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THE TAXATION OF REAL ESTATE SUBJECT TO MORTGAGE AND OTHER INCUMBRANCES

By Robert C. Brown*

The purpose of this paper is to examine the method of taxing real estate which is affected by incumbrances—either physical or legal. In particular, it is desired to consider the situation where the incumbrance is a mortgage or otherwise purely for security. And particular consideration is to be given to the propriety of taxing as real estate the interest of a non-resident mortgagee or similar incumbrancer in land within the jurisdiction.

Valuation of Real Estate for Tax Purposes

The rule is well recognized that real estate is to be valued for purposes of taxation at its actual and present market value. Prospective value is not to be considered, except in so far as it would be reflected in present value; nor is a higher value which might conceivably be realized by selling the property on a time basis. Even more clearly, a mere speculative value cannot properly be considered. A rather amusing example of this last principle appears in a New York case. Here the question was the tax assessment of hillside land in the City of New York. The hill was so steep as not to be suitable for building purposes, so that the land had very little present value. The city tax authorities contended, however, that it should be assessed upon a theoretical valuation, on the assumption that building sites should be blasted out of the side of the hill, suggesting that the cliffs at the back of the houses could be covered with morning glory vines so as to give the for-

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1 State v. Illinois Cent. R. R. (1861) 27 Ill. 64; Somes v. Meriden, (1934) 119 Conn. 5, 174 Atl. 184.

2 State v. Illinois Cent. R. R. (1861) 27 Ill. 64.

3 In re Taxes Bishop Estate. (1923) 27 Hawaii 190.

tunate inhabitants the advantages of living in a bower. The court, unromantically but correctly, dismissed this suggestion as an "iridescent dream," and declined to permit any addition to the value of the lots in their present condition.

The fact that the property cost more to acquire or build than its present market value will not permit it to be taxed at more than such market value,\(^5\) even though it appears that such excess expenditures were justified from the business standpoint.\(^8\) It is obvious that a property owner will often spend more for a home or even a business building which will be suitable to his own purposes and tastes than the property can possibly be expected to sell for. And a fortiori, property which has been inefficiently or extravagantly constructed cannot be taxed upon the basis of what has been spent for it, but only for what it will bring.\(^7\) No doubt such extravagance should generally be discouraged, but the inevitable loss to the property owner will be sufficient for that purpose, without saddling him with an eternal tax burden entirely out of proportion to the value of the property. On the other hand, the fact that the property is not now being used to its full capacity, or as advantageously as is reasonably possible, will not reduce the valuation;\(^9\) for it could readily be sold to a person who would be able to make full use of it.

The general rules having thus been laid down, the next problem relates to their application. Here considerable difficulties frequently arise. Ordinary commodities are constantly being bought and sold, so that their market value is generally ascertainable with considerable precision. Not so with respect to real estate, which is always, to some degree at least, unique, and which is not transferred very frequently. The best test of market value—namely, actual sales—is therefore generally not available. We must, accordingly, resort to other indications of such value, remembering always that these are mere evidence and therefore not decisive.

For example, the earnings of the property may be considered.\(^9\) Obviously this is not a decisive test,\(^10\) but it is often helpful. In-

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\(^5\)State v. Weiher, (1922) 177 Wis. 445, 188 N. W. 598.
\(^6\)Arlington Mills v. Salem, (1928) 83 N. H. 148, 140 Atl. 163. See also State v. Petrick, (1920) 172 Wis. 82, 178 N. W. 251.
deed, if the property is fully rented, and the rentals are on the usual terms in the community, such rentals may constitute a sufficiently accurate measure of the market value.\textsuperscript{11}

Similarly, cost of reproduction, while by no means decisive, may nevertheless be valuable evidence of the market value.\textsuperscript{12} Furthermore, other possible uses of the property than that in which it is presently employed may also be pertinent in this connection.\textsuperscript{13} In fact, any evidence which has a legitimate bearing upon the market price of real estate is properly to be considered in seeking to attain a fair estimate of its market value, which is the proper criterion for tax purposes.\textsuperscript{14}

In some special cases, there has been an intimation that the taxing value may deviate from the market value; but it is believed that such suggestions cannot be followed. It has been held that the valuation of submerged land is to be computed with reference to the cost of filling.\textsuperscript{15} This seems to be correct, since no one would purchase the land (other than purely as a speculation), except at a price which would enable him to incur the additional expense of filling the land, and still have a total investment not in excess of the then value of the land.

In another case,\textsuperscript{16} the New York courts had under consideration the proper assessment of the New York Stock Exchange Building. The owner insisted that the building constituted an incumbrance upon the land, because it was unusable for any other purpose whatever, and would, therefore, be unsalable except to a person who was willing to assume the additional burden of tearing down or at least radically altering the building. The court held, however, that the New York tax law required assessments at the "full" value, and that this statute applied even though there was no market value. It was decided that the cost of the building, the cost of reproduction, and other similar data might be considered in computing this "full" value.

