Opinion No. 61-68

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BY: OPINION OF EARL E. HARTLEY, Attorney General F. Harlan Flint, Assistant Attorney General

TO: F.E. McCulloch, Director, Income Tax Division, Bureau of Revenue, Santa Fe, New Mexico

QUESTION

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Laws 1961, Chapter 242, amended the Income Tax Law to increase the rate at which income is taxed. Should the new rate be applied retroactively to all income earned in all taxable years ending after the effective date of the law?

CONCLUSION

No.

OPINION

ANALYSIS

House Bill 405 became Law as Chapter 242, Laws 1961 and amended Sections 72-15-21 and 72-15-31, N.M.S.A., 1953 Compilation. Section 1 thereof amended Section 72-15-21 to increase the rate of taxation. Section 3 thereof provides as follows:

"The provisions of Sections 72-15-21 and 72-15-31, N.M.S.A., 1953 Compilation shall apply to all taxable years ending after the effective date of this act."

Section 4 of the Act declared an emergency. Section 5 provides as follows:

"The income tax rates provided in this act shall be in effect from the effective date of this act until December 31, 1963. After December 31, 1963 those income tax rates shall be the same as the rates existing on January 1, 1961."

The present question is raised because of problems of interpreting the new law. There is some ambiguity as to the true legislative intent and, in our view, the law is subject to two possible interpretations. The first of these two interpretations would permit the new rate to be applied to all income earned in any taxable year ending after the effective date of the act which was March 31, 1961. The phrase "taxable year" means "the calendar year or fiscal year ending during any calendar year upon the basis of which the net income is computed under this article . . ." Section 72-15-3. Therefore the term

"taxable year" applies to calendar years which end December 31 and fiscal years which may end on the last day of any month except December. It would, therefore, be apparent that under the first possible interpretation the statute would impose the new rate retroactively to different dates for different taxpayers. For example, we may take the calendar year taxpayer whose taxable year ends December 31, 1961 and compare his position with that of a fiscal year taxpayer whose taxable year ended April 30, 1961. Under this interpretation the calendar year taxpayer would pay the new rate upon all income earned between January 1, 1961 and December 31, 1961. On the other hand the fiscal year taxpayer would be required to pay the higher rate on all income earned between May 1, 1960 and April 30, 1961. Further consideration will be given to this factor at a later point in this opinion.

The second possible construction to which the new law is subject is indicated by the above quoted Section 5 of Chapter 242 which, in effect, declares that the rates provided in the Act shall be in effect from the effective date of the Act until December 31, 1963. This provision may be construed as indicating the legislative intent that the new rates apply to all taxable years ending after the effective date of the Act but only to that portion of such taxable years which falls after the effective date. In other words it may have been intended that the taxes be prorated by applying the old rate to that part of the taxable year before the effective date of the Act and the new rate to that part of the taxable year after the effective date. Under this construction of the Act, the effective date of the Act would become the universal starting date for the imposition of the higher rate of taxation.

In ascertaining the legislative intention, it is desirable to look at the possible consequences of a particular interpretation. It has been said to be a general rule that in determining the constitutional validity of the statute we must look to its "material and reasonable effect" 11 Am. Jur. 735, Constitutional Law, § 101. We have, therefore, considered Chapter 242, Laws 1961 in the light of the two aforementioned possible interpretations of which it is susceptible. As has been previously mentioned, one possible interpretation would result in giving it a retroactive effect. Retroactive laws are not invalid or unconstitutional as such, in New Mexico. Article II, § 19 of the New Mexico Constitution merely states that "no ex post facto law, bill of attainder, nor law impairing the obligation of contracts shall be enacted by the Legislature." Where retroactive laws have been declared unconstitutional, it has been because of specific constitutional prohibition against such laws. The New Mexico Constitution contains no such specific prohibition. In the absence of such an expressed prohibition, a law is not invalid merely because retroactive in operation. 16 (A) C.J.S. 94, Constitutional Law, Section 415. That the general rule applies to taxation statutes and even income tax laws is indicated by 16 (A) C.J.S. 116, Constitutional Law § 419. Since retroactive laws are not prohibited in New Mexico, the retroactive interpretation of the law under consideration would be valid unless it contravenes some other Federal or State constitutional restriction. It is our conclusion that if the retroactive construction were deemed to represent true legislative intent, the law would be unconstitutional by reason of violating Article II, § 18 of the New Mexico Constitution, Amendment XIV, U.S. Constitution or Article VIII, § 1,

