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Comments and Casenotes

CONSTITUTIONAL ASPECTS OF REDUCTION IN STATE PROPERTY TAX

By HERBERT M. BRUNE, JR.*

Reduction or repeal of the State property tax appears likely to rank as one of the vital questions in State affairs.¹ Apart from reasons of political or economic policy, for discussion of which the REVIEW would not be the proper forum, two legal or constitutional grounds have been advanced for the view that early repeal of the tax cannot be accomplished. These are, first, that the State has contracted with its bondholders not to repeal the tax until outstanding bonds are retired, and, second, that the taxes on certain gross receipts of utilities depend for their validity on the fact that they are substitutes for a State property tax, so that repeal of the general property tax would render these taxes unconstitutional.

State Constitutional Provision

All bonds of the State issued since the Constitution of 1851 have been authorized by laws calling for the levy of taxes to cover interest and amortization on such bonds.² Apart from road bonds which are serviced by the gasoline tax^{2a} and certain recent issues which are serviced by inheritance taxes, the outstanding funded indebtedness of the State³ has been issued under legislation calling for the levy of State property taxes, the maximum rate of 23.35 cents to be reached in 1939.⁴

The Constitutional provision authorizing and requiring such legislation reads as follows:

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¹ Editorial, "State Realty Tax," Baltimore Sun, Nov. 13, 1937.

² Md. Const., Art. III, Sec. 34 (as amended by Acts, 1924, Chap. 327, ratified November 4, 1924); Const. 1851, Art. III, Sec. 22; Const. 1864, Art. III, Sec. 33.

^{2a} Not issued on the general credit of the State.

³ Expected to be about \$52,000,000 as of the close of the year 1937.

⁴ According to the Budget submitted by Governor Nice to the 1937 regular session of the Assembly, "loan taxes" on property in the amount of \$5,288,662.50 were to be required in 1939 to service outstanding bonds. Additional bonds in the amount of \$10,052,000 were authorized by the Assembly in 1937; \$3,971,000 in principal amount of bonds were retired.

“No debt shall be hereafter contracted by the General Assembly unless such debt shall be authorized by a law providing for the collection of an annual tax or taxes sufficient to pay the interest on such debt as it falls due, and also to discharge the principal thereof within fifteen years from the time of contracting the same; and the taxes laid for this purpose shall not be repealed or applied to any other object until the said debt and interest thereon shall be fully discharged.”⁵

It is matter of public record that diversions of the annuity bond fund, as it is called, to general purposes have occurred on several occasions during the recent difficult years in State finances.⁶ Presumably these diversions were unconstitutional,⁷ but no proceedings were undertaken to enjoin them. The fund has subsequently been restored,⁸ and, according to latest reports, is now intact.

It is plain that outright repeal of the tax would be a violation of the terms of the Constitutional provision, even if coupled with the levy of a sufficient substitutional tax. If, however, the tax is not repealed, but the levy is merely suspended, conditional on revenue from substitutional taxes providing an equivalent sum, a more difficult question is presented. No direct authority has been found bearing on the scope and effect of similar constitutional provisions.⁹ Under such circumstances reference may be made to the evident purpose of the Constitutional provision in considering whether a conditional suspension of the levy would violate the prohibition against repeal.

The provision was adopted in the course of a program for reorganizing the State's finances, after bitter experiences following overextensions of the public credit.¹⁰ Purposes which may be gathered from the provision in the light of this background are that it was designed (1) to afford specific protection to bondholders of the State; (2) to improve the credit of the State thereby; (3) to furnish a check against large and constant increases in the State debt.¹¹ No purpose to favor one form of taxation over another can be

⁵ Md. Const., Art. III, Sec. 34.

⁶ See Reports of Comptroller, 1934, p. 38; 1935, p. 22; 1936, p. 20.

⁷ See *State v. Hendrickson*, 15 Md. 205 (1860).

⁸ Acts, 1937, Ch. 515 (p. 1224), the Budget Act of 1937.

⁹ Aside from a recent decision permitting use of general funds of the State to pay early installments of interest before the loan taxes are collected and thus saving the constitutionality of the State office building loan. *Bickel v. Nice*, 192 Atl. 777 (Md., 1937).

¹⁰ Niles, *Maryland Constitutional Law*, 186-188.

¹¹ The object is “to require the Assembly, when incurring an obligation, to meet the problem of punctual payment”. *Bickel v. Nice*, *supra*, note 9.

gathered from the provision, since the Assembly was given freedom to determine the form of taxation adopted to service any bond issue.^{11a} Accordingly, bond issues serviced by gasoline taxes¹² and by inheritance taxes,¹³ as well as those serviced by the real estate tax, have been authorized.

