

INCOLE T. Y.: Stockholders of Kansas City Life Insurance Company
subject to tax.

W-8
November 8, 1935.



Honorable Forrest Smith
State Auditor
Jefferson City, Missouri

Dear Sir:

This Department is in receipt of your request for an opinion with respect to the claim for state income tax against J. B. Reynolds and other individual stockholders of the Kansas City Life Insurance Company on dividends paid in 1930, 1931, 1932 and 1933.

We have been furnished by Mr. James W. Broadus and Mr. Frank W. McAllister, Counsel for J. B. Reynolds and others, a memorandum of authorities supporting their position in the matter. Briefly, it is the position of these gentlemen that the dividends they receive from the Kansas City Life Insurance Company are not subject to the income tax laws of the State of Missouri, for the reason that if the dividends had been paid by the Kansas City Life Insurance Company to a corporation the same would not be subject to tax, and to tax individual stockholders would be discriminatory and in violation of Section 3 of Article X of the Constitution of the State of Missouri, which provides as follows:

"Taxes may be levied and collected for public purposes only. They shall be uniform upon the same class of subjects within the territorial limits of the authority levying the tax, and all taxes shall be levied and collected by general laws."

Section 10115 Laws of Missouri 1931, page 365, provides in part as follows:

"There is hereby levied a per centum tax on net income in each year as follows: First, for the portion of the year 1931 after June 30, 1931, remaining after this act becomes effective and for the whole of each succeeding year thereafter, at the times and in the manner now or hereafter provided, a tax shall be levied upon, assessed against, collected from, and paid by every individual, a citizen or resident of this state, upon net income received from all sources during the preceding year in excess of the exemptions now or hereafter provided." * * * "

Section 10117 Laws of Missouri 1931, page 363, provides in part as follows:

"Income shall include gains, profits, and earnings derived from salaries, wages or compensation for personal services of whatever kind and in whatever form paid; and from professions, vocations, businesses, trade, commerce, or sales or dealings in property, whether real or personal, growing out of the ownership or the use of any interest in real or personal property; and from interest, rent, dividends, securities and gains, profits and earnings from any other transactions of any business carried on for gain or profit; and from any source whatever; * * * * *"

It is clear therefore from a consideration of these two statutes that in the absence of constitutional restrictions the dividends to J. B. Reynolds and others paid by the Kansas City Life Insurance Company are subject to the income tax law of the State of Missouri. It is claimed however that the following portion of Section 10117 violates Section 3 of Article X of the Constitution of the State of Missouri:

"Dividends on corporate stock owned by another corporation shall not be income of the corporation receiving such dividends where the corporation declaring the dividend has paid its tax to this state on the portion of its income subject to tax by this state." * * * "

In the case of State vs. Wisconsin Tax Commission, 163 N. W. 639, the Supreme Court of Wisconsin said:

"Much confusion of thought arises from regarding the income tax as a tax that is levied upon or attaches to property as such, irrespective of the person sought to be taxed. It is the recipient of the income that is taxed, not his property; and the vital question in each case is, Has the person sought to be taxed received an income during the tax year? If so, such income, unless specifically exempted, is subject to a tax though the property out of which it is paid may have been exempt from an income tax in the hands of the payor. It is the relation that exists between the person sought to be taxed and specific property claimed as income to him that determines whether there shall be a tax. If the person sought to be taxed is the recipient during the tax year of such specific property as income in its ordinary significance, then the person is taxed. But the tax is upon the right or ability to produce, create, receive, and enjoy, and not upon specific property. Hence the amount of the tax is measured by the amount of the income, irrespective of the amount of specific property or ability necessary to produce or create it. In the ordinary acceptation of the term this may be said to be a tax upon income as the statute denominates it. But the tax does not seek to reach

property, or an interest in property as such. It is a burden laid upon the recipient of an income. State ex rel. Manitowoc Gas Co. v. Wis. Tax Comm., 161 Wis. 111, 152 N. W. 848; State ex rel. Bundy vs. Nygaard, 183 Wis. 307, 158 N. W. 87.

It follows from this that though the surplus on hand January 1, 1911, was not assessable as income to the Northwestern Lumber Company, it was assessable as such to the stockholders thereof when distributed as dividends during 1911.* * * * *

The uniformity clause of our constitution does not apply to income taxes, the only uniformity required being uniformity within a class. A corporation is one person, a stockholder in the corporation is an entirely different person and both may be taxed separately, and the fact that income payable to an individual might be subject to tax whereas the same income if payable to a corporation would be exempt, does not violate the uniformity clause of our constitution. In fact, corporations might be entirely exempted from the provisions of our income tax law and the law yet remain valid. This is made clear in the case of Franklin vs. Carter, cited by the Circuit Court of Appeals, Tenth Circuit, and reported in 51 Fed. (2d) 345, wherein the Court said:

"The question here is whether the classification in the instant case rests upon a substantial difference and bears a reasonable relation to the object of the legislation. This precise question was considered in Conner v. State, 82 N.H. 128, 130 A. 357, and the court held the New Hampshire statute valid on the ground that avoidance of double taxation was a sufficient basis for such classification.

A general income tax law imposing a tax alike on corporations and natural persons will result in double taxation of the earnings of corporations paid as dividends, unless some method is devised to exempt either the corporation or its stockholders

from the tax on such earnings. In framing the income tax law in question, the Oklahoma legislature undertook to avoid the injustice of taxing both the corporation and its shareholders on the earnings paid as dividends, by providing that the shareholders should pay taxes on such earnings when received by them in the form of dividends, and exempting the corporation from the tax.

