

*Barrett  
Chewson  
W. J. Gowan*

LAW LIBRARY  
ARIZONA ATTORNEY GENERAL

February 25, 1954  
Opinion No. 54-34

TO: The Honorable Robert Brewer  
House of Representatives  
Capitol Building  
Phoenix, Arizona

RE: The constitutionality of the  
withholding provision contained  
in House Bill No. 1.

QUESTION: Is the withholding provision,  
as set forth in House Bill No. 1,  
constitutional?

This will acknowledge receipt of your request of January 28, 1954, for an opinion as to the constitutionality of the withholding provision contained in House Bill No. 1, designated as Section 88 thereof.

This question presents a phase of the payment and collection of income taxes which has not been squarely met by the courts of those jurisdictions whose tax laws relating to a tax on income embrace collection by the withholding or pay-as-you-go method.

The Federal Government incorporated a withholding provision into the Internal Revenue Code in 1943, said provision constituting every employer a collection agent for the United States by requiring employers to withhold an amount equal to the approximate tax owing from the wages and salaries paid their employees. See 26 U.S.C.A. §1621, et seq. Passed as an emergency measure to aid and implement the conduct of World War II, the pay-as-you-go method of income tax collection proved expedient in producing revenue and burdensome to employers who were forced to collect the tax at the source.

Since the time of the adoption of the withholding provision of the Internal Revenue Code several states of the United States and territories thereof have adopted withholding statutes to aid in the collection of income taxes. The states and territories now employing the pay-as-you-go method of tax payment and collection on resident and non-resident income alike, are Oregon, Vermont, Hawaii and Alaska.

The constitutionality of the federal withholding provision was first challenged by the case of *KELLEMS, ET AL., v. THE UNITED STATES*,

ET AL, (1951) 97 Fed. Supp. 681, wherein a manufacturer who had previously withheld and paid over to the Collector of Internal Revenue that amount of income tax assessed against her employees subsequently refused to so withhold and pay over, claiming that the amounts collected involuntarily could be recovered. The decision of the Federal District Court was that the evidence presented by the plaintiff was insufficient to show that she had acted as a reasonably prudent businessman in ascertaining that reasonable cause existed to contest the validity of the withholding provision thereby acting without reasonable cause and, therefore, wilfully in refusing to comply. By basing the determination of the issues raised on the point of sufficiency or insufficiency of the evidence required to support reasonable grounds for a challenge of the constitutionality, the court avoided a direct determination of the validity of the withholding statute.

Subsequently, the case of ABNEY v. CAMPBELL (1953) 206 F.2d 836, was decided in the United States Court of Appeals, Fifth Circuit. There the action was brought against the Collector of Internal Revenue to recover the amount seized by the defendant from the plaintiff's bank account for failure of the plaintiff to withhold from the salary paid her domestic help a certain percentage of the salary paid these employees and for failure to remit this amount, plus a like amount from the employer, to the Collector of Internal Revenue pursuant to the Federal Insurance Contributions Act, 26 U.S.C.A., §1400, et seq. The contentions raised by the plaintiff were that withholding imposed involuntary servitude upon employers in violation of the Thirteenth Amendment and that it was a deprivation of property and liberty without due process of law under the Fifth Amendment. The decision of the court was that the withholding provision did not impose the burden of involuntary servitude on employers, stating, in effect, that the collection of this tax, which was validly imposed, cannot be a violation of the Thirteenth Amendment. The court went on to say, in effect, that the taxing power of Congress is augmented by the widest powers of selection and classification, allowing all but the most arbitrary of classifications. For this reason, the inclusion of domestic employees within the provisions of this excise tax on business employment does not contravene the principles expressed in the Fifth Amendment. This case represents the first decision by a federal court that an employer could be compelled to act as an uncompensated collection agent for the taxing authority.

The state of Oregon adopted the collection-at-the-source principle in income taxation as applied to both resident and non-resident income in 1947. (1953) O.R.S. 88316.575 and 316.585. The constitutionality of the provisions of the Oregon withholding statute has not been contested to date. However, the efficacy of the statute was challenged by questioning the validity of the

procedure by which the act became a state law with the result that such procedure was upheld, leaving the withholding statute intact.

