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Robert C. Brown

Indiana University School of Law

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COMMENTS

STATE TAXATION OF NON-RESIDENTS ON STOCK OF DOMESTIC CORPORATIONS

The United States Supreme Court has of late years been using increasingly its trusty and adaptable weapon of the 14th Amendment to the Federal Constitution, in a vigorous warfare against double taxation. Probably not much has yet been accomplished against economic double taxation within a single state, but taxation of the same legal interest by several states has been increasingly frowned upon. At any rate, it is clear that the Court is no longer of the opinion, which at one period it often and confidently announced, that double taxation is in no way forbidden by the Constitution.¹ For example, tangible chattels are no longer subject to taxation by two or more states.² The same applies to intangible assets, so far as such assets consist of debts. Such assets are taxable only at the domicile of the creditor.³ And now the Court has carried the same idea still farther, and it seems almost to its logical conclusion, by holding

¹ See *Kidd v. Alabama*, 188 U. S. 730, 732, 23 Sup. Ct. 401 (1903).

² *Frick v. Pennsylvania*, 268 U. S. 473, 45 Sup. Ct. 403 (1925). The same rule applies to corporations. *Union Transit Co. v. Kentucky*, 199 U. S. 194, 26 Sup. Ct. 36 (1905).

³ See cases cited in notes 10 and 11.

in *First National Bank v. State of Maine*⁴ that the transfer by the death of the holder of corporate stock cannot constitutionally be taxed by the state where the corporation is incorporated, but only by the state of the domicile of the decedent.

In the principal case, the decedent was a resident of Massachusetts. The greater part of his estate consisted of stock of a Maine corporation. Most of the property of the corporation was also in Maine, but it is clear that this fact alone would not permit Maine to tax the transfer.⁵ However, the state court sustained the tax, upon the obvious ground that the stock of a Maine corporation was involved, and the transfer, being only possible with the permission of the state, was naturally taxable by it.⁶

As already said, this decision was reversed and the tax invalidated by the Federal Supreme Court. The opinion was written by Mr. Justice Sutherland; Mr. Justice Stone submitted a dissenting opinion, in which Justices Brandeis and Holmes concurred.

The prevailing opinion admitted that the result reached was not in accordance with a number of previous decisions of the Court, but contended that it was a logical and desirable result of the recently developed doctrine that indebtedness is taxable only at the domicile of the creditor. The dissenting opinion pointed out the difference between corporate stock and indebtedness, and renewed the protest, which has often been made of late years, though apparently without much effect, against the extension of the effect of the 14th Amendment in invalidating taxation deemed undesirable by the Court. This very protest emphasizes, however, the firm purpose of the majority to invalidate, under this conveniently vague constitutional provision, all taxation deemed by them seriously objectionable from an economic standpoint.

The present decision relates only to inheritance taxation. But there can be little doubt that its principle will be applied to property taxes also, so that no state except that of the domicile of the owner will be permitted to tax corporate stock as property. While the Court has sometimes intimated, probably only for the sake of caution, that the rules as to inheritance and

⁴ 52 Sup. Ct. 174 (Jan. 4, 1932).

⁵ *Rhode Island Trust Co. v. Doughton*, 270 U. S. 69, 46 Sup. Ct. 256 (1926).

⁶ *State v. First National Bank*, 130 Me. 123, 154 Atl. 103 (1931).

property taxation may not be the same,⁷ yet there appears no reason in principle or in its actual decisions for assuming that it will be more lenient with the states with respect to property taxes than it has been when inheritance taxes are concerned.⁸ In both classes of cases, the property must be considered to be outside the taxing jurisdiction of any state except that of the domicile of the owner.

As already said, the Court relies for its new doctrine upon its older, though still rather recent doctrine, that ordinary debts may only be taxed at the domicile of the creditor. For a long time the Court permitted the taxing of debts—or at least some kinds of debts—at the domicile of the debtor as well as that of the creditor.⁹ But this doctrine is now definitely negated. Only the jurisdiction of the creditor's domicile, may tax indebtedness or the securities which represent it, and it is immaterial that the securities are issued by the taxing state itself or its municipalities,¹⁰ or that the securities are kept in the state of the domicile of the debtor.¹¹ Thus, double taxation of indebtedness, in the sense of taxation of the same indebtedness by two states, seems definitely at an end.

However, this does not necessarily compel the result of the case now under consideration; on this point the dissenting opinion is correct. Stock of a corporation is legally quite distinct from its indebtedness, and while from a practical standpoint there is considerable similarity, it is far from identity.¹² Furthermore, as the Court was constrained to admit, there are many decisions which squarely permit the taxation of corporate stock by the state of incorporation, even when the holder is a non-resident.¹³ Indeed, there are important cases relating to the

⁷ See *Buck v. Beach*, 206 U. S. 392, 27 Sup. Ct. 712 (1907).

