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## State Jurisdiction to Tax Dividends and Stock Profits to Natural Persons

THE NATURE and trend of the recent decisions relating to state jurisdiction for tax purposes constitute familiar history.<sup>1</sup> Accepted common law doctrine led to decisions that estates<sup>2</sup> in land were by their very nature taxable only at the situs of the land.<sup>3</sup> The common law notion of territoriality of law, *quondam* quiescent in face of a temporary acceptance of the maxim *mobilia sequuntur personam*,<sup>4</sup> led in 1905 to the holding that chattels permanently situated in a single place were taxable there only, and not at the domicile of the nonresident owner.<sup>5</sup> It was also established that chattels stored within the state for an indefinite period,<sup>6</sup> or engaged in some productive activity within the state,<sup>7</sup> or held in the state for some purpose beneficial to the owner,<sup>8</sup> as distinguished from chattels merely in transit,<sup>9</sup> could be taxed within the state regardless of where the

<sup>1</sup> I have attempted a complete statement and analysis of these developments in a recent volume, HARDING, DOUBLE TAXATION OF PROPERTY AND INCOME (1933). Cases may be found in 1 BEALE, TREATISE ON THE CONFLICT OF LAWS (1935) c. 4A. There are many excellent law review articles cited *infra* note 25.

<sup>2</sup> "Estates" is the proper word in the early stages of development. In the cases of equitable interests and other claims not amounting to estates, there was some question as to the exclusive taxing jurisdiction at the situs. This is discussed in connection with *Senior v. Braden*, *infra* note 163.

<sup>3</sup> *Louisville & Jeffersonville Ferry Co. v. Kentucky* (1903) 188 U. S. 385. Where the title was broken into several parts, as for example as between mortgagor and mortgagee, the state was permitted to assess each separate interest to the owner thereof, provided of course the total assessment did not exceed a fair valuation of the land itself. See *Savings & Loan Soc. v. Multnomah County* (1898) 169 U. S. 421; *Myers v. Seaberger* (1887) 45 Ohio St. 232, 12 N. E. 796. See *infra* note 132.

<sup>4</sup> The vogue of this maxim as applied to various Conflict of Laws situations begins with Story's adoption in 1834. By 1880 it was on its way out. See STORY ON CONFLICT OF LAWS (8th ed. 1883) 543a.

<sup>5</sup> *Union Refrigerator Transit Co. v. Kentucky* (1905) 199 U. S. 194.

<sup>6</sup> *Susquehanna Coal Co. v. South Amboy* (1913) 228 U. S. 665. See *City Bank Farmers Trust Co. v. Schnader* (1934) 293 U. S. 112.

<sup>7</sup> *Gromer v. Standard Dredging Co.* (1912) 224 U. S. 362.

<sup>8</sup> *General Oil Co. v. Crain* (1908) 209 U. S. 211; *Bacon v. Illinois* (1913) 227 U. S. 504.

<sup>9</sup> *Coe v. Errol* (1886) 116 U. S. 517; *Carson Pet. Co. v. Vial* (1929) 279 U. S. 95. See Powell, *Contemporary Commerce Clause Controversies over State Taxation* (1928) 76 U. OF PA. L. REV. 773; Powell, *Taxation of Things in Transit* (1920-21) 7 VA. L. REV. 167, 245, 429, 497; BEALE, *op. cit. supra* note 1, § 118C.11.

owner might reside.<sup>10</sup> Imagined distinctions between *ad valorem* and inheritance taxes permitted the domiciliary state to continue to apply the latter to chattels permanently situated abroad.<sup>11</sup> It was felt that the *mobilia* maxim in some way continued to be effective in transfers of personalty at death.<sup>12</sup> The growing realization that *ad valorem* and inheritance taxes must rest upon a common jurisdictional basis<sup>13</sup> led, in 1925, to the holding that the domicil of the decedent could not constitutionally impose an inheritance tax upon chattels with a taxable situs in some other place.<sup>14</sup>

Intangible property interests are difficult to fit into a territorial scheme of law.<sup>15</sup> As applied to such wealth situs, at first glance, appears to be a fiction and not a fact.<sup>16</sup> Accordingly the cases applying an ever-stricter notion of territoriality to the taxation of chattels expressly or impliedly excepted intangibles therefrom. States were conceded a taxing jurisdiction based upon the *mobilia* maxim, thus creating a legal situs at the domicil of the owner of the wealth.<sup>17</sup> Other states were permitted to tax on a claim that the wealth had in some way acquired a useful situs therein, that it had become a composite part of the wealth within the state.<sup>18</sup> Other states were permitted to tax on a claim of jurisdiction in the widest international sense of a power *de facto* in some way to control, order, or regulate the interests of some person or persons in the

<sup>10</sup> Cases cited notes 6-8, *supra*.

<sup>11</sup> Numerous states had voluntarily ceased to collect inheritance taxes upon foreign-situated chattels.

<sup>12</sup> Certain courts overlooked, as many still do, the fact that the common law rule to the effect that the descent of personalty is governed by the law of the domicil of the intestate does not state a rule of jurisdiction. See GOODRICH, *CONFLICT OF LAWS* (1927) §§ 158, 161; BEALE, *op. cit. supra* note 1, §§ 303.1-303.3; *CONFLICT OF LAWS, RESTATEMENT* (Am. L. Inst. 1931) § 303.

<sup>13</sup> HARDING, *op. cit. supra* note 1, § 23.

<sup>14</sup> Frick v. Pennsylvania (1925) 268 U. S. 473, 42 A. L. R. 316.

<sup>15</sup> See Lowndes, *The Passing of Situs* (1932) 45 HARV. L. REV. 777.

<sup>16</sup> It is unfortunate that the Court chose the word "situs" to express its idea. The usual meanings of this word are hardly applicable to these cases. It is necessary to comprehend a new definition of the word, designated by some qualifying term: "taxable situs" has been commonly used. I have used the phrase "situs by integration" as suggestive of the economic and political concepts imminent in the recent decisions. HARDING, *op. cit. supra* note 1, §§ 7, 8. The Court, however, uses the word without adjectives. This should be no occasion for excitement if we but recall that a great deal of progress in the law has arisen from a slow re-definition of words. See, however, Lowndes, *Spurious Conceptions of The Constitutional Law of Taxation* (1934) 47 HARV. L. REV. 628, 630-9.

<sup>17</sup> Hawley v. Malden (1914) 232 U. S. 1; Fidelity & Columbia Trust Co. v. Louisville (1917) 245 U. S. 54.

<sup>18</sup> New Orleans v. Stempel (1899) 175 U. S. 309; Bristol v. Washington County (1900) 177 U. S. 133. Cases collected Note (1932) 76 A. L. R. 806.

intangible wealth.<sup>19</sup> Even more tenuous claims had to be considered.<sup>20</sup> The resulting multiple taxation brought a demand for relief, and the Supreme Court yielded to this demand in a series of cases beginning in 1930.<sup>21</sup> These cases established two things. The first was a specific proposition that the power to extort a tax from the owner of intangible wealth under threat of interfering in some way with his ownership, or of denying arbitrarily some right normally incident to his ownership, was not of itself sufficient to create a right to tax this same wealth. The aphorism, "The foundation of jurisdiction is physical power," so carefully nurtured in the field of taxation by Mr. Justice Holmes,<sup>22</sup> was discarded as a noxious weed.<sup>23</sup> The second thing established in the recent cases was a judicial ideal of, to quote Mr. Beale, "one man—one thing—one tax." The court reviewed its success in handling tangible property cases so as to eliminate virtually all multiple taxation of a single legal interest in the hands of a single person, and announced an intention to apply this same process to the field of intangibles.<sup>24</sup>

<sup>19</sup> *Blackstone v. Miller* (1903) 188 U. S. 189. A popular statement of this theory will be found in Carpenter, *Jurisdiction over Debts* (1918) 31 HARV. L. REV. 905, 918 *et seq.* See also STIMSON, JURISDICTION AND POWER OF TAXATION (1933), *passim*.

<sup>20</sup> As for example the claim of a state to tax a debt because the security for the debt was located within the state, *State v. Chadwick* (1916) 133 Minn. 117, 157 N.W. 1076, 158 N.W. 637; or the claim of a state to tax corporate shares because the corporation had property within the state, *Rhode Island Hospital Trust Co. v. Doughton* (1926) 270 U. S. 69, 43 A.L.R. 1374.

<sup>21</sup> These cases in the order of their appearance were: *Safe Deposit & Trust Co. v. Virginia* (1929) 280 U. S. 83, 67 A.L.R. 386, indicating but not deciding that the domicile of the *cestui* of a foreign-administered trust of intangibles could not tax the *cestui's* interest; *Farmers Loan & Trust Co. v. Minnesota* (1930) 280 U. S. 204, 65 A.L.R. 1000, holding that the state could not levy an inheritance tax upon debts owing by a resident debtor to a nonresident decedent; *Baldwin v. Missouri* (1930) 281 U. S. 586, 72 A.L.R. 1303, holding that the state could not tax the transfer of a local bank account and locally stored securities belonging to a nonresident decedent; *First National Bank v. Maine* (1932) 284 U. S. 312, 77 A.L.R. 1401, holding that the state of incorporation could not levy an inheritance tax upon shares owned by a nonresident decedent.

<sup>22</sup> *Blackstone v. Miller*, *supra* note 19. See also *Wheeler v. Sohmer* (1914) 233 U. S. 434.

<sup>23</sup> Mr. Justice Holmes' dissenting opinion in *Baldwin v. Missouri*, *supra* note 21, at 595, 596 states the rejected argument: "In this case the bonds, notes and bank accounts were within the power and received the protection of the State of Missouri; the notes so far as appears were within the considerations that I offered in the earlier decisions mentioned, so that logically Missouri was justified in demanding a quid pro quo; the practice of taxation in such circumstances I think has been ancient and widespread, and the tax was warranted by the decisions of this Court."

<sup>24</sup> "We have determined that in general intangibles may be properly taxed at the domicile of their owner and we can find no sufficient reason for saying that they are not entitled to enjoy an immunity against taxation at more than one place similar to that accorded to tangibles. The difference between the two things, although obvious enough, seems insufficient to justify the harsh and oppressive discrimination against intangibles contended for on behalf of Minnesota." Mr. Justice McReynolds in *Farmers Loan & Trust Co. v. Minnesota*, *supra* note 21, at 212.

The intangible tax decisions of 1930-32 settled some problems, but raised others.<sup>25</sup> Some writers were content to attack the decisions as based upon unsound principles, or perhaps upon a superarrogation of judicial authority.<sup>26</sup> It seemed necessary, however, to accept the new ideal of no multiple taxation of intangibles as seriously and deliberately made. The cases established that physical power was no longer sufficient to support a tax on intangible wealth. We must now choose between taxation at the domicile, based upon the *mobilia* maxim, and taxation in a nondomiciliary state, upon a theory of business situs,<sup>27</sup> that the wealth had in some way become dissociated from the person and residence of the owner and had become associated with an integral part of the wealth in the taxing state.<sup>28</sup> Under the new ideal one of these claims must yield to the other. The problem was attacked by many writers, of whom some concluded that the *mobilia* maxim had been established as the guiding principle in the taxation of intangibles; that intangibles henceforth were to be taxed only at the domicile of the owner.<sup>29</sup>

My own analysis of the cases, elsewhere set out in detail,<sup>30</sup> resulted in a contrary conclusion.<sup>31</sup> The history of the decisions relating to both *ad valorem* and inheritance taxes on both tangible and intangible property seemed to portray the birth and gradual ascension of an idea akin to "business situs." It appeared that taxing jurisdiction was not to be explained on the basis of the legal relationship between the taxing sovereign and the thing taxed, but rather upon the economic relationship

<sup>25</sup> See, in general, Brown, *Multiple Taxation by the States—What is Left of It?* (1935) 48 HARV. L. REV. 407; Merrill, *Jurisdiction to Tax—Another Word* (1935) 44 YALE L. J. 582; Rottschaefer, *State Jurisdiction to Impose Taxes* (1933) 42 YALE L. J. 305; Lowndes, *The Passing of Situs* (1932) 45 HARV. L. REV. 777; Galland, *Jurisdiction for Taxation of Shares of Stock* (1931) 4 ROCKY MT. L. REV. 20; Howard, *Recent Developments and Tendencies in the Taxation of Intangibles* (1931) UNIV. OF MO. BULL. LAW SER., No. 44; Peppin, *The Power of the States to Tax Intangibles or Their Transfer* (1930) 18 CALIF. L. REV. 638; Rottschaefer, *The Power of the States to Tax Intangibles* (1931) 15 MINN. L. REV. 741; (1931) 9 NO. CAR. L. REV. 415; Nossaman, *The Fourteenth Amendment in Relation to State Taxation of Intangibles* (1930) 18 CALIF. L. REV. 345.