New Mexico Constitution. Article II, § 18 of the New Mexico Constitution provides as follows:

"No person shall be deprived of life, liberty or property without due process of law; **nor shall any person be denied the equal protection of the laws."** (Emphasis supplied)

The Fourteenth Amendment of the United States Constitution insofar as it is of immediate concern to us declares that no state shall

"deny to any person within its jurisdiction the equal protection of the laws."

Article VIII, § 1 of the New Mexico Constitution provides the same type of protection in the more limited area of taxation.

"Taxes levied upon tangible property shall be in proportion to the value thereof and **taxes shall be equal and uniform upon subjects of taxation of the general class."** (Emphasis supplied)

We shall consider together the equal protection clauses of the Federal and State Constitutions as they apply to the present problem. If given the retroactive construction, it is our view that the subject law violates the equal protection clauses by permitting discrimination between those in the same class or by classifying those subject to the tax in an unreasonable, arbitrary, unjust and discriminatory manner. In order to avoid the prohibitions of the equal protection clause, classification cannot be arbitrary or capricious but must be reasonable and natural. In order for a classification to be valid it must rest upon reasonable differences between those persons included within it and those excluded. In order to avoid the strictures of the Fourteenth Amendment the classification must be based upon real and pertinent differences as distinguished from irrelevant and artificial ones. The rule as it is most frequently stated declares that a classification to be valid must always rest on a difference which bears a fair, substantial, natural, reasonable and just relation to the object, act or persons in respect to which it is proposed, 12 Am. Jur. 153, Constitutional Law, § 481.

We have previously described the manner in which the present law could be construed to discriminate between taxpayers using a fiscal year and those using a calendar year. It can readily be seen that the taxpayers in the two different broad categories may have nothing to distinguish them except that their taxable years end at different times. In all other respects such taxpayers could be identical. However, one of them could be required to pay a higher rate of income tax solely because he was operating on a fiscal year basis. It is granted that states have broad discretion in the imposition of taxes. The equal protection clause imposes no ironclad rule of equality and any reasonable classification will be upheld. "With all this freedom of action there is a point upon which the state cannot go without violating the equal protection clause. The state may classify broadly the subjects of taxation but in doing so it must proceed upon a rational basis. The state is not at liberty to resort to a classification that is palpably arbitrary. The rule is generally stated to be that the classification must rest on some ground of difference

having a fair and substantial relation to the object of the legislation so that all persons similarly circumstanced shall be treated alike." **Ohio Oil Company v. Conway,** 281 U.S. 146. See also **Connolly v. Union Sewer Pipe Co.,** 184 U.S. 540. If the New Mexico Legislature were deemed to have put calendar year taxpayers in one classification and fiscal year taxpayers in another, it is our view that such classification would violate the equal protection clause since there is no reasonable basis for taxing persons on a different basis who are in all respects identical except for their method of fiscal accounting. In the language of the United States Supreme Court in **Magown v. Illinois Trust and Savings Bank,** 170 U.S. 283,

"If there is inequality it must be because the members of a class are arbitrarily made such and burdened as such upon no distinctions justifying it."

It has been said that a statute making an arbitrary classification between incomes to be taxed and those in part or in whole exempt from or not subject to taxation is invalid. 85 C.J.S. 710 Taxation § 1090 C. The closest case on its facts to the situation confronting us does not provide a clear expression of applicable law but does carry a strong implication of how the court would have answered our question. That case is **John B. Semple & Co. v. Lewellyn,** 1 F.2d 745. In that case the court was attempting to determine which of two possible constructions should be attributed to the Revenue Act of 1917. Under one possible construction, the law would have placed a greater burden upon fiscal year taxpayers than upon calendar year taxpayers. In the words of the court:

"This means, if the interpretation is to be sustained, that Congress intended the Revenue Act of 1917 to be retroactive to the extent of imposing the 4 per cent tax on income accruing prior to January 1, 1917, and also intended to discriminate against corporations whose fiscal year ended on some date other than December 31st. Neither of such intentions is to be presumed, if any other interpretations of the act is possible. . . ."