⁸ See Lowndes, "Basis of Jurisdiction in State Taxation of Inheritance and Property," 29 Mich. Law Rev. 850.

⁹ *Blackstone v. Miller*, 188 U. S. 189, 23 Sup. Ct. 277 (1903); *Wheeler v. Sohmer*, 233 U. S. 434, 34 Sup. Ct. 607 (1914).

¹⁰ *Farmers Loan & Trust Co. v. Minnesota*, 280 U. S. 204, 50 Sup. Ct. 98 (1930). This case explicitly overrules *Blackstone v. Miller*, *supra*, note 9.

¹¹ *Baldwin v. Missouri*, 281 U. S. 536, 50 Sup. Ct. 436 (1930). See also *Beidler v. So. Car. Tax Comm.*, 282 U. S. 1, 51 Sup. Ct. 54 (1930).

¹² *In re Lund's Estate*, 236 N. W. 626 (Minn., 1931). See also the principal case in the state court, *supra*, note 6.

¹³ *Curry v. Baltimore*, 196 U. S. 466, 25 Sup. Ct. 297 (1905); *Hawley v. Malden*, 232 U. S. 1, 34 Sup. Ct. 201 (1914). Cf. *Bullen v. Wisconsin*, 240 U. S. 625, 36 Sup. Ct. 473 (1916).

validity and effect of inheritance taxation on non-resident estates, where the only property claimed to exist in the other state was stock of corporations existing under its laws.¹⁴ Indeed, as recently as 1931, a litigant, who successfully contested taxation of the transfer by death of debts owed to a decedent by a corporation of a state foreign to his domicile, even though all of the property and business of the corporation was in the state of its incorporation, did not even protest against the taxation by that state, of the transfer of the stock itself.¹⁵ The present decision, therefore, even after making all due allowance for the change of view which the Court had already shown in the indebtedness cases, must be regarded as distinctly revolutionary.

It is submitted, however, that the result is sound and desirable. There is, to be sure, serious question of the soundness of the doctrine that debts are subject to tax at the domicile of the creditor.¹⁶ This is especially pertinent with regard to inheritance taxes, on account of the opportunity to avoid any taxation at all, because of the doctrine that a state court will not entertain a suit to enforce the revenue laws of another state.¹⁷ But this possible unfairness is not applicable with respect to corporate stock, since whatever the state of incorporation loses in power to tax the stock held by non-residents can usually be made up by taxing the corporation itself.¹⁸ It is not surprising, therefore, that before the actual decision of the principal case, several students of the subject predicted that the Court would change its view, as it actually did in this case.¹⁹

But with all the revolutionary and apparently conclusive de-

¹⁴ *Maxwell v. Bugbee*, 250 U. S. 525, 40 Sup. Ct. 2 (1919), involved a bitter controversy as to the validity of the New Jersey inheritance tax on non-resident estates; but the only property in New Jersey was stock of New Jersey corporations. In *Frick v. Pennsylvania*, *supra*, note 2, the Court held that the state of domicile must, in computing the taxable estate, permit the deduction of inheritance taxes paid to other states in order to obtain the transfer of stock of corporations organized in these various states.

¹⁵ *Beidler v. So. Car. Tax. Comm.*, *supra*, note 11.

¹⁶ See for a strong argument that debts should be taxable at the domicile of the debtor, Carpenter, "Jurisdiction Over Debts for the Purpose of Administration, Garnishment, and Taxation," 31 Harv. Law Rev. 905.

¹⁷ *Colorado v. Harbeck*, 232 N. Y. 71, 133 N. E. 357 (1921).

¹⁸ See Lowndes, *op. cit.*, note 8.

¹⁹ See Rottschaefer, "The Power of the States to Tax Intangibles," 15 Minn. L. R. 741, and Pomerance, "The 'Situs' of Stock," 17 Corn. Law Quart. 43.

cisions on this subject which have appeared in the last few years, there are still some unsettled problems. In the first place, it is not probable that the court means to interfere with the economic double taxation which exists under the common practice of the taxing by a single state of the stock of a corporation held by its own residents, and of the corporation itself.²⁰ There is nothing unduly burdensome in this; but far worse than the taxation condemned in the principal case is the practice of many states of taxing consolidated corporations on the basis of their entire capital stock. Since a corporation incorporated in more than one state is a legal impossibility, the practice amounts to permitting a state to tax the stock of foreign corporations not doing business in the state. Yet this very unfair practice has thus far been approved by the Supreme Court,²¹ which has intensified the hardship by permitting the states to require any corporation to take out a domestic charter as a condition of allowing it to do business in the state.²² Thus it may be compelled to subject itself to this ruinous taxation. Here is a situation which cries far more loudly for a remedy, than that which was relieved in the principal case.