It is submitted, however, that "full" value can mean nothing more than market value. Probably the actual decision is correct, for the building can hardly be considered as a real incumbrance on the land. Certainly it could be altered for other purposes, and

\textsuperscript{11}Somes v. Meriden, (1934) 119 Conn. 5, 174 Atl. 184.
\textsuperscript{12}People v. Kalbfleish, (1898) 25 App. Div. 432, 49 N. Y. S. 546.
\textsuperscript{16}People v. Cantor, (1927) 221 App. Div. 193, 223 N. Y. S. 64.
the value of the materials, etc., might much more than take care of such additional cost. It would appear, then, that the building itself, as well as the land, has a market value, though undoubtedly such value would be difficult to estimate. The decision, therefore, should not be regarded as an authority that anything other than market value is the proper criterion for tax assessments. Certain it is that real estate cannot be assessed higher because of some special value which it may have to its present owner;\textsuperscript{17} nor can it be increased in assessed value merely because it is used by its owner in connection with other property also owned by him.\textsuperscript{18}

Coming a step closer to our fundamental problem of encumbered land is the situation where the land is subdivided horizontally, as, for example, by the sale of mineral rights. This is not the same as a division of mere interests in land, as by dividing estates or creating incumbrances. Land may be divided horizontally as well as vertically, and when that is done, we have actually different pieces of real estate, one above the other rather than side by side, as is the more usual situation. When such a division exists, it is not merely proper to tax the different pieces of real estate separately, but, in fact, the weight of authority is that the state must do so. With reference to this matter, the supreme court of Louisiana has said:

“A sale of a landowner's mineral rights, either in whole or in part, is therefore an alienation of a part of his interest in the land. It is a dismemberment of his ownership... In that respect it is more like a sale of an undivided interest in the land than like the imposing of a mortgage or an ordinary lease upon the land. A mortgage or an ordinary lease is not a transfer of any element of ownership in the property mortgaged or leased. For that reason mortgages and ordinary leases are not subjected to taxation by the Revenue Law.”\textsuperscript{19}

A so-called mineral “lease” is, according to the laws of most states, actually a sale of the minerals in place, and the owners of the minerals and of the royalty interests must be separately taxed upon their respective properties.\textsuperscript{20} Even non-mineral leases are


\textsuperscript{18}Davidson v. Board of Review, (1930) 209 Iowa 1332, 230 N. W. 304.

\textsuperscript{19}Shaw v. Watson, (1922) 151 La. 893, 92 So. 375, 378.

sometimes treated in the same way; but here we seem to have an incumbrance problem rather than one of physical division.

Even closer to our problem, though considering it from the opposite viewpoint, is the situation of land to which valuable appurtenances—for example, an easement across other land—are added. It would seem clear that such appurtenances add to the market value of such land, and therefore to its tax value. The supreme court of New Hampshire has said with reference to this:

"Easements are taxable; if appurtenant, they are in general taxed with and as a part of the land to which they belong. Easements in gross must necessarily be valued and taxed separately from the land out of which they are granted."

So, if water power is generated upon land, this addition to its value may be included in tax assessments, even though the power is actually used in another taxing subdivision of the state, or in another state.

The same idea has led to decisions that franchises under which business activities are conducted on the land in question are to be included in the valuation of the land. This seems correct enough if, in fact, the land cannot be sold apart from the franchise—as would ordinarily be the case with respect to railroads and perhaps other utilities. If, however, the land could reasonably be sold to one who did not hold such a franchise or who did not conduct such a business upon it, the franchise cannot properly be considered a part of the land, and cannot, therefore, be taxed as such. The obvious solution, to avoid the escape from tax of the franchise, is to impose an excise tax with respect to it. In fact, at the present time, nearly all such franchises are thus taxed, and no attempt is made to tax them as part of the land—an expedient which, however theoretically justifiable, is obviously clumsy and usually unjust.

If valuable appurtenances add to the value of land, it would

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23 Winnipesaukee Lake etc. Co. v. Gifford, (1887) 64 N. H. 337, 10 Atl. 849, 850.
24 Whiting-Plover Paper Co. v. Liuwood, (1929) 198 Wis. 590, 225 N. W. 177.
26 Stein v. Mobile (1850) 17 Ala. 234; Mobile v. Stein, (1875) 54 Ala. 23; Chicago, etc., Ry. v. State, (1906) 128 Wis. 553, 108 N. W. 557.
27 See Northern Pac. Ry. v. State, (1915) 84 Wash. 510, 147 Pac. 45.
28 State v. Petrick, (1920) 172 Wis. 82, 178 N. W. 251. See also, Davidson v. Board of Review, (1930) 209 Iowa 1332, 230 N. W. 394.
seem, by the same token, that unfavorable physical conditions would reduce its valuation. For example, a structure on the land which was actually an incumbrance upon it should reduce its value.\textsuperscript{29} It has been held, however, that where the owner of land valuable for water power purposes floods it for the purpose of developing power on other lands, the land first referred to is to be taxed on the basis of its potential value for generating power.\textsuperscript{30} This doctrine seems at least partly unsound. It is true that such property is, or may be, salable, but only at a reduction of the cost of draining off the water and putting the land in such shape as to develop its power. It seems clear that at least the market value is greatly diminished by the present flooding of the land. The courts seem to feel that a land owner should not be permitted to reduce the value of his land to escape taxes, but it is hardly to be supposed that a property owner will, at least under ordinary circumstances, actually destroy his property merely for this purpose.