A tax laid upon only the earnings of a corporation when paid to its stockholders as dividends results ultimately in a tax on a substantial portion of such earnings and avoids double taxation thereon.

It is our opinion that there is a substantial difference between corporations and natural persons for income tax purposes because, ordinarily, a large portion of the earnings of a corporation are paid to its stockholders as dividends and are income of both the corporation and such stockholders; that it affords a rational basis for the classification provided by the statute here in question; that such classification rests on a difference having a fair and substantial relation to the object of the legislation; and that it results in like treatment to all persons similarly situated." * * *

In the case of Shields vs. Williams, 19 S. W. (2d) 360, the Supreme Court of Tennessee said with respect to the uniformity section of the Tennessee Constitution:

"We see no necessity of an inquiry as to the nature of the income tax authorized by the Tennessee Constitution. Section 28 of article 2 of our Constitution, ex vi termini, excludes the income tax from the scope of the equality and uniformity clause. The language is that 'all property shall be taxed according to its value (ad valorem)' * * * so that taxes

shall be equal and uniform throughout the State.' The requirement for equality and uniformity applies to taxes on property taxed according to its value or ad valorem. Such requirement is not imposed with respect to privilege taxes authorized in the next clause, nor is such requirement imposed in the following clause on the authorized 'tax on incomes derived from stocks and bonds not taxed ad valorem.' Both the privilege tax clause and the income tax clause are special provisions, exceptions to the ad valorem tax clause, clear of the restrictions contained in the ad valorem tax clause.* * * * *

See also *Conner vs. State* (Sup. Ct. New Hampshire) 130 Atl. 357. *Appeal of Van Dyke* (Sup. Ct. of Wisconsin), 259 N. W. 700.

And in the case of *Dieffendorf vs. Gallet* (Sup. Ct. Idaho) 10 P. (2d) 307, 1. c. 317, the Court said:

"None of the classifications complained of are objectionable. *State ex rel. Knox vs. Gulf, M. & N. R. Co.*, 138 Miss. 70, 104 So. 689. The Supreme Court of the United States, in construing the Federal Income Tax, has uniformly sustained the progressive graduation of tax, and the differences in exemptions and rates of tax as applied to individuals and corporations. *Brushaber vs. Union Pacific R. Co.*, 240 U. S. 1, 38 S. Ct. 236, 60 L. Ed. 493, 504 L.R.A. 1917D, 414, Ann. Cas. 1917B; *Fort Smith Lumber Co. vs. Arkansas, etc.*, 251 U.S. 532, 40 S. Ct. 304, 64 L. Ed. 396, 399. Credits allowed to individuals are based upon the need of reserving to them unimpaired an income adequate to provide the necessities of life (In re Opinion of the Justices, 84 N.H. 559, 149 A. 321), a purpose which cannot be applied to corporations. See, also, *Stanley v. Gates*, 179 Ark. 886, 19 S. W. (2d) 1000. The progressive form

of tax has been upheld in State vs. Frear, 148 Wis. 456, 134 N.W. 673, 135 N. W. 164, L.R.A. 1915B, 569, 606 Ann. Cas. 1913A, 1147, and Shields vs. Williams, 159 Tenn. 349, 19 S. W. (2d) 261.* * * **

The Supreme Court of Missouri in 1933 in the case of Bacon vs. Ranson, 56 S. W. (2d) 786, likewise passed upon this question. Judge Ragland said:

"As to its contravention of the uniformity provision, we said: 'The Constitution (section 3, art. 10) provides 'taxes may be levied and collected for public purposes only. They shall be uniform upon the same class of subjects,' etc. By necessary implication this constitutional provision recognizes the power of the Legislature to classify the subjects falling within its restriction, and only requires that the tax shall be uniform upon the classified persons, or the classified subjects of taxation. In the Missouri act under review, persons, corporations, and entities are distinguished and classified. The act also provides a classification as to the amount of the portion of the net income of each class of persons, corporations, or entities which is subject to taxation therein. The act further provides for the payment of an identical rate of taxation upon each of the classifications of income subject to its burden, and that each person, corporation, or entity shall pay the same tax which is paid by every other person, corporation, or entity belonging to the same class. That the Legislature had the power to create such classification, is implied by the very terms of the provision of the Constitution (section 3, art. 10) that taxes thereunder shall be uniform upon the same class of subjects. Necessarily

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this language would be meaningless unless interpreted to empower the Legislature to create distinct classes of 'subjects.' In the act under review it is not even contended 'conceding the power to levy the tax) that the provisions distinguishing the persons and grading the tax to be paid in accordance with such distinctions are not founded in reason, in justice, and for the utility of the public--the true criteria which should govern all legislative action. Indeed, the essential justice of the various classifications of the act seems to be evident.' * * * * "

CONCLUSION.

In view of the foregoing, it is the opinion of this Department that the exemption provided for in Section 10117 as to dividends received by one corporation from another corporation, is not arbitrary nor discriminatory and does not violate Section 3 of Article X of the Constitution of the State of Missouri. This classification between corporations and private persons is reasonable and within the power of the General Assembly of the State of Missouri. Whether the exemption should or should not be provided for by law is not ours to determine, the propriety, wisdom and expediency of legislation being exclusively a matter for the Legislature.

Respectfully submitted,

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APPROVED:

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