Alaska has enacted a withholding statute which provides that every employer who makes a payment of wages or salaries shall deduct a tax from the wages and salaries paid in the amount of ten per cent (10%) of the Federal Income Tax deducted by the employer. The Alaska statute has been upheld in the case of ALASKA STEAMSHIP LINE v. MULLANEY (1949) 84 Fed. Supp. 561, Aff'd. 180 F. 2d 805. There, the entire income tax statute, including the withholding provision, was attacked by an employer of seamen in interstate commerce on the following grounds:

- (1) That the provision for the adoption of future amendments of the Federal Income Tax Law and the regulations thereunder constituted an unlawful delegation of legislative authority to Congress and Commissioner of Internal Revenue;
- (2) That the act as a property tax is lacking in uniformity, thereby violating the due process and the equal protection clauses of the Fourteenth Amendment to the United States Constitution; and
- (3) That the act burdened interstate commerce in the constitutional sense.

The court sustained the Act in its entirety, holding that even if the Legislature of Alaska adopted the federal tax laws by reference, no unconstitutional delegation of legislative power occurred. This opinion makes no distinction between a territory and a state as to the power to levy and collect such a tax, treating the Alaska Organic Act as equivalent to a state constitution.

In the absence of a provision in the New York state constitution authorizing the levy of an income tax, the state of New York imposed a net income tax on non-residents, the source of whose income arose in New York. Collection of this tax at the source was provided by a withholding provision constituting all employers of non-residents "withholding agents" for the amount of the tax. In the case of TRAVIS v. YALE & TOWNE MANUFACTURING CO., (1920) 40 S. Ct. 228, it was contended that non-residents of New York receiving income from a source within New York, were the victims of unconstitutional discrimination by being denied equal protection of the law, that the due process clause of the Fourteenth Amendment was violated and that the freedom of contract between employer and employee was impaired. The averment as to the impairment of the obligation of contract was dismissed where there was no evidence showing a contract in effect at the time of the passage of the Act which conflicted with the withholding provision.

The contention that the withholding means of collecting the tax was deprivation of property without due process of law was also refuted by the court which held that the excise tax itself was valid and that by virtue of the enforcement of the tax through withholding being the practical equivalent of a garnishment of credits, this means of collection was also valid.

A further constitutional objection to withholding was voiced in *WISCONSIN v. MINNESOTA MINING & MANUFACTURING CO.*, (1940) 61 S. Ct. 253. There, withholding was applied to payments made through dividends to residents and non-residents alike by domestic corporations wherever business was transacted and non-resident corporations doing business in Wisconsin. The Supreme Court of the United States held that the collection of this tax by means of withholding was not an undue burden upon interstate commerce, but rather that it was within the power of the state to levy and collect the tax in this manner.

Municipalities have entered the field of taxation of income where permitted to do so by their respective state constitutions, and where state legislatures have not preempted the field. Withholding, as a means of collection, has been employed by municipalities and has been upheld where contested. In the case of *ANGELL v. TOLEDO*, (1950) 153 Ohio State 179, it was held that where a state had not preempted the field, a municipality could levy and collect tax on income. A municipal ordinance providing for collection of the tax at the source by withholding measures was held a valid enactment. A similar holding was reached in *HUMPHREY v. HENDERSON* (1950) Ohio 58 Abs. 140. There, the Ohio court said that the power of the municipality of Youngstown to levy an income tax (including a withholding provision) exists so long as the state has not invaded or preempted this particular field by passing a law providing for this type of tax. The withholding provision was upheld as being non-discriminatory to taxpayers of the same class wherever situated within the state with reliance placed upon the validity of the federal withholding statute.

The city of Philadelphia has enacted a local income tax which incorporates a collection-at-the-source provision. The case of *CITY OF PHILADELPHIA v. WESTINGHOUSE ELECTRIC & MANUFACTURING CO.*, (Pa. 1946) 55 D & C 343, upheld the withholding provisions imposed by the city of Philadelphia in labeling this method of collection a valid power incidental to the power of the municipality to levy an income tax.

A Kentucky case, *COOK v. COMMISSIONERS OF SINKING FUND*, (1950) 226 S.W. 2d 328, also upheld withholding provisions of an income tax imposed by a municipality deciding that the levy and collection of the tax upon employees of the Federal Government was valid.