It seems fairly obvious, however, that the total valuation of the various interests in a piece of land cannot be in excess of the value of the land as a whole.\textsuperscript{31} The mathematical axiom that the whole is equal to the sum of its parts is clearly applicable, and the value of a piece of land certainly cannot be increased by dividing it up, physically or otherwise.

It is true, as we have seen, that leaseholds, if actually of substantial value, may be separately assessed;\textsuperscript{32} but such leaseholds obviously constitute an incumbrance upon the landlord's interest in the property, and reduce such reversionary value by the exact amount of the value of the leasehold.\textsuperscript{33} However, a few cases have been found actually, or apparently, inconsistent with the general principle just stated; and such authorities must be briefly considered.

In \textit{Woodburn v. Skagit County},\textsuperscript{34} it appeared that after the lands in question had been assessed for tax purposes, the assessor learned that the owners had rented hunting privileges on the land

\textsuperscript{29}See People v. Cantor, (1927) 221 App. Div. 193, 233 N. Y. S. 64.
\textsuperscript{32}See the cases cited in note 21.
\textsuperscript{34}(1922) 120 Wash. 58, 206 Pac. 834.
for $375 a year. He thereupon added to the previous assessed valuation, which had been computed upon the basis of purely agricultural use, an additional amount on account of the hunting privileges. This action of the assessor was approved by the court. It is believed this case is rightly decided, even though there is some language indicating that the additional use of the land permitted an assessment at more than its actual value. The truth would seem to be that the land was under-assessed at the start, and that the rental of hunting privileges merely evidenced this, rather than permitting the assessment of the land at more than its actual value. Land which in addition to its use for agricultural purposes can be rented for its hunting privileges is actually more valuable than if its use were restricted to agriculture alone.

It has also been held by the supreme court of Michigan that the "mortgage" on land may be assessed in addition to the value of the land as unmortgaged. This problem will be considered more at length hereafter, but it seems clear that a mortgage on land reduces the value to the mortgagor, though the amount of such reduction may not be readily ascertained. The tax on the "mortgage," therefore, cannot be sustained as a tax on the land, though it may well be sustained as a tax upon the debt owed to the mortgagee. The same court later admitted this with respect to a tax on a vendor's lien, which is economically equivalent to a purchase-money mortgage, though in this case treating the tax as an excise rather than a property tax.

The most troublesome cases in this category are two decisions by the supreme judicial court of Massachusetts, Lodge v. Swampscott, and Donovan v. Haverhill. In the former case, the plaintiff bought land which was subject to certain equitable restrictions, such restrictions diminishing the market value of the land. It was held that the land could be assessed only at the market value, subject to these restrictions. This seems obviously correct, and is in accordance with the theory already stated that the various interests in land, if assessed separately, cannot exceed the valuation of the land as a whole. It is true that equitable restrictions are rarely separately assessed because of the uncertainty of their value; but where they are so assessed, such assessed value must be deducted from the value of other interests in the land.

(1913) 216 Mass. 260, 103 N. E. 635.
(1923) 247 Mass. 69, 141 N. E. 564.
In *Donovan v. Haverhill*, however, the plaintiffs' land was reduced in value to them by subsisting leases, which they had given, for rents now inadequate. It was held that the city was justified in assessing the land at its full value without regard to the leases. The court attempted to distinguish *Lodge v. Swampscott*, though the attempt seems to have been neither very clear nor very successful. The *Donovan Case* has been adversely criticized,\(^3^9\) on the ground that such a result is unfair to the land owner.

As will presently appear, there are some situations where the taxing authorities are entitled to tax the land as a whole without regard to incumbrances upon it. But this does not seem to be such a case, as the landowner is in fact being taxed upon someone else's property, exactly as if he sold the mineral rights upon land and then were taxed upon the value of the land without regard to such sale.\(^4^0\) Possibly the two Massachusetts cases can be distinguished on the ground that in the *Lodge Case* the valuation was not reduced by the voluntary act of the present owners of the land, whereas in the *Donovan Case* it was. However, the court makes nothing of this distinction, and, on analysis, it does not seem to be sound, as the value of the land in both cases has been actually diminished. Besides, in the *Donovan Case* the lessees were, or at least ought to have been, subject to tax upon their own interests. It is therefore impossible to resist the feeling that the latter case is unsound.

**The Deduction of Incumbrances on Land**

It has been seen that if incumbrances on land are separately assessed for taxation, their valuation must be deducted from the value of the interest in the land subject to such incumbrances. However, there may be some question as to the necessity for such deduction at all. Some sorts of incumbrances certainly need not be deducted and separately assessed if the taxing jurisdiction does not desire to do so.\(^4^1\) It would seem, however, that incumbrances actually affecting the possession or use, and therefore necessarily affecting the value of land, should be deducted. Thus, as already seen, the value of leases on the land which diminish the value of the lessor's interest should be deducted.\(^4^2\) And a servient estate

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\(^3^9\)See (1924) 24 Col. L. R. 324.

