Vanderbilt Law Review

Volume 27
Issue 3 *Issue 3 - April 1974*

Article 3

4-1974

Constitutional Limitations on Income Taxes in Tennessee

Walter P. Armstrong, Jr.

Constitutional Limitations on Income Taxes in Tennessee

*Walter P. Armstrong, Jr.**

I. INTRODUCTION

Tennessee is one of only ten states[1] that do not impose a general personal income tax.[2] A general income tax has been attempted twice, and twice the Tennessee Supreme Court has declared it invalid under the state constitution.[3] For 100 years that court has construed the taxing provision of the constitution[4] to limit the legislative power to the imposition of "privilege" taxes, uniform ad valorem property taxes, and taxes on the income derived from stocks and bonds. From time to time the court has interpreted "privilege" expansively, sustaining taxes on such diverse subjects as qualification of foreign corporations,[5] corporate net earnings,[6] storage of gasoline,[7] and admission to theatres in Knox County[8] as "privileges." Yet it has steadfastly refused to use the same rationale to uphold a general income tax. And applying the constructional device of exclusion by affirmation, the court has maintained that the express constitutional grant of authority to tax the income from stocks and bonds implicitly denies the legislature the power to levy any other sort of income tax.[9]

Recognizing the severely regressive impact of the current Tennessee taxing system at low income levels,[10] and faced with a pre-

* Member Tennessee Bar; A.B., 1938, LL.B., 1941, Harvard University.

1. The other states that do not impose general personal income taxes are Connecticut, Florida, Nevada, New Hampshire, New Jersey, South Dakota, Texas, Wasbington, and Wyoming. CCH STATE TAX GUIDE ¶¶ 15-200 to -935 (1973).

2. Tennessee imposes a tax on the personal income derived from stocks and bonds. TENN. CODE ANN. §§ 67-2601 to -2635 (Supp. 1973).

3. Jack Cole Co. v. MacFarland, 206 Tenn. 694, 337 S.W.2d 453 (1960); Evans v. McCabe, 164 Tenn. 672, 52 S.W.2d 159 (concurring opinion at 52 S.W.2d 617) (1932).

4. This provision is article 2, § 28 of the Tennessee constitution.

5. Camden Fire Ins. Ass'n v. Haston, 153 Tenn. 675, 284 S.W. 905 (1926).

6. Bank of Commerce & Trust Co. v. Senter, 149 Tenn. 569, 260 S.W. 144 (1924).

7. Foster & Creighton Co. v. Graham, 154 Tenn. 412, 285 S.W. 570 (1926).

8. Knoxtenn Theatres, Inc. v. Dance, 186 Tenn. 114, 208 S.W.2d 536 (1948).

9. Evans v. McCabe, 164 Tenn. 672, 52 S.W.2d 159 (1932), *relied on in* Jack Cole Co. v. MacFarland, 206 Tenn. 694, 337 S.W.2d 453 (1960).

10. In 1970, Tennessee property and sales taxes absorbed 11.2% of the income for households with an annual income of $2,000 or less, whereas for families with incomes of $25,000 or over the tax burden amounted to only 3.1%. TENNESSEE TAX MODERNIZATION AND REFORM COMMISSION, SUMMARY REPORT ON TAX MODERNIZATION AND REFORM 2 (1973).

dicted cumulative shortfall in state revenue of 6.9 billion dollars by 1990,[11] the Tennesse Tax Modernization and Reform Commission has recommended the enactment of a general nongraduated 1.5 percent income tax.[12] The obvious method of accomplishing such a tax would seem to be a constitutional amendment, sidestepping the manifest judicial hostility to income taxes. But this course seems politically unfeasible, at least at present.[13] Thus, the only alternative is a reexamination of the case law interpreting the constitutional taxing provision in an effort to find a basis for prompting the Tennessee Supreme Court to reconsider its limited view of the legislature's power to tax.

II. Property, Privilege, and Section 28

Section 28 of article 2 of the Tennessee Constitution of 1870 provides in part as follows:

> All property real, personal or mixed shall be taxed . . . . All property shall be taxed according to its value, that value to be ascertained in such manner as the Legislature shall direct, so that taxes shall be equal and uniform throughout the State. No one species of property from which a tax may be collected, shall be taxed higher than any other species of property of the same value, but the Legislature shall have power to tax Merchants, Peddlers, and privileges, in such manner as they may from time to time direct. The portion of a Merchants Capital used in the purchase of Merchandise sold by him to non-residents and sent beyond the State, shall not be taxed at a rate higher than the ad valorem tax on property. The Legislature shall have power to levy a tax upon incomes derived from stocks and bonds that are not taxed ad valorem.

The Tennessee Supreme Court first considered article 2, section 28 of the 1870 constitution in *Jenkins v. Ewin,*[14] in connection with an 1871 act providing that "in addition to the advalorem tax to be paid by merchants on their capital, they shall be liable and required to pay a license tax equal in amount to the advalorem tax; *Provided,* That in no case shall the license tax be less than five dollars . . . ."[15] In an opinion by Chief Justice Nicholson, who had been a member of the constitutional convention at which the 1870 constitution was drafted, the Tennessee Supreme Court upheld the statute

11. *Id.* at 24.

