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The Doctrine of Constructive Fraud in the Washington Law of Taxation

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COMMENTS

THE DOCTRINE OF CONSTRUCTIVE FRAUD IN THE WASHINGTON LAW OF TAXATION

Two recent Washington decisions, *Bellingham Development Co. v. Whatcom County*[1] and *Grays Harbor Pac. R. Co. v. Grays Harbor County*[2] present separate phases of a problem which has been frequently considered by the Supreme Court of Washington and concerning which that court has formulated a general rule: namely, that the court will relieve a taxpayer from the burden of an excessive tax where the conduct of the taxing officers has been so improper that it can be called "constructively fraudulent", even though the officers acted in good faith.[3] The rule is clearly a proper one, but, like so many "general rules", the application of it to a

[1]86 Wash. Dec. 619, 59 P. (2d) 920 (July 22, 1936).
[2]88 Wash. Dec. 398, 62 P. (2d) 1347 (Dec. 14, 1936).
[3]First Thought Gold Mines v. Stevens County, 91 Wash. 437, 157 Pac. 1080 (1916).

concrete case presents many difficulties, and it is hoped that here some light may be thrown on the characteristics of that will o' the wisp, constructive fraud, so that its presence, or absence, in future cases can be more nearly ascertained.

At the outset it must be noted that it is beyond the scope of this comment to attempt a discussion of the *remedies* available to a taxpayer who has been the victim of improper conduct on the part of the taxing officers[4], nor does this comment purport to exhaust the field of situations in which the taxpayer has a remedy, because the constructive fraud cases form only a segment of the cases in which the court will grant relief from the effects of improper conduct of the taxing officers.

The cases in which the doctrine of constructive fraud has been considered and elaborated may be roughly classified as appears below.

1. *Cases in which the taxpayer has been the victim of deliberately unequal taxation.*

When the taxing officer deliberately assesses different kinds of property at different fractions of their fair cash values, his action closely approaches actual fraud. Accordingly the court will grant relief on a showing that "the officers fraudulently, capriciously, or tyrannically refused to exercise their judgment by adopting a rule or system designed to operate unequally".[5] In *Spokane & East. Trust Co. v. Spokane County*[6] and *Yakima Valley Bank & Trust Co. v. Yakima County*[7] the assessor deliberately valued for taxation the bank stock of petitioners at a higher percentage of its actual value than he valued other property. In both cases the petitioners were given relief. In *Pac. Tel. & Tel. Co. v. Wooster*[8] the court enjoined the assessor from spreading on the tax rolls an increase in the valuation of petitioner's property of 17% over that set by the state tax commission. (The basis for the *injunctive* relief was that the assessor's acts were void.) The court refused to relieve petitioner in *Doty Lum. & Shingle Co. v. Lewis County*[9] because there was no showing that the discrimination was intentional and deliberate, and petitioner's property had admittedly not been valued at more than its fair cash value.

2. *Cases in which purely arbitrary official action results in excessive valuation of property.*

The taxpayer can get relief if he can show, by clear and convincing evidence, that his property has been over-valued or over-assessed as a result of arbitrary action on the part of the taxing

[4]On the point of available remedies since 1931 see in part: Laws, 1931, c. 62 (REM. REV. STAT. § 11315); Casco Co. v. Thurston County, 163 Wash. 666, 2 P. (2d) 677, 77 A. L. R. 622 (1931) (noted in 7 WASH. L. REV. 230); Mountain Timber Co. v. Cowlitz County, 163 Wash. 543, 2 P. (2d) 69 (1931); Denny v. Wooster, 175 Wash. 272, 27 P. (2d) 328 (1933); Pac. Tel. & Tel. Co. v. Wooster, 178 Wash. 180, 34 P. (2d) 451 (1934); and Ballard v. Wooster, 182 Wash. 408, 45 P. (2d) 511 (1935).

[5]Andrews v. King County, 1 Wash. 46, 23 Pac. 409, 22 Am. St. Rep. 136 (1890).

