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Taxation -- The Property Basis of Inheritance Taxation of Intangibles -- Inheritance Tax on Shares of Non-Resident at Corporate Domicile

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rule was first definitely established in *Meyers Co. v. Battle*[16] which held that notice of dishonor was necessary notwithstanding a collateral agreement that the indorser would assume the liability of an "original promisor." A much later case *Busbee v. Creech*[17] was to the same effect. By the language tenor of *Wrenn v. Lawrence Cotton Mills* it seems that our rule has been extended; namely, so that *no* collateral agreement which imposes primary liability on the indorser will be enforced, whether its tendency is to dispense with the necessity for the notice of dishonor or to repel the effect of the statute of limitations. The court's careful consideration of the terms of the N. I. L. in each of the later cases and the absence of that consideration in the earlier cases indicates the possibility that when the proper occasion arises, the court may overrule *Sykes v. Everett* and declare those parol agreements which *limit* the indorser's *liability* also unenforceable.

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Taxation—The Property Basis of Inheritance Taxation of Intangibles—Inheritance Tax on Shares of Non-Resident at Corporate Domicile

The United States Supreme Court has recently decided in the case of *Farmers' Loan and Trust Co. v. Minnesota,*[1] that the State of Minnesota cannot levy an inheritance tax upon the transfer of bonds issued by that State and by its municipal corporations, owned and held by a non-resident decedent. Such a radical departure from the opposite rule as laid down in *Blackstone v. Miller,*[2] affecting as it does enormous interests, is of itself a landmark in the law of taxation. Its greater interest, however lies in the indication of a trend in tax principles designed to relieve of the burdens of double taxation, and offering an avenue for a rationalization of the fundamental conceptions of tax jurisdiction.

[16] 170 N. C. 168, 86 S. E. 1034 (1915); *cf.* Bank v. Wilson, 168 N. C. 557, 84 S. E. 866 (1915) where the same point was raised but expressly left unsettled.

[17] 192 N. C. 499, 135 S. E. 326 (1926) criticised in BIGELOW, BILLS, NOTES AND CHECKS (Lile 3 ed. 1928) §426, n. 7, as follows: "neither the reasoning nor the result will likely be followed elsewhere." The learned author misinterpreted the facts to mean that the defendant indorsers were accommodating the plaintiff. See also 5 WIGMORE, EVIDENCE (1923) §§2443-2445; (1924) 38 HARV. L. REV. 391; BRANNAN, NEGOTIABLE INSTRUMENTS LAW (4th ed. 1926) §§63-64.

[1] 280 U. S. 204, 50 Sup. Ct. 98 (1930). See Note (1930) 43 HARV. L. REV. 792; (1930) 64 U. S. L. REV. 158.

[2] 188 U. S. 189, 23 Sup. Ct. 277, 47 L. ed. 439 (1902).

That an inheritance tax is a tax upon the transfer, whether upon the right to receive or the right to transmit, and not upon the property itself is well settled.[3] But what states have such jurisdiction as will support the tax has long been in controversy.

Bases of jurisdiction to tax, both property and inheritance, have heretofore been predicated upon one or more of three factors: (1) Situs: physical situs of tangibles,[4] and situs of intangibles by reason of jurisdiction over the owner;[5] (2) a user of the laws of a state necessary to effect the transfer;[6] (3) the protection given to the debtor and his property at his foreign domicile, which gives the chose in action its value.[7] The instant case supported by the decisions in *Frick v. Pennsylvania*[8] and *Rhode Island Hospital Trust Co. v. Doughton*[9] inevitably necessitates the conclusion that neither of the

[3] "Thus the tax is not upon the property in the ordinary sense of the word but upon the right to dispose of it, and it is not until it has yielded its contribution to the state that it becomes the property of the legatee." United States v. Perkins, 163 U. S. 625, 16 Sup. Ct. 1073, 41 L. ed. 287 (1895); *In re* Morris' Estate, 138 N. C. 259, 50 S. E. 682 (1905); Washington County Hospital Ass'n. v. Mealey, 121 Md. 74, 88 Atl. 136, Ann. Cas. 1915B 1050, 48 L. R. A. (N. S.) 373. So a state may tax a bequest of United States bonds exempt from a property tax. Plummer v. Coler, 178 U. S. 115, 20 Sup. Ct. 829, 44 L. ed. 988 (1899). A majority of the states consider it a tax upon the right to receive. Danna v. Danna, 226 Mass. 297, 115 N. E. 818 (1917); GLEASON & OTIS, INHERITANCE TAXATION (4th ed. 1925) 256, but the U. S. Supreme Court has held it to be on the right to transmit. New York Trust Co. v. Eisner, 256 U. S. 345, 41 Sup. Ct. 506, 65 L. ed. 620 (1920), in which case the rate of tax is based upon the entire value of the estate without reference to the specific beneficiaries.

