstone of the Constitution without being expressly made such. See Cooley, Constitutional Limitations (8th ed. 1927) 351–5.

[5] 254 Ky. 11, 70 S.W.(2d) 967 (1934).

[6] Id. at 13. When the *same* standard is applied in court A to test the reasonableness of a given classification as is used in courts B, C, and D, the A court may then be criticised on its application of the standard to a given situation in light of similar applications by courts B, C, and D.

[7] See note, (1938) 112 A.L.R. 305, 308–11.

[8] State Tax Comrs. v. Jackson, 283 U.S. 527, 51 S. Ct. 540 (1931); Fox v. Standard Oil Co., 294 U.S. 87, 55 S. Ct. 333 (1935); Southern Grocery Stores v. South Carolina Tax Comm., 55 F.(2d) 931 (1934); C. F. Smith Co. v. Fitzgerald, 270 Mich. 659, 259 N.W. 352 (1935); Safeway Stores v. City of Portland, 149 Ore. 581, 42 P.(2d) 162 (1935). The imposition of a higher license fee on each store in a chain in excess of one was held valid in Great Atlantic & Pacific Tea Co. v. Maxwell, 199 N.C. 433, 154 S.E. 838 (1930); and in Fredericksburg v. Sanitary Grocery Co., 168 Va. 57, 190 S.E. 318 (1937). In Great Atlantic & Pacific

Points of difference justifying a different classification for chain stores and independently owned units were enumerated at great length in *Tax Comrs.* v. *Jackson.*[9] Despite the generally pronounced character of these differences, the court in the instant case is content with saying, "These same points of difference appear between the owners of independent units."[10] The court seems to have not considered that, while a few of these differences do occur between independent store operators, it is only the chains that possess them all in a marked degree. It is apparent that these factors have constituted a line of demarcation sufficiently distinct to call forth special chain store taxes in many

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Tea Co. v. Grosjean, 301 U.S. 412, 57 S. Ct. 772 (1937), it was held that a state tax graduated on basis of the number of stores in the chain, whether operated in the state or not, does not arbitrarily and unreasonably discriminate. In J. C. Penney Co. v. Diefendorf, 54 Idaho 374, 32 P.(2d) 784 (1934), a statute imposing the same amount on each store, the tax graduated and dependent upon the number of stores in the state under same ownership was upheld. A similar tax in Florida was upheld in State ex rel. Lane Drug Stores v. Simpson, 122 Fla. 582, 166 So. 227 (1935). The only other state that appears to share the Kentucky view is Georgia, and it is not at all certain that Georgia would hold the present classification unreasonable. In Douglas v. Southern Georgia Grocery Co., 180 Ga. 519, 179 S.E. 768 (1935), a city ordinance was held discriminatory for imposing a tax on the business of operating one of a chain of five or more grocery stores and not taxing where the chain numbered less than five stores. North Carolina, which refused to sustain a chain store license tax in Great Atlantic & Pacific Tea Co. v. Doughton, 196 N.C. 145, 144 S.E. 701 (1928), ($50 on each store in chains of six or more), upheld a $50 tax on each store in excess of one in Great Atlantic & Pacific Tea Co. v. Maxwell, 199 N.C. 433, 154 S.E. 838 (1930).

[9] 283 U.S. 527, 51 S. Ct. 540 (1931). Some of the differences were stated to be: "quantity buying, which involves the application of the mass process to distribution, comparable to the mass method used in production; buying for cash and obtaining the advantage of a cash discount; skill in buying, so as not to overbuy, and at the same time keep the stores stocked with products suitable in size, style and quality for the neighborhood customers who patronize them; warehousing of goods and distributing from a single warehouse to numerous stores; abundant supply of capital, whereby advantage may be taken of opportunities for establishment of new units; a pricing and sales policy different from that of the individual store involving slightly lower prices; a greater turnover, and constant analysis of the turn-over to ascertain relative profits on varying items; unified, and therefore cheaper and better advertising for the entire chain in a given locality; standard forms of display for the promotion of sales; superior management and method; concentration of management in the special lines of goods handled by the chain; special accounting methods; standardization of store management, sales policies and goods sold." Other obvious advantages might be enumerated: Rebates obtainable by virtue of tremendous amount of business, prestige that comes from size and number, greater cost to state of policing, and, what should not be overlooked, a varied clientele. The latter factor has never been emphasized though its importance is readily recognizable. Merchandise which becomes stale or soiled so as not to be suitable for sale in the big uptown markets may be transferred to a store "across the tracks" where its sales appeal is in no appreciable degree impaired.