\(^4^0\)See the cases cited in note 20.

\(^4^1\)See 3 Cooley, Taxation, 4th ed., sec. 1161.

\(^4^2\)In re Taxes Bishop Estate, (1923) 27 Hawaii 190.
should be assessed at its value subject to easements, this value being added to the assessment of the dominant estate.43

Quite otherwise, however, is the situation with regard to incumbrances merely for security, of which mortgages are the typical example. Here, neither the possession nor the use of the property is immediately affected, and the taxing jurisdiction is therefore under no obligation to deduct the value of the incumbrances—which value is very difficult to ascertain anyway. It is certainly not necessarily the amount of the debt secured, since the debt may be, and frequently is, paid without resorting to the land.

The leading case on this point is *Paddell v. New York,*44 where it was held that a mortgagor was not entitled to a deduction from the assessed value of his property of the amount of the mortgage debt. The court, speaking by Mr. Justice Holmes, buttressed its reasoning not only upon the practical consideration already stated—namely that the amount to be deducted is really unascertainable—but also upon the important historical consideration that mortgaged land has from the earliest times generally been so assessed. And the practical necessity, or at least convenience, of the taxing power was given due weight in the following statement:

"And it may perhaps be doubted whether there is even a logical objection to the sovereign power giving notice to all persons who may acquire property within its domain that when it comes to tax it will not look beyond the tangible thing, and that those who buy it must buy it subject to that risk."45

The doctrine that no deduction need be made from the assessment of real property for taxation because of mortgages upon such property has been reiterated in a number of cases.46 It has even been held that the mortgagor is not entitled to the deduction when he is no longer in possession, but no foreclosure has been effected.47 Nor is it material that the mortgage indebtedness exceeds the value of the land so that the equity of redemption is probably of no value at all.48 Of course this means that under this procedure the mortgagee has no taxable interest in the land, and if he is

44(1908) 211 U. S. 446, 29 Sup. Ct. 139, 53 L. Ed. 275.
45(1908) 211 U. S. 446, 450, 29 Sup. Ct. 139, 53 L. Ed. 275.
to be taxed, it must be on some other basis—generally a property tax upon the indebtedness owed to him. The doctrine has not always been applied in inheritance tax cases, but here the situation is somewhat different, as the tax is to be measured not by the value of the land, but by the value of the interest of the deceased mortgagor—which obviously cannot exceed the value of the equity of redemption.

Ordinarily, of course, the mortgagee has no obligation to pay the taxes on the property, and it would seem that he generally has no duty to refrain from purchasing it at a tax sale without affecting the lien of his mortgage. He may also claim against the mortgagor for taxes paid by him on the premises, unless, indeed, a suit to foreclose is barred by the statute of limitations. If, however, the mortgagee has foreclosed and bought in the premises, he is liable for all real property taxes thereafter assessed.

Nevertheless, a number of states do have a provision by which the mortgagee's interest in real property is taxed separately. In some jurisdictions the whole amount of the mortgage indebtedness is deducted from the value of the property, and only the remainder taxed to the mortgagor, the value up to the mortgage debt being taxed to the mortgagee. In others the amount of the deduction from the mortgagor's interest is limited by the statute to a definite maximum amount. In either case, there can be no serious question as to the validity of such a provision, at least so far as resident mortgagees are concerned.

While the state would not lose any revenue through this expedient, because the taxes which are saved to the mortgagor must generally be paid by the mortgagee, yet the deduction has been allowed when the mortgage was to the state which, of course, is not subject to tax. However, some statutes are so drawn as to pre-

51See 2 Jones, Mortgages, 8th ed., sec. 1538.
52In re May, (1907) 218 Pa. St. 64, 67 Atl. 120.
53Hill v. Townley, (1891) 45 Minn. 167, 47 N. W. 653.
56People v. Board of Supervisors, (1888) 77 Cal. 136, 19 Pac. 257; Smith v. Keagle, (1888) 78 Cal. 4, 20 Pac. 152. See also Grand Lodge, etc. v. Sarpy County, (1916) 99 Neb. 647, 157 N. W. 344, holding that the statute applies, so that the mortgage can be taxed on his interest in the land even though the debt itself was non-taxable.
clude this result, the provision being for the deduction of the mortgage debt, or a part thereof, only when the mortgagee is subject to state taxation. In some cases the provision for such deduction is not made applicable to railroad and other corporate mortgages securing bond issues; but there may be some question as to whether this classification complies with the equal protection clause of the federal and state constitutions.

At any rate, the deduction will not be required unless claim therefor is made in accordance with the local statute. It has further been held that even if the proper notice is given and the assessment is nevertheless made solely in the name of the mortgagor to the extent of full value of the land, the assessment is not void, but is merely erroneous as having been made in the wrong name. However, such a statute provides for separate interests of the mortgagor and the mortgagee for this purpose, so that a mortgagee who is compelled to pay all the taxes on the land can recover from the mortgagor only the amount paid upon the equity of redemption. Furthermore, if the mortgage debt exceeds the total value of the land, all of the taxes have to be paid by the mortgagee. The general purpose of these statutes is to require the mortgagee to assume part of the tax burden, and, in fact, some effort has been made in several jurisdictions to preclude an arrangement between the parties to the mortgage by which the entire tax burden is thrown upon the mortgagor. However, it has been, in fact, rather difficult to enforce this requirement.

