2-9-2009

Pro-Taxpayer Interpretation of State-Local Laws

Steve R. Johnson
Florida State University College of Law

Pro-Taxpayer Interpretation Of State-Local Tax Laws

by Steve R. Johnson

Sometimes, from a taxpayer's perspective, it is better to be challenging a state or local tax determination than a federal tax determination. One reason for that is the canon that "[tax] statutes are to be construed most favorably for the taxpayer."[1] Scores, if not hundreds, of federal tax cases espoused that principle, especially during the 1890s to 1940s. However, the principle fell into disuse at the federal level in ensuing decades and, indeed, was replaced by prorevenue canons.[2] A seeming attempt to revivify the canon at the federal level earlier this decade[3] appears to have withered on the vine. In contrast, the pro-taxpayer canon retains vigor in cases involving state and local taxation. The Mississippi Supreme Court remarked: "It is a well-established rule that a taxing statute must be strictly construed against the taxing power and in favor of the taxpayer, and all doubts as to whether or not a tax has been imposed must be resolved in favor of the taxpayer."[4] Many state decisions have held to the same effect in cases involving a wide range of state and local levies.[5]

Part I below describes the rationales for the pro-taxpayer canon. Part II examines whether the canon is pure boilerplate or whether it actually affects case outcomes. Part III discusses limits on the canon and ways in which state and local revenue authorities can seek to counter it.

I. Rationales for the Canon

At least four different reasons have been given by state courts to justify the pro-taxpayer canon. The most basic rationale has been recognized for centuries. Taxation is wholly positivistic. No one is liable for tax unless some statute affirmatively makes him liable for tax. It would traduce that fundamental principle if taxing statutes were extended beyond their terms or if liability were to be "imposed upon the citizen upon vague or doubtful interpretations."[6]

If the first justification adverts to the government's responsibility to the citizen, the second relates to the citizen's duty to the government. We expect citizens to honor their obligations to pay taxes they legally owe. "Tax laws, like all other laws, are made to be obeyed. They should therefore be intelligible to those who are expected to obey them."[7]

The third rationale has a counterpart in contract law. In interpreting insurance policies and other contracts, courts commonly interpret ambiguous instruments adversely to the parties who drafted them. Of course, it is the state and local governments that draft tax statutes, and plenty of those statutes are ambiguous in critical respects. In interpreting ambiguous instruments adversely to their drafters, the courts hope to encourage more careful drafting. That is not a realistic hope for statute

---

[1]*Farr v. Weaver*, 145 P.2d 203, 205 (Okla. 1943).

[2]*See* Steve R. Johnson, "Should Ambiguous Revenue Laws Be Interpreted in Favor of Taxpayers?" *Nev. Lawyer*, April 2002, p. 15.

[3]*United Dominion Inds., Inc. v. United States*, 532 U.S. 822, 839 (Thomas, J., concurring) and *Id.* at 839 n.1 (Stevens, J., dissenting).

[4]*State Tax Comm'n v. Edmondson*, 196 So. 2d 873, 876 (1967) (*quoting State v. Johnson*, 118 So. 2d 308, 313 (Miss. 1960)).

[5]*See, e.g.*, *Atlantic Gulf Communities Corp. v. City of Port St. Lucie*, 764 So. 2d 14, 19 (Fla. App. 1999) (non-ad valorem assessments); *Barnes v. Doe*, 4 Ind. 132 (1853) (property tax); *Merchants Wholesale Grocery Co. v. City of Frankfort*, 244 S.W.2d 468, 469 (Ky. 1951) (local license tax); *Lancaster*

(Footnote continued in next column.)

County Bd. of Equalization v. Condev West, Inc., 581 N.W.2d 452, 469 (Neb. App. 1998) (property tax); *State v. Eldodt*, 267 Pac. 55, 56 (N.M. 1928) (estate tax). The *Farr* and *Edmondson* cases cited above involved, respectively, intangible personal property tax and income tax.

[6]*In re Del Busto's Est.*, 1888 WL 3690, at *7 (Pa. Orph. 1888).