[4] Realty may be taxed only in the state where located. Land Title Co. v. Tax Comm., 131 S. C. 192, 126 S. E. 189, 42 A. L. R. 417 (1925); *In re* Swift, 137 N. Y. 77, 32 N. E. 1096 (1892). Personalty taxed where located. Coe v. Erol, 116 U. S. 517, 6 Sup. Ct. 475, 29 L. ed. 715 (1886); Tobey v. Kipp, 214 Mass. 477, 101 N. E. 988 (1913); but *cf.* Union Refrigerator Transit Co. v. Ky., 199 U. S. 194, 26 Sup. Ct. 36, 50 L. ed. 150 (1905), as to property tax, and Frick v. Pennsylvania, 268 U. S. 473, 45 Sup. Ct. 603, 69 L. ed. 1058, 42 A. L. R. 316 (1925), as to inheritance tax.

[5] State Tax on Foreign Held Bonds, 15 Wall. 300, 21 L. ed. 179 (1872); Blodgett v. Silverman, 277 U. S. 1, 48 Sup. Ct. 410, 72 L. ed. 749 (1927) (also holding municipal bonds and other specialties to be intangibles). Safe Deposit and Trust Co. v. Virginia, 280 U. S. 83, 50 Sup. Ct. 59 (1929).

[6] Bullen v. Wisconsin, 240 U. S. 625, 36 Sup. Ct. 473, 60 L. ed. 830 (1915); People v. Union Trust Co., 255 Ill. 168, 99 N. E. 377, L. R. A. 1915D 450; *cf.* Frick v. Pennsylvania, *supra* note 4.

[7] Blackstone v. Miller, *supra* note 2; Bliss v. Bliss, 221 Mass. 201, 109 N. E. 148, L. R. A. 1916A 889; Southern Pacific Co. v. Kentucky, 222 U. S. 63, 32 Sup. Ct. 13, 56 L. ed. 96 (1911). This theory denounced in Beale, *Jurisdiction to Tax* (1918) 32 HARV. L. REV. 587; *cf.* Carpenter, *Jurisdiction Over Debts* (1917) 31 HARV. L. REV. 905, 929.

[8] *Supra* note 4.

[9] 270 U. S. 69, 46 Sup. Ct. 256, 70 L. ed. 475, 43 A. L. R. 1374 (1926), reversing 187 N. C. 263, 121 S. E. 741 (1924).

last two of these factors govern, but that the controlling requisite element is territorial jurisdiction of the property taxed. In the first of the two cases mentioned it was held that tangible personalty may be taxed only where it is physically located, although its transmission, by will or intestacy, is governed by the law of the decedent's domicile,[10] while, in the second case, North Carolina was denied the right to levy an inheritance tax on a non-resident's shares in a foreign corporation although over two thirds of the property of the corporation was located in the state.[11] In the case of *State Tax on Foreign Held Bonds,*[12] it was decided that a property tax could not be imposed on intangibles owned and held by a non-resident, by the domiciliary state of the debtor, but the Blackstone Case, following this case by thirty years, permitted an inheritance tax upon such property upon the conclusion that since this tax was upon the transfer and not the property, there was a taxing jurisdiction in a state whose laws must needs be invoked in order for the devisee or distributee to acquire his right to the property, and whose laws gave it the protection that rendered it valuable. This doctrine, repudiated by a large number of states and avoided by about two thirds of them by reciprocity agreements, has nevertheless persisted as the supreme law until the decision in the instant case.[13]

So, conceding it as uncontrovertibly settled that the situs of intangibles is at the domicile of the owner,[14] the case under discussion decides this: that the jurisdiction necessary to sustain an inheritance

