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Opinion No. 03-081

Applicability of the Professional Privilege Tax to Judges and Payment of the Tax by the Judicial Branch

QUESTIONS

1. Does the fact that state judges may not practice law while they are serving as judges have any effect on their obligation to pay the Professional Privilege Tax?

2. May the judicial branch pay the Professional Privilege Tax on behalf of elected judges?

3. If the answer to question #2 is negative, may the legislature impose the $200 tax increase (from $200 to $400) on the judges without creating a prohibited decrease in compensation?

OPINIONS

1. No. The Professional Privilege Tax is a tax upon having been granted the privilege of engaging in an enumerated occupation through licensure, and not a tax upon the actual practice of such an occupation in Tennessee. It is not necessary that one practice law in order to be subject to the tax; merely having been granted the privilege of engaging in the practice of law creates the tax obligation. Thus, all persons, including judges, who hold an active law license are liable for the tax whether they engage in the actual practice of law during a particular period or not.

2. No. Payment of the Professional Privilege Tax on behalf of the judges would constitute an increase in their compensation and violate Article VI, Section 7 of the Tennessee Constitution.

3. Yes. The State's authority to tax is not related to the compensation of state employees.

ANALYSIS

I. Operation of the Professional Privilege Tax.

Tennessee's Professional Privilege Tax is codified in Tenn. Code Ann. §§ 67-4-1701 *et. seq.* The statute provides, "There is levied a tax on the privilege of engaging in the following vocations, professions, businesses or occupations:... (5) Persons licensed as attorneys by the supreme court of

Tennessee." Tenn. Code Ann. § 67-4-1702(a)(5). Tenn. Code Ann. § 67-4-1703(a) sets the amount of the tax at four hundred dollars ($400) due and payable on June 1 of each year.

Having a license to practice law is a privilege that may be taxed. Article II, Sec 28(c) of the Tennessee Constitution provides, "The legislature shall have power to tax merchants, peddlers, and privileges, in such manner as they may from time to time direct..." When interpreting this section with regard to licensed attorneys, the Tennessee Court of Appeals stated:

> The practice of law is an honorable profession and clearly the members of the profession exercise a privilege granted by the issuance of a license from the Supreme Court. Our legislature has the constitutional power to tax privileges, just as it has the power to tax merchants and peddlers. Persons that exercise privileges should not be given preferential treatment and allowed to avoid their fair share of the tax burden when they, like other holders of licenses, can derive a lucrative income from the exercise of the privilege.

Cox v. Huddleston, 914 S.W.2d 501 (Tenn. App. 1995), *app. denied*, Aug. 28, 1995. It is well settled law that the General Assembly has the power to levy a tax upon the privilege of being licensed to engage in an enumerated occupation. *Simmons v. Johnson*, 1998 WL 321572 (Tenn. Ct. App., June 19, 1998).

II. Judges are subject to the tax despite the prohibition against their practicing law.

In the State of Tennessee, judges must maintain a law license.[1] It is the privilege of holding this law license that the General Assembly has sought to tax. It is important to recognize that the tax has been determined to be a tax on the privilege of having been granted a license and "not a tax upon the actual practice" of such an occupation in Tennessee. *Simmons v. Johnson*, 1998 WL 321572 (Tenn. Ct. App., June 19, 1998). The tax, therefore, functions as a licensing tax, regardless of whether the license-holder chooses to exercise the privilege that has been granted. *Id.*

Some have argued, however, that the tax is inapplicable to judges and chancellors because Tenn. Code Ann. §17-1-105 prohibits them from practicing law. We find this argument unpersuasive. As indicated above, the Professional Privilege Tax does not tax the "practice of law," but rather the privilege of holding a law license. Thus the statute imposes the tax upon licensure, without regard to the extent to which one exercises the privilege that has been granted during the year. Nevertheless, the tax scheme does exempt persons who are inactive or retired according to the

[1] Tenn. Code Ann. §17-1-106 provides that "judges of the supreme court, court of appeals, chancery courts, circuit courts, and criminal courts, and courts exercising the jurisdiction imposed in one (1) or more of the last three (3) named courts, shall be learned in the law, which must be evidenced by the judge being authorized to practice law in the courts of Tennessee." Tenn. Code Ann. §16-15-5005 states that general sessions judges "shall be licensed to practice law."

regulations of the appropriate licensing board, and who have therefore surrendered their right to practice. In this regard, Tenn. Code Ann. § 67-4-1708(a) provides:

> The privilege tax levied by this part upon the privilege of engaging in certain occupations requiring registration or a license do[es] not apply to a person so registered or licensed, if the person is inactive or retired pursuant to the regulations of the appropriate licensing board.