12. *Id.* at 31.

13. Article 2, § 28 was amended at the Constitutional Convention of 1971, hut the amendment made no effort to provide a firmer constitutional basis for an income tax. Instead, the amendment dealt only with a detailed scheme for assessment of the ad valorem property tax. Another convention has been called for 1978, but it seems that voter hostility will again prevent the consideration of an income tax.

14. 55 Tenn. 456 (1872).

15. Act of Jan. 24, 1871, ch. 51, § 2, [1870-71] Tenn. Acts 60.

as a constitutional exercise of legislative power. In a lengthy discussion of section 28, the court explained the essential dichotomy in the legislative taxing power: although the legislature is severely restricted in taxing property, "as to merchants, peddlers, and privileges, the Legislature is not to be restricted, but may exercise the taxing power without restrictions, either as to the amount, or as to the manner or mode of exercising the power."[16] The court was at pains to point out that the taxation of merchants, peddlers, and privileges is entirely unaffected by the twin constitutional commands that property be taxed according to value uniformly throughout the state and that no one species of property be taxed at a rate higher than other species of equal value.

Thus the 1871 revenue act was upheld as a valid exercise of the legislature's unfettered power to tax merchants. Moreover, while the court was careful to note that its holding made unnecessary a finding that merchandizing is a privilege,[17] the reasoning of the opinion clearly would apply to any activity that is a privilege, since the power to tax privileges is similarly exempt from all restrictions under the same clause of the constitution. Furthermore, the inclusion of both merchants and privileges in this clause makes immaterial the question whether the occupation of merchant is a privilege.[18]

In determining the scope of the legislative taxing power, it was obviously important to define the term privilege. In *Phillips v. Lewis*,[19] the court recognized that unlimited legislative discretion in declaring privileges would emasculate the property tax restrictions:

> If the power conferred to tax in this mode is only equivalent to the will or discretion of the legislature, then the constitution, or this clause, is practically a nullity, ceases to be any rule, or to operate at all over the subject, but only the will of the legislative body would be supreme over the question, so that, in fact, anything and all property could be taxed exclusively in this way, and thus the rule of taxation according to value be annulled.[20]

Ten years later, ignoring this decision, the court stated that a privilege is "whatever the Legislature choose to declare to be a privilege, and tax as such."[21]

Apparently sharing the fears earlier expressed in *Phillips*, the

16. 55 Tenn. at 478.

17. *Id.* at 474-75.

18. *See* American Book Co. v. Shelton, 117 Tenn. 745, 771, 100 S.W. 725, 731-32 (1907); Kelly & McCaden v. Dwyer, 75 Tenn. 180, 189-90 (1881) (separate opinion of Cooper, J.).

19. 3 Tenn. Cas. 230 (Tenn. Sup. Ct. 1877).

20. *Id.* at 244.

21. Kurth v. State, 86 Tenn. 134, 136, 5 S.W. 593, 594 (1887); *accord,* Burke v. Memphis, 94 Tenn. 692, 30 S.W. 742 (1895). Presaging a later line of cases, the court in the Turnpike Cases, 92 Tenn. 369, 372, 22 S.W. 75 (1893), qualified the *Kurth* definition by

court in *Railroad v. Harris*[22] retreated somewhat and stated that "[a]t the least, any occupation, business, employment, or the like affecting the public, may be classed and taxed as a privilege."[23] The concept of privilege as a business or occupation affecting the public appears to be a limitation upon the right of the legislature to declare whatever it chooses a privilege and to tax it as such. The *Harris* court, however, did describe the legislative discretion in this area as "very comprehensive,"[24] and its use of the phrase "at the least" implies that the suggested limitation really was intended to be an illustration of, rather than a restriction on, legislative power.

Six years after *Harris,* the court in *Trentham v. Moore*[25] further defined and clarifled the privilege concept. Recognizing a conflict in the prior cases, the court attempted a reconciliation by defining a privilege as "whatever business, pursuit, or avocation, affecting the public, the legislature may choose to declare to be a privilege, and to tax as such."[26] Thus the court concluded that a single act could not be taxed as a privilege, since a single act alone could not constitute a business, avocation, or pursuit.[27] Given the evolving definition of privilege, it is not surprising that the merchant and peddler classifications were subsumed into the privilege concept. Merchandising and peddling apparently were considered examples of the pursuits that come within this concept. Thus the court in *Railroad v. Harris* was able to say that the constitution recognizes "only two general kinds of taxation—*ad valorem* and privilege. These cover the whole domain of taxation, and beyond these the Legislature may not go in the imposition of taxes."[28]

It therefore appears that the subject of taxation must be either property or a privilege, and this depends upon its innate characteristics and not merely upon the legislature's designation or characterization. In addition, it was held at an early date that the legislature is without power to create exemptions from taxation. In *Memphis v. Memphis City Bank,*[29] the Tennessee Supreme Court construed

adding that "whatever occupation affects the public may be . . . classed and taxed as [a privilege]."

22. 99 Tenn. 684, 43 S.W. 115 (1897).