Unless particular State revenues have been provided for a bond issue, the holder of a State bond has no legal means of compelling its payment.¹⁴ If, in addition to the revenues originally appropriated, other sources of revenue are provided, it seems clear that the position of the bondholder has been materially improved rather than the reverse. The enactment of a new or other form of tax applicable to outstanding bond issues, coupled with a direction to State and local officials to suspend the property levy only to the extent that other funds are actually realized,¹⁵ gives the bondholder two sources out of which his bonds are payable. Thus it adequately protects him, safeguards the credit of the State, and does not affect or impair the State policy against issuing bonds without providing funds for their payment.

The suggested conclusion that the purposes of the Constitutional provision are in no substantial degree impaired by conditional suspension of the property tax is fortified by consideration of the meaning of the word "repeal". Repeal has been authoritatively defined as "the abrogation or destruction of a law by a legislative act".¹⁶ If the property levy is not abrogated or destroyed but is continued in existence for the further security of bondholders, provided other funds do not measure up to expectations, it seems that the tax has not in fact been "repealed".

^{11a} Careful bond counsel, passing on the Emergency Bond Issue of 1935, suggested the possibility that the "annual tax or taxes," required by the Constitutional provision, might be limited to property taxes. It is believed that such a construction would import into the provision a requirement not to be found in the natural meaning of the words used and is, therefore, not to be anticipated.

¹² Acts, 1935, Ch. 563, authorizes road bonds in the amount of \$3,000,000 to be paid from certain motor vehicle and gasoline taxes. Since the general credit of the State is not pledged, it is arguable that this is not a "debt created by the General Assembly", within the meaning of the Constitutional restriction.

¹³ Acts, 1935, Ch. 91, provides for a general bond issue of \$8,500,000, serviced primarily by inheritance taxes and only secondarily by an additional property tax.

¹⁴ *Louisiana v. Jumel*, 107 U. S. 711, 27 L. Ed. 448, 2 S. Ct. 128 (1883); *Sawyer v. Colgan*, 102 Calif. 283, 36 Pac. 580, 834 (1894); *Colbert v. State*, 86 Miss. 769, 39 So. 65 (1906); *Opinion of Justices*, 49 Mo. 216 (1872).

¹⁵ Cf. method of servicing relief bonds in Illinois as described in *Michaels v. Barrett*, 355 Ill. 175, 188 N. E. 921 (1934). See also Md. Acts, 1935, Ch. 91.

¹⁶ 3 *Bouvier's Law Dictionary*, 2887.

Impairing Obligation of Contract

While a law repealing the property tax would violate the provision of the State Constitution, that provision can itself be amended. The effect of a statute or constitutional amendment as impairing contract rights of bondholders, guaranteed to them under the Federal Constitution, must therefore be considered.

Outright repeal of the property tax would impair the obligation of the State's contract and would be held invalid under the Federal Constitution.¹⁷ Even the adoption of a State constitutional amendment repealing the tax would, as applied to outstanding bonds, impair the State's contract.¹⁸ A law repealing the tax would be disregarded, and State officers could be compelled by mandamus to collect and apply the tax.¹⁹ But if the tax is repealed by a State constitutional amendment, officers cannot be compelled to disregard the amendment; being part of the fundamental law of the State, it necessarily furnishes the guide to action by executive officers, and the bondholder will have a right without a remedy.²⁰ While a State constitutional provision cannot be asserted in violation of the basic Federal law in a suit against private litigants or municipal corporations, it is equally true that the State itself, in its sovereign capacity, cannot be coerced against its own supreme law.²¹

In the leading case in which these views were expressed by the Supreme Court, Louisiana had, by constitutional amendment, abolished taxes applicable to bonds, without providing other revenue.²² Loss of State credit through such action would make unlikely any effort to follow a similar course here. If adequate substitutional revenue is provided, and the real estate tax kept in reserve, no substantial right of bondholders has been impaired. Without substantial injury it is not apparent how a bondholder could show

¹⁷ Louisiana v. Jumel, supra, note 14; Board of Liquidation v. McComb, 92 U. S. 531, 23 L. Ed. 623 (1876); Bunch v. Wolerstein, 62 Miss. 56 (1884); State, ex rel. Judd, v. Cooney, 97 Mont. 75, 32 P. (2d) 851 (1936); 1 Quindry, Bonds and Bondholders, Sec. 86. And see Morton v. Comptroller General, 4 S. Car. 430 (1873). Cf. Ex parte Young, 209 U. S. 123, 28 S. Ct. 441, 52 L. Ed. 714 (1908); In re Tyler, 149 U. S. 164, 13 S. Ct. 785, 37 L. Ed. 689 (1893).