<sup>26</sup> These criticisms hardly improve upon Mr. Justice Holmes' succinct dissent in *Baldwin v. Missouri*, *supra* note 21.

<sup>27</sup> *Supra* note 18.

<sup>28</sup> Coupled with those cases usually referred to as involving business situs, we find those upholding the taxation of a fair share of the so-called corporate excess or good-will value at the place or places of business of the corporation, as distinguished from the state of incorporation. *Adams Exp. Co. v. Ohio* (1897) 166 U.S. 185; *Rowley v. Chicago & N. W. R. Co.* (1934) 293 U.S. 102; HARDING, *op. cit. supra* note 1, §§ 18, 50-52.

<sup>29</sup> See the discussion in Brown, *op. cit. supra* note 25, at 420-430. See also *Peoples Bank v. State* (1930) 209 Iowa 685, 228 N. W. 638.

<sup>30</sup> HARDING, *op. cit. supra* note 1, c. IV.

<sup>31</sup> See also Howard, *loc. cit. supra* note 25.

between them. If the wealth taxed was usefully employed within a state, if it had become an integral part of the composite wealth within that state, if it was functioning as a part of the economic organism centering in that state, or if it was held at rest in that state for the purpose of receiving some benefit flowing from the activities of the economic group constituting the state, then it was taxable in that state.<sup>32</sup> This same doctrine of economic situs for taxation, tagged for convenience "situs by integration," was found in decisions relating to taxes upon persons<sup>33</sup> and taxes upon the doing of acts.<sup>34</sup> Under this doctrine, domicil, a legal relationship between sovereign and the owner of the wealth, would not be sufficient to establish taxing jurisdiction. The domicil, as such, could tax only where the wealth was found not to have acquired a situs by integration in some other place.<sup>35</sup> In such a case it does little damage to the imagination to assert that the wealth really has its economic center in the person of the owner; that the *mobilia* maxim in this case states a fact.<sup>36</sup> On such an analysis, the prediction was made that the business situs cases and others resting upon a similar doctrine would not be affected by the 1930-32 decisions, and that ultimately they would prevail over claims of a right to duplicate taxation at the domicil.<sup>37</sup>

The ultimate solution is yet to be determined. A subsequent opinion reiterates the right of the domicil to tax intangibles not shown to have acquired a situs by integration elsewhere.<sup>38</sup> A more recent decision makes

<sup>32</sup> HARDING, *op. cit. supra* note 1, c. III. A brief comparison of this approach with the more conventional one is contained in 1 BEALE, *op. cit. supra* note 1, §§ 118A.4, 118C.2.

<sup>33</sup> It would seem to be agreed that the state cannot levy a personal tax upon a person merely going through the state. *Crandall v. Nevada* (1868) 6 Wall. 35; *Clarke v. P. W. & B. R. Co.* (1870) 4 Houst. (Del.) 158. A personal tax may be laid, however, upon one who tarries in the state for a beneficial purpose although he does not acquire a domicil or residence therein. *Haavik v. Alaska Packers' Ass'n* (1924) 263 U. S. 510; Note (1924) 22 MICH. L. REV. 495; *Alaska Packers' Ass'n v. Hedenskoy* (C. C. A. 9th, 1920) 267 Fed. 154. The latter case aptly brings out the parallel. But see BEALE, *op. cit. supra* note 1, § 118B.3. Citizenship seems to be quite unimportant on the jurisdictional issue so long as there is physical presence as defined. See HARDING, *op. cit. supra* note 1, § 25.

<sup>34</sup> See *ibid.*, § 27.

<sup>35</sup> See *ibid.*, §§ 12, 20.

<sup>36</sup> It has been suggested that this idea of a residuary power in the domicil to tax property which has not acquired a situs by integration elsewhere is in some way inconsistent with the integration test of jurisdiction. I cannot see, however, why an attack upon the *mobilia* maxim in those cases where it states an obvious falsehood precludes its use when it approximates fact.

<sup>37</sup> HARDING, *op. cit. supra* note 1, §§ 15, 18, 20. See Rottschaefer, *State Jurisdiction to Impose Taxes* (1933) 42 YALE L. J. 305, 316; Howard, *op. cit. supra* note 25, at 25-29.

<sup>38</sup> *Commonwealth of Virginia v. Imperial Coal Sales Co.* (1934) 293 U. S. 15, involving a Virginia corporation with its principal office within the state. It was

it clear that the 1930-32 cases detract in no way from the right of the non-domiciliary state to tax locally integrated intangibles.<sup>30</sup> No Supreme

engaged in the commission brokerage of coal, making contracts for the sale of coal to be delivered in numerous places, and then causing the coal to be shipped from the mines to the purchaser. The corporation owned neither coal nor coal mines. All contracts were closed in the Virginia office. Payments were made to the Virginia office, and the proceeds were kept there. Virginia sought to levy a "capital tax" which was in effect an *ad valorem* tax on money on hand and in banks, and on the excess of bills and accounts receivable over bills and accounts payable. The supreme court of appeals of the commonwealth held that the constitutional privilege of interstate commerce was sufficient to defeat this tax. *Com. v. Imperial Coal Sales Co.* (1933) 161 Va. 718, 167 S. E. 268, 172 S. E. 927, *aff'g* on rehearing (1934) 161 Va. 736. The United States Supreme Court reversed on the basis of previous decisions, the Court holding that the intangibles concerned appeared on the facts to be taxable in Virginia, the domicile of the corporate owner, and that the fact that the owner was engaged solely in interstate commerce, if true, was not sufficient to exempt its intangible property from an otherwise applicable nondiscriminatory *ad valorem* tax. The case was then reargued in the court of the commonwealth on the issue not previously decided, whether the company could claim the benefit of section 427 of the Tax Code providing for the exemption of domestic corporations doing no part of their business within the state. The court held that not only did the corporation do a substantial part of its business in Virginia, but that practically all of its business was there located, and held the entire value of intangibles taxable. *Com. v. Imperial Coal Sales Co.* (Va. 1936) 183 S. E. 234.

<sup>30</sup> *Wheeling Steel Corp. v. Fox* (1936) 298 U. S. 193. The corporation was chartered in Delaware and was licensed in Ohio, Minnesota, and West Virginia. It had a statutory office in Delaware, but its principal office and place of business was in West Virginia. It had fourteen sales offices in various cities, owned or controlled mining properties in five states, and had a fleet of boats and barges plying the Ohio and Mississippi Rivers. The facts showed that the general officers resided and worked in West Virginia, that all sales contracts were finally closed there, all payments were made to that office. Ordinary commercial accounts were paid from the West Virginia office. Stock in the corporation was transferable in New York and dividends were paid from there, although declared in meetings in West Virginia. Other items showed that West Virginia could claim 27.1% of realty and tangible personalty belonging to the corporation; that 24.2% of goods sold were shipped from West Virginia plants. Bank deposits in West Virginia totalled 36.8% of the whole, but only 14.3% of the West Virginia deposits were derived from West Virginia plants. About 16.7% of the notes and accounts receivable were derived from West Virginia manufactures. The company had previously paid an Ohio tax on \$250,133 in intangibles claimed to be situated in that state. The West Virginia statute imposed an ordinary *ad valorem* tax on foreign corporations having a chief place of business within the state and included within the tax base all bank deposits and accounts and notes receivable, as well as miscellaneous intangible investments. The county assessor listed the corporation for intangibles slightly in excess of the entire amount of bank deposits and accounts receivable. The State Tax Commission reduced this sum slightly. The state circuit court ordered the assessment reduced to exclude all items except the bank deposits and accounts receivable derived from the sale of goods manufactured in West Virginia. On appeal it was held that the case was not covered by the *mobilia* maxim; that the facts showed the acquisition of a business situs in West Virginia. It was argued in the opinion that the entire business of the company was centered in West Virginia, and that *prima facie* all the intangible values used in or growing out of the business would be there taxable, unless and until it appeared that all or part of the intangibles had

Court case since 1930 has presented the issue of domiciliary taxation in the face of integration elsewhere. Subsidiary developments, however, have presented no reason for alteration of the prediction that ultimately the domiciliary state will be required to give way.<sup>40</sup>

acquired a taxable situs in some other place. The court raised a presumption of regularity of the assessment of \$250,133 of intangibles in Ohio and held that this might be deducted from the total, but that the remaining amount was taxable in West Virginia. *In re Wheeling Steel Corporation Assessment* (1935) 115 W. Va. 553, 177 S. E. 535. This was affirmed. The opinion by the Chief Justice makes the following points: (1) This is an *ad valorem* tax and subject to the requirement that the property taxed be within the territorial jurisdiction of the taxing state; (2) In general intangibles are without a situs in the ordinary sense and are treated as localized at the domicile for tax purposes; (3) Intangibles are accorded the same immunity from multiple taxation as are chattels; (4) Intangibles may acquire a taxable situs in some place other than the domicile by reason of becoming integral parts of some business there conducted; (5) "To attribute to Delaware, merely as the chartering state, the credits arising in the course of the business established in another state, and to deny to the latter the power to tax such credits upon the ground that it violates due process to treat the credits as within its jurisdiction, is to make a legal fiction dominate realities in a fashion quite as extreme as that which would attribute to the chartering state all the tangible possessions of the Corporation without regard to their actual location;" (6) While it might be necessary to apportion an income tax between the states containing factory and sales office respectively, it is not necessary that accounts receivable be so apportioned; while the account is in a sense derived from the factory, it is in no sense a part of the factory; (7) Accounts receivable are properly attributed to the place "where they arise in the course of the business of making contracts of sale;" (8) While the bank deposits are maintained in several states, the deposits are all made from the West Virginia office, and all withdrawals and disbursements are controlled from there, and on the face of these facts would appear to be localized in fact at the West Virginia office; (9) The state court properly construed the statute to permit the deduction of intangibles properly taxed elsewhere and neither party is in position to challenge the correctness of permitting the deduction of intangibles taxed in Ohio. The entire opinion in this case appears to be consistent with and in support of the integration principle previously discussed.

<sup>40</sup> In addition to the comforting phraseology of the Wheeling case just cited, other sources may be relied upon. In *Atlantic Lumber Co. v. Commissioner* (1936) 56 S. Ct. 887, the corporation was created in Delaware but maintained its principal office and a sales office in Massachusetts. Its business consisted of selling lumber in a number of states, all of which was shipped from sources outside the state of Massachusetts. Massachusetts sought to tax the corporation on the "corporate excess" measured in proportion to other assets employed within the state. It was held (affirming [Mass. 1935] 197 N. E. 525) that this corporate excess was properly taxable in Massachusetts, and that the maintenance of the general corporate office within the state was a doing of local business and thus sufficient to remove the corporation from the protection of the interstate commerce exemption accorded under *Alpha Portland Cement Co. v. Massachusetts* (1925) 268 U. S. 203, 44 A. L. R. 1219.

In *State v. Atlantic Oil Producing Company* (1935) 174 Okla. 61, 49 P. (2d) 534, it was held that Oklahoma might tax a foreign corporation upon credits and receivables arising out of business conducted in the Oklahoma branch office of a foreign corporation, notwithstanding the Oklahoma office accounted to a district office of the same corporation in Texas.

In *Mecklenburg County v. Sterchi Bros. Stores* (1936) 210 N. C. 79, 185 S. E.

## JURISDICTION TO TAX CORPORATE STOCK

Applying the decided cases and the principles above enunciated to the taxation of corporate stock, we may lay down the following:

(1) The state of incorporation as such may levy neither an *ad valorem* nor an inheritance tax upon shares of stock owned by a non-

454, the corporation was chartered in Delaware and had its principal office in Tennessee. It was engaged in operating a chain of furniture stores selling on the installment plan. One such store was located in North Carolina. Conditional sales contracts were made there. The contracts were collected in that state and the money deposited in local banks. The main office in Tennessee supervised the business, paid the rent, and supplied the merchandise for sale. It was held that North Carolina could tax the corporation upon the present worth of the unpaid conditional sales contracts held by it and arising from the North Carolina business. The court relied on the *Wheeling Steel Company* case, *supra* note 39, and had nothing to say about the possibility of duplicate taxation elsewhere.