When it comes to the situation of a non-resident mortgagee, the problem is more difficult. Indeed, for a long time it was considered that any such scheme would be precluded by the famous

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57 State v. Silvers, (1870) 41 N. J. L. 505; Steinfeld v. State, (1930) 37 Ariz. 389, 294 Pac. 834. See also State v. Rowe, (1922) 108 Neb. 232, 188 N. W. 107, upholding a change of the statute, bringing about this result.


59 Russell v. Croy, (1901) 164 Mo. 69, 63 S. W. 849. It would seem, however, that there is sufficient difference between corporate mortgages securing negotiable bonds and ordinary mortgages to justify this difference in treatment. Chicago, etc., Ry. v. State, (1906) 128 Wis. 553, 108 N. W. 557.


61 Polomares Land Co. v. Los Angeles County, (1905) 146 Cal. 530, 80 Pac. 931.

62 Savings & Loan Soc. v. Davidson, (C.C.A. 9th Cir. 1897) 38 C. C. A. 365, 97 Fed. 696, construing the law of California.


64 See Russell v. Croy, (1901) 164 Mo. 69, 63 S. W. 849.
Case of the State Tax on Foreign-Held Bonds.\textsuperscript{65} This case held unconstitutional a Pennsylvania statute imposing a tax upon interest paid by a domestic corporation upon bonds held by non-residents, such bonds being secured by a mortgage upon real estate in Pennsylvania. The court took the position that the bondholders had no property in Pennsylvania, saying as to this:

“"The property mortgaged belonged entirely to the company, and so far as it was situated in Pennsylvania was taxable there. If taxation is the correlative of protection, the taxes which it there paid were the correlative for the protection which it there received. And neither the taxation of the property, nor its protection, was augmented or diminished by the fact that the corporation was in debt or free from debt. The property in no sense belonged to the non-resident bondholder or to the mortgagee of the company. The mortgage transferred no title; it created only a lien upon the property. Though in form a conveyance, it was both at law and in equity a mere security for the debt.

"Such being the character of a mortgage in Pennsylvania, it cannot be said, as was justly observed by counsel, that the non-resident holder and owner of a bond secured by a mortgage in that state owns any real estate there. A mortgage being there a mere chose in action, it only confers upon the holder, or the party for whose benefit the mortgage is given, a right to proceed against the property mortgaged, upon a given contingency, to enforce, by its sale, the payment of his demand. This right has no locality independent of the party in whom it resides. It may undoubtedly be taxed by the state when held by a resident therein, but when held by a non-resident it is as much beyond the jurisdiction of the state as the person of the owner."\textsuperscript{66}

The court also argued that such a tax impaired the obligation of the contract between the corporation and the bondholders.

The reasoning of the court, in so far as it is based upon the contracts clause of the constitution, is demonstrably false and has been clearly repudiated. It is entirely clear that the state had never agreed not to tax this interest. Furthermore, the argument quoted above, that the bondholders had no property in Pennsylvania, because a mortgage does not constitute an interest in real estate, is likewise entirely unsound. This will be dealt with more fully hereafter. The true justification of the decision is that the tax which Pennsylvania sought to impose was actually upon the debt, and the debt is to be regarded as situated, for tax purposes, at the domicile not of the debtor but of the creditor.\textsuperscript{67} Therefore, Pennsylvania had no jurisdiction to impose this tax.

\textsuperscript{65}(1872) 15 Wall. (U.S.) 300, 21 L. Ed. 179.
\textsuperscript{66}15 Wall. (U.S.) 300, 322-23, 21 L. Ed. 179.
\textsuperscript{67}See Brown, Multiple Taxation by the States—What Is Left of It, (1935) 48 Harv. L. Rev. 407.
These fallacies of the Case of the State Tax on Foreign-Held Bonds were successfully demonstrated in 1892 by the Michigan supreme court in Common Council v. Board of Assessors. This case upheld a statute requiring the mortgagor's and the mortgagee's interests in land to be separately assessed, though the mortgagor was to be held liable for the entire tax if it was not collected from the mortgagee. The court stated that there was no injustice to the mortgagor in this, since, except for the special statute, the mortgagor would have to pay the entire tax anyway. The reasoning of the State Tax on Foreign-Held Bonds Case, to the effect that a mortgage is not an interest in land, is effectively rebutted in the following statement from the prevailing opinion:

"But, while it is true that the mortgage is a mere security for the debt, yet it conveys a qualified property in the land. While it is not an estate which entitles the mortgagee to possession before foreclosure, it is nevertheless an estate or interest in lands which is protected by our registration laws as fully as any other title or interest.""}

The same doctrine, that a non-resident mortgagee may be taxed on his interests in land situated within the taxing jurisdiction, was finally approved by the federal Supreme Court in the leading case of Savings and Loan Society v. Multnomah County. Here an Oregon statute, providing for such taxation, was held to be valid with respect to a California corporation holding a mortgage on Oregon land. The reasoning of the Case of the State Tax on Foreign-Held Bonds was repudiated by the court, so far as that case had taken the position that a mortgagee has no interest in the land. Pertinent excerpts from the opinion follow:

"If the law treats the mortgagee's interest in the land as real estate for his protection, it is not easy to see why the law should forbid it to be treated as real estate for the purpose of taxation.""
It is to be noted, however, that only the reasoning of the *Case of the State Tax on Foreign-Held Bonds* was repudiated; the actual decision of that case, that only the domicile of the creditor can impose a property tax upon debts, still stands and has, in fact, in the last few years, been very strongly reinforced.\(^7\)

It is obvious that such a tax upon a non-resident mortgagor’s interest cannot be imposed without an explicit statute to that effect. In fact, comparatively few jurisdictions now attempt to do it. But if *Savings and Loan Society v. Multnomah County*\(^6\) is still to be recognized as in good standing, any state may, at its discretion, impose such a tax. This problem must therefore be considered.

### The Problem of Multiple Taxation

As has already been pointed out, the problem of multiple taxation is often presented in inheritance tax cases as well as in property tax cases;\(^7\) yet this particular problem is rarely presented in such cases. If the mortgagor dies, the inheritance tax may undoubtedly be measured by the entire value of the land, without respect to the mortgage;\(^8\) though of course only land within the taxing jurisdiction can be used as a measure of any inheritance tax. Generally, however, an allowance is made for the indebtedness, even though the mortgagor was a non-resident.\(^9\) If the mortgagee dies, only one or two states have even apparently asserted the right to impose an inheritance tax with respect to the transfer of his interest, if he was a non-resident.\(^8\) But this obviously raises the same fundamental problem, more frequently presented in the property tax cases here considered.

The first step toward the solution of this problem is to ascertain

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\(^{75}\)See Brown, *Multiple Taxation by the States—What is Left of It*, (1935) 48 Harv. L. Rev. 407. The opinion of the Maryland court in *Allen v. National Bank*, (1901) 92 Md. 509, 48 Atl. 78, that the *Savings & Loan Soc. Case* wholly overrules the *State Tax on Foreign-Held Bonds Case*, is shown to be false by the opinion in the former case itself. See also *Musgrove v. Baltimore, etc., R. Co.*, (1909) 111 Md. 629, 75 Atl. 245.\(^{76}\)

\(^{77}\)See *Baldwin v. Missouri*, (1930) 281 U. S. 586, 50 Sup. Ct. 436, 74 L. Ed. 1056.\(^{77}\)

\(^{76}\)See *In re Hallenbeck*, (1921) 231 N. Y. 409, 132 N. E. 131.


\(^{80}\)In *In re Stanton*, (1905) 142 Mich. 491, 105 N. W. 1122, such a claim was made, but the tax was apparently really measured by the notes held by the non-resident; and such a tax is clearly not now permitted. Of course, notes or other evidences of indebtedness held by a resident decedent may be included in the measure of inheritance tax upon his estate, even though such indebtedness is secured by mortgage on land outside the state. *State v. Probate Court*, (1920) 144 Minn. 155, 176 N. W. 493.
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the nature of the mortgagee's interest. If it is an interest in land, it would seem that such interest can properly be taxed by the jurisdiction where the land is, even though the mortgagee is a non-resident.

It is submitted that the mortgagee's interest is an interest in land, and this irrespective of the particular theory of mortgages which the state purports to follow. The federal Supreme Court has said:

"A brief definition of a mortgage under modern law is not easy to make. At common law a mortgage was a conditional conveyance to secure the payment of money or the performance of some act, to be void upon such payment or performance. By more modern law and under the statutes of many states a mortgage is a mere lien upon land. Its dominant attribute is security, but nevertheless it must be regarded as 'both a lien in equity and a conveyance at law.' Pomeroy, § 1191. The interest of a mortgagee in the land is therefore conveyed to him by the mortgagor, and even if under the laws of Montana a mortgage is primarily security for a debt and creates a lien only, it is a lien which may become the title. The decree of the court conveying the title is, of course, the act of the law, but it is the act of the law consummating the act of the mortgagor. And the sale and deed relate to the date of the mortgage, conveying the title which was then possessed by the mortgagor."

The same doctrine is followed explicitly even in states like New York, which have gone farthest in enunciating the so-called "lien" theory of mortgages. There may be some question as to the exact nature and effect of the mortgagee's interest, but there cannot be any doubt that he has some interest in the land. If he has not, it is impossible to see how he can obtain complete title through a court action without the cooperation of the mortgagor;"

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81United States v. Commonwealth etc. Trust Co., (1904) 193 U. S. 651, 655-56, 24 Sup. Ct. 546, 48 L. Ed. 830. It will be noted that this reasoning also repudiates that which has been quoted from Case of the State Tax on Foreign-Held Bonds, (1872) 15 Wall. (U.S.) 300, 21 L. Ed. 179. The Court has recently invalided the Frazier-Lemke Act in Louisville Joint Stock Bank v. Radford, (1935) 295 U. S. 555, 55 Sup. Ct. 855, 79 L. Ed. 1593, on the ground that the act deprives the mortgagee of his property without due process of law. Thus, it is clear that the court still regards the mortgagee as having a property interest in the mortgaged land.