[6]70 Wash. 48, 126 Pac. 54, Ann. Cas. 1914 B 641.

[7]149 Wash. 552, 271 Pac. 820 (1928).

[8]178 Wash. 180, 34 P. (2d) 451 (1934).

[9]60 Wash. 428, 111 Pac. 562, Ann. Cas. 1912 B 870 (1910).

official, and it seems that here, as well as in class No. 1, the amount of over-valuation need not be very great.[10] In *Whatcom County v. Fairhaven Land Co.*[11] the court said, "An arbitrary assessment of property without the exercise of the assessor's judgment, based upon knowledge or information, is an illegal assessment, and is a fraud on the property owner, and may always be taken advantage of by the latter in some manner." It preferred, however, to decide the case on the ground of a "palpably excessive over-valuation", as the valuation was twice the actual value of the property. In *Benn v. Chehalis County*[12] the assessor valued the property, without viewing it, at double its actual value, and relief was granted. The taxpayer in *Weyerhauser Timber Co. v. Pierce County,*[13] won its suit to recover taxes paid under protest because it showed that the assessor had used 60% of the full value of its property as a base for taxation when required by statute to use a base of 50% and that the assessor had valued its timber lands on a flat rate and by means of a zone system without regard for the accessibility, quality, and marketability of the timber. The case of *In re Metropolitan Bldg. Co.*[14] was one in which the county assessor valued plaintiff's leasehold at $700,000.00, and the state tax commission ordered a valuation of $1,375,000.00. The superior court restored the assessor's valuation, and the supreme court affirmed the order, saying that the tax commission had used an arbitrary and purely theoretical basis of valuation and that such arbitrary and capricious conduct amounted to constructive fraud when it resulted in such an over-valuation. The cases of *Carlisle v. Chehalis County*[15] and *Blumauer v. Mann*[16] are authority for the proposition that "before an assessment can be set aside on the ground that the taxing officer acted arbitrarily or fraudulently in increasing a valuation the evidence must be clear to that effect," and in those cases the evidence was decidedly not sufficiently clear.

3. *Cases of the taxation of non-taxable property.*

The taxation of non-taxable property does not come strictly within the borders of the constructive fraud doctrine. It may, however, result in an over-valuation of taxable property and hence may be briefly considered here. In *Spokane & East. Trust Co. v. Spokane County*[17] the assessor included the value of plaintiff's non-taxable securities in determining the taxable value of plaintiff's stock. As this action resulted in taxation of the non-taxable property, plaintiff prevailed in an action to recover taxes paid under protest.

4. *Cases of excessive valuation reached by a process of valuing the property on a fundamentally wrong basis or theory.*

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[10]Weyerhauser Timber Co. v. Pierce County, 97 Wash. 534, 167 Pac. 35 (1917).
[11]7 Wash. 101, 34 Pac. 563 (1893).
[12]11 Wash. 134, 39 Pac. 365 (1895).
[13]97 Wash. 534, 167 Pac. 35 (1917).
[14]144 Wash. 469, 258 Pac. 473 (1927).
[15]32 Wash. 284, 73 Pac. 349 (1903).
[16]72 Wash. 429, 130 Pac. 491 (1913).
[17]153 Wash. 332, 280 Pac. 3 (1929).