[7]*Philadelphia Storage Battery Co. v. Lederer*, 21 F.2d 320, 321-322 (E.D. Pa. 1927).

drafting. There is no evidence that legislatures draft tax laws better as a result of the pro-taxpayer canon. If it cannot accomplish its primary goal, however, the canon can achieve a secondary objective: punishing the drafter (the governmental unit) for creating controversy through its sloppy drafting. In any event, that rationale has been expressly invoked in some state tax cases,[8] and it surely has cast its shadow in other cases even when it has not been expressly invoked.

Taxation is fiscal, not 'penal in nature.'

The fourth rationale is the most dubious, but I mention it for completeness since it has appeared in a few decisions. There is another canon: that tax penalties are strictly construed.[9] Some decisions have applied a similar theory to tax liabilities generally. "The right to tax is penal in nature, and this right must be strictly construed in favor of the taxpayer."[10] That is a bizarre notion. The power to tax may be the power to destroy,[11] but taxation is fiscal, not "penal in nature." It is the means by which governments obtain the wherewithal to support the services and activities that the people have demanded or permitted through the democratic process.

II. Significance of the Canon

Various canons of construction are rehearsed in countless thousands of judicial opinions. One often wonders, though, how significant they were to the outcomes of the cases. No doubt, their incantation is often ritualistic, an empty piety or a pretext seeming to explain a result that actually proceeded from other judicial thoughts or impulses. Yet it would go too far to suggest that canons never materially influence case outcomes. Canons are worth studying for both "talk the talk" reasons (to be able to "make a noise like a lawyer" on brief) and for "walk the walk" reasons (because they sometimes determine outcomes or help to determine outcomes).

So it is with the pro-taxpayer canon. The canon is mentioned in some state-local tax opinions in what is obviously an introductory boilerplate or an end-of-opinion afterthought. The canon is unlikely to have been important in such cases. However, some other opinions create a definite sense that the canon was an important part of the mental process by which the judge(s) decided the case. For example:

- The Indiana income tax imposed a lower rate of tax on income from one type of transaction than income from other types. Plausible arguments were made by the taxpayer that its transactions at issue fell within the favored type and by the state that they fell outside the favored type. The court held that, in that situation, "the doubt must be resolved by giving the statute that construction most favorable to the taxpayer," and it allowed the taxpayer the benefit of the lower rate.[12]
- Maryland sales tax law granted a 60-day grace period for providing a resale certificate. The statute could have had alternative reasonable interpretations on the facts of the case. In part based on the pro-taxpayer canon, the court selected the interpretation that rendered the taxpayer not liable.[13]
- In small amount transactions, there were alternative ways to construe the computation of liability under a municipal entertainment tax in Pennsylvania. The court used the pro-taxpayer canon to uphold the method of computation that resulted in lower tax.[14]

III. Limits on the Canon

In light of the foregoing, taxpayers and their representatives would do well to assert the pro-taxpayer canon in litigation whenever plausible in the circumstances of the particular case. That assertion, however, would hardly be the end of the case. Depending on the jurisdiction and the type of exaction involved, the state or local revenue authority might respond along any of three lines, as described below.

---

[8] *See, e.g., Hawaiian Trust Co., Ltd. v. Borthwick*, 35 Haw. 429, at *4 (Haw. 1940).

[9] *See* Steve R. Johnson, "The Canon that Tax Penalties Should Be Strictly Construed," 3 *Nev. L.J.* 495 (2003). The penalty canon will be discussed in a future installment of this column.

[10] *In re Director of Property Valuation*, 161 P.3d 755, 761 (Kan. 2007) (*quoting In re Tax Exemption Application of Kaul*, 933 P.2d 717, 725 (Kan. 1997)).

[11] *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819) ("the power to tax involves the power to destroy"). Before this oft-quoted statement, however, Chief Justice Marshall's *McCulloch* opinion acknowledged "that the power of taxing the people and their property, is essential to the very existence of government, and may be legitimately exercised on the objects to which it is applicable, to the utmost extent to which the government may choose to carry it . . . . In imposing a tax, the legislature acts upon its constituents. That is, in general, a sufficient security against erroneous and oppressive taxation." *Id.* at 428.