¹⁸ Louisiana v. Jumel, supra, note 14; Cf. State of Florida v. Palm Beach Dist., 121 Fla. 746, 164 So. 851 (1935); State of Florida v. Boring, 121 Fla. 781, 164 So. 859 (1935).

¹⁹ Board of Liquidation v. McComb, supra, note 17; Cf. Meriwether v. Garrett, 102 U. S. 472, 26 L. Ed. 197 (1880).

²⁰ Louisiana v. Jumel, supra, note 14.

²¹ Cf. Louisiana v. Jumel, supra, note 14, with State of Florida v. Palm Beach Dist., supra, note 18, and State of Florida v. Boring, supra, note 18.

²² Louisiana v. Jumel, supra, note 14.

any legal basis for complaint,²³ apart from the question of the State's sovereign immunity,²⁴ nor could the credit of the State suffer through an amendment affording such complete protection of the interest of bondholders.

Practical as well as legal considerations, therefore, would suggest that a Constitutional amendment permitting repeal of the property tax should be coupled with a saving clause keeping the levy in reserve for the further security of outstanding bonds. There remains the possibility of procuring from bondholders a waiver of the real estate levy conditional on other revenue proving sufficient.²⁵ Bondholders might be induced to have such waivers indorsed on their bonds in consideration of being granted the additional security of another specific tax. These and other considerations make it desirable that any plan relating to the realty tax should be worked out in cooperation with representatives of bondholders or of the bankers who purchased the bonds and resold them to the public.

That the credit of the bonds would not be impaired by the change is indicated by the credit now enjoyed by the Emergency Bond Issue of 1935.²⁶ Bonds issued under that act, payable primarily out of special taxes and only secondarily from the property tax, which is not resorted to as long as the other revenue is sufficient, are selling at prices equal to those of bonds secured primarily by the property tax.

Effect Upon Gross Receipts Taxes

The gross receipts taxes on utilities involve constitutional conceptions which are today in a state of some uncertainty.²⁷ It was formerly the rule that a tax on gross

²³ *State of Florida v. Boring*, supra, note 18; *Storen v. Sexton*, 200 N. E. 251 (Ind., 1936). Cf. *Perry v. United States*, 294 U. S. 330, 55 Sup. Ct. 432, 79 L. Ed. 912 (1935). See also 5 *Pomeroy*, Eq. Jur. (4th Ed.), Sec. 2218; *Wood on Mandamus* (3rd Ed.), p. 36. A party seeking to have a statute declared unconstitutional must show that he is actually injured by its operation. *Louisville R. Co. v. Finn*, 235 U. S. 601, 35 Sup. Ct. 146, 59 L. Ed. 379 (1915); *Southern R. Co. v. King*, 217 U. S. 524, 30 S. Ct. 594, 54 L. Ed. 868 (1910).

²⁴ *Louisiana v. Jumel*, supra, note 14; *Carolina Glass Co. v. South Carolina*, 240 U. S. 305, 36 S. Ct. 293, 60 L. Ed. 658 (1916).

²⁵ The right to raise Constitutional questions may be waived. *Booth Fisheries Co. v. Industrial Commission*, 271 U. S. 208, 46 S. Ct. 491, 70 L. Ed. 908 (1926).

²⁶ Acts 1935, Ch. 91.

²⁷ Cf. *Pullman Co. v. Richardson*, 261 U. S. 330, 43 S. Ct. 366, 67 L. Ed. 682 (1923), and *New Jersey Bell Tel. Co. v. State Board*, 280 U. S. 338, 50 S. Ct. 111, 74 L. Ed. 463 (1930), with *Potomac Elec. Power Co. v. Hazen*, 90 F. (2d) 408 (1937), cert. den. 58 S. Ct. 11 (Oct. 11, 1937).

receipts from interstate business,²⁸ or a franchise tax measured partly by gross receipts from interstate business,²⁹ was invalid as a burden on commerce unless it could be regarded as a property tax or in lieu of a property tax on the value of the company's intangible property or franchises.³⁰ Changes in the personnel of the United States Supreme Court since its last decision indicate that a close division of opinion may exist on the validity of certain gross receipts taxes.³¹ Within the last month the Court has upheld a franchise tax on a foreign corporation which was measured by its total authorized capital,³² and this was regarded as a deviation from previous views of the Court.³³

In Maryland the gross receipts tax is levied in addition to property taxes, except in the case of domestic railroad companies.³⁴ It therefore, under the former rule, could not be collected as applied to interstate receipts, unless limited to the equivalent of a tax on the companies' property,³⁵ and the taxing authorities have in practice limited it to receipts from local business.³⁶ It would seem, therefore, that repeal of the property tax will not reduce present tax collections under the gross receipts law except possibly from domestic railroad companies.