82Hubbell v. Moulson, (1873) 53 N. Y. 225; Simpson v. Del Hoyo, (1883) 94 N. Y. 189. In both of these cases the court explicitly admits that a mortgage is a conveyance to the mortgagee of an interest in the land; furthermore, the results in both cases cannot be rationalized on any other theory.

83See Gavit, Under the Lien Theory of Mortgages is the Mortgage Only a Power of Sale?. (1931) 15 MINNESOTA LAW REVIEW 147.

84See Durfee, The Lien or Equitable Theory of the Mortgage—Some
for one who has no interest in property whatever cannot obtain title to it without a voluntary conveyance by the owner.\textsuperscript{65} It is clear, therefore, that the mortgage itself is a conveyance of an interest—limited and undefinable, but nevertheless clearly existing—from the mortgagor to the mortgagee.\textsuperscript{66} Upon this interest, it would seem that the mortgagee could constitutionally be taxed.

But is this multiple taxation? No doubt this is an immaterial question when both parties to the mortgage are residents of the taxing state. It is clear that the debt may be taxed to the mortgagee, and the land also be taxed at its full value, either to the mortgagor alone or divided between the mortgagor and mortgagee. From a legal standpoint, at least, there are two pieces of property, namely the debt and the land. Yet the unfairness of this is so evident, at least when it is carried to its logical extreme, that many states have reduced the burden by taxing the creditor only on his "net credits," permitting the deduction of his indebtedness.\textsuperscript{67} This is permitted even when the state constitution forbids exemptions not therein specified, the courts holding that this is no exemption, but merely a deduction preventing taxation upon purely fictional property.\textsuperscript{68} The deduction of indebtedness is permitted, even though it is secured by property in another state.\textsuperscript{69} All this is not directly in point, especially as such a deduction is permitted only by express statutory provision,\textsuperscript{70} but it does indicate that there is danger in assuming the absence of multiple taxation merely because more than one piece of property, in the legal sense, can be found.

\textsuperscript{65}See, for example, State v. Pearson, (1853) 24 N. J. L. 254; Lancaster County v. McDonald, (1905) 73 Neb. 453, 103 N. W. 78.

\textsuperscript{66}Floror v. Sheridan, (1893) 137 Ind. 28, 36 N. E. 365. The mortgage exemption granted in Indiana to the mortgagor is justified by the same reasoning. State v. Smith, (1902) 158 Ind. 543, 63 N. E. 25.


\textsuperscript{68}Occasional dicta to the contrary can still be found, as, for example, in Adams v. Colonial, etc., Mortgage Co., (1903) 82 Miss. 263, 34 So. 482, and Chicago, etc., Ry. v. State, (1906) 128 Wis. 553, 108 N. W. 557. Cf., also, the quotation referred to in note 19. It is believed, however, that practically all modern cases reach a result which is inconsistent with any other theory than that the mortgagee has a real, though limited, interest in the land.

\textsuperscript{69}State v. Pearson, (1853) 24 N. J. L. 254.
Nevertheless, in view of what has been said, it may well be contended that there is actually no multiple taxation under the doctrine of *Savings and Loan Society v. Multnomah County.* The mortgagee, as has been demonstrated, has property within the state wherein the land is situated. Because he has interest in that very land, there seems to be no reason why he should not pay a tax on that interest, if the state desires to exact such a tax, just as any other non-resident is taxed upon land owned by him in the state. If he were a resident, he could also be taxed upon the debt. Since he is a non-resident, this cannot be done; but there seems to be no reason that he should be exempt from tax upon what is within the state's taxing jurisdiction—namely, his interest in real estate within the state. Some courts have conceded that this may result in multiple taxation from an economic standpoint; but such a concession does not apparently affect the validity of the tax upon the non-resident's property in the state.

Yet the concession is itself dangerous, and may prove to be fatal. It cannot be denied that the doctrine of the *Savings and Loan Society Case* inevitably involves multiple taxation in an economic sense. A quotation from the argument of counsel in the Mississippi case of *Adams v. Colonial, etc., Mortgage Co.*, criticizing the *Savings and Loan Society Case*, seems unanswerable from that point of view. This reads as follows:

"The sophistry of this reasoning is very apparent, when we reflect that, on the concession here made by the court, the state where the creditor resides may be taxed [sic] upon the debt secured by the mortgage, and thus he would be liable to double taxation for the same item of property . . . once in his own state on the debt, and once in Oregon on the instrument which evidences and secures it. If further refutation is needed, it is sufficient to point out that a security divorced from the debt which it secures is a phantom, and can have no taxable value."
defending it on the theory that such economic multiple taxation is unobjectionable.97

Furthermore, no matter how liberal the federal Supreme Court may have been in the past, there is little question that it is now tending to invalidate all multiple taxation where more than one state is concerned.98 For all practical purposes, this has been accomplished with respect to tangible property; and the decisions of the past four or five years99 have shown a strong tendency to restrict the taxation of intangible property also to one jurisdiction—namely, that of the owner. Where intangible property consists of a debt, this means that it is taxable only at the residence of the creditor. Accordingly, if the doctrine of Savings and Loan Society v. Multnomah County is to be regarded as sanctioning a tax upon the indebtedness by a state other than that of the domicile of the mortgagee, that case will probably no longer be followed.