The case of *Metropolitan Bldg. Co. v. King County*[18] was a case in which the assessor valued plaintiff's leasehold on the basis of the amount of the investment and the duration of the term, whereas a leasehold is to be valued, for taxation purposes, at the actual present value of the term. Hence the assessor proceeded on a fundamentally wrong basis, and plaintiff was held entitled to relief even though, apparently, there was not such an excessive valuation as would otherwise have been sufficient to justify relief. The same rule was applied in *Samish Gun Club v. Skagit County*[19], where the assessor increased the valuation of plaintiff's land fifteen-fold because, as he stated, plaintiff was using it as a hunting preserve. The assessor also said that he wouldn't have increased the valuation if the land had not been so used. The use to which land *may* be put may be considered as bearing on value, said the court, but the use that *is* being made of the land may not be taxed, as taxes fall on the land, not on the use made of it. Hence the assessor proceeded on a "fundamentally wrong basis", and where he does so "the courts will grant relief, and this regardless of the action of the board of equalization in the premises." The rule of these two cases was slightly altered in the most recent pronouncement of the court on the question.[20] That case was an action to recover taxes paid under protest. The assessor had valued plaintiff's railroad as a system on the assumption that it was a common carrier. The court held that the road was a private road and not a common carrier and that hence the valuation was made on a fundamentally wrong basis. However, it went on to say that "this alone is not enough to warrant the court's interference, but when such procedure results in a valuation palpably exorbitant and greatly disproportionate to valuations of property of like character in the same taxing district, the court will intervene and revalue the property." The valuation set by the assessor was almost double the true cash value of the property.

5. *Cases of excessive valuation reached by considering the speculative or future value of the property.*

Closely akin to the "fundamentally wrong basis" cases are those cases in which the court accords to the taxpayer a remedy against an excessive valuation reached by considering the speculative or future value of the property. In *Case v. San Juan County*[21] the assessor thought there was valuable limestone on petitioner's land and accordingly valued the land at $50,000.00. Without limestone the land would have been worth about $1,400.00, and there had been no tests made to ascertain the presence of limestone. The court held that property was to be assessed on the basis of its fair market value at the time of assessment and that any valuation over $15,000.00 for this land was excessive and constructively fraudulent. The assessor in *First Thought Gold Mines, Ltd. v. Stevens*

[18]62 Wash. 409, 113 Pac. 1114, Ann. Cas. 1912 C 943 (1911).

[19]118 Wash. 578, 204 Pac. 181 (1922). *Cf.* Woodburn v. Skagit County, 120 Wash. 58, 206 Pac. 834 (1922).

[20]Grays Harbor Pac. R. Co. v. Grays Harbor County; Saginaw Logging Co. v. Grays Harbor County, 88 Wash. Dec. 398, 62 P. (2d) 1347 (1936).

[21]59 Wash. 222, 109 Pac. 809 (1910).

County[22] valued plaintiff's mining land in 1912 at $40,000.00 as a going mine whereas it was valuable only as a prospect and worth about $10,000.00. The court reduced the assessment and cancelled the excessive tax, saying "It is the established law in this state that courts will grant relief from a grossly inequitable and palpably excessive over-valuation of real property for taxation as constructively fraudulent, even though the assessing officers may have proceeded in good faith, and this without regard to the action of the board of equalization." In *Finch v. Grays Harbor County*[23] plaintiff's land was valued at four times its actual value, as the assessor considered the speculative value of the land. The assessment was promptly reduced. In *Willapa Electric Co. v. Pacific County*[24] plaintiff's street railway was valued at $90,000.00 by the state board of equalization; the trial court reduced this to $30,000.00, but refused to go down to the salvage value ($15,000.00) of the property because the court was unwilling to assume that prosperity was forever gone from Pacific County. The supreme court, however, reduced the valuation to $15,000.00 by applying the test of market value at the time of assessment. The taxpayer was unable to get relief in *Wash. Union Coal Co. v. Thurston County*[25] because it was unable to show an over-valuation with sufficient clarity to warrant a disturbance of the assessment, although it did show that the assessor had increased the valuation because he thought that there was coal in the land, whereas it was not certain that there was coal there.

6. *Cases of flagrantly excessive valuation unaccompanied by other improper conduct.*

The factor that underlies the whole doctrine of constructive fraud is excessive valuation. In the preceding classes of cases there have been other elements of improper conduct. We come now to the cases in which "flagrantly excessive valuation" was held to be of itself sufficient to warrant the interposition of the court on behalf of the taxpayer. It is perhaps significant to note that of the thirty-two cases examined under this head there were only fifteen[26] in which the court saw fit to grant relief to the taxpayer;

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[22] 91 Wash. 437, 157 Pac. 1080 (1916).

