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The Constitutionality of Certain Indirect Approaches to Raising the Assessment Level

By ELVIS J. STAHR, Jr.

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It seems plain common sense that among the most effective methods the legislature might employ to effect the raising of assessments toward the goal of fair cash value would be the enactment of statutes giving practical incentives to property owners and to local assessment officers to start raising the level of assessments at the grass roots. The constitutionality of several types of such incentives will be considered briefly in this article, which is a summary of longer memoranda of law.

I

May the legislature prohibit the writing of property insurance in amount greater than the assessed value of the property to be insured? It is believed that it could constitutionally do so, for several reasons.

(a) Public policy. Equitable assessment of property for tax purposes, which does not now exist in Kentucky, but which would indisputably be in the public interest, can only be achieved by adopting the same standard throughout the state. The standard prescribed by section 172 of the Kentucky Constitution is fair cash value. A statute whose object was to aid in achieving that standard would seem to have overriding considerations of public policy in its favor.

(b) Constitutional mandate. It is the duty of all branches of the state government to give effect to the state Constitution. A statute which sought to implement an express mandate (section 172) of that Constitution, even by indirection, would be entitled to the most favorable possible consideration by the courts.

(c) Power of legislature to limit corporate powers. The powers of domestic corporate insurers are limited to those set forth in their charters, and those of foreign corporate insurers to those permitted by the laws of the state where they seek to do business. In Kentucky, the powers of the latter may not exceed those of the former (Constitution 202; Allin v. American Indemnity Co., 246 Ky. 396). The powers of both may be restricted or revoked by the legislature at any time. Constitution 37 provides that “every grant of a franchise, privilege or exemption, shall remain subject to revocation, alteration or amendment.” See Orient Ins. Co. v. Daggs, 172 U. S. 557.

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Hence it would seem that limits on the amount of insurance which companies may lawfully write on any one piece of property may be set by the legislature, in the exercise of its power to amend or revoke corporate powers and privileges. The only specific constitutional restriction is that it must act through a general law (Constitution 59 [17]).

A puzzling question as to the state's power to regulate foreign insurance corporations has existed since the decision, in U. S. v. South-Eastern Underwriters Assn., 322 U. S. 533 (1944), that insurance business is interstate commerce when carried on across state lines. A careful study of the McCarran Act (15 U. S. C. 1011-1015), together with subsequent Supreme Court cases involving the point, leads to the conclusion that, so long as Congress refrains from regulating interstate insurance business, the states will retain their previous power to do so, in all respects involved in the instant problem. See 164 A. L. R. 500 and 34 A. B. A. J. 539.

(d) Police power of legislature to regulate insurance. The Constitution of Kentucky does not mention insurance, hence contains no specific limitation on the power of the legislature to regulate it. Insurance is a business affected with a public interest and therefore may be regulated in the exercise of the police power. "Corporations engaged in the business, both domestic and foreign, must conform their business and contracts to the provisions of the statutes in the states where they do business. . . . This power . . . to regulate the business of insurance is very broad." See 1 Couch on Ins., sec. 244, and cases there cited.

Virtually every aspect of the business has been subjected to regulation by statutes of the various states, and their constitutionality has been upheld. See 36 A. L. R. 1512 and 72 A. L. R. 1173. A statute may limit the extent of risk in any one policy (32 C. J., p. 983, 44 C. J. S., p. 522; Glens Falls Ins. Co. v. Hawkins, 126 S. W. 1114). The amount of new business an insurance company may do may be limited by statute (Bush v. New York Life Ins. Co., 119 N. Y. Supp. 796). Limitation of risks has been said to be constitutional in opinions of the Supreme Court (German Alliance Ins. Co. v. Lewis, 233 U. S. 389; National Ins. Co. v. Wanberg, 260 U. S. 71).

The right of the state to guard against overinsurance has also been recognized (1 Couch on Ins., sec. 74b; see Hartford Live Stock Ins. Co. v. Gibson, 256 Ky. 338).

