



# *Supreme Court of Tennessee*

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**FOR IMMEDIATE RELEASE**

July 24, 2009

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## **Supreme Court Rules Statute Taxing Unauthorized Substances Unconstitutional**

**Nashville, Tenn.** - In a 3-2 decision, the Tennessee Supreme Court upheld rulings by the Loudon County Chancery Court and the Eastern Section of the Court of Appeals, each of which had struck down a statute designed to impose a tax on controlled substances. In an opinion that left open the prospect of remedial legislation, the state's highest court ruled that the current statutory language could not be classified as a tax on "merchants, peddlers, and privileges," which constitutes the extent of the State's power to tax under article II, section 28 of the Tennessee Constitution.

In the case of Waters v. Farr, Justice Gary R. Wade, who wrote for a majority composed of Chief Justice Janice M. Holder and former Chief Justice William M. Barker, first observed that the statute at issue was designed to impose a tax only upon those who "possess" illegal substances and not upon sellers or those with the intent to sell – "merchants" or "peddlers." The Court also concluded that because the possession of controlled drugs was a crime and specifically prohibited by statute, the taxing statute did not fall within the "privilege" category of the state's taxing powers. Finally, the Court rejected claims that the legislation violated constitutional due process and federal and state protections against self-incrimination and double jeopardy, therefore giving the General Assembly the ability to further refine the statute to bring it within the state's taxing powers.

Steven Waters, then 51 years of age, paid \$12,000 for almost 1,000 grams of cocaine from an undercover agent in Knox County in April of 2005, and was subsequently assessed a tax of more than \$55,000. Later, the contents of his bank account were seized by the Department of Revenue. Although Waters was eventually convicted and sentenced for his purchase of the illegal drugs, he first filed suit challenging the constitutionality of the taxing statute. In 2006, Chancellor Frank Williams ruled that the legislation failed to afford due process to Waters and breached his right not to incriminate himself.

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The Court of Appeals unanimously affirmed the Chancellor’s decision but on different grounds, holding that the constitution permitted only a tax on “privileges”, and, because possession of controlled substances was a crime, the state had not granted Waters any “privilege” to possess cocaine.

On appeal to the Tennessee Supreme Court, the state had argued that even if the authority to tax did not fall within the “privilege” powers, Waters might be classified as a “merchant” or “peddler” – separate grounds for taxing authority by the state – an issue not addressed in either the Loudon Chancery Court or the Court of Appeals.

Justice William C. Koch, Jr., joined by Justice Cornelia A. Clark, would have upheld the new tax. In an opinion concurring in part and dissenting in part, Justices Koch and Clark disagreed with the majority opinion that determined the tax exceeded the legislature’s power to tax “merchants” or “peddlers.” The dissenting justices concluded that the tax could be constitutionally applied to drug dealers under the merchants and peddlers clause of article II, section 28 of the Tennessee Constitution.

Several other state legislatures have attempted to establish a tax on the possession or sale of controlled substances with mixed results. Constitutional challenges have often been successful, but Tennessee’s General Assembly crafted a statutory scheme similar to one that has been upheld in North Carolina. The state constitution in North Carolina does not have a “merchants, peddlers, and privileges” clause, but does explicitly permit a state income tax.

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