[23] 121 Wash. 486, 209 Pac. 833, 24 A. L. R. 644 (1922).

[24] 160 Wash. 412, 295 Pac. 152 (1931).

[25] 105 Wash. 208, 177 Pac. 774, 2 A. L. R. 1546 (1919).

[26] In the following cases relief from an excessive over-valuation was granted: Knapp v. King County, 17 Wash. 567, 50 Pac. 480 (1897); Landes Estate Co. v. Clallam County, 19 Wash. 569, 53 Pac. 670 (1898); Dickson v. Kittitas County, 42 Wash. 429, 84 Pac. 855 (1906); Simpson Logging Co. v. Chehalis County, 80 Wash. 245, 141 Pac. 344 (1914); Stimson Timber Co. v. Mason County, 112 Wash. 603, 192 Pac. 994 (1920); Grays Harbor Lum. Co. v. Grays Harbor County, 122 Wash. 625, 211 Pac. 270 (1922) (personal property); Northern Pac. R. Co. v. Pierce County, 127 Wash. 369, 220 Pac. 826 (1923); Inland Emp. R. Co. v. Whitman County, 128 Wash. 358, 223 Pac. 6 (1924); Tacoma Mill Co. v. Pierce County, 130 Wash. 358, 227 Pac. 500 (1924); Norpia Realty Co. v. Thurston County, 131 Wash. 675, 231 Pac. 13 (1924); Inland Emp. Land Co. v. Grant County, 138 Wash. 439, 245 Pac. 14 (1926); Inland Emp. Land Co. v. Douglas County, 149 Wash. 253, 270 Pac. 812 (1928); Bestman v. Snohomish County, 169 Wash. 244, 13 P. (2d) 503 (1932); Northwestern & Pac. Hypotheekbank v. Adams County, 174 Wash. 447, 24 P. (2d) 1086 (1933); Belling-

whereas relief was granted in fifteen out of the twenty cases heretofore considered under the other classifications. Further, the fact that the trial courts were reversed in only five cases out of thirty-two may be observed as perhaps an indication that the supreme court is loathe to disturb the action of a trial court on a matter in which opinion evidence is so important.

The cases in this class are too numerous to discuss individually. There are intimations in the earlier cases that the court would go behind the determinations of the taxing officers only where the taxpayer could show actual fraud or where such fraud could be "conclusively presumed".[27] However, such a conclusive presumption could be raised from a palpably excessive over-valuation[28], and the rule presently applied is that "excessive valuation alone * * * may be of such a pronounced character as to entitle the taxpayer to relief."[29] There need be no evidence of lack of uniformity, as the court intimated there must be in *Kinnear v. King County*,[30] since the case of *Tacoma Mill Co. v. Pierce County*[31] expressly decided that point. The important question, of course is: What amount of over-valuation must the taxpayer prove? In the great bulk of the cases the court apparently insisted on an over-valuation

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ham Development Co. v. Whatcom County, 86 Wash. Dec. 619, 59 P. (2d) 690 (1936).

In the following cases relief was not granted: Olympia Water Works v. Gelbach, 16 Wash. 482, 48 Pac. 251 (1897) (personal property); Noyes v. King County, 18 Wash. 417, 51 Pac. 1052 (1898); Edison Elec. Co. v. Spokane County, 22 Wash. 168, 60 Pac. 132 (1900) (personal property); Templeton v. Pierce County, 25 Wash. 377, 65 Pac. 553 (1901)); Northern Pac. R. Co. v. Pierce County, 55 Wash. 108, 104 Pac. 178 (1909); Vancouver Water Works Co. v. Clarke County, 55 Wash. 112, 104 Pac. 180 (1909); National Lum. & Manufacturing Co. v. Chehalis County, 86 Wash. 483, 150 Pac. 1164 (1915); Hillman's S. C. L. & R. Co. v. Snohomish County, 87 Wash. 58, 151 Pac. 96 (1915); Heuston v. King County, 90 Wash. 200, 155 Pac. 773 (1916); *cf.* Inland Emp. L. Co. v. Grant County, 138 Wash. 439, 245 Pac. 14 (1926); Northwestern Improvement Co. v. Pierce County, 97 Wash. 528, 167 Pac. 33 (1917); Kinnear v. King County, 124 Wash. 102, 213 Pac. 472 (1923); Monroe Water Co. v. Snohomish County, 124 Wash. 216, 213 Pac. 926 (1923) (personal property); Northwestern Lum. Co. v. Grays Harbor County, 129 Wash. 250, 224 Pac. 681 (1924) (personal property); Crosby v. Kitsap County, 154 Wash. 212, 281 Pac. 494 (1929); Wiley v. Spokane County, 159 Wash. 291, 292 Pac. 279 (1930); North Shore Land Co. v. Grays Harbor County, 168 Wash. 16, 10 P. (2d) 235 (1932); Baker Investment Co. v. Pierce County, 175 Wash. 669, 27 P. (2d) 1092 (1933).