23. *Id.* at 702, 43 S.W. at 119.

24. *Id.*

25. 111 Tenn. 346, 76 S.W. 904 (1903).

26. *Id.* at 352, 76 S.W. at 905.

27. Because a single act cannot be a privilege, it becomes "a matter of importance 'whether they make a business of it, or not,' since if they do not, there is no privilege to be subjected to taxation." *Id.* at 353, 76 S.W. at 905.

28. 99 Tenn. at 701-02, 43 S.W. at 119.

29. 91 Tenn. 574, 19 S.W. 1045 (1892).

the constitutional imperative "[a]ll property shall be taxed" to prohibit all tax exemptions except those permitted or required in section 28 itself. Therefore, the legislature's attempt to exempt a corporation from ad valorem taxes upon its capital stock and shares of stock was void for lack of legislative power.[30] Similarly, the legislature is without power to impose other forms of taxation in lieu of those specified in section 28. In *Ellis v. Louisville & Nashville R.R.*[31] the court held unconstitutional section 11 of the Act of March 24, 1875,[32] which authorized a railroad to pay one and one-half percent of its gross earnings in lieu of all other property taxes. The rationale of the *Ellis* case, as described by the Chancellor in *Memphis & Charleston R.R. v. Gaines,*[33] is that a percentage tax on corporate income is not a property tax at all,[34] but an exemption from property taxation, which is beyond the legislative competency.[35]

Thus it was apparent that the most promising avenue of legislative discretion in raising revenues was characterization of various activities as privileges. Accordingly, the court in *Wilson v. State*[36] approved a "privilege tax" on "all carts, buggies, surreys, wagons, traction engines, automobiles and motorcycles, used upon the public highways . . . ."[37] The court reaffirmed the legislature's unlimited power to tax privileges and concluded that the challenged statute did not impose a tax directly on the property, but upon the

30. The court noted that article 2, § 28 of the constitution "declares what property *may* be and what *shall* he excepted from taxation, and directs that all the rest *shall be taxed.* By that mandatory direction the Legislature is *prohibited* from making any other exemptions from taxation upon any ground or consideration whatever . . . ." *Id.* at 588, 19 S.W. at 1048.

31. 67 Tenn. 530 (1876).

32. Act of March 24, 1875, ch. 78, § 11, [1875] Tenn. Acts 104.

33. 3 Tenn. Ch. 604 (1877).

34. It should be noted that the United States Supreme Court reached an essentially different conclusion in Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895), which held a federal levy on the rents and income from real property to be a direct tax in violation of article 1, § 9, of the Constitution. This decision, of course, resulted in the adoption in 1913 of the sixteenth amendment, authorizing Congress to lay and collect taxes on incomes from any source without apportionment. The Supreme Court made it clear at an early date that the United States Constitution leaves largely unrestricted the power of a state to impose a general income tax on its citizens, subject only to the general provisions of the fourteenth amendment, which restrict all state legislation. *See* Lawrence v. State Tax Comm'n, 286 U.S. 276 (1932).

35. The prohibition on creating exemptions applies, of course, even though the legislature labels the levy a "special assessment" rather than a tax. Reelfoot Lake Levee Dist. v. Dawson, 97 Tenn. 151, 36 S.W. 1041 (1896). In *Dawson,* a special assessment was held unconstitutional in part because it imposed a tax on land within a certain area but exempted personalty in the same area.

36. 143 Tenn. 55, 224 S.W. 168 (1920).

37. Act of Apr. 15, 1919, ch. 657, § 1, [1919] Tenn. Private Acts 1974.

privilege of operating vehicles upon the public highways. The court did not consider whether its decision was inconsistent with the holding in *Trentham v. Moore*[38] that a taxable privilege must be a business, pursuit, or avocation rather than a single act. Whatever the logic of classifying the operation of a motor vehicle as a business, pursuit, or avocation, the *Trentham* requirement apparently was not abrogated—four years after *Wilson* it was reaffirmed in *H. G. Hill Co. v. Whitice.*[39]

In 1923, the legislature imposed upon all corporations doing business within Tennessee an excise tax equal to three percent of their net earnings from business done wholly within the state.[40] The constitutionality of this statute was challenged promptly and upheld in *Bank of Commerce & Trust Co. v. Senter.*[41] The court explored at length the origins and effect of excise taxation and concluded that the word "excise" includes "every form of taxation which is not a burden laid directly upon persons or property; in other words . . . every form of charge imposed by public authority for the purpose of raising revenue upon the performance of an act, the enjoyment of a privilege, or the engaging in an occupation."[42] The court therefore held that "excise tax" and "privilege tax" are synonymous terms, since an excise tax is nothing more than an indirect or privilege tax. Thus the court was able to uphold the statute under section 28 as a levy on the privilege of doing business in corporate form.[43] This tax, in substantially the same form but for

38. 111 Tenn. 346, 76 S.W. 904 (1903). *See* text accompanying notes 25-27 *supra.*