In *Manufacturers' Trust Co. v. Hackett* (1934) 118 Conn. 101, 170 Atl. 792, the question involved was the right of the domicil of the owner to tax securities the physical evidences of which were retained in another state. The estate contended that the intangibles had acquired a business situs in the other state. The court found as a fact that this was not the case and concluded "In the absence of such situs, they would be taxable by the town of Stamford, the place of decedent's domicile."

In *Miami Coal Co. v. Fox* (1931) 203 Ind. 99, 176 N. E. 11, 79 A. L. R. 333, (1931) 31 Col. L. Rev. 1198, the state sought to tax a domestic corporation upon certain bills and accounts receivable. The corporation showed that its principal place of business was in Illinois and that the receivables were derived from business done in Illinois. The court, while professing not to decide the case on the issue of federal constitutionality, did find as an apparently necessary construction of the Indiana statute that the acquisition of a business situs in Illinois deprived the domiciliary state of the power of duplicate taxation. "The legislative intent is to permit the laying of the tax only upon the basis of property that is within the jurisdiction of this state."

In *Klose's Estate* (1934) 147 Ore. 512, 34 P. (2d) 636, the decedent's domicil sought to tax a bank account situated in Germany. The opinion proceeded as in *Manufacturers' Trust Co. v. Hackett*, *supra*, to state as a general rule that the acquisition of a business situs in another place would defeat the domiciliary taxation, but found as a fact that no such situs had been acquired. The issue was whether the laws of Germany prohibiting the withdrawal of the account from that country would give it a permanent situs there.

*Middlekauff v. Galloway* (1935) 151 Ore. 671, 52 P. (2d) 197, involved the liability of a resident *cestui que trust* under a special Intangibles Income Tax Law. The income involved was from a trust partly of intangibles administered in Iowa. The statute was construed to limit the taxing power of the state to income from intangibles with a situs in Oregon. The court then held that whatever the nature of the *cestui's* interest in the trust estate, such interest had its taxable situs at the place of administration in Iowa and not at the domicil. The case is thus authority on *ad valorem* rather than income taxes. In 1933 the statute was amended to include income from "nonresident estates and trusts." ORE. CODE SUPP. (1935) 69-1424 (1). See Note (1936) 15 ORE. L. REV. 270. The constitutionality of such an amendment is discussed hereinafter.

*Hill v. Carter* (C. C. A. 9th, 1931) 47 F. (2d) 869, arose on a similar question of construction of an income tax law. It was decided in the same manner and becomes an authority against the taxation of a *cestui* at his domicil upon any interest in the foreign-administered trust of intangibles.

Both of the two cases next preceding rest upon *Safe Deposit & Trust Co. v.*



resident.<sup>41</sup> There is reason to believe that such a right may be stipulated for at the time the corporation is created without running foul of the doctrine of unconstitutional conditions, but even if such an exaction is upheld it ceases to be a tax in the ordinary sense and becomes a contractual payment for a benefit voluntarily purchased.<sup>42</sup> It would seem impossible for the state to reach this same result by a use of the reserved right to amend, alter, or repeal charters granted.<sup>43</sup>

(2) An *ad valorem* or inheritance tax cannot be levied by a state upon the nonresident owner of shares in a foreign corporation merely because the corporation owns property or has a place of business within the state.<sup>44</sup>

Virginia, *supra* note 21, which appeared to strike out taxation of any interest in a foreign-administered trust of intangibles at the domicile of the *cestui*. Technically, as pointed out in Mr. Justice Stone's dissent, this was perhaps dictum. The entire series of cases since 1929 strengthens the initial impression that such, however, was the purpose of the court. This is the interpretation placed on the case by the Middlekauff and Hill cases cited above as well as by several other well considered cases. See, *Baltimore v. Gibbs* (1934) 166 Md. 364, 171 Atl. 37; *MacClurkan v. Bugbee* (1930) 106 N. J. L. 192, 150 Atl. 443; *Brown, Taxation of Trust Property* (1935) 23 Ky. L. J. 403. The income tax case of *Hutchins v. Commissioner*, *infra* note 159, is also highly persuasive on this point. See also Note (1932) 79 A. L. R. 344.

In *Fidelity & Columbia Trust Co. v. Louisville*, *supra* note 17, sustaining a domiciliary tax on an account in a foreign bank, Mr. Justice Holmes assumes that the account had acquired a business situs at the place of deposit—but the facts as stated show the contrary to have been the case. Mr. Justice McReynolds in *Senior v. Braden*, *infra* note 163, and hereinafter discussed in detail, classes the case as overruled to the same extent as *Blackstone v. Miller*.

<sup>41</sup> *First National Bank v. Maine*, *supra* note 21; *HARDING, op. cit. supra* note 1, § 19. *Cf. Oglesby v. Pacific Finance Corp.* (Ariz. 1934) 38 P. (2d) 646. *Cf. BEALE, op. cit. supra* note 1, § 118C.27. Some of the courts seem to have difficulty in accommodating themselves to this idea. *Intermountain Agricultural Credit Ass'n v. Payette County* (1934) 54 Idaho 307, 31 P. (2d) 267. This case relied upon *Corry v. Baltimore* (1905) 196 U. S. 466, and upon imagined distinctions between jurisdiction for *ad valorem* taxes and jurisdiction for inheritance taxes. *Corry v. Baltimore* is believed to deal not with the general jurisdiction question but with the power of the state to reserve the right to tax as a condition to the creation of the corporation, as to which see the note next following. It must be insisted today that so far as concerns situations between the several states of the United States there would seem to be no situation in which a state could levy an *ad valorem* tax in which it could not also levy an inheritance tax. *HARDING, op. cit. supra* note 1, § 23. One should compare the opinion in *State v. First Bank Stock Corp.* (Minn. 1936) 267 N. W. 519; *Rottschaefer, op. cit. supra* note 37, at 319-323; *Howard, op. cit. supra* note 25, at 47-48; *Lowndes, op. cit. supra* note 15, at 787.

<sup>42</sup> *Harding, Taxation of Shares in Domestic Corporations* (1933) 27 ILL. L. REV. 887. That such a right has been reserved would not affect the taxing jurisdiction of other states. *State v. First Bank Stock Corp.*, *supra* note 41.

<sup>43</sup> *Harding, op. cit. supra* note 42, at 903-908. That the amending power is to be so narrowly limited is indicated in the recent case of *Phillips Pet. Co. v. Jenkins* (1936) 297 U. S. 629.

<sup>44</sup> *Rhode Island Hospital Trust Co. v. Doughton* (1926) 270 U. S. 69, 43 A. L. R. 1374; *State v. Dunlap* (1916) 28 Idaho 784, 156 Pac. 1141; *Welch v. Treasurer* (1916) 223 Mass. 87, 111 N. E. 774.

(3) An *ad valorem* or inheritance tax cannot be levied by a state upon the nonresident owner of shares of a foreign corporation merely because the physical evidence of the stockholder's interest is found within the state.<sup>45</sup>

(4) Shares in a foreign corporation, owned by a nonresident, may be so employed within the taxing state as to acquire a situs by integration or business situs, and thus be subject to *ad valorem* or inheritance taxation within that state.<sup>46</sup>

(5) Shares in a corporation, foreign or domestic, may be taxed at the domicile of the shareholder regardless of where the certificate or other physical evidence may be,<sup>47</sup> so long as it does not appear that the wealth represented thereby has acquired a situs by integration in some other place.<sup>48</sup>

(6) The state of incorporation as such may levy a simple excise or stamp tax,<sup>49</sup> such as the conventional stock transfer tax, upon each change of ownership of shares in such corporation.<sup>50</sup>

(7) A stock transfer tax may be levied by a state other than the state of incorporation where the actual act of transfer of the stock, such as the delivery of the certificate or the making of appropriate entries in the stock transfer records, occurs within the territorial limits of the state.<sup>51</sup>

#### JURISDICTION TO TAX INCOME—GENERAL CONSIDERATIONS<sup>52</sup>

The situation with respect to the state taxation of income is similar in confusion to that with respect to the taxation of intangibles prior to

<sup>45</sup> *Baldwin v. Missouri*, *supra* note 21, refuting the implications of *Wheeler v. Sohmer*, *supra* note 22.

<sup>46</sup> This situation is expressly excepted from *First Nat. Bank v. Maine*, *supra* note 21. Its present validity seems assured by *Wheeling Steel Corp. v. Fox*, *supra* note 39. Such a state of facts was found to exist in *State v. First Bank Stock Corp.*, *supra* note 41.

<sup>47</sup> *Kidd v. Alabama* (1903) 188 U. S. 730; *Hawley v. Malden*, *supra* note 17; *First Nat. Bank v. Maine*, *supra* note 21; *BEALE, op. cit. supra* note 1, § 118C.28; *Notes* (1926) 43 A. L. R. 686; (1927) 48 A. L. R. 997. Interesting Canadian cases are collected in *Falconbridge, Situs and Transfer of Intangibles in the Conflict of Laws* (1935) 13 CANADIAN B. REV. 265, 275-278.

<sup>48</sup> This limitation rests of course upon the validity of the reasoning set forth in the text preceding.

<sup>49</sup> That the power of the state to levy a nominal stamp tax upon the execution of a document within its borders is not destroyed by the constitutional inability of the state to tax the real wealth represented by the document is demonstrated in *Graniteville Mfg. Co. v. Query* (1931) 283 U. S. 376.

<sup>50</sup> This would follow from *New York ex rel. Hatch v. Reardon* (1907) 204 U. S. 152. The exception is expressed in *First Nat. Bank v. Maine*, *supra* note 21.

<sup>51</sup> *New York ex rel. Hatch v. Reardon*, *supra* note 50.

<sup>52</sup> See generally, *Nossaman, State Taxation of Income* (1936) 24 CALIF. L. REV. 524; *Day, The Taxable Situs of Income* (1922) 8 CORN. L. Q. 36; *Rottschaefer, State Jurisdiction of Income for Tax Purposes* (1931) 44 HARV. L. REV. 1075; *Lowndes,*

1930. Most of the state statutes have been in existence for not more than five or six years and were enacted to meet what was thought to be a drastic need for additional public revenue and for the most part are designed to make the most of available sources. Most statutes are applicable (1) to all income arising from sources within the state, regardless of the residence of the taxpayer, and (2) to all income of local residents regardless of where earned or realized. Many of the statutes add verbiage purporting to tax the nonresident upon the "privilege" of earning the income within the state, and to tax the resident upon the "privilege" of receiving and enjoying the income within the state. Other language characteristic of excise taxation is also employed. This language has little to do with jurisdiction, but is designed to avoid the pitfalls involved in the problem of whether an income tax is to be subjected to the state constitutional limitations upon *ad valorem* taxes.<sup>53</sup> A recent decision in Pennsylvania reminds us that this is by no means a closed issue.<sup>54</sup>

In deciding taxing jurisdiction issues, the United States Supreme Court has rightly refused to be bound by the legislative tag attached to the exaction under review. A tax upon the person of the owner "measured by property" is held to be a tax upon the property.<sup>55</sup> An inheritance tax upon the "privilege of transmitting from the dead to the living" or upon the "privilege of inheriting" is held to be a tax upon the corpus of the estate.<sup>56</sup> Similar shift has been made of artistic language

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*State Jurisdiction to Tax Income* (1932) 6 TEMP. L. Q. 486; Kessler, *Some Legal Problems of State Income Taxation* (1925) 34 YALE L. J. 759, 863. The matter is considered in extended detail in HARDING, *op. cit. supra* note 1, c. VIII.

<sup>53</sup> This drafting technique has materially assisted sympathetic courts in sustaining progressive and graduated income taxes in the face of constitutional provisions for uniformity in property taxation. See, for example, *Diefendorf v. Gallet* (1932) 51 IDAHO 619, 10 P. (2d) 307; *In re Opinion of the Justices* (Me. 1935) 178 ATL. 621; *Bacon v. Ranson* (1932) 331 MO. 985, 56 S.W. (2d) 786; *O'Connell v. State Bd. of Equalization* (1935) 95 MONT. 91, 25 P. (2d) 114; *State ex rel. Haggart v. Nichols* (N. D. 1935) 265 N. W. 859; *Brown, The Nature of the Income Tax* (1933) 17 MINN. L. REV. 127; *Rottschaefer, State Income Tax and the Minnesota Constitution* (1928) 12 MINN. L. REV. 683; *Harsch, State Income Taxation as Affected by Property Tax Limitations* (1931) 6 WASH. L. REV. 97; *Traynor & Keesling, The Scope and Nature of the California Income Tax* (1936) 24 CALIF. L. REV. 493; *Legis.* (1935) 20 IOWA L. REV. 825; *Rottschaefer, The Minnesota State Income Tax* (1934) 18 MINN. L. REV. 93-103.