[27]Noyes v. King County, 18 Wash. 417, 51 Pac. 1052 (1898); Edison Elec. Co. v. Spokane County, 22 Wash. 168, 60 Pac. 132 (1900); Templeton v. Pierce County, 25 Wash. 377, 65 Pac. 553 (1901) ("The assessor and board of equalization act in a *quasi*-judicial capacity in making or equalizing assessments. The law presumes that they have performed their duty in a proper manner."); Northern Pac. R. Co. v. Pierce County, 55 Wash. 108, 104 Pac. 178 (1909); Vancouver Water Works Co. v. Clarke County, 55 Wash. 112, 104 Pac. 180 (1909).

[28]Knapp v. King County, 17 Wash. 567, 50 Pac. 480 (1897); Landes Estate Co. v. Clallam County, 19 Wash. 569, 53 Pac. 670 (1898); Templeton v. Pierce County, 25 Wash. 377, 65 Pac. 553 (1901).

[29]Tacoma Mill Co. v. Pierce County, 130 Wash. 358, 361, 227 Pac. 500 (1924).

[30]124 Wash. 102, 213 Pac. 472 (1923).

[31]130 Wash. 358, 227 Pac. 500 (1924).

of at least double the true value before it would interfere. In *Simpson Logging Co. v. Chehalis County*[32] the quantity of plaintiff's timber was over-estimated only 25%, and the court reduced the assessment. This may be explained, however, by the fact that even the board of equalization did not completely approve the county's cruise. In *Inland Empire R. Co. v. Whitman County*[33] the over-valuation was only $100,000.00 out of a value of over $3,000,000.00. The fact that the court granted relief may be explained by the presence of an element of valuation by considering a value other than the fair cash value of the property at the time of assessment.[34]

The most recent case on the point is that of *Bellingham Development Co. v. Whatcom County*[35], in which the court affirmed a judgment for plaintiff in an action to recover taxes paid under protest, although the over-valuation was only 42%. This fact lends weight to the statement of the court that "there is no fixed rule as to the disparity required between the assessed value and the value found by the court to establish constructive fraud". It may be that this case indicates a tendency to relax the prior "rule", but until further cases elaborate this holding it is submitted that a taxpayer seeking relief on the short ground of excessive over-valuation will do well to come to court armed with clear and convincing proof of an over-valuation of at least double the fair cash value of the property if he wishes to prevail on that ground alone; if he cannot produce such evidence he had better rely exclusively on the tender mercies of the administrative hierarchy.

If, on the other hand, he can show not only that his property has been over-assessed, but also that it was over-assessed as a result of one or more of the types of improper administrative action discussed above, he may well be able to get relief from the courts upon a showing of a comparatively small over-assessment.

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[32]80 Wash. 245, 141 Pac. 344 (1914).

[33]128 Wash. 358, 223 Pac. 6 (1924).

[34]*Cf.* Willapa Elec. Co. v. Pacific County, 160 Wash. 412, 295 Pac. 152 (1931).

[35]86 Wash. Dec. 619, 59 P. (2d) 920 (1936).