It might be argued that the legislature, in enacting the type of statute under consideration, had violated section 1 (5) of the Kentucky Constitution, which provides that all men have the inherent and inalienable right "of acquiring and protecting property." But does this mean the state is compelled to permit a citizen to "protect" more taxable property than he is willing to pay taxes upon? It must be remembered, too, that, in regulating insurance, the legislature may abridge the liberty of contract of both insurer and policyholder. Hartford Live Stock Ins. Co. v. Gibson, supra ("Contract rights are not absolute but must yield to the public good"); Hartford Accident Co. v. Nelson County, 291 U. S. 352 ("The business of insurance is one peculiarly subject to supervision and control . . . . Liberty of contract is not an absolute concept. It is relative to many conditions of time and place and circumstance. The constitution has not ordained that the forms of business shall be cast in imperishable moulds"—per Cardozo, J.); Kenton, etc., v. Goodpaster, 304 Ky. 233 ("Because of the public interest an insurance company and its policyholders do not have the inviolate rights which characterize private contracts.")

Two excellent pronouncements on the limits of the police power in regu-
lating insurance are the opinion of
the Supreme Court in German Alli-
ance Ins. Co. v. Kansas, 233 U. S.
389, and the opinion of Commissioner
Stanley of the Court of Appeals in
Kenton, etc., v. Goodpaster, supra.
Both should be carefully studied,
though space does not permit lengthy
quotation from them here.

(e) The power to regulate insur-
ance may be exercised in indirect aid
of another power. This proposition
has already been sustained in Ken-
tucky. Everyone is familiar with the
common type of statute prohibiting a
murderer from collecting the proceeds
of his victim's insurance, but I refer
more particularly to such statutes as
KRS 281.450-470, requiring certain
insurance policies on taxicabs and
city busses to conform to certain
standards, and providing that insur-
ance companies shall not be relieved
of liability on such policies until the
expiration of a fixed period after
notification to the state of intention
to cancel, regardless of any contract
between the parties. These statutes
were held constitutional and applied
in Maryland Casualty Co. v. Baker,
304 Ky. 296, wherein Judge Dawson
wrote:

"... These statutes were enacted by
the legislature in the exercise of its
police power for the safety and pro-
tection of the public in its transpor-
tation dealings with common carriers
or operators of motor vehicles for
hire upon the highways of the Com-
monwealth. ... The policies involved
here were executed in order that the
taxicab owner might retain his permit
and continue the operation of his
business, and the policies and the
statutes must be read and construed
together. ... As a general rule statu-
tory requirements are to be considered
in construing contracts of insurance,
and mandatory statutory provisions
must be read into the policies [citing
cases]; ... and where restrictive pro-
visions of a liability policy conflict
with statutory requirements, the
statute must control." (Emphasis
added.)

Equally or more significant is the
case of Gross v. Commonwealth, 256
Ky. 19, which dealt with the constitu-
tionality of KRS 281.080. The Court
wrote in part: "The appellant at-
tacks the constitutionality of this
quoted provision ... for the reason,
he contends, that ... the Legislature
... is without power to delegate the
wide, unbridled authority which it
possesses to legislate to a subordinate
commission, which is here attempted,
he asserts, in this act in delegating to
the tax commission the undefined and
unlimited authority to fix the amount
of the insurance to be carried by taxi
owners 'in such penal sums or maxi-
mum amounts as said Commission
may deem necessary,' etc. ... How-
ever, we do not agree that ... the
statute here attacked is to be held in-
valid. ... [The statute] clearly repre-
sents an exercise by the Legislature of
the state's police power to regulate
and govern the transportation for hire
of persons and property by motor ve-
ciles on the state's public highways,
for the protection of the interests and
welfare of its thus traveling citizens.
The means adopted by the Legislature
for their protection in the exercise of
this police power, so long as they have
an ascertainable relevancy to the ob-
ject sought, are within the scope of
that power." (Emphasis added.)

The important point is that the
Court clearly recognized that the leg-
islature could fix the amount of ins-
urance to be carried, and the main
issue was merely whether it could
delegate that power. The Court held
it could. The regulation of insurance
was held a valid, constitutional means
of aiding the police power to promote
safety on the highways. No ascertain-
able reason exists why regulation of
insurance could not be a valid means of aiding the taxing power as well, or of aiding in implementing the express constitutional mandate regarding assessments. As a matter of fact, the taxing power has frequently been declared by the courts to be a supreme attribute of sovereignty, as is the police power.

(f) If doubt exists as to the constitutionality of a statute, it will be resolved in favor of validity. This is a maxim too well known to require documentation here.

(g) A statute limiting the amount of risk would be no more “unreasonable” a regulation than existing valued policy statutes or statutes regulating amount of premium, amount of proceeds payable, amount of reserves, amount of dividends, kinds of investments, or amount of deposits, or prohibiting discrimination in rates, rebates, and so on. Yet all these things have, over and over, been held constitutional. The statute under consideration would be in the public interest and reasonably calculated to assist in attaining the public goal of fair value assessments for tax purposes. That is sufficient in the circumstances.