With a single exception, the recent cases in the federal Supreme Court, which have definitely shown its hostility to multiple taxation of this sort,100 apparently have not considered this particular problem. The one case which did mention it was Baldwin v. Missouri.101 Mr. Justice McReynolds, at the close of his opinion for the majority in that case, said, apparently rather casually:

"This cause does not involve the right of a state to tax either the interest which a mortgagee as such may have in lands lying therein, or the transfer of that interest."102

It should be noted also that the dissenting opinion of Mr. Justice Stone cited the Savings and Loan Society Case and stated that it should not be deemed to be overruled.103 It must be confessed, however, that since this is in a dissenting opinion, it might well be regarded as some authority that the case so mentioned has, in fact, been discredited.

Prophecy as to the final result in this controversy is necessarily

100 Cited in note 99.
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hazardous. In the writer's opinion, however, the court is likely to adhere to the doctrine of the Savings and Loan Society Case and to continue to hold that a state may constitutionally tax the interest of a non-resident mortgagee as real estate. It is impossible to deny that such a result does involve the possibility of a multiple economic burden—a tax upon the debt at the domicile of the creditor-mortgagee, and a tax upon the mortgagee at the place where the mortgaged land is situated. And it is likewise impossible to deny that the recent cases which have been referred to give sufficient argumentative basis for invalidating such taxation on this very ground.

But the better reasoning seems to be the other way. Granted that the creditor is holding the mortgage merely as security, yet this security constitutes an interest in land within the taxing jurisdiction. If the land tax is to be deemed an additional burden upon the debt, yet it seems economically fair that the creditor should pay this, because of his enjoyment of the additional security. At least it should be within the authority of the state in its discretion to impose such a tax. It is submitted, therefore, that the doctrine of Savings and Loan Society v. Multnomah County is, at least arguably, economically desirable as well as technically sound. The tendency of the federal Supreme Court to invalidate multiple taxation seems on the whole desirable, but it should not be carried so far as to prevent the taxing of an actual interest in real estate merely because that interest happens to be held solely for security.

CONCLUSION.

It has been seen that real estate is to be taxed at its market value—a rule which is really without any exceptions. Where a particular piece of property is held by several persons, either because of physical divisions or by reason of their holding undivided interests, each person is to be taxed according to his own interest. The total of these interests should equal, but not exceed, the value of the property considered as a whole.

If the property is subject to present incumbrances reducing its value to the owner, such valuation should be correspondingly re-

205 See note 99.
206 Cf. the quotation referred to in note 96.
307 There is an exception, of course, where real property is held by a life tenant or other holder of a limited freehold estate. In such a case, the entire property is assessed to the present holder, and no taxes are collected from the remainderman. 3 Cooley, Taxation, 4th ed., sec. 1107.
duced and the incumbrances taxed to their owners—normally, of course, the owners of adjoining land to which such incumbrances are appurtenant. It is well settled, however, that this rule does not apply to incumbrances merely for the purpose of security—of which a mortgage is the typical example. In most jurisdictions, the practice is to tax such land without regard to the incumbrances, and it is entirely settled that such a practice is legally justifiable.

On the other hand, it has been regarded as equally well settled that a taxing jurisdiction may, if it chooses, tax the mortgagee's interest in the land, at a value not exceeding the mortgage debt, separately from the mortgagor's interest, which in that event must be proportionately reduced in value. Such is clearly the doctrine where both parties to the mortgage are subject to the taxing jurisdiction of the state; and there are authoritative decisions to the same effect\(^\text{108}\) even though the mortgagee is a non-resident.

This last doctrine may conceivably contravene a strong, though comparatively recent, line of decisions by the federal Supreme Court to the effect that taxation by more than one state of debts and other intangible property violates the fourteenth amendment of the federal constitution, and that the only jurisdiction entitled to tax debts as property is the domicile of the creditor. It may be urged that a tax upon the interest of the non-resident mortgagee is an economic burden upon the debt and therefore would violate this rule, the debt being clearly taxable at the domicile of the creditor-mortgagee. The technical answer to this argument is that the mortgagee owns an interest in real estate in the taxing state where the land is situated, and should be subject to tax thereon. The more realistic argument seems to be that the mortgagee has an actual benefit through the holding of the security in the taxing state, and there is therefore no very clear economic injustice in subjecting him to this tax. In the opinion of the writer, therefore, the court can, and should, adhere to this doctrine. In that event, a state may, if it chooses, divide the interest of mortgagor and mortgagee in the same real estate, and tax each in proportion to his own interest. By this means, a mortgagee of land within the state may be taxed upon his interest (which cannot exceed the amount of the mortgage debt) even though he is a non-resident of that state and is, therefore, not subject to taxation upon the debt itself. Where it is not done, the mortgagor will, of course, be taxable upon the entire value of the land.