[10] *In re* Coppock, 72 Mont. 431, 234 Pac. 258, 39 A. L. R. 1152 (1925); Chicago Ry. Co. v. Sturm, 174 U. S. 710, 19 Sup. Ct. 797, 43 L. ed. 1144 (1898); but *cf.* Frick v. Pennsylvania, *supra* note 4; Blackstone v. Miller, *supra* note 2; Hilton v. Guyot, 159 U. S. 113, 163, 16 Sup. Ct. 139, 40 L. ed. 95 (1895) holding that the laws of decedent's domicile governing descent and distribution of property having foreign situs depend upon their adoption by the foreign sovereign and not upon any force of their own. Since the domiciliary state may at will, before the transfer change its laws of distribution, it would seem that it has the power to alter material rights of the legatees.

[11] *Supra* note 9.

[12] 15 Wall. 300, 21 L. ed. 179 (1872).

[13] *Supra* note 10.

[14] The *maxim mobilia sequntur personam* is generally used to express this fact. But see Note (1930) 78 U. PA. L. REV. 532, discussing the Safe Deposit & Trust Case, *supra* note 5, where the court says, that the above maxim will not be applied " . . . if to do so would result in inescapable and patent injustice. . . . " However it is submitted that in the case of intangibles, the actual strict application and not its abrogation will afford the desired relief from double taxation. See the concurring opinion of Mr. Justice Stone. No cases have been found which deny a state the right to tax its residents' intangibles. For the purpose of attachment and garnishment debts have a situs wherever the debtor or his property may be found.

tax upon a given transfer of property is identical with that required for a property tax, and that the former, in the absence of Federal exemptions,[15] may not be collected where the latter may not.

Two anomalous situations, however, continue to exist, and to mar the above theory of escape from double taxation: (1) the "business situs" theory, under which intangibles localized by a constant use as a stock in trade in a foreign locality are deemed to have a physical situs there for the purpose of taxation,[16] and (2) the tax, both property and inheritance, on the shares of a domestic corporation owned and held by a non-resident.[17] The "business situs" theory will not be discussed here.

In *Tappan v. Merchants' National Bank*,[18] the question before the court was whether the State of Illinois could levy a property tax on shares in a national bank owned and held by residents of that state, and collect such tax through the corporation at the place where the bank was situated and nowhere else. The court speaking through Mr. Chief Justice Waite decided in the affirmative, but by the following unfortunately ambiguous dictum:

They (shares of national bank stock) are a species of personal property which is in one sense, intangible and incorporeal, but the

[15] A tax may be levied upon the succession to property which the state has no power to subject to direct tax. United States v. Perkins, *supra* note 3; Snyder v. Bettman, 190 U. S. 249, 23 Sup. Ct. 803, 47 L. ed. 1035 (1902) federal securities, Plummer v. Coler, *supra* note 3; and constitutional provisions requiring uniformity and equality of assessment have no application. Campbell v. California, 200 U. S. 87, 26 Sup. Ct. 182, 50 L. ed. 382 (1905); see Keeney v. New York, 222 U. S. 525, 32 Sup. Ct. 105, 56 L. ed. 299 (1911).

[16] New Orleans v. Stempel, 175 U. S. 309, 20 Sup. Ct. 110, 44 L. ed. 174 (1899); Fidelity & Columbia Trust Co. v. City of Louisville, 245 U. S. 54, 38 Sup. Ct. 40, 62 L. ed. 145, L. R. A. 1918C 124; 2 COOLEY, TAXATION, (4th ed. 1924) §§465, 467.

[17] Corry v. Baltimore, 196 U. S. 466, 25 Sup. Ct. 297, 49 L. ed. 556 (1904); Hawley v. Madden, 232 U. S. 1, 12, 34 Sup. Ct. 201, 58 L. ed. 477 (1913); Hannis Distilling Co. v. Baltimore, 216 U. S. 285, 293, 30 Sup. Ct. 326, 54 L. ed. 482 (1909); Van Allen v. Assessors, 3 Wall. 573, 18 L. ed. 229 (1865); Jellenik v. Huron Copper Mining Co., 177 U. S. 1, 20 Sup. Ct. 559, 44 L. ed. 647 (1899); Maxwell v. Bugbee, 250 U. S. 525, 40 Sup. Ct. 2, 63 L. ed. 1124 (1919); Rhode Island Hospital Trust Co. v. Doughton, 270 U. S. 69, 81, 82, *supra* note 9; Abingdon Bank v. Washington County, 88 Va. 293, 13 S. E. 407 (1891); South Nashville St. Ry. Co. v. Morrow, 87 Tenn. 406, 11 S. W. 348, 2 L. R. A. 853 (1889). The right to levy such tax was denied in N. C. v. Ry. Comm'rs., 91 N. C. 454 (1884), but under the Laws of 1893, ch. 296, §14 appropriate legislation was enacted and the tax adopted. Willey v. Comm'rs., 111 N. C. 397, 16 S. E. 542 (1892); Brown v. Jackson, 179 N. C. 366, 369, 102 S. E. 739 (1920).