<sup>54</sup> *Kelley v. Kalodner* (1935) 320 PA. 180, 181 ATL. 598. The implications of this case are made more striking by the subsequent case upholding a flat rate corporate income tax law. *Turco Paint & Varnish Co. v. Kalodner* (1936) 320 PA. 421, 184 ATL. 37. See also *Eliasberg Bros. Merc. Co. v. Grimes* (1920) 204 ALA. 492, 86 SO. 56, 11 A. L. R. 300; *Culliton v. Chase* (1933) 174 WASH. 363, 25 P. (2d) 81.

<sup>55</sup> *Union Refrigerator Transit Co. v. Kentucky*, *supra* note 5.

<sup>56</sup> "In this court the presently approved doctrine is that no state may tax anything not within her jurisdiction without violating the 14th Amendment . . . Also no state may tax the testamentary transfer of property wholly beyond her power, or impose death duties reckoned upon the value of tangibles permanently located outside

designed to avoid constitutional limitations upon taxation of interstate commerce.<sup>57</sup> The only important field in which the language of the statute may have considerable effect upon constitutionality is that of corporate excise taxation,<sup>58</sup> in which the element of bargain-and-sale is not entirely lacking.<sup>59</sup>

In passing upon the constitutionality of state income tax legislation, the Supreme Court has directed little attention to whether the state considers the exaction an excise or a property tax.<sup>60</sup> Instead, the jurisdic-

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her limits . . . Tangibles with permanent situs therein, and their testamentary transfer, may be taxed only by the state where they are found. And, we think, the general reasons declared sufficient to inhibit taxation of them by two states apply under present circumstances with no less force to intangibles with taxable situs imposed by due application of the legal fiction." McReynolds, J., in *Farmers Loan & Trust Co. v. Minnesota*, *supra* note 21. See also *Frick v. Pennsylvania*, *supra* note 14.

<sup>57</sup> *Fisher's Blend Station, Inc. v. Tax Commission* (1936) 297 U. S. 650, freeing a radio broadcasting station from the burden of a general occupation tax measured by gross receipts. *Legis.* (1936) 49 HARV. L. REV. 473. *Notes* (1936) 34 MICH. L. REV. 1231; (1936) 45 YALE L. J. 495.

<sup>58</sup> Thus a tax upon a base which would have sustained a property tax was invalidated because the taxpayer was a foreign corporation doing only interstate commerce and the tax was called a franchise tax. *Alpha Portland Cement Co. v. Massachusetts* (1925) 268 U. S. 203, 44 A. L. R. 1219. *Cf.* *Atlantic Lumber Co. v. Commissioner*, *supra* note 40. Powell, *Contemporary Commerce Clause Controversies over State Taxation* (1928) 76 U. OF PA. L. REV. 773, 791-793. A state prohibited generally from taxing income from certain federal sources may include the amount of such income in fixing a nondiscriminatory corporate franchise tax. *Pacific Co. v. Johnson* (1932) 285 U. S. 480. These cases do not involve jurisdictional problems but deal with the taxation of income or property exempt under some other constitutional provision. Even in franchise tax cases an effort to exceed jurisdictional limitations is apt to result in trouble. See *Western Union Tel. Co. v. Kansas* (1910) 216 U. S. 1; *Cudahy Packing Co. v. Hinkle* (1929) 278 U. S. 460.

<sup>59</sup> When the exaction is upon the statute books at the time the domestic corporation is chartered or the foreign corporation is admitted to do business, we have to consider not only whether it may be sustained on ordinary principles of jurisdiction, but whether if invalid as a tax it may be sustained on the basis of consent. This involves a consideration of the so-called doctrine of "unconstitutional conditions." There is as yet no rule prohibiting the voluntary relinquishment of a constitutional privilege. The issue turns rather upon the nature and extent of the public interest in the particular privilege involved. Thus the cases which would refuse to enforce an individual's consent to an imposition imposing an unreasonable burden on interstate commerce would not necessarily prohibit a consent to taxation involving property in another state, but not involving interstate commerce. See *Harding, op. cit. supra* note 42; *Merrill, Unconstitutional Conditions* (1929) 77 U. OF PA. L. REV. 879.

<sup>60</sup> The holding in *Pollock v. Farmers Loan & Trust Co.* (1895) 157 U. S. 429, (1895) 158 U. S. 601, that a tax upon the income from property was merely another tax on the property, has since been explained and limited to the precise question of federal taxing power there involved. The same idea however was quite apparent in *Shaffer v. Carter* (1920) 252 U. S. 37; in *Maguire v. Trefry* (1920) 253 U. S. 12; and in the recent case of *Senior v. Braden* (1935) 295 U. S. 422, 100 A. L. R. 794. There was but a trace of it in *Lawrence v. State Tax Commission* (1932) 286 U. S. 276, 87 A. L. R. 374. These cases are discussed hereinafter.

tional issues have been decided on the assumption that the income tax is *sui generis*.<sup>61</sup> Many writers have conjured with the decisions in an effort to call up the guiding spirit thought to dwell therein. There has been considerable diversity of result, but there are some definite conclusions to be drawn.

#### THE SOURCE OF INCOME

In the first place it seems beyond dispute that a state may tax income derived from sources within the state, regardless of where the recipient may reside.<sup>62</sup> There is, however, the problem of defining and locating the *source*. In legal contemplation income does not arise spontaneously. Income would not include wealth acquired by way of gift or finding.<sup>63</sup> The legal approach is to look for some property or services or combination of property and services from which it may be said that the income is derived. In the case of income derived from property, we think of the recipient as the owner of some legally recognized interest in wealth, and receiving some sort of current beneficial return because he is such an owner. This beneficial return we think of as arising either by way of natural increase or yield of the property owner, or as becoming available to the owner as the result of some use to which the property has been

<sup>61</sup> But see Maguire, *Relief from Double Taxation of Personal Incomes* (1923) 32 YALE L. J. 757, 760.

<sup>62</sup> The following excerpt though lengthy seems worthy of inclusion. "In our system of government the States have general dominion, and, saving as restricted by particular provisions of the Federal Constitution, complete dominion over all persons, property, and business transactions within their borders; they assume and perform the duty of preserving and protecting all such persons, property, and business, and, in consequence, have the power normally pertaining to governments to resort to all reasonable forms of taxation in order to defray the governmental expenses. Certainly they are not restricted to property taxation, nor to any particular form of excises. In well-ordered society, property has value chiefly for what it is capable of producing, and the activities of mankind are devoted largely to making recurrent gains from the use and development of property, from tillage, mining, manufacture, from the employment of human skill and labor, or from a combination of some of these; gains capable of being devoted to their own support, and the surplus accumulated as an increase of capital. That the State, from whose laws property and business and industry derive the protection and security without which production and gainful occupation would be impossible, is debarred from exacting a share of those gains in the form of income taxes for the support of the government, is a proposition so wholly inconsistent with fundamental principles as to be refuted by its mere statement. That it may tax the land but not the crop, the tree but not the fruit, the mine or well but not the product, the business but not the profit derived from it, is wholly inadmissible." Pitney, J., in *Shaffer v. Carter*, *supra* note 60, at 50-51. See Notes (1921) 15 A. L. R. 1326; (1934) 90 A. L. R. 484.

<sup>63</sup> While the economists have argued over whether a single fortuitous increment by way of gift may properly be called income, both statutes and judicial decisions have excluded it. The association of income with a source is perhaps mandatory under the language of the Sixteenth Amendment. *Cf. Eisner v. Macomber* (1920) 252 U. S. 189, 9 A. L. R. 1570.

put. Included in the taxable flow of benefits from property to owner are dollar benefits gained from the sale of the property upon the market.<sup>64</sup> Here the jurist and legislator have gone beyond currently accepted economic doctrine.<sup>65</sup> Whether or not it be good policy to tax capital gains realized upon the sale of assets, the asset sold is said to be a source of the resultant gain.<sup>66</sup>

In other cases the income cannot be said to arise from the ownership of anything within the ordinary definitions of property, but is derived from the personal services and labor of the recipient.<sup>67</sup> In a great many cases we find this element of labor combined with the ownership of property, as where the income arises from labor upon property owned. Most modern business activity, of the entrepreneur type, is found to combine property and personal skill as the source of the income derived.

Accepted legal doctrine requires that we draw a distinction between the *immediate* source of the income with respect to a particular recipient, and what might be called the *ultimate* source of the same income. The erection of a pyramid of distinct legally recognized property interests on the basis of a single item of economic wealth is a currently accepted fact. A corporation, for example, owns a factory and the machinery and materials therein. Its legal ownership is complete. Doe owns stock in this same corporation. This stock represents a number of intangible rights in Doe with respect to third persons generally, the state, the other persons owning shares in the corporation, and the persons in control of the management of the corporate business. Doe's legal ownership of these intangible rights is complete and is legally distinct from the ownership

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<sup>64</sup> Practically all the statutes are applicable to capital gain as well as to income in the ordinary sense, although one occasionally encounters differentiations as to rates.

<sup>65</sup> Strictly from a layman's viewpoint, there appears to be a growing conviction among economic writers that the capital gain item is properly included in income, notwithstanding the contrary opinion of the classical writers.

<sup>66</sup> As noted hereinafter there is also an element of personal skill entering into most transactions where capital assets are sold at a dollar profit. In fairness, this skill must also be said to be a source of the gain. At this stage one encounters arguments based upon *Willcuts v. Bunn* (1931) 282 U. S. 216, 71 A. L. R. 1260, sometimes cited for the proposition that a tax upon capital gains is in no sense a tax on the asset sold. It is to be noted that the sole question in that case was whether the implied exemption of state and local bonds from federal taxation, previously extended to the interest from such bonds, was to be extended further to include profits made upon the sale of the bonds, particularly where the bonds were originally issued at par so that the capital gain did not represent deferred interest. The decision denying the exemption did not turn on any issue of identity or lack of identity between the bond and the resale profit, but upon the point that it did not appear that the tax would interfere materially with the fiscal operations of the exempt governmental unit.

<sup>67</sup> That wages and salary earned by a nonresident gainfully employed within the state may be taxed is made clear by the decision in *Travis v. Yale & Towne Mfg. Co.* (1920) 252 U. S. 60, decided the same day as *Shaffer v. Carter*, *supra* note 60.

rights of the corporation in the factory and supplies.<sup>68</sup> Doe in turn pledges these shares of stock to Roe to secure a loan from Roe to Doe. This debt represents a legally recognized property interest in Roe, separate and distinct from Doe's ownership of the stock or the corporation's ownership of the factory. Nevertheless, the real security back of the debt is the corporate business and factory. As the law creates these separate property rights in these different persons, it permits the taxation of each and all of them to their respective owners.<sup>69</sup> The corporation must pay taxes upon the factory and other property owned by it. Doe must pay taxes upon his stock and Roe must pay taxes upon the value of the debt. It is argued that this is objectionable multiple taxation, and some of the statutes give relief against it in some instances. However, there is as yet no constitutional prohibition against multiple taxation of this sort. Nor is such taxation difficult to defend. This pyramiding of legal interests does create something saleable and useful in addition to the basic wealth at the bottom. It is a truism that wealth in motion is of greater current value than wealth stagnant. The added value is reflected in these superimposed legal interests.<sup>70</sup> Whether sound or not, we must at present accept this situation. It lies definitely outside the announced judicial ideal of "one thing—one person—one tax."

Turning from property interests to income, we find a similar situation. Assuming that the corporate business is functioning properly, an income will be derived from the combination of property and labor in the factory and in the corporate management. This income in turn will rise, in whole or in part, through the entire pyramid or set of pyramids based upon the corporation. A part for example, will go to pay interest on the corporate debts. A part will be transmitted to Doe in the form of dividends upon his stock. Doe in turn will transmit all or a part to Roe as interest upon his borrowings. According to our legal definitions, both Doe and Roe have received income, although these steps involve no actual increase in the net worth of the economic structure. The structure

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<sup>68</sup> This is hardly the place to enter into an extended discussion of the logical soundness or the social implications of the fiction of separate corporate entity. See Laski, *The Personality of Associations* (1916) 29 HARV. L. REV. 404; Dodd, *Dogma and Practice in the Law of Associations* (1929) 42 HARV. L. REV. 977; Radin, *The Endless Problem of Corporate Personality* (1932) 32 COL. L. REV. 643.