39. 149 Tenn. 168, 258 S.W. 407 (1924). In this case, the court repeated the familiar incantation about privileges: "A privilege is whatever business pursuant [*sic*], occupation, or vocation affecting the public the legislature chooses to declare and tax as such." *Id.* at 174, 258 S.W. at 408. The decision upheld, however, a tax on "traveling stores," and the court was not faced with the taxation of a single act. Perhaps for this reason, the court in *H.G. Hill* did not refer to the earler, seldom-cited case of State *ex rel.* Stewart v. Louisville & N.R.R., 139 Tenn. 406, 201 S.W. 738 (1918), which upheld a tax on the transfer of realty. Presented essentially with a tax on a single act, the court was able to conclude that "the later cases . . . did not restrict the definition of privilege to the exercise of an occupation or business . . . but expanded it to include a single transaction which the legislature had made a privilege." *Id.* at 413, 201 S.W. at 739. Thus it may be that the definition of privilege varies with the factual setting of tbe case.

40. Act of Feb. 16, 1923, ch. 21, §§ 1-7, [1923] Tenn. Acts 84.

41. 149 Tenn. 569, 260 S.W. 144 (1924).

42. *Id.* at 579, 260 S.W. at 147. The court was quoting from 26 RULING CASE LAW § 18, at 34 (1920), but appeared to accept the definition as its own.

43. The court seemed to rely in part upon Atlas Powder Co. v. Goodloe, 131 Tenn. 490, 175 S.W. 547 (1915), which it cited for the proposition that the "legislature could not levy a direct tax upon property or the income from property, but could levy a tax upon the occupation, activity or business as a corporation." 149 Tenn. at 582, 260 S.W. at 147. Although *Goodloe* did uphold an entrance fee imposed upon foreign corporations, no issue was raised under the Tennessee constitution. Therefore, *Senter*'s reliance on this case may be misplaced.

various amendments to increase its scope, remains in effect today.[44] Since *Senter*, its constitutionality has been seldom challenged and invariably upheld.[45]

Two years later, the court in *Camden Fire Insurance Association v. Haston*[46] relied on *Senter* to uphold a privilege tax upon foreign corporations doing business in Tennessee based upon a percentage of their capital stock.[47] The court had little difficulty rejecting the argument that the tax was in essence a property tax,[48] apparently concluding that *Senter* required a finding of constitutionality.

In 1926, the court in *Foster & Creighton Co. v. Graham*[49] was faced with a revenue act constitutionally more troublesome than the corporate taxes previously considered. Chapter 58 of the Public Acts of 1923 levied a tax of two cents per gallon on those engaged in selling gasoline and on those storing gasoline and withdrawing it for sale or other use.[50] Complainant stored and withdrew large quantities of gasoline for private use in its construction business and accordingly argued that the statute in essence imposed an unconstitutional direct property tax. Rejecting that argument, the court discussed and relied upon two United States Supreme Court cases that characterized levies on the use and consumption of gasoline as excise taxes.[51] The court also noted that because gasoline is intrinsically dangerous and may affect the public health, the state has the right to regulate its use and handling, and one method of regulation is the imposition of a privilege tax on its storage and consumption.[52]

---

44. TENN. CODE ANN. §§ 67-2701 to -2724 (Supp. 1973).

45. *See, e.g.*, General Sec. Co. v. Williams, 161 Tenn. 50, 29 S.W.2d 662 (1930).

46. 153 Tenn. 675, 284 S.W. 905 (1926).

47. Act of Apr. 13, 1907, ch. 434, § 1, [1907] Tenn. Acts 1477.

48. The court observed that the elements of property in a corporation are the capital stock, the corporate property, and the franchise of the corporation. In the court's view, the challenged act did not tax any of these elements, but rather was a fee for the privilege of conducting business in Tennessee. It deemed the levy a valid privilege tax even though the state did not issue a license to recipients of the privilege. 153 Tenn. at 689-90, 284 S.W. at 908-09.

49. 154 Tenn. 412, 285 S.W. 570 (1926).

50. The tax was imposed upon "persons, firms, or corporations, dealers or distributors, storing any of the products mentioned in this Act, and distributing the same, or allowing the same to be withdrawn from storage, whether such withdrawal be for sale or other use . . . ." Act of Apr. 13, 1925, ch. 67, § 2, [1925] Tenn. Acts 151, *amending* Act of March 24, 1923, ch. 58, § 3, [1923] Tenn. Acts 150. The tax was raised to 3¢ per gallon by the Act of Feb. 2, 1925, ch. 4, § 1, [1925] Tenn. Acts 8. The taxpayer in *Foster & Creighton* was assessed at the 3¢ rate.

51. Texas Co. v. Brown, 258 U.S. 466, 479 (1922); Bowman v. Continental Oil Co., 256 U.S. 642, 648-49 (1921). In both cases, the Court considered primarily the burden imposed on interstate commerce by local taxing statutes.