Incidentally, the scope of any such statute would presumably be limited to insurance on real property improvements.

III

Another effective method for indirect stimulation of local assessments might be to distribute state financial aid for local schools derived from the so-called school equalization fund on some basis which would reflect directly the extent to which the local units are helping themselves by meeting certain minimum requirements as to assessment. For instance, it might prove effective to distribute this aid on the basis of the extent to which the local unit is approaching assessment at 100 per cent of market value. A formula for determining the amount of aid in proportion to the improvement in assessment could be worked out by comparing the amount of revenue produced locally at the existing ratio to full value with the amount which would be raised by a 100 per cent valuation. There would seem to be no constitutional obstacle to the use of this or any other method inasmuch as the only pertinent provision, section 186, as amended in 1940, provides:

“... the General Assembly shall by general law prescribe the manner of the distribution and use of the public school fund for public school purposes. Provided that each school district in the Commonwealth shall receive on a census pupil basis its proportionate part of at least ninety per cent of any fund accruing to the school fund. The remainder of any fund accruing to the school fund may be distributed upon other than a census pupil basis.” (Emphasis added.)

Further, at the present time KRS 157.053 requires the Kentucky Tax Commission to certify to the State Board of Education that any board of education applying for aid from the equalization fund has a ratio of assessed valuation of property to fair cash value equal to the average ratio throughout the state. This statute, enacted in 1942, has not been challenged
and there is no reason to believe that the formula provided therein or any other would make similar legislation unconstitutional. Any doubt, that the purpose of the 1940 amendment to section 186 creating the equalization fund and permitting it to be distributed on other than a census pupil basis was to leave the legislature unrestricted in the matter is dispelled by the opinion in Talbott v. Kentucky State Board of Education, 244 Ky. 826, which hastened the adoption of the amendment by deploiring in no uncertain terms any constitutional restrictions on distribution of state aid to schools.

IV

Under present practice, railroad property and public service corporation franchises are valued by the Department of Revenue at "fair cash value." This valuation is then reduced to a figure—now 80 per cent—which is supposedly the average of assessment ratios for all counties. The reduced valuation is then allocated by standard rule and certified to the local taxing districts which assess taxes on that valuation regardless of whether the local assessor is assessing other property in the district at a 40 per cent or 100 per cent ratio. As a result counties with low ratios actually take tax money away from hard-pressed counties with high ratios.

It would seem fairer to equalize after allocation. In addition to being fairer, equalization after allocation would provide some incentive for counties with low assessment ratios to bring them up to the state average. Could the Department of Revenue value such property at full cash value, allocate it to the counties and then require the local taxing authorities to equalize this property at the local rate before assessing the tax against it? Could the Department at the same time assess for state taxes on the same basis or on full value as reduced under the present formula? These problems are not simple, but it is submitted that the proposals may be found to satisfy the Constitution.

At one time there was no equalization of railroad property with locally assessed property, and the Court of Appeals held that the resulting denial of equality did not prevent the 100 per cent assessment of railroad property (Louisville Ry. v. Commonwealth, 105 Ky. 710). The Supreme Court of the United States, however, sustained an injunction a few years later in L. & N. R. Co. v. Greene, 244 U. S. 499, on the ground that the systematic assessment of railroad property at 75 per cent by the state while local property was assessed at 52 per cent was discriminatory. Ever since that time there has existed an uneasy truce under which the Department in its valuation takes the average assessment ratio sufficiently into account to prevent the utilities from objecting. It is submitted that the rule of the Greene Case would be equally well satisfied by requiring the utility to resort to the county equalization board for equalization. If the Department itself puts such an equalization into effect in advance of certification there would seem to be no objection insofar as local taxes are concerned.

If the state property tax were also assessed on the basis of the total of the equalized allocations, it might raise some question of uniformity (see Mobile R. Co. v. State Tax Comm., 374 Ill. 75, and J. W. Martin, Research Report to the Virginia Public Service Tax Study Committee, p. 85), although that question would appear to be little, if any, more serious than uniformity questions which might be raised with respect to the present procedure. If the state tax continued to be levied on the basis now used (average of county ratios), there would seem to be no new constitutional objection arising from the fact that a different system was used for equalizing local taxes.