[12] *Gross Income Tax Dep't v. Harbison-Walker Refractories Co.*, 48 N.E.2d 834, 837 (Ind. App. 1943); *see also Coolspring Stone Supply, Inc. v. County of Fayette*, 929 A.2d 1150, 1157-1158 (Pa. 2007) (Saylor, J., concurring) (suggesting a similar approach as to categorization in a real estate tax case).

[13] *A.N.B. Corp. v. Comptroller of Treasury*, 1990 WL 10957, at *6-7 (Md. Tax Ct. 1969).

[14] *In re Williams Grove, Inc. Appeal*, 1972 WL 15888, *4 (Pa. Com. Pl. 1972).

First, the government might sometimes be able to argue that the canon does not apply because the law at issue is not a tax measure at all but legislation of a different character.[15] Of course, that riposte will only occasionally be available to the government. However, classification issues such as "is this a tax or is it a fee?" have arisen with increasing frequency in recent years as cash-strapped states and localities have become increasingly creative (or desperate) in revenue raising.[16]

Taxpayers and their representatives would do well to assert the pro-taxpayer canon in litigation whenever plausible in the circumstances of the particular case.

Second, the most important limitation on the pro-taxpayer canon is that it can operate only when the statute is ambiguous regarding the point at issue in the case.[17] Indeed, it could hardly be otherwise. If even laws clearly supporting the government's position were interpreted in favor of taxpayers, those laws would have been essentially repealed. Thus, a natural line of argument for the revenue authority is to maintain that the statute in question is clear, rendering inapplicable the pro-taxpayer canon.

That argument raises two subsidiary questions: What degree of ambiguity or doubt must be present? And by what sources are taxing statutes' meanings, and thus their possible ambiguity, to be ascertained?[18] Unsurprisingly, the cases have not always answered those questions identically. In general, however, courts have required "real doubt" as opposed to any shadow of a doubt as to the statute's meaning in order to trigger the canon,[19] and they have looked not just at the statute's language but also at other indicators or sources of meaning, including the statute's purpose, structure, and context.[20]

The third possible line of attack against the pro-taxpayer canon is to invoke a different canon that points to an opposite result in the case. The "dueling canons" phenomenon is well-known in litigation, and it is not always easy to predict which competing canon a court will favor in a particular case.

The most important limitation on the pro-taxpayer canon is that it can operate only when the statute is ambiguous regarding the point at issue in the case.

Which competing canon(s) the revenue authority may be able to invoke to counter the pro-taxpayer canon will depend on the law of the particular jurisdiction and on the circumstances of the case. Here are some possibilities:

- The taxpayer may be arguing that the transaction comes within a statutory exemption or exclusion from taxation. However, in many states, there are cases holding that tax exemptions and exclusions are strictly, narrowly construed.[21]
- Some states also provide that tax deductions are construed narrowly.[22]
- In a seemingly smaller number of states, there is case law to the effect that revenue statutes

---

[15]*See, e.g., Brown v. Board of Educ.*, 863 So. 2d 73, 75 n.3 (Ala. 2003)

[16]*See, e.g.*, Sylvia Dennen, "Tax or Fee — What's in a Name?" *State Tax Notes*, Aug. 13, 2007, p. 423, *Doc 2007-16733*, or *2007 STT 157-2*; Kathleen K. Wright, "Is the California Governor's Healthcare Plan Funded by a Fee or a Tax?" *State Tax Notes*, Jan. 29, 2007, p. 261, *Doc 2007-1658*, or *2007 STT 20-4*.

[17]*See, e.g., Goodwin v. Citizens & So. Nat'l Bank*, 76 S.E.2d 620, 623 (Ga. 1953); *Enron Oil & Gas Co. v. Department of Revenue & Tax'n*, 820 P.2d 977, 980-982 (Wyo. 1991).