52. The court was unimpressed by complainant's argument that the right to store

Once the privilege or excise characterization had been attached, the court had little difficulty upholding the statute, uttering the familiar incantation that the "legislature has unlimited and unrestricted power to tax privileges, and this power may be exercised in any manner or mode in its discretion."[53]

In 1929, the legislature for the first time undertook to impose a tax on the income from certain stocks and bonds not taxed ad valorem,[54] and in the same year the statute was upheld by the Tennessee Supreme Court in *Shields v. Williams.*[55] The court concluded that the revenue act was of the sort specifically authorized by the clause in section 28 providing that the "Legislature shall have power to levy a tax upon incomes derived from stocks and bonds that are not taxed ad valorem." Thus the challenged tax was constitutionally unaffected by the property tax requirements of uniformity and equality. Finally, the court noted that the tax in question, like the privilege tax, is a special exception to the property tax clause and is therefore "clear of the restrictions contained in the *ad valorem* tax clause."[56]

Against this background, it was perhaps inevitable that the legislature would undertake the enactment of a general graduated state income tax. This it did in chapter 21 of the Acts of the Extra Session of 1931, which imposed such a tax, with certain exemptions, upon incomes of all sorts.[57] The following year in *Evans v. McCabe*[58] the Tennessee Supreme Court held the act unconstitutional under section 28 of the 1870 constitution. The court first conceded without citation of authority that the power to tax is a sovereign power,

gasoline in quantity is a "natural right" not subject to privilege characterization. In addition, the court cited Ogilvie v. Hailey, 141 Tenn. 392, 397, 210 S.W. 645, 647 (1919), for the proposition that "a single act may be declared a privilege." 154 Tenn. at 422, 285 S.W. at 573. *See* Seven Springs Water Co. v. Kennedy, 156 Tenn. 1, 5, 299 S.W. 792, 793 (1927); note 39 *supra* and accompanying text.

53. 154 Tenn. at 429, 285 S.W. at 575.

54. Act of Apr. 12, 1929, ch. 86, §§ 1-13, [1929] Tenn. Acts 210, *as amended,* Act of Apr. 13, 1929, ch. 116, §§ 1-6, [1929] Tenn. Acts 385.

55. 159 Tenn. 349, 19 S.W.2d 261 (1929).

56. *Id.* at 366, 19 S.W.2d at 267. One year after *Shields,* the Tennessee Supreme Court held that stocks and bonds whose income is taxed are thereby exempt from ad valorem taxes. Hamilton Nat'l Bank v. Shipp, 160 Tenn. 311, 23 S.W.2d 667 (1930).

57. For noncorporate taxpayers, the operative provision was as follows:

> A tax is hereby imposed upon and with respect to the entire income of every resident, individual, trust or estate, which tax shall be levied, collected and paid annually upon such entire net income as herein computed . . . .

Act of Dec. 19, 1931, ch. 21, § 3, [1931] Tenn. Acts 2d Extra Sess. 194. The rate structure was mildly graduated, ranging from 1% of the first $2,500 of net income to 5% of all net income over $15,000.

58. 164 Tenn. 672, 52 S.W.2d 159, 617 (1932).

restrained only by the limitations of the state and federal constitutions. Section 28 of the state constitution, however, does restrict the legislature's power and discretion, primarily through the equality and uniformity principles. The court described these restrictions as an attempt to remedy legislative abuses facilitated by the more permissive constitution of 1834. Nevertheless, it was thought necessary to qualify the initial broad language of section 28 with such exceptions as the privilege tax provision and the clause permitting taxation of the income from certain stocks and bonds. The court concluded that the latter clause constitutes an exception either to the restrictions on property taxation or to the legislative discretion in taxing privileges, depending on the characterization of a tax on incomes as a property tax or a privilege tax.[59] Accepting as the proper rule of interpretation that the exceptions from a power mark its extent,[60] the court was able to hold the challenged statute unconstitutional whether it was viewed as a property tax or a privilege tax:

> It therefore seems to us, treating the assailed tax as a property tax . . . that when the constitution by way of exception to a general provision against inequality in taxation conferred upon the legislature the power to tax only one class of incomes, that instrument necessarily denied to the legislature the power to tax incomes of other classes. Likewise, treating the income tax as a privilege tax, when the constitution, after it had sanctioned the power of the legislature to tax other privileges without restriction, designated one class of incomes to be taxed, that instrument necessarily denied to the legislature the power to tax incomes of other classes.[61]

Thus the court invalidated the general income tax on the basis of a rule of construction without investigating the inherent nature and effect of an income tax and without characterizing it as a privilege tax or a property tax. If the court had not followed this principle of construction, presumably it would have been forced to classify the income tax as either a property tax or a privilege tax. Had the court selected the first alternative, the income tax would have been invalid, as the Commissioner of Finance and Taxation conceded, under the uniformity clause of section 28.[62] On the other hand, it is

59. "If the [stock and bond] income tax is a property tax, the authority to discriminate between incomes arising from particular stocks and bonds and incomes arising from other sources makes of the income tax clause an exception to the equality and uniformity clause. If the income tax is a privilege tax, the authority to tax incomes upon prescribed conditions makes of the clause an exception to the unconditional and unlimited authority to tax privileges generally." *Id.* at 678, 52 S.W.2d at 161.

60. The court found support for this rule of construction in 2 early United States Supreme Court cases, Brown v. Maryland, 25 U.S. (12 Wheat.) 419, 438 (1827), and Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 191 (1824).