In a New Mexico case wherein a legislative classification was challenged as being unreasonable the court unequivocally followed the general rule. **State v. Sunset Ditch Co.,** 48 N.M. 17, 145 P. 2d 219.

For the above stated reasons, it is our conclusion that the first alternative construction of Chapter 242, Laws 1961 could result in inequality of the constitutionally prohibited type. While we rest our decision upon the violation of the equal protection clauses, we feel that the retroactive construction of the law would also be in violation of the limitation imposed by Article VIII, § 1, New Mexico Constitution. Under that construction we feel that the income tax would not be "equal and uniform upon subjects of taxation of the same class" as is required by that section of the Constitution. The United States Supreme Court has construed this section of our Constitution in the case of **Bowman v. Continental Oil Company,** 252 U.S. 642. In its opinion the Court quoted Article VIII, § 1 and stated as follows:

"Clearly the first part of this refers to property taxation. The tax imposed by the Act under consideration upon the sale or use of all gasoline sold or used in this state is not property taxation, but in effect, as in name, an excise tax. We see no reason to doubt the power of the State to select this commodity as distinguished from others, in order to impose an excise tax upon its sale and use; and since the tax operates impartially upon all and with territorial uniformity throughout the state we deem it 'equal and uniform upon subjects of taxation of the same class', within the meaning of Section 1 of Article VIII."

It is the obvious conclusion of the United States Supreme Court that the two phrases of Article VIII, § 1, are separable, the first being applicable solely to property taxes and the second applying to all other taxes or at least to all excise taxes.

The Bowman interpretation was later concurred in by the New Mexico Supreme Court in **George E. Breese Lumber Company, et al., v. Mirabal, State Comptroller,** 34 N.M. 643, 287 Pac. 699. While there is authority to the effect that income taxes are property taxes, the general view is that an income tax is more within the category of excise taxes. 85 C.J.S. 697, Taxation, § 1089. It would, therefore, be our view that the income tax being an excise tax is subject to the limitations imposed by Article VIII, § 1, New Mexico Constitution, and that for the reasons previously stated, Chapter 242 would violate the equality clause if it were given the retroactive construction.

The New Mexico Supreme Court has aligned itself with the majority in ruling that if at all possible, statutes should be construed in a manner which will result in a determination that the law is constitutional. **State ex. rel. Clancy v. Hall, State Treasurer,** 23 N.M. 422, 168 Pac. 715; **Abeytia v. Gibbons Garage,** 26 N.M. 622, 195 Pac. 515. In the **Clancy** case, the Court stated in part as follows:

"When a statute is before the court for construction and the language of the act is reasonably susceptible of two constructions, one of which would render the act inoperative and in contravention of the constitution or law of the land, and the other would uphold the statute, it is the duty of the court to adopt the latter construction."

It has also been stated to be a general rule that the Legislature is presumed to have acted with the full knowledge of the constitutional scope of its powers and that it did not intend to exceed its powers. 82 C.J.S. 544, Statutes, § 544; Statutes, § 316. It is also a general rule that statutes should be construed as a whole and, if possible, effect should be given to the entire statute and to every part thereof. 82 C.J.S. 691, Statutes, § 345.

It is our conclusion that Chapter 242 is reasonably subject to the second interpretation mentioned above and that that interpretation should be implemented in order to preserve the constitutionality of the law. In other words it is our ruling that the tax rate increase imposed by Chapter 242 was imposed prospectively from the effective date of the Act and that it will be necessary to prorate the taxes so as to impose the new rates upon only that portion of a taxpayer's taxable year after the effective date of the Act. In doing so it will be more possible to give effect to the entire Act and to all of its parts

because Section 5 of Chapter 242 carries a strong implication that the new tax rate shall be imposed prospectively and should not be applied to income earned prior to the effective date of the Act.

We are well aware of the administrative burden that this interpretation will place upon the Bureau of Revenue. However, the rules of construction cited and the alternative of an unconstitutional income tax law demand this result.