[18] 19 Wall. 490, 503, 22 L. ed. 189, 195 (1873), citing Van Allen v. Assessors, *supra* note 17, and construing the National Currency Act of Feb. 25, 1863, 12 Stat. at Large 668.

law which creates them may separate them from the person of their owner for the purpose of taxation and give them a situs of their own.

That language cited with approval in a following line of cases, dealing with both a tax directly upon the shares and upon the transfer thereof by a deceased owner, gave rise to a rule, now firmly imbedded, that a state chartering a corporation could by a provision in its charter or by general legislative enactment fix the situs of its shares in that state, and consequently lay both property and inheritance taxes upon such property and its transfer.[19] After the decision in *State Tax on Foreign Held Bonds* a property tax on choses in action, except corporate shares, was no longer valid but the right to levy an inheritance tax under the theory as advanced in the Blackstone Case was not denied.[20]

Three arguments have from time to time been offered to sustain both property and inheritance taxes on the corporate shares of non-residents, namely: (1) that a state in granting a right which it might at will withhold, may impose any condition it sees fit upon the exercise of the franchise granted, (2) that a share of stock is more than an ordinary chose in action and represents an interest in the property and franchises of the corporation which are located within the state, (3) the fact that the law of the incorporating state gives value to the chose in action through its protection of the debtor and his property, and the offer of access to its courts, as announced in the Blackstone Case. As to the first, it is settled beyond doubt that a State may annex no unconstitutional conditions to the grant of a franchise.[21]

[19] It is believed that this tax originated as follows: Few states imposed inheritance taxes until 1885 when New York passed its law, although Pennsylvania adopted one in 1826. See 26 R. C. L. 165. By this time the dictum of Mr. Chief Justice Waite on the Tappan case had become a deeply rooted precedent. In 1891, in Abingdon Bank v. Washington County, *supra* note 17, Fauntleroy, J. said, "If a state may do this (tax non-residents' national bank shares) as to stock and stockholders created by the Congress of the United States, a *fortiori*, it may legislate to authorize a county to levy a tax for county purposes upon the shares of a bank located within the county." It was apparently not considered that the right to tax the national bank shares was derivative from a sovereign who had nation wide jurisdiction and who could delegate such right and regulate its exercise as it saw fit. See Note (1903) 58 L. R. A. 513, at 580-581. Also in the Tappan case the tax reviewed was one levied by a county of the state upon the shares held by all the *residents* of the state, and the question as to non-residents was not in issue. The case could have been correctly decided upon the proposition that a state had the power to regulate the collection of taxes levied upon its citizens. The tax in question was a property tax, and upon such precedent was the present tax nourished.

[20] *Supra* note 7.

[21] See HENDERSON, THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW (1918) 132 *et seq.*

Thus, providing that property which under existing rules is located clearly without the territorial limits of the sovereign shall have a taxable situs within the state is patently unconstitutional. Situs is a fact, determinable at a given time by existing physical circumstances, and is not subject to removal from place to place at the will of a legislature.[22] The Rhode Island Hospital Trust Case affirming the view taken in a long line of prior decisions disposes of the second contention, which appears absurd when it is considered that often, part or all of the property of the domestic corporation is located in a foreign state. And when a corporation is incorporated in three or four states it logically follows and has been held that each state has the right to tax upon the full value of the shares regardless of the location of its property.[23] The practise is to apportion the amount of the tax in each state according to the value of the property situated there; though difficulty in logic occurs when intangibles are to be apportioned and when tangibles are located in jurisdictions foreign to the taxing states. This is a matter of comity between the states however, and not of law.[24]

It is submitted that the third argument above has exerted the greatest influence toward sustaining the tax on corporate shares, to which it must be confessed, it is even more applicable than the case of other evidences of indebtedness, and that the first two contentions are subordinate to it and apparently groundless. Logically then, the inheritance tax on non-residents' domestic corporate shares would seem to fall with the tax in the Farmers' Loan and Trust Case.