61. 164 Tenn. at 680, 52 S.W.2d at 161.

62. In a concurring opinion, one judge took the position that "the term 'All Property'

at least conceivable that the court could have characterized the income tax as a privilege tax, which, absent the court's rule of construction, would be a valid exercise of the legislature's discretion.

Following the decision in *Evans v. McCabe,* the Tennessee Supreme Court continued to reaffirm the principles upon which it was based. A number of cases dealt with exclusion by affirmation, each in slightly different language.[63] The court also elucidated and defined further the holding in *Bank of Commerce & Trust Co. v. Senter.*[64] For example, in *Memphis Dock & Forwarding Co. v. Fort,*[65] the corporate taxpayer's business was limited to holding title to rental property and to collecting and distributing rental income. The taxpayer protested the levy of an excise tax on its net earnings. The court found the tax constitutional even assuming that the ownership and rental of corporate property is not a taxable privilege. Relying on *Senter,* the court reasoned that the tax, though measured by corporate earnings, was actually levied upon the "privilege of doing business as a corporation and exercising the corporate powers for the purpose of producing a profit."[66] Similarly, in *Corn v. Fort*[67] the court upheld a privilege tax measured by the amount of capital invested in Tennessee—at least insofar as the statute applied to corporations.[68] In reaching this conclusion, the court relied upon *Senter* for the proposition that the right to do business in

. . . includes income from tangibles, such as land, stocks and bonds . . . ." *Id.* at 683, 52 S.W.2d at 617. The judge would have invalidated the statute on this ground, without relying on rules of construction applicable to the Federal Constitution, contracts, and statutes. These rules "must be applied, if at all with great caution to the State Constitution, to which the Legislature need not look for grant of power, but alone for limiting restrictions and prohibitions." *Id.* at 684, 52 S.W.2d at 617.

63. In Magevney v. Karsch, 167 Tenn. 32, 58-59, 65 S.W.2d 562, 571 (1933), the court relied on *Evans v. McCabe* in concluding that "no rule [is] better established with reference to the construction of written instruments than that the exception of particular things from general words shows that the things excepted would have been within the general language, had the exceptions not been made." *Magevney,* however, construed a will rather than a constitution. *See also* Perry v. Sevier County Beer Comm'n, 181 Tenn. 696, 703, 184 S.W.2d 32, 34 (1944).

64. 149 Tenn. 569, 260 S.W. 144 (1924). *See* notes 41-45 *supra* and accompanying text.

65. 170 Tenn. 109, 92 S.W.2d 408 (1936).

66. *Id.* at 111, 92 S.W.2d at 409.

67. 170 Tenn. 377, 95 S.W.2d 620 (1936).

68. The act attempted to tax partnerships engaged in business but excluded individuals. The court found this statutory classification arbitrary and capricious and held the act unconstitutional as applied to partnerships: "[W]e can see no substantial reason for imposing this tax on a simple partnership, composed of individuals, and exempting the single individuals, who may, perhaps, be engaged in the same kind of business as the partnership." *Id.* at 387, 95 S.W.2d at 624.

corporate form is a taxable privilege and was at pains to point out that the capital-investment measuring device did not transform the act into a property tax.[69]

In a 1947 private act,[70] the legislature imposed a five percent tax on the price of admission tickets to certain places of amusement in Knox County. The statute was upheld in *Knoxtenn Theatres, Inc. v. Dance*[71] as a tax upon the privilege of operating an amusement. The court first analyzed the long line of privilege cases up to 1948 and determined that the holding in *Trentham v. Moore*[72]—that a single act cannot be a taxable privilege—no longer was an accurate statement of Tennessee constitutional law. The court concluded that "the pursuit of a pleasure may be taxed as a privilege and . . . a single act may be taxed as such" and expressly rejected "the insistence that nothing but a business or occupation may be declared a privilege . . . ."[73] Therefore, the court found itself compelled to hold that the legislature did not overstep its constitutional authority in taxing as a privilege attendance at a place of amusement.

Another aspect of *Knoxtenn*, although of questionable precedential effect, suggests a constitutional rationale for the general income tax. Upon petition to rehear, the taxpayer insisted that because the legislature had not specifically declared attendance at a place of amusement to be a privilege, the act was invalid. In denying the petition, the court essentially found that the levy of the tax implies a legislative intent to create a privilage, thereby obviating the need for any express declaration. By way of illustration, however, the court cited with apparent approval *Hutchison v. Montgomery*,[74] which discovered in the Tennessee inheritance tax an unexpressed legislative intent to convert the acquisition of property from a decedent into a taxable privilege. Furthermore, the court in *Hutchison* made it clear that the privilege lay in the receipt of property, not in the transmission of property. Thus there is some authority for the proposition that receiving property is a privilege that the legislature may tax. It should be noted, however, that Tennessee always has viewed the right to inherent property as a creature

69. *Id.* at 389, 95 S.W.2d at 624.

70. Act of March 14, 1947, ch. 776, §§ 1-10, [1947] Tenn. Private Acts 3168.

71. 186 Tenn. 114, 208 S.W.2d 536 (1948).