<sup>69</sup> Hawley v. Malden, *supra* note 17.

<sup>70</sup> It is not attempted here to state any quantitative theory of values. I am trying merely to make the point that the seemingly artificial concept of corporate personality does have some considerable basis in fact (see the many interesting excerpts collected in STEVENS ON CORPORATIONS [1936] c. 1) and that credits evolved from the legal multiplication of tangible assets into many items of distinct property interests in distinct persons are substantial enough to form the basis of a great proportion of the business transactions of the current era.

is perhaps artificial, but is necessarily so, so long as the legal doctrine of separate corporate entity persists.

When we think of source, it seems safe to say that the corporate income has its source in the manufacturing and management process. When the same income reaches Doe as dividends, it is arguable that its source as well is to be found in the corporate activities. However, the dividend, so far as Doe is concerned, represents a yield of the wealth invested in his legally recognized property interest, the share of stock. To Doe, the source of the income is the corporate stock. When Doe in turn transmits this wealth to Roe as interest, Roe receives it because he at a previous time had exchanged wealth for the legally recognized property interest of a debt owing from Doe. To Roe, the source of the interest money is the debt. It is believed that this fairly states the popular meaning of the phrase "source of income," different though it may be from the definition of the economist. This popular meaning merely means that the recipient assigns as the source of income, so far as the income flows from property, that legally created property interest *owned by the recipient himself* and without which he would not receive this benefit. This debt, this share of stock, or whatever it is, is the *immediate* source of the income to this recipient.<sup>71</sup> The *ultimate* source is to be found one or more steps back in the process where the new wealth was first called into existence.

As will be seen, the cases dealing with taxation of income accruing to a nonresident from a source within the taxing state are dealing with the immediate source as defined above, rather than with the ultimate source in the economic sense.

Having fixed upon the source of the particular income in question, the next task is to assign to this source a taxable situs. If the income arises from personal services performed wholly within a single state, the income has its source within that state and is there taxable.<sup>72</sup> If the income arises from the employment of tangible property within a single state, the income has its source in, and is taxable in that state.<sup>73</sup> If the two things are combined in a single state, the same result follows. In many cases, however, the source must be said to have an orbit rather than a situs. Goods are manufactured in one place and sold for profit in another. Personal services in two or three states bring a return which is finally realized in still another state. No one state can claim to have within its borders the source of the entire income. Yet each state is entitled to tax the income in the proportion in which it may properly be said to have

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<sup>71</sup> See HARDING, *op. cit.* *supra* note 1, §§ 30-32.

<sup>72</sup> Travis v. Yale & Towne Mfg. Co., *supra* note 67.

<sup>73</sup> Shaffer v. Carter, *supra* note 60.



a local source.<sup>74</sup> If the proportion to which each place has contributed can be separately measured, the measure of a single state's right to tax is obvious.<sup>75</sup> If separation is not possible, then the state is protected in taxing upon the basis of an apportionment formula designed to determine within reasonable limits that portion of the entire income which is fairly to be taxed in that state.<sup>76</sup> The operation is similar to the use of unit rule formulae enabling particular states to tax a fair share of ambulatory or transitory chattels, and intangibles such as corporate excess or good will, having a situs within an area not confined to the limits of a single state.<sup>77</sup> The technical phases have been discussed in many places.<sup>78</sup> The doctrine is built up in aid of fair taxation of such income at the source, and in no way prevents fair taxation there.

<sup>74</sup> *Underwood Typewriter Co. v. Chamberlain* (1920) 254 U. S. 113; *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission* (1924) 266 U. S. 271; *Hans Rees' Sons, Inc. v. North Carolina* (1931) 283 U. S. 123; *Norfolk & Western R. Co. v. North Carolina* (1936) 297 U. S. 682.

<sup>75</sup> A number of income tax statutes provide that where by separate accounting procedures it is possible to segregate the items of profit accruing from sources in the taxing state, such separate accounting should be the basis of the income tax assessment. Illustrations may be found in *Standard Oil Co. v. Thoresen* (C. C. A. 8th, 1928) 29 F. (2d) 708; *Standard Oil Co. v. Wisconsin Tax Commission* (1929) 197 Wis. 630, 223 N. W. 85; *Ford Motor Co. v. State* (1935) 65 N. D. 316, 258 N. W. 596. This same procedure is adopted in numerous other states even though not expressly provided for. This should always be done, where possible, even though the statute is silent. See *S. S. Kresge Co. v. Bennett* (S. D. N. Y., 1931) 51 F. (2d) 353, where, however, the accounts were rejected as inaccurate. This is merely one phase of the admitted right of the taxpayer to show that a statutory apportionment formula does not reflect the facts. Cf. *Greene v. Wisconsin Tax Commission* (Wis. 1936) 266 N. W. 270, where the statute provided that an individual taxpayer moving into the state during the taxable year should be taxed on that proportion of his annual income that his residence in the state during the year should bear to his residence elsewhere. The court held that this could not constitutionally be applied in the face of a showing that only a very small fraction of the annual income actually did accrue after the taxpayer became resident in Wisconsin.

<sup>76</sup> *Huston, Allocation of Corporate Net Income for Purposes of Taxation* (1932) 26 ILL. L. REV. 725; *HARDING, op. cit. supra* note 1, §§ 48-57.

<sup>77</sup> The well-known cases are collected in *HARDING, op. cit. supra* note 1, §§ 50-52. See also, *Great Northern R. Co. v. Weeks* (1936) 297 U. S. 135, (1936) 4 G. WASH. L. REV. 538, (1936) 49 HARV. L. REV. 1012, (1936) 84 U. OF PA. L. REV. 784; *Pullman Co. v. Murray* (1935) 171 Okla. 450, 43 P. (2d) 428; *Rowley v. Chicago N. W. R. Co.*, *supra* note 28; *Isaacs, The Unit Rule* (1926) 35 YALE L. J. 838.

<sup>78</sup> Considerable ingenuity is required to devise formulae for various types of business. The great bulk of cases, however, appear to involve ordinary manufacturing and trading enterprises. The so-called Massachusetts formula would probably sustain a claim of prima facie fairness in the greatest number of cases. This is based upon the three factors of proportionate tangible assets, payroll and sales within the state:

$$\frac{\text{Mass. Tangibles}}{\text{Total Tangibles}} + \frac{\text{Mass. Payroll}}{\text{Total Payroll}} + \frac{\text{Mass. Sales}}{\text{Total Sales}} \div 3 \times \frac{\text{Total allocable net income}}{\text{income}}$$

The possibilities of compensating errors makes this more desirable than attempts to allocate income on the basis of but one or two items. *HARDING, op. cit. supra*

When the immediate source of the income is intangible personalty, the problem of locating the source in space becomes difficult. It is, however, no different in kind from that of assigning a taxable situs to intangible property for purposes of *ad valorem* or inheritance taxes. We have seen that in most cases the intangible property interest is held to have acquired no situs apart from the person of the legal owner thereof, and is taxable at the domicile of the owner and not elsewhere.<sup>79</sup> In such a situation it would seem proper to argue that income flowing to the owner as the result of the ownership of such property has its source at the domicile of the owner and not elsewhere.<sup>80</sup> To illustrate: A simple debt

note 1, § 55. The National Tax Association in 1928 recommended a formula slightly more complicated in nature and including the added factor of proportionate purchases in the state. PROCEEDINGS, NATIONAL TAX ASSOCIATION, 1928, pp. 428 *et seq.* In 1934, however, the Committee on Uniformity of that Association recommended the adoption of the Massachusetts formula. PROCEEDINGS, 1934, pp. 260-267. This report contains a concise summary of the operation of the plan. A similar approval of the Massachusetts plan is voiced in the 1935 report of the Interstate Commission on Conflicting Taxation. CONFLICTING TAXATION (American Legislators' Association, 1935) 146. Undoubtedly there is at present a considerable movement for uniformity in this field, and the Massachusetts formula appears the likely basis of such action. See also *Kelley v. Kalodner*, *supra* note 54; *United Advertising Corp. v. Lynch* (C. C. A. 2d, 1933) 63 F. (2d) 243. Any detailed study in this field should begin with FORD, THE ALLOCATION OF CORPORATE INCOME FOR THE PURPOSE OF STATE TAXATION (SPECIAL REPORT OF THE NEW YORK STATE TAX COMMISSION NO. 6) (1933). See also Carroll, *Allocation of Business Income, The Draft Convention of the League of Nations* (1934) 34 COL. L. REV. 473.

<sup>79</sup> As previously explained, the business situs cases constitute a valid exception to this doctrine. The corporate excess cases, beginning with and based upon *Adams Express Co. v. Ohio*, *supra* note 28, constitute merely a specific application of the business situs principle. The trust cases fall in the same category. While we are perhaps accustomed to speak of the *cestui* as having an intangible personal right, an attempt to classify this right for purposes of *ad valorem* taxation requires that we consider it an interest or special ownership in the trust corpus, complementary to the "naked" legal title of the trustee. This brings us to the conclusion that the property right of the *cestui* in a trust consisting of lands or tangibles is localized at the situs of the lands or tangibles concerned, and that the property interest of the *cestui* in a trust of intangibles is localized at the integrated situs of the intangibles, usually the place of administration of the trust. The recent tax cases of *Safe Deposit & Trust Co. v. Virginia*, *supra* note 40, and *Senior v. Braden*, *supra* note 60, hereinafter discussed, appear to support this contention. It is also supported by the recent conflict of laws decisions assigning to the place of administration jurisdiction over trusts of intangibles (CONFLICT OF LAWS, RESTATEMENT [Am. L. Inst. 1931] § 297) and assigning a similar jurisdiction to the situs where the trust consists of lands. *Cavers, Trusts Inter Vivos and the Conflict of Laws* (1930) 44 HARV. L. REV. 161; *Beale, Living Trusts of Movables in the Conflict of Laws* (1932) 45 HARV. L. REV. 969. Cf. *Swabenland, The Conflict of Laws in Administration of Express Trusts of Personal Property* (1936) 45 YALE L. J. 438. See *Hutchison v. Ross* (1933) 262 N. Y. 381, 187 N. E. 65, 89 A. L. R. 1007, *rel'g den.* (1933) 188 N. E. 102.

<sup>80</sup> All prevalent theories of income taxation would agree upon a domiciliary tax upon income from intangibles also taxable at the domicile. The decisions herein discussed relating to local source and its definition sustain the proposition that such income is not to be taxed elsewhere.

has its "taxable situs" at the domicil of the creditor, and is not taxable at the residence, or place of business of the debtor, nor at the situs of the security for the debt. Interest paid on the debt has its ultimate source in the property and business of the debtor. On the basis of such source the income out of which the interest is ultimately to be paid is properly taxable *to the debtor* at the situs of the property or business from which the *debtor* derives it. When a part of this income is paid over to the creditor as interest, it becomes new income in the hands of the creditor. It comes to the creditor as the result of his ownership of a property interest which is legally entirely separate and distinct from the business and property of the debtor, and is beyond the taxing jurisdiction of the state of domicil or place of business of the debtor. It is an obvious contradiction to argue that the state admittedly without power to a tax a debt owing a nonresident creditor, may nevertheless levy an income tax upon the interest paid on such debt, on a theory that the interest is derived from a local source.<sup>81</sup> This is particularly true in view of the wide-