From the foregoing authority it appears that the imposition of

a tax on income, if valid and constitutional in the first instance, may be attended by a collective adjunct such as provisions for withholding the tax at the source. Thus far, in the history of the pay-as-you-go method of collection, the placing of the employer in the position of withholding agent has withstood all controversy relating to constitutionality. The exact question of the constitutionality of ascribing to an employer the duties of acting as the collection agent for the Federal Government with no compensation has not as yet come before the United States Supreme Court, although the appeal in the case of ABNEY v. CAMPBELL, supra, is pending. The state court decisions in sustaining withholding provisions of state and municipal tax statutes appear to rely upon the soundness and validity of the principle of withholding as employed by the United States Government.

Notwithstanding the fact that neither the United States Supreme Court nor the remainder of the Federal courts, save the Federal courts in the KELLEMS and ABNEY cases, supra, have been confronted with this problem, it is the conclusion of the Department of Law that withholding provisions, in general, are valid and constitutional as a power of collection incidental to the power to levy a tax on income. This view is not dictated entirely by the existing decisions and opinions relating both directly and indirectly to this issue, but is substantiated in part by the absence of competent authority to the contrary. Our research has failed to disclose a case holding the subject method of collecting income taxes to be unconstitutional.

The Constitution of Arizona confers broad powers with regard to taxation upon the Legislature. Article 9, Section 12, provides as follows:

"§12. (Types of taxes.)--The law-making power shall have authority to provide for the levy and collection of license, franchise, gross revenue, excise, income, collateral and direct inheritance, legacy, and succession taxes, also graduated income taxes, graduated collateral and direct inheritance taxes, graduated legacy and succession taxes, stamp, registration, production, or other specific taxes."

Our law-making body is granted wide latitude in passing legislation for the purpose of levying and collecting taxes. This delegation of power to the Legislature contains no restriction relating to the collection of taxes at-the-source through withholding.

Turning to those particular provisions of House Bill No. 1 relating to withholding, it is noteworthy that the employer, as

withholding agent, is afforded an option as to the amount to be withheld from the wages or salaries paid, see §88 (f) (1) and (6). A flat rate of one-half of one per cent (1%) may be deducted by the employer or he may withhold certain amounts to be determined by the withholding tables attached to and made a part of the Bill. While this option is unique with respect to the proposed Arizona legislation with no counterpart in existing legislation, either on the federal or state level, such option would not appear to affect the constitutionality of the subject provision. The tenor of the pay-as-you-go theory remains undisturbed by the exercise of this option, inasmuch as the ultimate tax liability of the individual taxpayer is determined by the use of the aforementioned withholding tables, irrespective of the option elected by the employer. Provision is made for the refund to the taxpayer of all moneys collected in excess of the actual tax liability.

Section 88 (h) of the proposed bill specifies that the withholding agent must withhold and transmit the amount of tax pursuant to the provisions of the withholding section without recourse to legal or equitable actions in any court of law or equity. The intent of the Legislature in including this particular provision would appear to be for the purpose of limiting the parties, who can question the amount of tax withheld, to the State of Arizona (as the taxing authority) and the individual taxpayer. It prevents the injection of a third party (the employer) into any such controversy by denying him access to the courts to protest the collection and transmittal of the tax.

The position of the withholding agent offers no grounds for an objection as to the amounts withheld and transmitted, inasmuch as the burden of meeting the obligation of the tax imposed rests upon the employee. In this respect, the proposed provision does not deprive the withholding agent of the rights afforded him under the United States Constitution and the Constitution of Arizona. However, the denial of access to the courts would not extend to the withholding agent in his objection to his becoming an uncompensated agent of collection. That access to the courts would be available to an employer to contest the constitutionality of the withholding principle on this ground, appears indisputable in view of the KELLEMS and ARNEY cases, supra, wherein the duties of collection accorded the employer, as withholding agent, were in issue.

In the opinion of the Department of Law, the withholding provisions of House Bill No. 1 are valid and constitutional. This conclusion is necessarily based upon the same sources which uphold withholding generally, as well as from the lack of authority disputing the validity of withholding.

ROSS F. JONES  
The Attorney General

WILLIAM PENN  
Assistant to the  
Attorney General