72. 111 Tenn. 346, 76 S.W. 904 (1903). *See* notes 25-27 *supra* and accompanying text.

73. 186 Tenn. at 119, 208 S.W.2d at 538. In reaching this conclusion, the court relied on Ogilvie v. Hailey, 141 Tenn. 392, 210 S.W. 645 (1919). *See* note 52 *supra.*

74. 172 Tenn. 375, 112 S.W.2d 827 (1938).

of statute law and not a natural right.[75] Therefore, it may be improper to support the general income tax with principles announced in the inheritance tax context.

On the same day that rehearing was denied in *Knoxtenn,* the court decided *Hooten v. Carson,*[76] which upheld a state sales tax. Appellant contended that the sale of food was not taxable, since the purchaser ultimately bore the burden of the tax and the right to acquire food for sustenance was not a privilege but a nontaxable natural right. Rejecting this argument, the court found it unquestionable that the state may tax the privilege of selling food. Furthermore, this taxing power was not impaired merely because the tax was passed to the buyer "as a matter of reasonable tax practice and regulation."[77] Finally, the court brushed aside the natural right argument:

> Regardless of whether the right to buy or sell is a natural right, we think the law is well settled that the State in the exercise of its sovereign power may impose a privilege tax upon any and all business transactions to the end that the general public be protected from unfair trade practices . . . .[78]

During this period, the Tennessee Supreme Court also continued to uphold the state corporate excise tax,[79] which is imposed upon the privilege of doing business in corporate form and is measured by net earnings.[80] Encouraged perhaps by the success of the corporate excise tax, perhaps by the inheritance tax analogy in *Knoxtenn Theatres, Inc. v. Dance,*[81] the legislature in 1959 enacted an income tax that provided in part:

> This tax shall not be construed as a tax on the privilege of carrying on business in Tennessee, the same being upon the privilege of being in receipt of or realizing net earnings in Tennessee . . . .[82]

---

75. "[T]he right of any person to succeed to property of a deceased person, whether by will or inheritance, is a creature of statute law, and the manner in which it shall pass by no means a natural right." State v. Alston, 94 Tenn. 674, 680, 30 S.W. 750, 751 (1895).

76. 186 Tenn. 282, 209 S.W.2d 273 (1948).

77. *Id.* at 288, 209 S.W.2d at 275.

78. *Id.* at 288-89, 209 S.W.2d at 275.

79. TENN. CODE ANN. §§ 67-2701 to -2724 (Supp. 1973). *See, e.g.*, American Bemberg Corp. v. Carson, 188 Tenn. 263, 219 S.W.2d 169 (1949); R.J. Reynolds Tobacco Co. v. Carson, 187 Tenn. 157, 213 S.W.2d 45 (1948).

80. Under the same privilege analysis, the court also upheld the state corporate franchise tax, TENN. CODE ANN. §§ 67-2901 to -2931 (Supp. 1973), which is based on the corporate capital stock, surplus and undivided profits. *See* Nashville Trust Co. v. Evans, 195 Tenn. 205, 258 S.W.2d 761 (1953); *cf.* Texas Gas Transmission Corp. v. Atkins, 197 Tenn. 123, 270 S.W.2d 384 (1954).

81. 186 Tenn. 114, 208 S.W.2d 536 (1948). *See* notes 70-75 *supra* and accompanying text.

82. Act of March 21, 1959, ch. 252, § 1, [1959] Tenn. Acts 737. Since the tax was

The statute was promptly challenged and came before the Tennessee Supreme Court in *Jack Cole Co. v. MacFarland*,[83] in which the taxpayer argued that the tax was in effect a property tax, invalid under section 28 of the constitution. The court quoted at length from *Evans v. McCabe*[84] and, without commenting on the quoted material, concluded that because "the right to receive income or earnings is a right belonging to every person, this right cannot be taxed as privilege."[85] The court presented no reasons for its holding that every person has the right to receive income. Moreover, the court apparently derived its definition of "privilege" from the 1871 case of *Lonas v. State*,[86] from which it quoted the following passage:

> Privileges are special rights, belonging to the individual or class, and not to the mass; properly, an exemption from some general burden, obligation or duty; a right peculiar to some individual or body.[87]

The *Lonas* case may be an improper definitional source, since it dealt with the application of the privileges or immunities clause of the fourteenth amendment to a Tennessee statute prohibiting interracial marriage. Additionally, the court failed to discuss the more recent privilege cases, such as *Knoxtenn Theatres, Inc. v. Dance*[88] and *Hooten v. Carson*,[89] that might have supported the State's position in the case.[90]

III. CONCLUSION

Until either article 2, section 28 or the judicial construction of that section is modified, Tennessee will be unable to levy a general personal income tax. The revenue needs of the state will rise dramatically during the next twenty years, placing increasing strain on the antiquated and regressive privilege-property tax structure now in effect.[91] As noted earlier, a constitutional amendment specifically

---

imposed only on corporations, the legislative characterization of the tax is particularly important.

83. 206 Tenn. 694, 337 S.W.2d 453 (1960).

84. 164 Tenn. 672, 52 S.W.2d 159 (1932). *See* notes 58-61 *supra* and accompanying text.