[18]For further discussion of when statutory meaning is plain, see an earlier installment of this column. Steve R. Johnson, "Use and Abuse of Plain Meaning," *State Tax Notes*, Sept. 22, 2008, p. 831, *Doc 2008-19121*, or *2008 STT 185-3*.

[19]*See, e.g., United States v. Wigglesworth*, 28 F. Cas. 595, 597 (C.C. Mass. 1842) ("real doubt"); *Edmondson*, *supra* note 4, 196 So. 2d at 875 ("sufficiently clear"); *Duke Power Co. v. South Car. Tax Comm'n*, 354 S.E.2d 902, 904 (S.C. 1987) (Harwell, J., dissenting) ("It is possible for reasonable minds to differ as to the proper interpretation of the statute in question.").

(Footnote continued in next column.)

[20]*See, e.g., Wright v. Bilafer*, 1994 WL 879561, at *2 (Mass. Super. 1994) ("when the statute is read as a whole, it is clear and internally consistent"), *aff'd*, 663 N.E.2d 572 (Mass. 1996); *Redford Opportunity House v. Township of Redford*, 2004 WL 1103769, at *2 (Mich. App. 2004) (not reported) (language of the statute); *National Paving Co., Inc. v. Director, Div. of Tax'n*, 3 N.J. Tax 133, 138 (1981) (context of the statute), *aff'd*, 4 N.J. Tax 535 (1982); *Valley Fidelity Bank & Trust Co. v. Benson*, 448 S.W.2d 394, 396 (Tenn. 1969) (purposes of the act).

[21]*See, e.g., Department of Tax'n v. DaimlerChrysler Serv. N.A., LLC*, 119 P.3d 135, 137 (Nev. 2005); *H.R. Options, Inc. v. Wilkins*, 807 N.E.2d 363, 363 (Ohio 2004); *Dick Simon Trucking, Inc. v. Utah State Tax Comm'n*, 84 P.3d 1197, 1199 (Utah 2004). A future installment of this column will discuss in greater detail the canons that tax exemptions and deductions are read narrowly.

[22]*See, e.g., AIA Serv. Corp. v. Idaho State Tax Comm'n*, 30 P.3d 962, 965 (Idaho 2001).

"are always liberally construed so as to effectuate the chief object and purpose of their enactment," namely filling the fisc.[23]

- If the case involves not the determination of tax liability but instead the collection of already determined taxes, another canon may come into play. In general, "statutes establishing administrative procedures for collection and assessment of taxes will be construed in favor of the government."[24]
- If the taxpayer's argument entails challenging the constitutionality of a tax statute, a hurdle will be that most states accord to statutes a strong presumption of constitutionality and so impose a heavy burden of proof on challengers.[25]
- Many state courts accord some level of deference (the level varying considerably among the states) to determinations of the revenue authority.[26]

Conclusion

The pro-taxpayer canon is one of the oldest interpretational devices in tax litigation. It has been substantially abandoned at the federal level, but it retains considerable vigor in cases involving state and local taxes. Although the canon applies only to ambiguous tax statutes and may yield to counter canons or presumptions, the pro-taxpayer canon has impact in enough cases that it should be one of the arrows in the quivers of taxpayers and their representatives. ☆

Interpretation Matters is a column by Steve R. Johnson, the E.L. Wiegand Professor of Law and associate dean for faculty development and research, William S. Boyd School of Law, University of Nevada, Las Vegas. He can be contacted at steve.johnson@unlv.edu.

[23]*Isbell v. Gulf Union Oil Co.*, 209 S.W.2d 762, 764 (Texas 1948).

[24]*Calhoun County Assessor v. Consolidated Gas Supply Corp.*, 358 S.E.2d 791, 793 (W. Va. 1987) (citations omitted).

[25]*See, e.g., DaimlerChrysler Co., LLC v. Billet*, 858 N.Y.S.2d 836, 839 (App. Div. 2008).

[26]*See, e.g., National Transp., Inc. v. Howlett*, 345 N.E.2d 767, 770-771 (Ill. App. 1976). I will explore this fascinating and intricate subject in future installments of this column.