This provision necessarily implies that the tax applies to all licensed individuals who are not inactive or retired, or whose licensing board has not established such a status.

All attorneys holding an active license issued by the Tennessee Supreme Court are subject to the annual tax levied by § 67-4-1702(a)(5). The tax applies without regard to the manner in which an attorney has chosen to utilize that license. Whether the attorney engages in private practice, corporate practice, government practice, or pursues a different line of work altogether, the tax applies if the individual maintains an active law license. The tax applies if the licensed attorney takes down her shingle but maintains her license on the chance that she might want to practice actively at a later time. In administering the tax, the Commissioner of Revenue is bound to consider only that a current license exists and need not take note of how it has been used, unless the lawyer has been classified by the Supreme Court as retired or inactive.

It might appear, at first glance, that because judges are barred from the practice of law that they might be classified as retired or inactive for the purposes of licensure in Tennessee. However, judges in Tennessee must maintain a law license to serve as a judge. Tenn. Code Ann. §§17-1-106 and 16-15-5005. It does not appear that a judge could be considered retired or inactive and still meet the qualifications for judgeship in Tennessee. Because judges maintain active law licenses, they are subject to the Professional Privilege Tax.

III. <u>Payment of the tax on behalf of judges is prohibited.</u>

In order to make plain that employers could pay the Professional Privilege tax on behalf of the affected employees, the recent General Assembly amended Tenn. Code Ann. §67-4-1709(a) by passage of 2003 Senate Bill 1874/House Bill 1991 (This opinion will assume that the bill will not be vetoed by the governor and becomes law). This statute now states:

> Each individual licensed or registered to engage in a vocation, profession, business, or occupation listed in §67-4-1702(a) shall be liable for the tax. Any employer, including any governmental entity, may choose to remit the tax imposed by this part on behalf of persons subject to the tax who are employed by such employer.

This provision is in keeping with an opinion previously issued by this Office which states that, generally, there exists no constitutional or statutory impediment to payment of the professional

privilege tax by State agencies. Op. Tenn. Att'y Gen. No. 95-061 (May 26,1995). While this proposition is still generally true, a question has arisen regarding payment of the Professional Privilege Tax on behalf of judges. Tennessee Constitution. Art. VI, Sec. 7 provides:

> The judges of the Supreme or Inferior Courts, shall, at stated times, receive a compensation for their services, to be ascertained by law, which ***shall not be increased or diminished during the time for which they are elected***. They shall not be allowed any fees or perquisites of office nor hold any other office of trust or profit under this State or the United States.

(emphasis added). It seems clear that payments made by the State directly to a judge would constitute an increase in a judge's compensation. But if the State decides to pay a tax on behalf of a judge, should that payment be considered "compensation"?

The term "compensation" is not defined in Tennessee's Constitution and only sparingly in Tennessee case law. In *United States Fidelity and Guaranty Co. v. Union Railway Co.*, 182 Tenn. 412, 416, 187 S.W.2d 615 (1945), *reh'g denied* (1945), while interpreting a different statutory scheme, the Tennessee Supreme Court concluded that the term "compensation" connotes broadly remuneration, satisfaction for an outlay, or loss suffered. The federal government has defined "compensation for services" to include fees, commissions, fringe benefits, and similar items. 26 U.S.C.A. §61(a)(1). While it appears that payment of a tax on behalf of an employee might be considered a fringe benefit, neither of these definitions of compensation clearly addresses the situation at hand. We then turn to case law to determine what courts have considered to be compensation to an employee.

Generally, payments from employers are considered to be compensation to employees when made on their behalf. "Where an employee has received payments in cash or kind from his employer in addition to his agreed salary there is a strong presumption that such payments are additional compensation and taxable to the employee." *Lee v. United States*, 219 F.Supp. 225 (W.D.S.C. 1963). Further, "payment of an additional sum by an employer to an employee carries a strong presumption that it is for services rendered." *Poorman v. Commissioner of Revenue*, 131 F.2d 946 (9th. Cir. 1942).