85. 206 Tenn. at 699, 337 S.W.2d at 456.

86. 50 Tenn. 287 (1871).

87. *Id.* at 306.

88. 186 Tenn. 114, 208 S.W.2d 536 (1948). *See* notes 70-75 *supra* and accompanying text.

89. 186 Tenn. 282, 209 S.W.2d 273 (1948). *See* notes 76-78 *supra* and accompanying text.

90. Since *Jack Cole*, the court has given no indication that it will depart from its position in that case. *See* Gallagher v. Butler, 214 Tenn. 129, 144, 378 S.W.2d 161, 167 (1964); *cf.* Tennessee Trailways, Inc. v. Butler, 213 Tenn. 136, 142-43, 373 S.W.2d 201, 203-04 (1963).

91. *See* note 11 *supra* and accompanying text.

authorizing a personal income tax does not appear to be a likely prospect for the foreseeable future.[92]

The only feasible solution seems to be the passage of a nongraduated income tax, such as that proposed by the Tax Modernization and Reform Commission[93] in an effort to prompt the Tennessee Supreme Court to reconsider and retreat from its present construction of section 28. This may not be as futile as it might at first appear. A nongraduated income tax, exempting the income from property taxed ad valorem, bears at least a surface resemblance to a property tax, and might be characterized as such. This tax would reach the income from personal services, tapping a major new source of revenue.

The first judicial stumbling-block to a nongraduated tax is the court's "exclusion by affirmation" rationale in *Evans v. McCabe*.[94] That argument, carried over from *Railroad v. Harris*, is reasonable but not compelling. "Exclusion by affirmation" is a canon of construction, not a rule of substantive law. Other states whose constitutions mention only property and privilege taxes have nevertheless sustained their income taxes, rejecting arguments that to mention two types of tax serves to prohibit all others.[95] It is true that the Tennessee constitution seems unique in its express mention of incomes from stocks and bonds, but this might as plausibly be interpreted by the familiar principles of *ejusdem generis*, rather than exclusion by affirmation; thus the provision lends itself equally to the interpretation that the constitution requires that the property whose income is taxed must be exempted from ad valorem taxation.

Suppose, nevertheless, that the broad exclusion by affirmation argument is adhered to, forcing the tax to stand, if at all, as either a privilege or a property tax. A strong argument can be made for the proposition that the tax is a valid privilege tax if the court reconsiders its decision in *Jack Cole*. *Jack Cole* has received its share of criticism in the past,[96] and more criticism is deserved. That case glibly holds, without citation of authority, that realizing and receiving income is not a privilege that can be taxed.[97] It should be apparent from the line of cases already detailed in this article that

92. *See* note 13 *supra*.

93. *See* note 12 *supra*.

94. *See* note 61 *supra* and accompanying text.

95. Stanley v. Gates, 179 Ark. 886, 19 S.W.2d 1000 (1929); Diefendorf v. Gallet, 51 Idaho 619, 10 P.2d 307 (1932).

96. *See* Hartman, *State and Local Taxation—1961 Tennessee Survey*, 14 VAND. L. REV. 1401, 1403-05 (1961).

97. 206 Tenn. at 699, 337 S.W.2d at 456.

the court has never been able to place an authoritative finger on the definition of privilege; it has declared that no single act may be taxed as a privilege, but has held that admission to a theatre and operation of a motor vehicle are taxable privileges. In the face of decisions holding that the purchase of goods and pursuit of pleasure were taxable privileges rather than natural rights, the court declared in *Jack Cole* that the receipt of income was a nontaxable natural right. The whole morass of judicial equivocation inspires no confidence. One cannot believe that the last word on the subject of privilege has been authoritatively uttered by the Tennessee court, especially since very respectable authority exists for the concept that the receipt of income is indeed a taxable privilege. The United States Supreme Court in *New York ex rel. Cohn v. Graves*[98] has said of an income tax:

> The tax . . . is founded upon the protection afforded by the state to the recipient of the income in his person, *in his right to receive the income,* and in his enjoyment of it when received. These are *the rights and privileges* which attach to domicil within the state.[99]

The success of other states with their income taxes[100] and the defects in the present Tennessee tax structure[101] provide compelling public policy grounds for a judicial reexamination of the constitutional limitations on income taxes in Tennessee. The case law restricting the legislature to ad valorem property taxes, taxes on the income from stocks and bonds, and privilege taxes is confusing and not altogether convincing, especially in its espousal of exclusion by affirmation and its analysis of the meaning of "privilege." It would not be unreasonable for the court to reconsider these decisions in the light of the predicted revenue crunch and sustain an income tax, either as an inherent sovereign power, a valid property tax, or a tax on the privilege of receiving income.

---

98. 300 U.S. 308 (1937).

99. *Id.* at 312-13 (emphasis added); *see* Lawrence v. State Tax Comm'n, 286 U.S. 276 (1932).

100. Income taxes surpassed property taxes and sales taxes as the primary source of state revenues in 1973. Wall Street J., Jan. 9, 1974, at 1, col. 9.

101. *See* notes 10 & 11 *supra* and accompanying text.