[10] 278 Ky. 367, 379, 128 S.W.(2d) 581, 587 (1939).

states[11] which taxes have been held valid by the highest courts of the states and by the Supreme Court in most instances.[12] Had the court been inclined to sustain the classification, it could have relied on the decisions of those other courts and the enactment of similar legislation by other states as a weighty factor on the side of the reasonableness of the classification. If reasonableness of a classification is to be measured by what a reasonable man would determine, it is hard to see how this classification can be unreasonable.[13]

The stand taken by the court in the instant case is particularly difficult to understand in view of the language in the *Williams*[14] decision. There it was said, "The fact that a statute discriminates in favor of certain classes does not make it arbitrary, if the discrimination is found upon a reasonable distinction, *or if any state of facts reasonably can be conceived to sustain it.* A classification adopted by a Legislature in imposing occupation taxes will be held constitutional if there are substantial differences between the occupations separately classified, *and such differences need not be great.*"[15] (Italics added.) There *is* a recognized difference between a business carried on in the ordinary unit store and a business operated by means of a chain of stores.[16]

[11] About one-half of the states according to the dissenting opinion. Id. at 383, S.W. at 589.

[12] Ibid.

[13] As a matter of fact, the Kentucky court in Moore v. State Board of Charities and Corrections, 239 Ky. 729, 40 S.W.(2d) 349 (1931), expressly recognized the distinctions between large retailers and small and held that such distinctions were a sufficient basis for a graduated sales tax apportioned upon the amount of gross sales per year. The court enumerates some of the advantages as follows: "unified and superior management, manifesting itself in lower operating costs, greater efficiency in purchasing, buying for cash and thus obtaining cash discounts, warehousing goods, and distributing from a single warehouse to numerous stores, thus involving less liability for ad valorem taxes (since, as in the case of chain stores, there is no need for such a stock in any one store to be on hand on the assessment date as is required in an independent store) pricing and sales policy; greater rapidity of turnover, less advertising costs per store or department—all are those which the large retailer enjoys to his profit and which the small retailer does not enjoy. These advantages manifest themselves in both gross and net profits. Thus the proof establishes that the ratio of net gain either to sales or to capital invested is very much higher in the case of large-scale merchants than in that of the small-scale ones whether the large-scale ones be of the chain store type or of the department store type, or even of the specialty store type." *Supra*, at 353.

[14] Williams v. City of Bowling Green, 254 Ky. 11, 70 S.W. (2d) 967 (1934).

[15] Id. at 14. It was stated by the court in Great Atlantic & Pacific Tea Co. v. Grosjean, 301 U.S. 412, 424, 57 S. Ct. 772 (1937), "We cannot say that classification of chains according to the number of units must be condemned because another method more nicely adjusted to represent the differences in earning power to the individual stores might have been chosen, for the legislature is not required to make meticulous adjustments in an effort to avoid incidental hardships."

[16] Notes 6 and 7, *supra;* R.C.L. Per. Supp. "Licenses" (1939) (Pocket part, 1288, sec. 32).