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<sup>81</sup> HARDING, *op. cit. supra* note 1, § 36. "It would seem only proper, however, that if a state is to tax not tangible wealth but legal categories it must tax in a manner consistent with those categories. This is the ultimate principle of *Farmers Loan & Trust Co. v. Minnesota*, and the other cases denying taxing jurisdiction over the debt at the domicil of the debtor. No longer can the state assert a general policy of taxing the legal category of a debt, as distinct from the property on which it was created, and at the same time assert jurisdiction over a particular debt on the basis of the situs of the property advanced to the borrower, the ability of the state to collect the debt, or some other ground." *Ibid.* Many statutes fall into this inconsistency, in that they provide that the resident taxpayer is to be taxed upon interest from all sources, and provide at the same time that interest paid a nonresident creditor by a resident debtor shall be considered as income from a source within the state and there taxed. The cases appear to agree that any state with jurisdiction to tax the debt itself may tax the interest derived therefrom. The three cases at hand involving the converse situation support the proposition here stated, that a state without jurisdiction to tax the debt cannot tax the interest money as income. *State ex rel. Manitowoc Gas Co. v. Wisconsin Tax Commission* (1915) 161 Wis. 111, 152 N. W. 848, held that interest paid by a domestic corporation doing a local business to its nonresident bondholders did not constitute an income derived by the bondholders from sources within the state, under a general statutory provision taxing all income from local sources. The language in this opinion is squarely in support of the present thesis. In the case of *Domenech v. United Porto Rican Sugar Co.* (C. C. A. 1st, 1932) 62 F. (2d) 552, the Puerto Rican statute in question provided expressly that "interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise" should be taxed to the nonresident recipient as income from sources within Puerto Rico. The Circuit Court of Appeals held that the statute could not constitutionally be applied to interest payments by a Puerto Rico corporation with its business in Puerto Rico to Maryland banks not doing business in the territory. The loans involved were negotiated in Maryland, and both principal and interest were there payable. The court adopted the same reasoning as here presented. In *Indian & General Investment Trust, Ltd. v. Borax Consolidated, Ltd.* [1920] 1 K. B. 539, the question was whether an American debtor could deduct from interest money due in England to an English creditor, the tax on the interest money which he had been required by the laws of the United States to withhold and

spread use of special income taxes in lieu of the ineffective *ad valorem* taxes upon intangible wealth.<sup>82</sup>

#### TAX ON DIVIDEND BASED ON POWER OVER CORPORATION

Turning to corporate stock we find a similar situation. There is in the beginning an income to the corporation, taxable to the corporation at its place or places of business and in whole or in part<sup>83</sup> at the state of incorporation. A part of this income in turn is passed on to the shareholder in the form of dividends. As such it represents in law an income to the shareholder quite distinct from the income to the corporation. The source of the income to the shareholder (the dividend) is the corporate stock. For a state to claim the right to tax the income on a theory of local source, it would have to establish that this immediate source, the corporate stock, is within its taxing jurisdiction. If this analysis be correct, a dividend representing income to a nonresident shareholder would not be subject to income taxation by a state claiming on the ground that it is the state of incorporation, or that the corporate business and property are located therein.<sup>84</sup> A recent Wisconsin case approaches this issue.<sup>85</sup> The court had previously adopted the approach here set forth, holding as a matter of statutory construction that interest paid a nonresident creditor by a resident debtor is not income from a source within the state.<sup>86</sup> In the instant case the court affirmed its belief

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to pay to the United States as upon the income of the English creditor from American sources. The Court denied his right to make the deduction, holding that the contract by its terms and by law was governed by the law of England and was beyond the jurisdiction of the United States. *Cf. Maguire, op. cit. supra* note 61, at 763. All this adds up to Professor Powell's observation that "Common sense requires that the fruit and the tree be treated alike in taxes upon non-residents." Note (1920) 20 Col. L. Rev. 457, at 459. Nossaman, *op. cit. supra* note 52, at 533, considers the matter entirely settled. But see, Day, *loc. cit. supra* note 52.

<sup>82</sup> Where we are concerned with the special Intangibles Income Tax Law (in lieu of *ad valorem*) instead of with a general income tax law, some of the problems are avoided by a tendency in the courts to construe the statute so as to require the local taxability of source as well as income. This makes the question one of statutory construction rather than constitutional powers. See *Middlekauff v. Galloway*, and *Hill v. Carter*, both *supra* note 40. I am convinced, however, that the states are up against the same limitations regardless of the name of the tax.

<sup>83</sup> Limitations upon the taxing power at the domicile or state of incorporation are discussed hereinafter.

<sup>84</sup> In view of the parallel treatment of debt and corporate stock in *Farmers Loan & Trust Co. v. Minnesota* and *First National Bank v. Maine*, both *supra* note 21, and the unanimous line of cases holding interest money paid a nonresident creditor by a resident debtor is not income from a local source, it is believed that the proposition above stated follows as a matter of syllogistic logic.

<sup>85</sup> *State ex rel. Froedtert Grain & Malting Co. v. Tax Commission* (Wis. 1936) 265 N. W. 672, 267 N. W. 52.

<sup>86</sup> *State ex rel. Manitowoc Gas Company v. Wisconsin Tax Commission, supra* note 81.

in the soundness of that case. Nevertheless, a 2½% tax on dividends was upheld. The reason assigned was that the tax did not purport to be an income tax, or in any way to be a tax upon the dividend or the shareholder,<sup>87</sup> but was an excise tax "for the privilege<sup>88</sup> of declaring and receiving dividends out of income derived from property located and business transacted in this state."<sup>89</sup> The excise was to be paid by the

<sup>87</sup> "It is contended that the language imposes a tax upon the recipient of the dividend. The language is perhaps susceptible to the construction that the Legislature so considered it. But it is immaterial how the Legislature considered it . . . . However the Legislature may have regarded the tax, we have no difficulty in construing the statute as imposing an excise or privilege tax upon the transaction involved of transferring the dividends from the corporation to its shareholders." Per Fowler, J., *supra* note 85, at 675.

<sup>88</sup> Counsel appear to have wasted a great deal of time in arguing that the declaration and payment of dividends constituted a "right" and not a "privilege" and that therefore the tax could not be levied. It would appear clear by now that, granted the jurisdictional and other requisites, an otherwise valid excise upon an act is not to be defeated on the basis of a jurisprudential classification of the subject matter of the tax as a right, privilege, immunity, or what-not.

<sup>89</sup> The argument made was that this was a tax upon the act of transferring rather than upon the property transferred, and principal reliance was upon *Magoun v. Illinois Trust & Sav. Bank* (1898) 170 U.S. 283, which however held no more than that a state could constitutionally levy an inheritance tax, and could classify the several inheritances for the purpose of fixing both rates and exemptions according to the degree of relationship between the deceased and the legatee or heir. However, in the preface to the opinion it is said: "1. An inheritance tax is not one on the property, but one on the succession. 2. The right to take property by devise or descent is the creature of the law, and not a natural right—a privilege, and therefore the authority which confers it may impose conditions upon it." (Per McKenna, J., at p. 288). This statement is the basis of the Wisconsin court's argument. However, it has been settled for a long time that jurisdiction to impose inheritance taxes does not depend on whether inheritance is called a right or a privilege. Some courts call it a right. The rest of the quotation is meaningless today. The final part of the excerpt that the authority conferring the privilege of inheritance may impose conditions in the nature of a tax was the underlying theme of Holmes' opinions beginning with *Blackstone v. Miller*, *supra* note 19. That this argument alone will not sustain a claim of jurisdiction today is clear. If the cases beginning in 1930 decide anything, they decide that jurisdiction to levy an inheritance tax measured by the value of the property transferred must rest upon jurisdiction over the property itself; that an inheritance tax measured by value cannot be sustained where an ordinary *ad valorem* tax would fail. *HARDING, op. cit. supra* note 1, § 23. See *supra* note 41; Note (1936) 11 WIS. L. REV. 587.

The court relied upon *Orr v. Gilman* (1902) 183 U.S. 278, which, however, held only that New York might by statute enacted after the death of the donor provide that the inheritance tax upon the exercise of a power of appointment should be levied as though the property passed from the donee of the power. The property involved was real estate located in New York and subsequently converted into personalty which was held in New York. No jurisdictional issue was involved, although there was a futile attempt to obtain the benefit of a local provision exempting certain of the property from ordinary *ad valorem* taxes.

Considerable reliance was had upon *Home Ins. Co. v. New York* (1890) 134 U.S. 594, which, however, involved no issue of jurisdiction but merely whether the state in applying a franchise tax on domestic corporations measured in part by divi-

corporation and deducted from the dividend.<sup>90</sup> Right here the real question arises. Concededly the state may tax domestic<sup>91</sup> or foreign<sup>92</sup> corporations on income derived from business done within the taxing state.<sup>93</sup> Also there would appear to be no objection to measuring this tax by that part of the income distributed as dividends, rather than on the basis of total income.<sup>94</sup> Where only one class of shares is involved, the amount of the tax, being a proper deduction from profits or surplus before the declaration of dividends, will reduce the available dividend funds. In such a case the shareholder comes out about the same whether the tax is called a franchise tax on the corporation or a tax on the dividends. Within these limits and within them only can the holding of the Wisconsin court be sustained. But suppose the corporation has outstanding an issue of 6% preferred stock. May the directors declare a 6% dividend on the preferred and then declare a dividend on the common, at the same time withholding from the preferred shareholders the 2½% tax? If the Wisconsin statute is, as the court indicates, merely a malformed franchise tax then its amount is deductible from surplus for dividends along with other taxes and is ultimately to come out of the

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dends could include therein dividends derived from earnings on United States securities. The assumption found in the opinion that the state had a complete taxing jurisdiction over the stock must be qualified in light of *First Nat. Bank v. Maine*, *supra* note 21.

<sup>90</sup> There is of course no doubt as to the power to collect at the source if the jurisdictional requisites are met. *Infra* note 100.

<sup>91</sup> *Pacific Co. v. Johnson*, *supra* note 58. In taxing domestic corporations it appears to be still within the power of the state to measure a franchise tax by all corporate income regardless of source. This is merely the stipulated price of corporate privileges, and is to be distinguished from the domiciliary income taxation of individuals.

<sup>92</sup> *Underwood Typewriter Co. v. Chamberlain*, and other cases cited, *supra* note 74.

<sup>93</sup> Except so far as limited in its bearing on interstate commerce by the decision in *Crew Levick Co. v. Pennsylvania* (1917) 245 U. S. 292, this tax may be measured by gross receipts from local business. This is commonly done in taxing insurance companies. *Hanover Fire Insurance Co. v. Harding* (1926) 272 U. S. 494, 49 A. L. R. 713. Interstate commerce of course is not freed from nondiscriminatory net income taxes. *United States Glue Co. v. Oak Creek* (1918) 247 U. S. 321.

<sup>94</sup> *Home Ins. Co. v. New York*, *supra* note 89; *Barnes v. Philadelphia & R. R. Co.* (1873) 17 Wall. 294. In *Union Oil Associates v. Johnson* (Cal. 1934) 32 P. (2d) 360, the California court held that a foreign holding company, owning all the stock of a California corporation, was "doing business" in California so as to be subject to a franchise tax computed on the basis of the proportion of dividends, paid by the California corporation to the holding company, which represented California income to the California corporation. This entirely unacceptable definition of doing business was retracted on rehearing. (1935) 2 Cal. (2d) 727, 43 P. (2d) 291, 98 A. L. R. 1499. The use of a holding company to escape proper local taxes may be prevented by suitable legislation—but such legislation does not extend the state's taxing jurisdiction. *Curtis Companies v. Wis. Tax. Comm.* (1933) 214 Wis. 85, 251 N. W. 497, 92 A. L. R. 1065. *HARDING, op. cit. supra* note 1, § 57.

earnings on the common shares. The preferred shareholder would be entitled to his 6% if and when earned, without having his dividend diminished in this way.<sup>95</sup> On the other hand if this be a tax on dividends, and if the state is to be held to have the right to tax the dividend, the right of the corporation to deduct its amount from the 6% declared will have to be upheld. This problem the Wisconsin court does not decide. By torturing the tax into a sort of franchise tax the court saved it in the instant case because, as pointed out, calling it a dividend tax does no real harm except where as here it misleads the taxpayer into instituting fruitless litigation.<sup>96</sup> Legislative labels no longer decide cases. We may concede a certain excise tax jurisdiction. The state may tax the execution of writings within its borders.<sup>97</sup> It may tax sales within its borders.<sup>98</sup> It may tax corporate acts within its borders.<sup>99</sup> However, the liability for such taxes falls upon the person doing the act within the taxing state. There is nothing in this excise tax idea empowering the taxing state as a matter of sovereign authority to create in the taxpayer of first instance a legal right of reimbursement against another person not present in, or acting in, or owning property in, the taxing state.<sup>100</sup> There is

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<sup>95</sup> Of course if the net earnings of the corporation were precisely 6% on the preferred or even less, the imposition of the tax would prevent the directors from making available the fullest possible dividend on the preferred stock. The result, however, would be no different from that reached in any other case of oppressive taxation on a relatively unprofitable business.

