LOCAL TAXATION OF REALTY INCOME NOT PRE-EMPTED BY STATE PROPERTY TAX

Benua v. City of Columbus,
78 Ohio L. Abs. 152, 152 N.E.2d 550 (1958)

Plaintiff sought a declaration that the Columbus city income tax[1] was invalid as applied to rentals derived from certain properties situated within that city. Plaintiff relied on the so-called "pre-emption" doctrine[2] and the fact that the state of Ohio levies a general property tax.[3] The court held that local taxation of realty income is not pre-empted by state property tax.

Simply stated, the doctrine is that the levying of a particular tax by the state pre-empts that field of taxation and municipalities are thereby precluded from levying the same or a similar tax.[4] Three reasons have been advanced by the Supreme Court of Ohio as the basis of this doctrine.

(1) It is analogous to the pre-emption doctrine which has been attached to the commerce clause of the federal constitution.[5]

(2) Section 3, Article XVIII of the Ohio Constitution grants municipalities ". . . powers of local self-government . . . as are not in conflict with general laws."[6]

(3) The pre-emption is an implied exercise of the power to limit municipal taxation granted to the General Assembly by Section 13, Article XVIII[7] and Section 6, Article XIII[8] of the Ohio Constitution.

Recent cases have relied upon the last reason. In other words, in applying the pre-emption doctrine the courts are looking for an implied legislative intention to foreclose a particular field of taxation to the municipalities.

It would seem quite clear that under the doctrine the cities could not levy a tax on real property outside the auspices of the state general property tax.[9] The problem is to determine whether or not the pre-emption extends to a tax on the rentals received from real property.

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[1] COLUMBUS, OHIO, ORDINANCE 1073-56 (1956).

[2] For a discussion of the development of the pre-emption doctrine see Glander and Dewey, *Municipal Taxation; A Study of the Pre-emption Doctrine,* 9 OHIO ST. L.J. 72 (1948).

[3] OHIO REV. CODE § 5705 (1953).

[4] Haefner v. City of Youngstown, 147 Ohio St. 58, 68 N.E.2d 64 (1946).

[5] City of Cincinnati v. American Tel. & Tel. Co., 112 Ohio St. 493, 147 N.E. 806 (1925).

[6] *Ibid.*

[7] "Laws may be passed to limit the power of municipalities to levy taxes. . . ." See City of Cincinnati v. American Tel. & Tel. Co., *supra* note 5.

[8] "The General Assembly shall provide for the organization of cities . . . and restrict their power of taxation . . . so as to prevent the abuse of such power." See Firestone v. City of Cambridge, 113 Ohio St. 57, 148 N.E. 470 (1925).

[9] *Supra* note 3.

The cases dealing with pre-emption are not numerous and few rules have been formulated for determining its scope in any given case. In *Haefner v. City of Youngstown*[10] a municipal tax on public utility rates was declared invalid. The court pointed out that the state levied a tax on the gross receipts of utilities[11] and specifically exempted the sales of such utilities from the state sales tax.[12] This, it was said, indicated the intention of the General Assembly that the sales of utilities should not be subject to taxes other than the gross receipts tax.

A similar argument was used by the court in *Ohio Finance Co. v. City of Toledo*[13] to invalidate a city income tax as applied to the net income of a dealer in intangibles derived from the income yield of his intangibles. The state of Ohio taxes the owner of intangibles at five per cent of the their income yield.[14] Dealers are exempted from this tax.[15] The shares of such a dealer are, however, taxed at five mills of their fair value[16] and it is provided that this latter tax shall be in lieu of all other taxes on the dealer's intangible property.[17]

What the court has done in these two cases is to extend the pre-emption doctrine past the "same or similar" test. The court found in both instances that the state *indirectly* taxed the event which the cities attempted to tax and expressly exempted that event from some other state tax. This, they said, as effectively pre-empted that tax field as would the levying of the same tax by the state.

By applying the reasoning of the *Haefner* and the *Ohio Finance* cases we may develop an argument for the plaintiff. Section 5701.06 (C)(1) of the Ohio Revised Code exempts interests in lands, and rents derived therefrom, from the definition of investments for purposes of the intangible property tax. This, it could be argued, is an expression of legislative intent that there shall be no tax on the incidents of land ownership other than the general property tax. This argument would be in keeping with the idea of "taxed indirectly and expressly exempted from another state tax" discussed in the preceding paragraph.

However, there is not unanimous approval for the expansion of the pre-emption doctrine. In the *Ohio Finance* case, a three-judge dissent

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[10] *Supra* note 4.

[11] OHIO GEN. CODE § 5483 (1941) (now OHIO REV. CODE § 5727.38 (1957)).

[12] OHIO GEN. CODE § 5546-2 (1951) (now OHIO REV. CODE § 5739.02(E)(2) (1955)).

[13] 163 Ohio St. 81, 125 N.E.2d 731 (1955).

[14] OHIO GEN. CODE §§ 5638, 5638-1 (1943) (now OHIO REV. CODE §§ 5707.04 (A)(1953), 5707.03(A)(1956)).

[15] OHIO GEN. CODE § 5366 (1933) (now OHIO REV. CODE § 5711.01(A) (1953)).

[16] OHIO GEN. CODE § 5638-1 (1943) (now OHIO REV. CODE § 5707.03(E) (1956)).

[17] OHIO GEN. CODE §§ 5409, 5414-3 (1931) (now OHIO REV. CODE § 5725.26 (1953)).

argued that the dealer was not taxed on the income yield of his intangibles and that the pre-emption doctrine should be more narrowly interpreted.

The lack of certainty which the doctrine has today puts a municipal tax on unstable grounds until such time as every phase of it is validated by adjudication. This state of affairs promotes litigation and often a city which had hoped to obtain a new revenue source finds itself instead with the added expense of implementing to no avail and unsuccessfully defending an invalid tax.

Governments today require sizable amounts of revenue but the burden of providing that revenue must not be unfairly heavy upon any class of individuals. In applying the doctrine the courts are attempting to balance these considerations. But they must balance them with a more or less mechanical formula which precludes a more comprehensive inquiry into whether or not the tax burden is being fairly distributed.

The aforementioned constitutional provisions[18] give the power to limit municipal taxation to the General Assembly, not the courts; and in keeping with the spirit of home rule it could be argued that municipal taxes should be upheld in the absence of a clear legislative mandate to the contrary.

Stanley K. Laughlin, Jr.

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[18] See notes 7, 8 *supra.*