To so hold, however, will not mean that the incorporating state can levy no tax on such shares. There still exists a true basis for taxation, upon which apparently through misconception the inheritance tax was predicated.[25] The "right to be a corporation "as distinguished from the "right to do business" is a franchise granted by the sovereign to the stockholders[26] upon which an excise tax may

[22] There is no more reason in holding unconstitutional a provision by the incorporating state declaring that the situs of bonds, issued by the domestic corporation and held by a non-resident *stockholder,* shall be in the state.

[23] Knowlton v. Moore, 178 U. S. 41, 20 Sup. Ct. 747, 44 L. ed. 969 (1899); Northern Cent. Ry. Co. v. Fidelity Trust Co., 152 Md. 94, 136 Atl. 66, 60 A. L. R. 558 (1927).

[24] Welch v. Treasurer, 223 Mass. 87, 111 N. E. 774 (1916); *cf.* Kingsbury v. Chapin, 196 Mass. 533, 82 N. E. 700, 13 Ann. Cas. 738 (1907).

[25] *Supra* note 19.

[26] Fiestam v. Hay, 122 Ill. 293, 13 N. E. 501, 3 Am. St. 492 (1887); Memphis Ry. Co. v. Ry. Commr's., 112 U. S. 609, 5 Sup. Ct. 299, 28 L. ed. 837 (1884);

be levied.[27] For such tax there need be no property within the jurisdiction of the state. There is no conflict under this type of tax, with the Rhode Island Hospital Case since there the franchise was "the right to do business," granted to the corporate entity and not the stockholders.

It is desirable that the domestic inheritance tax on foreign held shares be declared invalid. Reciprocity arrangements among the great majority of the states have reduced the revenue thus derived to a mere pittance.[28] The only effect this tax seems to have is to hamper the administration of decedents' estates consisting partly of corporate stock and to increase the tendency to conceal intangible assets.[29]

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Wills—Construction—Words of Limitation

The residuary clause of a will gave the testator's wife the residue of the property "to be used by her so long as she lives and enjoys the same." *Held:* that the widow gets fee title.[1]

The absence of words of inheritance is not fatal to the creation, by will, of an estate in fee,[2] although, at common law, a general devise without words of limitation carried only a life estate.[3] As a general rule, a devise of the residue of an estate is presumed to pass

4 THOMPSON, CORPORATIONS, (3d ed. 1927) §§2919-2920; but *cf.* Bank of California v. San Francisco, 142 Cal. 276, 75 Pac. 832, 64 L. R. A. 918 (1904).

[27] What is meant here is an annual tax upon the franchise, not upon the theory that the franchise is property within the state, but in the nature of a license tax upon the privilege of being a corporation within the taxing state. Such a tax is analogous to one levied upon a non-resident for a license to drive an automobile upon the highways of the taxing state.

[28] In 1928, twenty-two states levied inheritance taxes upon intangibles of non-residents. Florida, Alabama, District of Columbia, and Nevada have no inheritance tax laws. Eight states allow absolute exemption to such property. Twelve states belong to reciprocity groups, while Idaho, New Mexico, Nebraska, and Wyoming do not generally exercise their right to tax property of this type. See report of the Tax Commission of North Carolina (1928) at page 521.

[29] See Report of the Tax Commission of North Carolina (1928) pages 505-6 where instances of delay in administration of estates, causing shrinkage in values of property are cited.

[1] Pfeifer v. Wright, 34 F. (2nd) 690 (N. D. Okla. 1929).

[2] *In re* Kidd's Estate, 293 Pa. 21, 141 Atl. 644 (1928).

[3] 1 TIFFANY, REAL PROPERTY (2nd ed. 1920) 76. But see the interesting case of Willcut v. Calinan, 98 Mass. 75 (1867) (a devise of a tomb and other real property was held to be in fee in spite of the absence of words of inheritance, the court reasoning that the testator did not intend for the devisee to take a mere life estate in a burial place.