<sup>96</sup> A subsidiary question would arise as to whether a common shareholder resident in New York, who received but \$97.50 out of his \$100 dividend because of the deduction of the tax, would be taxable in New York on an income of \$97.50 or \$100. The lower figure would appear to be the proper basis of assessment.

<sup>97</sup> *Graniteville Mfg. Co. v. Query*, *supra* note 49 (upholding a stamp tax of four cents per hundred dollars or fraction thereof on promissory notes or other obligations for the payment of money actually executed within the state).

<sup>98</sup> The sales tax cases are hardly in point, since we usually find both buyer and seller present and acting within the state, either in person or by agent, and find the property sold also within the territorial limits. In such a case no jurisdictional issue is involved. Where the buyer is acting only by correspondence or where the goods are not within the state, most of the cases allowing an exemption properly rest on the interstate commerce feature involved. There is, however, a jurisdictional problem in these latter cases.

<sup>99</sup> *New York ex rel. Hatch v. Reardon*, *supra* note 50 (upholding a tax of two cents per hundred dollars face value or fraction thereof on agreements for the sale of corporate stock within the borders of the state, irrespective of the residence of the parties or the place of incorporation).

<sup>100</sup> There are of course many cases upholding collection of the tax at the source, with a right in the person paying the tax over against the person ultimately liable, but these are cases where the jurisdiction of the taxing state over the real subject matter of the tax cannot be disputed. Thus we find taxes upon property may be collected from the person in possession with a right of reimbursement from the real owner. *Carstairs v. Cochran* (1904) 193 U. S. 10. A valid tax on corporate shares may be collected from a domestic corporation with a right of reimbursement from the shareholders. *Corry v. Baltimore*, *supra* note 41. Tax on royalties

nothing in the excise tax idea which would justify the taxpaying corporation in deducting the 2½% tax from the 6% preferred stock dividend.

Realizing no doubt the weakness of its position, the Wisconsin court sought to bolster its case by making an argument for local source of the income. It was sought to distinguish dividends from interest payments on the ground that the latter might not be earned by the debtor, and if earned, might be earned outside the taxing state. The dividend tax was applicable only to dividends actually earned within the state.<sup>101</sup> The court in effect disregards the corporate fiction for the sole purpose of applying this tax and argues as though the income to the corporation really accrued to the shareholder in the first instance, while at the same time treating the corporation as a separate entity for other purposes. This "now you see it—now you don't" handling of the corporate fiction in order to sustain a multiplicity of taxes was proscribed in *Rhode Island*

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from local oil lands may be collected from lessee with right of reimbursement from royalty owner. *Forbes v. Mid-Northern Oil Co.* (1935) 100 Mont. 10, 45 P. (2d) 673. Collecting tax on reversionary interest in local lands from lessee, with right to deduct the tax from the rental payments to the lessor. *Vermont & Canada R. Co. v. Vermont C. R. Co.* (1890) 63 Vt. 1, 21 Atl. 262, 10 L. R. A. 562. Collecting income tax on wages earned within state from the local employer with a right of deduction against the nonresident employee. *Travis v. Yale & T. Mfg. Co.*, *supra* note 67. All of these cases may be rested upon the notion that the person paying the tax in the first instance is subrogated to the state's lien on a subject matter undeniably within its jurisdiction. That the power to collect from a person within the state cannot confer taxing jurisdiction is demonstrated in *State Tax on Foreign-held Bonds* (1873) 15 Wall. 300. It is still an open question whether the state may create an ordinary personal liability against the nonresident taxpayer, enforceable even in the taxing state. That this cannot be done is indicated in *Dewey v. Des Moines* (1899) 173 U. S. 193; *New York v. McLean* (1902) 170 N. Y. 374, 63 N. E. 380; *Beale, op. cit. supra* note 1, § 118B.5. A contrary result is indicated in *Greenbaum v. Commonwealth* (1912) 147 Ky. 450, 144 S. W. 45, Ann. Cas. 1913D 338; *Nickey v. Rice* (1933) 167 Miss. 650, 145 So. 630, 146 So. 859. This latter case was affirmed *sub nom.* *Nickey v. Mississippi* (1934) 292 U. S. 393, but the Court refused to decide the constitutional issue, holding merely that the state could collect the tax from other property within its jurisdiction, and pointing out that the present proceeding had been instituted by an attachment of such property and that the owner had appeared in an effort to cause the attachment to be released. Even though the taxing state could create a personal liability for taxes against the nonresident individual, the prevailing Conflict of Laws rule would deny the enforcement of the claim in another state. CONFLICT OF LAWS, RESTATEMENT (Am. L. Inst. 1931) §§ 443, 610. Claims for corporate franchise taxes have been enforced as in the nature of contractual obligations. *People of New York v. Coe Mfg. Co.* (1934) 112 N. J. L. 536, 172 Atl. 198; *Milwaukee County v. M. E. White Co.* (1935) 296 U. S. 268. Sack, *(Non)Enforcement of Foreign Revenue Laws in International Law and Practice* (1933) 81 U. OF PA. L. REV. 559; Leflar, *Extrastate Enforcement of Penal and Governmental Claims* (1932) 46 HARV. L. REV. 193; Hazelwood, *Full Faith and Credit Clause as Applied to Tax Judgments* (1934) 19 MARQUETTE L. REV. 10.

<sup>101</sup> The statute is thus to be differentiated from those which expressly include as income from local sources, all dividends paid by domestic corporations.



*Hospital Trust Co. v. Doughton*,<sup>102</sup> an inheritance tax case. All the arguments used in the Wisconsin case, *e. g.*, excise tax, tax on transfer as opposed to ownership, ultimate ownership, were advanced and refuted in the *Doughton* case, so that the matter appears to be settled. If some state should abolish the corporate fiction entirely, it would then be able to advance the local source idea with some hope for success.

#### TAX ON STOCK PROFITS BASED ON POWER OVER CORPORATION

In the matter of profits resulting from the sale of stock, the situation is a bit different. We ordinarily think of capital gains, resulting from the sale of wealth, as income (if it be income at all) derived from the wealth sold.<sup>103</sup> The source of the income would thus be situated at the situs of the property sold.<sup>104</sup> Many statutes so provide. This is but a partial truth. A great deal of the income may be due to manufacturing or other process in some other place. If this be the case, this must be deducted from the taxable income at the place of sale, either through actual measurement,<sup>105</sup> or through an apportionment formula,<sup>106</sup> or some other means. Furthermore, a measure of the profit may be due to personal skill of the seller, such as bargaining, in some other place. *Shaffer v. Carter*<sup>107</sup> would indicate that this element of personal skill may safely be disregarded so long as it does not assume material proportions, and the entire gain taxed at the situs of the property involved. On the other hand, the *Hans Rees* case<sup>108</sup> embodies a definite warning that due allow-

<sup>102</sup> (1926) 270 U. S. 59, holding that North Carolina could not levy an inheritance tax on shares in a New Jersey corporation owned by a Rhode Island decedent, the tax being measured by that proportion of the value of the shares that represented corporate assets in North Carolina, as compared with total corporate assets.

<sup>103</sup> See note to *Willcuts v. Bunn*, *supra* note 66. *Cf.* the cases relating to state inheritance taxation of federal securities, *Plummer v. Coler* (1900) 178 U. S. 115; and federal inheritance taxation of state securities, *Griener v. Lewellyn* (1922) 258 U. S. 384.

<sup>104</sup> *HARDING, op. cit. supra* note 1, § 40. *Cf.* *Commissioner I. R. v. East Coast Oil Co.*, S. A. (C. C. A. 5th, 1936) 85 F. (2d) 322.

<sup>105</sup> *Supra* note 75.

<sup>106</sup> *Supra*, notes 74, 76-78.

<sup>107</sup> *Supra* note 60. "The fact that it required the personal skill and management of appellant to bring his income from producing property in Oklahoma to fruition, and that his management was exerted from his place of business in another state, did not deprive Oklahoma of jurisdiction to tax the income which arose within its own borders. The personal element cannot, by any fiction, oust the jurisdiction of the state within which the income actually arises and whose authority operates over it in rem. At most there might be a question whether the value of the service of management rendered from without the state ought not to be allowed as an expense incurred in producing the income; but no such question is raised in the present case, and hence we express no opinion upon it." Per Pitney, J.

<sup>108</sup> *Hans Rees' Sons v. North Carolina*, *supra* note 74, invalidating an apportionment of income from local business on the basis of proportionate tangibles within the state, upon a showing that a considerable portion of the income was due to skilled buying operations in other states, with the result that the apportionment formula demonstrably assigned too much income to North Carolina.

ance must be made for the fact that a part of the income resulted from personal skill exercised elsewhere, if such be established as fact. It would, however, appear to be impossible to construct any sort of a rational apportionment formula to care for this situation.<sup>109</sup> Probably in practice the burden of proof will decide the cases; that is, the state of situs of the property sold may tax the entire capital gain, except to the extent that the taxpayer can show that the gain was augmented by the exercise of personal skill elsewhere. To the extent that such skill contributed to the income, the income would be taxable at the place the skill was exercised.<sup>110</sup> As a practical matter, however, this tax would not be laid except where the taxpayer had an established business in such place. In this latter case, the business situs doctrine would seem sufficient to furnish necessary rules of decision.

If the property sold is not within the state, and if the sales transaction is not within the state,<sup>111</sup> it would seem clear that the state can not claim the right to tax the capital gain upon any theory of source. It would follow that a profit realized by the sale of a debt would not be taxable at the domicile of the debtor as such. It would also follow that a profit realized from the sale of corporate stock would not be taxable by the state of incorporation as such, or by a state on the claim that the corporate property or business is located therein. There is convincing authority for these propositions.<sup>112</sup>

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<sup>109</sup> It will be reflected in slight degree by the inclusion of a payroll factor in the formula.

<sup>110</sup> By analogy to any other case of personal services producing income within the state. Cf. *State ex rel. Lerner* (1933) 213 Wis. 267, 251 N.W. 456.

<sup>111</sup> That the sales transaction itself occurs outside the state, effectively eliminates the excise tax analogies.

<sup>112</sup> *Newport Co. v. Wisconsin Tax Commission* (1935) 219 Wis. 293, 261 N.W. 884, 100 A.L.R. 1204; (1936) 11 Wis. L. Rev. 300. The taxpayer was a Delaware corporation with factories in Wisconsin and four other states. Its tax return for the year in question was on a separate accounting basis. From 1923 to 1927 the corporation owned a large block of stock in the Milwaukee Gas & Coke Co., a Wisconsin corporation. This stock was not used directly in connection with the Wisconsin business of the taxpayer. Instead most of it was held by an Ohio trust company as security for bonds of the Newport Company, and the remainder was in an Illinois safe deposit box. The corporation normally held its directors' meetings in Wisconsin, but in 1927 a special meeting was had in New York and the sale of this stock was authorized. The sales transaction was completed in New York and Pennsylvania and the certificates were delivered in Ohio. Wisconsin claimed the right to tax the resulting profit of \$2,274,589. This the court denied, saying the rule to be "that as to nonresidents there may be no imposition of income taxes upon income derived from property or business located without the State; that the situs of such intangibles as corporate stock is the domicile of the owner; that since property of this character, owned by a foreign corporation, is not located within the state of Wisconsin, it is not subject to an income tax levied by that state." The state sought to sustain the tax on the business situs principle, claiming that the

## TAX AT BUSINESS SITUS OF STOCK

So far, we have proceeded upon the normal assumption that the corporate stock involved in the transaction is taxable at the domicile of the owner, and there only. It has been pointed out, however, that shares of stock may acquire a business situs at some other place.<sup>113</sup> This would not result from the fact that the share certificates are kept within the state.<sup>114</sup> The wealth represented by the shares, however, may be employed in connection with a local business in a manner sufficient to meet the integration test. Possible cases would be shares constituting the stock in trade of the New York brokerage business of a Connecticut citizen, or shares belonging to a Delaware corporation with its offices and business situated entirely in Illinois,<sup>115</sup> or with its principal place of business there and the stock not being used in connection with any one part of the entire business.<sup>116</sup> Since it is clear that the shares would be taxable at this business situs, irrespective of the domicile of the owner, it would seem to follow that this same state of business situs could levy an income tax upon the dividends paid upon the shares.<sup>117</sup> In such a case the source of the income is within the taxing state. The same state could tax gains

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corporation has its principal place of business within the state. The statute provided that in such a case the foreign corporation should be taxed as locally domiciled. The court first stated that the centralization of the manufacturing business in Wisconsin would not of itself be sufficient to confer jurisdiction to tax income from foreign sources not an integral part of the unitary business. It was held on the facts that the principal place of business was not in Wisconsin. It was further held that Wisconsin could not by legislative fiat domesticate a foreign corporation doing local business so as to extend the taxing power of Wisconsin to property and to income situated elsewhere. There is dictum to the effect that such a condition could not constitutionally be attached to even the initial admission of the corporation to the state. *Cf. Harding, loc. cit. supra* note 42.