In *Old Colony Trust Co. et al. v. Commissioner of Internal Revenue*, 279 U.S. 716, 49 S.Ct. 499, 73 L.Ed. 918 (1929), an employer had been paying the income taxes due upon the salaries of all the officers of the company. The Board of Tax Appeals determined that these payments by the employer were taxable income to the employee. The Supreme Court agreed, holding that "[t]he discharge by a third person of an obligation to him is equivalent to receipt by the person taxed." *Id.* at 729. While this case concerned an income tax, it is difficult to see how a privilege tax would not be viewed in like fashion. Further, when one considers the strong presumption that payments from an employer are compensation, it becomes clear that payment by the judicial branch for judges' Professional Privilege Taxes must be considered additional compensation.

In addition, courts have consistently held that payment of insurance premiums by an employer constitutes income to the employee. Insurance premiums and professional privilege taxes are similar in the sense that both provide a benefit to the employer and employee and both are paid in the course of employment. In *Lee*, 219 F.Supp. 225 (W.D.S.C. 1963), the employer paid the insurance premiums for an employee and the benefits arising under the policy were for the benefit of the employee. The court held that the amount paid as premiums was additional compensation for the employee's services. *Id.* at 227. *See also Kane v. City of Flint*, 342 Mich. 74, 69 N.W.2d 156, 158 (1955); *State ex rel. Parsons v. Ferguson*, 46 Ohio St.2d 389, 348 N.E.2d 692, 694 (1976).

This office also examined a similar question with regard to members of public utility boards. Op. Tenn. Att'y Gen. No. 94-005 (January 13,1994). All members of public utility boards were directed by statute to serve without compensation. This office opined that payment of health insurance premiums on the members' behalf would constitute compensation and would be prohibited by statute. *Id*.

Consequently, we believe that payment of the Professional Privilege Tax on behalf of judges by the judicial branch would constitute increased compensation to the judges and violate Article VI, Sec. 7 of the Tennessee Constitution. Tenn. Code Ann. §67-4-1709(a) makes clear that the liability to pay the Professional Privilege Tax is that of the individual, and not the employer or any other entity. Furthermore, we have located no cases which would tend to overcome the presumption that these types of payments are compensation to the employee.

IV. The increase in the tax is not a decrease in a judge's compensation.

On September 1, 1998, when all Tennessee judges began their current terms of office, the Professional Privilege Tax was two hundred dollars ($200) per year. On July 15, 2002, the amount of the tax was increased from two hundred ($200) to four hundred dollars ($400) and full-time state employees were excluded from payment. Before the first payment became due under the new provisions, the General Assembly repealed the full-time state employee exemption, and allowed employers to make the privilege tax payments on behalf of employees.

One might then ask, if a payment of the tax on behalf of the judges is considered compensation, is not the increase in the amount of the tax (from $200 to $400) a decrease in the judge's compensation?

Central to this theory that increased taxes create decreased compensation is the fact that the State both taxes its employees and provides compensation to them for their services. When monies flowing to and from an employee and the State are considered, a tax increase increases the funds of the State and necessarily depletes the resources of the employee.

However, an employee's personal resources and his or her compensation for services are entirely different concepts. A tax may decease an individual's net worth, but his or her compensation remains unchanged. In other words, there is no direct relationship between

compensation and taxation such that an increase in one dictates a decrease in the other, even if the tax seeks to tax the privilege of having a license to perform a certain type of work. Likewise, a lawyer working for the Tennessee Bar Association does not suffer a decrease in compensation when the Bar raises the cost of mandatory CLE courses. Taxation and judicial compensation must be treated as separate concepts.

To view this matter otherwise would suggest that judges would not be subject to tax increases of any kind. Any state tax would necessarily decrease a judge's compensation when the tax was raised. We do not believe that Article VI, Section 7, the Tennessee Constitution can be read in this manner.

Based upon the foregoing, we must conclude that the $200 increase in the Professional Privilege Tax does not create a $200 decrease in judges' incomes.

V. Conclusion.

The Professional Privilege Tax is a levy upon the possession of a license and not upon the practice associated with the license. As such, judges are subject to the Professional Privilege Tax. The judiciary may not begin making payments of this tax on behalf of the judges during their present terms in office. This State's taxing power is separate from judicial compensation and as such, Article VI, Section 7 of the Tennessee Constitution does not shield judges from increases in the Professional Privilege Tax.

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