²⁸ *Pullman Co. v. Richardson*, *supra*, note 27.

²⁹ *New Jersey Bell Tel. Co. v. State Board*, *supra*, note 27.

³⁰ *United States Ex. Co. v. Minnesota*, 223 U. S. 335, 32 S. Ct. 211, 56 L. Ed. 459 (1912). Or the tax may be validly imposed in substitution for "the ordinary tax upon property", that is, property both tangible and intangible. See *Postal Tel. Co. v. Adams*, 155 U. S. 688, 15 S. Ct. 268, 360, 39 L. Ed. 311 (1895).

³¹ Mr. Justice Brandeis dissented in the *New Jersey Bell Telephone Co.* case and Mr. Justice Stone took no part in the decision. Justices Hughes, Roberts, Cardozo and Black have subsequently been appointed to the Court.

³² *Atlantic Refining Co. v. Virginia*, 58 S. Ct. 75 (decided Nov. 8, 1937).

³³ See *Alpha Portland Cement Co. v. Massachusetts*, 268 U. S. 203, 45 S. Ct. 477, 69 L. Ed. 916 (1925), and *Cudahy Packing Co. v. Hinkle*, 278 U. S. 460, 49 S. Ct. 204, 73 L. Ed. 454 (1929), distinguished in the opinion in *Atlantic Refining Co. v. Virginia*, *supra*, note 32, on the ground that in those cases the corporation had already been admitted to the State. See also *Prentice-Hall, State and Local Tax Service*, Par. 7029.

³⁴ Md. Code, Art. 81, Sec. 91.

³⁵ See doubt expressed in *Postal Tel. Co. v. Harford Co.*, 131 Md. 96, 101 Atl. 600 (1917). Even though imposed in addition to property taxes, the gross receipts levy (which is expressly declared to be a franchise tax) is clearly valid when measured by receipts from intrastate business alone, unless it burdens interstate commerce. *Pacific Tel. & Tel. Co. v. Tax Commission*, 297 U. S. 403, 56 S. Ct. 222, 80 L. Ed. 760 (1936).

³⁶ A recent sampling of returns of utilities under the gross receipts tax shows that they customarily report only a small fraction of the statutory estimate of their total receipts in Maryland, ranging from one-fourth to one-eighth. The statute in terms requires that the tax be paid on that proportion of total gross receipts of the company which the mileage in Maryland bears to the total mileage. See Md. Code, Art. 81, Sec. 91 (b).

Conclusions

Broadly speaking, private persons, unless they are materially injured by a proposed change in State policy, should not be permitted to control the form of taxation which the legislature may see fit to impose. Any waiver of the State's sovereign powers and immunities should not be extended beyond the necessities of the occasion upon which the waiver is made. Accordingly, if bondholders are adequately protected by a substitutional tax and by keeping the property tax in reserve (as was done in the case of the Emergency Bond Issue of 1935), they should not be permitted to obstruct such changes as may be desired by the people of the State.

It is believed that formal breach of the State's contract against repeal would not result from conditional suspension of the levy. Nor could a substantial impairment of the contract obligation be shown. Litigation by a minority bondholder is always possible, however, and for this reason a Constitutional amendment might offer a more desirable procedure as tending to make the State's legal position impregnable.⁸⁷

No suggestion is made that a breach of contract would be desirable or justifiable on the ground of the State's immunity from suit. On the contrary, the necessity of preserving the State's credit is an adequate guaranty against unfair dealing with the State's bondholders and bankers.

⁸⁷ It has been assumed that Article 15 of the Declaration of Rights, as amended in 1915, will furnish no obstacle to repeal or suspension of the State property tax. Prior to the 1915 amendment it was held that State and local taxes on tangible personal property and on improvements could not be repealed as long as these taxes are retained on land, since the requirement of uniformity would be violated. *Wells v. Hyattsville*, 77 Md. 125, 26 Atl. 357 (1893). Doubtless the amendment permits separate treatment of different classes of property, although an undefined requirement of uniformity remains. *Susquehanna Power Co. v. State Tax Commission*, 159 Md. 334, 151 Atl. 29 (1930); *aff'd* 283 U. S. 291, 51 S. Ct. 434, 75 L. Ed. 1042 (1931). A constitutional amendment would avoid all question of conflict with Article 15.