The wisdom or expediency of basing a classification upon such differences for the purpose of levying a license tax is generally considered to be a legislative, not a judicial, responsibility.[17]

The dissent, to the effect that the method of classification employed by the legislature is not arbitrary and unreasonable, seems, in light of present day decisions, to express the more logical and acceptable view. It conforms to the accepted rule as to the respective functions of court and legislature,[18] and is not necessarily contra to previous holdings of the Kentucky court. The cases relied upon by the court to show by analogy that the present classification cannot be sustained are distinguishable on their facts from the instant case. None of them involved a classification of stores based upon the number of units under one management.[19]

The rule that mere differences in details in the manner of conducting a business are not sufficient to justify a classification for the purpose of taxation[20] cannot be controlling unless it be conceded that chains differ from unit stores only in details of management. Such a concession the minority of the court are unwilling to make. The quotation from *Gordon* v. *City of Louisville*[21] was not intended to limit for all time the bases on which a license tax could be levied. It was merely an enumeration of the theories that had been applied up to that date and

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[17] "At the outset, it may be said that the wisdom or propriety of an act of the Legislature is not a matter for the courts to determine. When the validity of a legislative act is challenged, the sole duty of the courts is to determine whether or not it violates any constitutional provision . . . A correlative rule, universally recognized, is that every doubt and presumption will be resolved in favor of the validity of an act of the Legislature, and courts should not declare an act of the Legislature unconstitutional unless satisfied of its unconstitutionality beyond a reasonable doubt." Burton v. Mayer, 274 Ky. 245, 250, 118 S.W. (2d) 161, 164 (1938).

"It is not the function of a court to make itself the arbiter between competing economic theories professed by honest men on grounds not wholly frivolous." Cardozo, dissenting in Stewart Dry Goods Co. v. Lewis, 294 U.S. 550, 569, 55 S. Ct. 525 (1934). See also Safeway Stores v. City of Portland, 149 Ore. 581, 42 P. (2d) 162, at 169 (1935).

[18] Note 17, *supra.*

[19] The closest analogy would seem to require a conclusion contrary to that reached by the majority in the instant case. In Strater Bros. Tobacco Co. v. Com., 117 Ky. 604, 609, 78 S.W. 871, 872 (1904), the court states: "This court has upheld ordinances imposing a license or occupation tax on liverymen based upon the number of vehicles employed in their business."

[20] 278 Ky. 367, 380, 128 S.W.(2d) 581, 588 (1939).

[21] "In this state we recognize as valid the imposition of license taxes based upon three theories; one being a uniform tax upon all persons engaged in the same business without any reference to the amount of business done, another that levies a uniform tax upon the volume of business done without changing it in the proportion that the business increases . . . and yet another is the division of a general class . . . into separate classes according to the volume of business done, and the imposition of a different tax upon each division into which the class is divided." Id. at 375-6, S.W. at 586.

as the tax then in dispute fell naturally into one of those divisions an added category was not needed at that time.[22]

It is unfortunate that the act in the instant case was held to create an unreasonable classification, without reference to the amount of tax imposed. The unhappy effect of the decision, if allowed to stand, will be twofold: First, to perpetuate in Section 181 of the constitution a requirement of uniformity which is neither an expressed nor a necessarily implied part thereof; second, and more serious, to prevent the legislature's classifying retail businesses according to the number of stores under one ownership within the state, and imposing a different tax on each class, regardless of the amount of the tax. In view of the fact that the gross sales tax[23] passed on in *Moore* v. *Board of Charities*[24] was declared invalid by the Supreme Court of the United States,[25] it would appear that the legislature's hands are now completely tied insofar as a substantial revenue from retail chain stores is concerned. Had the present decision been made to depend on the question of whether the amount of the tax was unreasonable and confiscatory, this result would have been avoided.

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[22] Gordon v. City of Louisville, 138 Ky. 442, 128 S.W. 327 (1910).
[23] Kentucky Acts, (1930) c. 149.
[24] 239 Ky. 729, 40 S.W.(2d) 349 (1931), cited *supra*, note 13.
[25] The classification of gross sales for the purpose of taxation was said to be arbitrary and to violate the equal protection clause. Stewart Dry Goods Co. v. Lewis, 294 U.S. 550, 55 S. Ct. 525 (1934).