This case appears to be in line with the earlier case of *State ex rel. Manitowoc Gas Co. v. Wisconsin Tax Commission*, *supra* note 81, and, in view of the strained statutory construction there adopted, is not affected by the subsequent decision in *State ex rel. Froedtert Grain & Malting Co. v. Tax Commission*, *supra* note 85.

<sup>113</sup> *Supra* note 46.

<sup>114</sup> *Baldwin v. Missouri*, *supra* note 21.

<sup>115</sup> If all the business activities are centered in some state other than the state of incorporation, all the intangibles employed in the business will be taxed at the sole place of business. *Wheeling Steel Corp. v. Fox*, *supra* note 39. This same state should be able to tax the income from such intangibles. See also *State v. First Bank Stock Corp.*, *supra* note 42.

<sup>116</sup> If the foreign corporation has its principal place of business within the state, but also conducts business elsewhere, the intangibles with a business situs at this place would be limited to those which had not been so identified with the business of a particular foreign branch as to acquire a business situs there. Admittedly intangibles may acquire a business situs at subordinate branches. See the cases cited *supra* note 40. These distinctions are also suggested in *Newport Co. v. Wisconsin Tax Commission*, *supra* note 112.

<sup>117</sup> In the *Newport* case the Tax Commission correctly so contended. It failed, however, to prove the fact of business situs.

resulting from the sale of the shares, subject to the same personal skill factor mentioned above. There is some indirect judicial authority for these propositions.<sup>118</sup>

#### RIGHT OF DOMICIL TO TAX INCOME—GENERAL CONSIDERATIONS

Turning to the question of domiciliary taxation of the dividend or stock profit, we encounter a different issue. One thing we may assume as true, without further discussion: The state of domicil of the recipient of income may certainly levy a tax upon such income as is not shown to have been derived from sources outside the taxing state.<sup>119</sup> It would seem to follow that in the great bulk of cases, where there is no claim that the stock has acquired a business situs elsewhere, the domicil of the shareholder may tax him upon dividends and stock profits received.

What, then, if it appear that the stock has acquired a business situs elsewhere, so that some other state is properly claiming the right to tax the dividends and profits as income from a source within the taxing state? What is to be the result if the Court should finally hold that dividends paid by domestic corporations, or from the proceeds of local corporate business, are income from a local source and thus taxable as against nonresident shareholders? Would such facts affect in any way the taxing power of the domiciliary state?

Most income tax statutes purport to tax resident individuals upon all income received, regardless of source. Some statutes make similar claims with respect to taxing the entire income of domestic corporations. Most of the writers on public finance assume that this is a desirable objective.<sup>120</sup> To the lawyer, the situation poses two questions: (1) Is the doctrine of "one thing—one person—one tax," so prominent in *ad valorem* and inheritance taxation, to be extended to income taxation? (2) In case the doctrine is so extended, must domiciliary income taxation give way in the face of well-founded taxation of the same income at its

<sup>118</sup> See *Interstate Bond Co. v. State Revenue Comm.* (1935) 50 Ga. App. 744, 179 S. E. 559.

<sup>119</sup> This is pointed out specifically in virtually every case denying taxation on a theory of local source. It is either mentioned or tacitly assumed in every case upholding domiciliary taxation. Upholding domiciliary income taxes upon dividends from foreign corporations not doing a local business: *Wiseman v. Interstate Public Service Co.* (1935) 191 Ark. 255, 85 S.W. (2d) 700; *Conner v. State* (1925) 82 N. H. 126, 130 Atl. 357. In neither of these cases was there anything to indicate that the stock had acquired a taxable situs outside the domicil of the shareholder. Certain other prominent decisions assume the domiciliary taxing power, although involving and deciding other issues. *Colgate v. Harvey* (1936) 296 U. S. 404, 102 A. L. R. 54; *Shields v. Williams* (1929) 159 Tenn. 349, 19 S. W. (2d) 261; *State ex rel. Dulaney v. Nygaard* (1921) 174 Wis. 597, 183 N. W. 884; *Lapham v. Tax Comm.* (1923) 244 Mass. 40, 138 N. E. 708.

<sup>120</sup> The argument is set forth by Leland, *infra* note 130.

source? There seem to be valid reasons for answering both questions affirmatively.

If, ultimately, we decide as several states have decided, that the income tax is nothing more than another type of property tax upon the source of the income,<sup>121</sup> the question answers itself. Jurisdiction over the source of the income would confer exclusive jurisdiction to tax the income therefrom.

If we are concerned with a special tax upon income from intangibles in lieu of the ordinary *ad valorem* taxes, the problem largely cares for itself. These statutes are quite normally construed as requiring the same jurisdictional basis as would be required for the *ad valorem* tax itself.<sup>122</sup> Recently, however, there has been a slight tendency to claim for these special intangibles taxes the wider jurisdictional basis previously claimed for ordinary income taxes.<sup>123</sup>

If we decide, as some states have, that the income tax is a property tax upon income as property (as distinguished from those which consider the tax as one on the source), the domiciliary state will have to forego its claim to tax all income and be content to tax the income from foreign sources if, as, when, and to the extent that, such income subsequently acquires a taxable situs within the state.<sup>124</sup> This likewise would eliminate most of the overlapping claims.

Suppose, however, that we think of the tax as *sui generis*, or as a personal tax, or as some would have it, as an excise on the receipt and enjoyment of the income? On the basis of this reasoning, some cases announce without hesitation that the domicil may tax the income in its entirety.<sup>125</sup> Some of these however antedate 1930. We must consider the fact that in 1930 what the Supreme Court thought desirable considerations of policy brought about the final culmination of a long fight to eliminate duplicate property and inheritance taxes. We must also remember that every argument of fairness, justice, or public policy, whether we believe it sound or unsound, applied in the field of duplicated *ad valorem* and inheritance taxes, will apply with at least the same force in the field of

<sup>121</sup> Cases cited *supra* note 54. This theory has been the bugaboo of the income tax adherents for years. See the articles cited *supra* note 53.

<sup>122</sup> *Middlekauff v. Galloway*; *Hill v. Carter*, both *supra* note 40. The issue is also involved in *Senior v. Braden*, hereinafter discussed.

<sup>123</sup> See Note (1936) 15 ORE. L. REV. 270.

<sup>124</sup> The adoption of this theory of course raises a great many difficult questions as to uniformity, equality, and the like.

<sup>125</sup> *Crescent Mfg. Co. v. Tax Commission* (1924) 129 S. C. 480, 124 S. E. 761; *State v. Gulf M. & N. R. Co.* (1925) 138 Miss. 70, 104 So. 689; *Lawrence v. Mississippi State Tax Commission* (1931) 162 Miss. 338, 137 So. 503; *Ross v. McCabe* (1933) 166 Tenn. 314, 61 S. W. (2d) 479; *State v. Weil* (Ala. 1936) 168 So. 679. There are several dozen cases containing dicta to the same effect.

duplicated income taxes. If it is socially undesirable to tax a man in two places on his farm in one of them, it is as undesirable to tax him in two places on the rent received from that same farm. It seems not an overstatement to assert that at the present time the possibilities of multiple income taxation involve prospects quite beyond anything imagined in the era of multiple inheritance and property taxes. We must also remember that the pressure of multiple taxation is an old story in the field of inheritance taxation, and is relatively new in income taxation. The cumulative weight of protest of individuals involved has only begun to make itself felt. I am confident in my own mind that the drama of *Union Transit*, of *Frick*, of *Baldwin v. Missouri*, *et al.*, is yet to be reenacted on the same stage. The cast will be quite new; but the plot will be familiar; and the curtain will ring down on the same finale. This is in part prophecy, but it is to a considerable extent based upon well reasoned judicial pronouncements of very recent date.

If we are to choose between taxation of income at the source and taxation of the same income at the domicile of the recipient, the claim of the source is difficult to ignore.<sup>126</sup> Income does not come into being in a vacuum. Except in very unusual instances, income cannot be said to result solely from the efforts of the recipient. In our present economy income results from a social demand for the goods or services of the individual. The income is created by the social and economic organism in which the individual labors or in which his property is employed. The state of origin in claiming the right to tax income is merely claiming the right to retake a part of the benefits created in largest measure by the business entity within the state, as a contribution toward the further maintenance and development of this cooperative economy. "The income tax proceeds to tax the individual who has participated within the group function, upon the individual benefits actually received. It is merely the final exaction in return for the benefits conferred under the social and economic solidarity of the people. It rests ethically upon the idea that those who benefit most directly from the structural whole should contribute most to the cost of its maintenance and operation. When we look at the income tax in this real aspect, and discard for the moment legalistic and economic jargon, it appears that jurisdiction for the imposition of an income tax does not differ materially from jurisdiction for the purpose of other taxes. The state levies the one type in return for the opportunity afforded, and levies the other in return for the opportunity realized upon."<sup>127</sup>

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<sup>126</sup> See the excerpt *supra* note 62.

<sup>127</sup> HARDING, *op. cit. supra* note 1, at 153. Cf. Brown, *The Nature of the Income Tax* (1933) 17 MINN. L. REV. 127.

We arrive then at the tentative proposition that as soon as the social pressure against the present duplicate taxation of the same income to the same person, first at the source and then at the domicil, makes itself sufficiently felt, domiciliary taxation of income is to give way to a claim of exclusive jurisdiction to tax such income at its source in the non-domiciliary state. How soon this is to be will in turn depend upon how soon the state income tax spreads into the states having no such tax but containing large financial centers, and also upon how far the present tendency to increase the state income tax rates may develop.<sup>128</sup>

*(To be concluded in the March issue)*

*Arthur Leon Harding.*

UNIVERSITY OF IDAHO,  
MOSCOW, IDAHO.

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<sup>128</sup> That the pressure is already being felt is manifest in the attempts of state legislatures to get together with reciprocity statutes, and the attempt to solve the international problem by means of treaty. There is no space to discuss the details of these proposals. However, we encounter the argument that this problem should be left in its entirety to the legislatures; that for the Supreme Court to interfere is for the Court improperly to impair the sovereign authority of the states. This argument I cannot concede. The states must be left free to exercise the greatest possible authority consistent with a federal scheme of government. Confessedly this sovereignty is threatened, but the culprit is not to be found in the judiciary. Certain of the legislative proposals, *e.g.*, that the United States collect these taxes and divide with the states, do contain such a threat. However, it is to be noted that a distinguishing feature of most of our younger scholars is an almost unlimited faith in the efficacy of legislation. Some states have enacted reciprocity statutes, but it appears that many of them actually stand to benefit by the rule of reciprocity employed. There seems to be little hope for the universal adoption of some single rule. Certainly it cannot be asserted that the legislative branch has demonstrated any supreme intelligence in dealing with this problem. Nor can we expect any magnanimous gestures in the face of steadily mounting fiscal requirements. Relatively slight margins of profit in most of our competitive businesses make them most sensitive to multiple taxation. Even a slight duplication of taxes on one competitor may make him unable to continue. Certainly something had to be done to keep this threat within reason. The United States Supreme Court seems to have been the only body with the *will*, the intelligence, and the authority to do it. I believe the result to be of sufficient value to justify the Court's action. But see Book Review (1934) 29 ILL. L. REV. 128. *Cf.* Fraenkel, *The Supreme Court and The Taxing Power of The States* (1934) 28 ILL. L. REV. 612. It appears impossible to lay down any rule that the Court should or should not decide policy issues. Where the due process issue involves only the internal policy or polity of a single state, the Court has managed pretty well to avoid decisions on such a basis. However, when the question of policy is not internal, but has to do with the relationship between states, or relationship between a state and a citizen of another state, this seems to be an entirely proper subject for judicial consideration. The continued existence of a federated government appears to require the existence of some agency capable of settling these issues so as to eliminate as much of the friction as may be possible. The double taxation cases constitute merely an instance of the exercise of this function. A recently published article by Nossaman, *op. cit. supra* note 52, appears to reach a conclusion substantially similar to that in HARDING, *loc. cit. supra* note 1 and here again set forth.