Kentucky Law Journal

Volume 26 | Issue 1 Article 7

1937

Taxation--Constitutional Law--Discrimination as to Rate

Louis H. Levitt
University of Kentucky

In the *Fehr* case the gas tank valves were shown to be defective and the gas tank was not furnished by the defendant. The keg was shown to be sound and the beer had tasted all right the night before the explosion, negativing any suspicion of its being abnormally fermenting. Therefore the plaintiff, in fact, had as much chance to know the cause of the injury as did the defendant and the burden of proof was justly left with the plaintiff.

VINCENT F. KELLEY.

TAXATION—CONSTITUTIONAL LAW—DISCRIMINATION AS TO RATE

The question of the constitutionality of a Kentucky statute, taxing deposits in Kentucky banks at a rate of one-tenth of one percent annually, as compared to five-tenths of one percent on bank deposits which are located outside the State, arose in the case of *Commonwealth* v. *Madden's Exr.*[1] The appellee's contention is that the above statute is in violation of the Fourteenth Amendment to the United States Constitution since it attempts to apply different rates of taxation to property of the same class, and that the distinction upon which the legislature bases its power to impose a different rate of taxation is arbitrary and discriminatory. He contends also, that the State cannot, upon mere difference of location, justify a difference in rates regarding property in the same class. The entire issue resolves itself to this: Is the classification made by the Kentucky statute,[2] between deposits in Kentucky banks and deposits in other banks located outside the State, a reasonable classification? If it is a reasonable classification, is the difference in rate between local and foreign banks arbitrary and discriminatory?

Application of the Fourteenth Amendment to the United States Constitution and Section 171 of the Kentucky Constitution definitely indicates that a State cannot apply different rates of taxation to property having the same classification. The state may classify different kinds of property into different classes and impose different rates of taxation upon the different classes, but the difference must rest upon some genuine distinction and not upon one of time or place.

In *Louisville Gas Co.* v. *Coleman*,[3] the Kentucky Mortgage Tax Act was held to violate the Fourteenth Amendment to the United States Constitution because the statute could not impose a tax on the recording of mortgages having a maturity of more than five years and no tax on the recording of mortgages having an earlier maturity, and still be considered fair and non-discriminatory.

---

[1] 265 Ky. 684, 97 S. W. (2d) 561 (1936).

[2] Ky. Stat., Sec. 4019a-1.

[3] 277 U. S. 32, 72 L. Ed. 770, 48 Sup. Ct. 423 (1928).

In *State* v. *Hoyt*[4] the court held invalid a state statute the effect of which was to impose a tax upon the sales of goods manufactured within the state, while leaving the sales of goods manufactured without the state free from taxation. The court ruled that the classification could not be based upon any difference in the goods, because there was none; nor on the fact that they were made in different states, for that bore no proper and just relation to the classification but was purely arbitrary; nor on the difference of residence of the manufacturers for the same reason.

In *Colgate* v. *Harvey*,[5] a Vermont statute was held to have violated the Fourteenth Amendment to the United States Constitution by virtue of the fact that it attempted to tax the interest from loans made outside the state and exempted interest earned from loans made within the state. The courts in other decisions[6] have indicated that the judiciary is reluctant to accept mere differences having no reasonable and fair substantial relation to the subject matter with regard to which such classification is proposed.

The court in *F. S. Royster Guano Co.* v. *Virginia*[7] stated:

> "The classification in order to avoid the constitutional prohibition, must be founded upon pertinent and real differences, as distinguished from irrelevant and artificial ones. The test to be applied is—does the statute arbitrarily and without genuine reason impose a burden upon one group of taxpayers from which it exempts another group of taxpayers, both of them occupying substantially the same relation toward the subject matter of legislation. Mere difference is not enough."

In the case of *Chalker* v. *Birmingham & Northwestern Ry. Co.*,[8] the court held a Tennessee statute which taxed construction companies on the basis of the location of their chief office invalid on the ground that the basis of the difference in the tax rate was arbitrary and discriminatory. The court stated:

> "We can find no adequate basis for taxing individuals according to the location of their chief offices, the classification we think is arbitrary and unreasonable. Under the United States Constitution a citizen of one state is guaranteed the right to enjoy in all states equality of commercial privileges with their citizens, but he cannot have his chief office in every one of them."

The same reasoning may be applied to the instant case.

In *State Tax Comm. et al.* v. *Shattuck et al.*,[9] the Intangible Prop-

---

[4] 71 Vt. 59, 42 Atl. 973 (1899).

[5] 296 U. S. 404, 80 L. Ed. 299, 56 Sup. Ct. 252 (1935).

[6] Gulf, Colorado & Sante Fe Ry. Co. v. Ellis, 165 U. S. 150, 41 L. Ed. 666, 17 Sup. Ct. 255 (1897); in re Harkness' Estate, 83 Okla. 107, 204 Pac. 911 (1922); F. S. Royster Guano Co. v. Virginia, 253 U. S. 412, 64 L. Ed. 989, 40 Sup. Ct. 560 (1920).

[7] *Supra*, n. 6.

[8] 249 U. S. 522, 63 L. Ed. 748, 39 Sup. Ct. 366 (1919).

[9] —Ariz.—, 38 P. (2d) 631 (1934).

erty Tax Act, which was passed by the legislature in the state of Arizona in 1933, which exempted domestic insurance companies and companies who paid taxes on premiums from paying the intangible property tax, but provided for all other insurance companies to pay such tax, was held to be in violation of the Arizona Constitution which provides as follows: "All taxes shall be uniform upon the same class of property."[10]

The court, in *McPherson* v. *Fisher*,[11] made a similar decision. The plaintiff in this case challenged the constitutionality of an Oregon statute which imposed a tax upon her income from intangibles without exemption because her husband had an income in excess of $2,500, and granted an exemption to unmarried women with the same income. The statute was held to be in contravention of Art. I, Section 32, of the Oregon Constitution.

The statute as applied in the *Colgate* v. *Harvey*[12] case in effect states that if a citizen resident in Vermont loans money at five percent interest or less in other states he must pay a tax upon the income from such loans, but if he makes the loans within the state of Vermont at the same rate, no tax whatever shall be imposed. It reasonably is not open to doubt that the discriminatory tax here imposed abridges the privileges and immunities of a citizen of the United States to loan money and to make contracts with respect thereto in any part of the country. The dissenting opinion of this case stated:

> "Exemption of income from investments in property within the State and taxation of like income from without the State are thought to be valid, but the privileges and immunities clause of the Federal Constitution, it is declared, forbids any difference in taxation of income from investments made without the State. A conclusion which can only be attributed to the belief that this discrimination as distinguished from others is arbitrary and unreasonable."

As a final consideration, it does not seem to be a satisfactory solution to the problem to simply say that the Kentucky Statutes, Section 4019a-1, is valid and reasonable, in distinguishing between bank deposits in Kentucky banks and deposits in other banks located without the State, without reconciling the aforementioned cases. To say that the classification is for the purpose of keeping deposits in local banks so as to benefit local business, a purely legislative motive, is to admit that the statute is arbitrary. Therefore, the classification of bank deposits as local and foreign would be based upon a "mere difference" insufficient to justify a difference in the rate of taxation of property within the same class. Assuming that the classification is reasonable, the rate of taxation based on the difference in location is arbitrary and unreasonably discriminatory, since it deprives one of the constitutional guarantees that inure to him as a citizen of the United States.

LOUIS H. LEVITT.

---

[10] Art. 9, Sec. 1.
[11] 143 Ore. 615, 23 P. (2d) 913 (1933).
[12] *Supra*, n. 5.