The question has also been mooted as to whether these tax cases have any effect on the previously-approved practices with respect to the settlements of decedent's estates and of garnishments, in both of which debts and corporate stock are treated as having situs outside the domicile of the stockholder or creditor. There seems to be no reason to think that there is any necessary connection between these two classes of cases and the new taxation doctrines; furthermore the law as to the settlement of estates is in this particular quite satisfactory.²³ On the other hand, the rule that a debt may be garnished wherever the debtor can be found²⁴ has been criticised with much justice. So the Court may desire to change the rule, and, if it does, this new tax doctrine will be of assistance in rationalizing a change in the garnishment rule.

²⁰ See Ballantine on Private Corporations, p. 25.

²¹ *The Delaware Railroad Tax*, 18 Wall, 206 (U. S. 1873); *Kansas City, etc. R. R. Co. v. Stiles*, 242 U. S. 111, 37 Sup. Ct. 58 (1916).

²² *Railway Express Agency v. Virginia*, 282 U. S. 440, 51 Sup. Ct. 201 (1931).

²³ See *Baker v. Baker Eccles & Co.*, 242 U. S. 394, 37 Sup. Ct. 152 (1917).

²⁴ *Chicago, etc. Ry. Co. v. Sturm*, 174 U. S. 710, 19 Sup. Ct. 797 (1899); *Harris v. Balk*, 198 U. S. 215, 25 Sup. Ct. 625 (1905).

It is probable, also, that the new doctrine will not prevent the states from taxing intangible property of a foreign corporation, which is definitely connected with business done in the state. This is a situation where such property (usually good-will or similar assets) has an actual as distinguished from a merely legal situs, as is more usually the case with intangibles, because of the fact that it increases the profitableness of the business done within the taxing state. Such a tax, therefore, seems entirely proper.²⁵

But the most important question left unsettled by the principal case and its predecessors is whether or not the "business situs" doctrine is still accepted. This doctrine is that a state may tax directly, or impose an inheritance tax with respect to, intangible property, either debts or stock, owned by a non-resident but used by him in carrying on business within the state levying the tax. So long as there were somewhat continuous business activities, as distinguished from mere isolated transactions, the Court has clearly and repeatedly sustained the tax.²⁶ The doctrine involves double taxation, as the state of domicile or incorporation is permitted to tax the same property.²⁷ But as an original question, the cases now under consideration,²⁸ since they were not considered to involve continuous business activities, do not seem to affect this principle.

The doubt as to the present status of the business situs doctrine arises from the fact that in all of these late cases the Court referred to the doctrine and explicitly declined to pass upon it. In at least one of them,²⁹ the state taxing authorities urged, and it seems with much force, that the doctrine was applicable, because the decedent was carrying on business in the state; but the Court held otherwise. In the principal case, the Court, with real if perhaps unconscious irony, stated that the

²⁵ *Adams Express Co. v. Ohio*, 165 U. S. 194, 17 Sup. Ct. 305; 166 U. S. 185, 17 Sup. Ct. 604 (1897). The same doctrine was applied in the case of an individual taxpayer, in *Citizens Bank v. Durr*, 257 U. S. 99, 42 Sup. Ct. 15 (1921).

²⁶ The leading case is *New Orleans v. Stempel*, 175 U. S. 309, 20 Sup. Ct. 110 (1899), but there are several other cases to the same effect.

²⁷ *Fidelity, etc. Trust Co. v. Louisville*, 245 U. S. 54, 38 Sup. Ct. 40 (1917); *Blodgett v. Silberman*, 277 U. S. 1, 48 Sup. Ct. 410 (1928). See also *Cream of Wheat Co. v. Grand Forks*, 253 U. S. 325, 40 Sup. Ct. 558 (1920).

²⁸ The principal case, and the cases cited in notes 10 and 11, *supra*.

²⁹ *Beidler v. So. Car. Tax Com.*, *supra*, note 11.

question must be reserved until an occasion "when, if ever, it properly shall be presented for our consideration."³⁰ Obviously, if the Court never finds an occasion for the application of the business situs doctrine, the doctrine itself is as good as dead. Therefore, while it is not safe to say that this business situs doctrine is no longer accepted, one may properly express great doubts of its continued application.

But subject to the possibility, though extreme improbability, of a further change of view by the Court, the doctrine of the principal case seems to definitely settle the law on this point. An owner of stock of a foreign corporation may be confident that he will not be subjected to a tax with respect thereto by the state of incorporation, and that his estate will be similarly immune from inheritance taxation by the same state, with respect to such stock. Most lawyers will probably welcome this new doctrine; but all must shudder when they think of the numerous and complicated tax proceedings, which they have conducted, as it now turns out, uselessly, and even more at the recollection of the millions of dollars which they have permitted their clients to pay to states which the Supreme Court now decides had no authority to collect a penny.

ROBERT C. BROWN.

Indiana University School of Law.

³⁰ 52 Sup. Ct. 178.