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NOTES AND COMMENTS

Taxation—North Carolina Income and Property Taxation of Stock in Foreign Corporations.

The 1931 North Carolina Revenue Act imposed a tax of six per cent, without exemptions, on income from stock in foreign corporations, either in cash or stock dividends, received by individuals, fiduciaries, partnerships, or corporations, resident in North Carolina, or by non-resident fiduciaries if held for residents of North Carolina.¹ The tax is imposed as a condition of exemption of such shares of stock from *ad valorem* taxation, and failure to pay this income tax makes the holder of the shares of stock liable for the *ad valorem* tax at the residence of the owner.² The act states that the situs of stock owned by residents of this state who have paid the income tax is at the place where the corporation carries on its principal business; but the situs of shares owned by residents who fail to pay this tax is at the residence of the stockholder in North Carolina.³

This method of taxing foreign stock was recommended by the 1930 State Tax Commission.⁴ It was estimated that the tax would yield a larger sum than was paid when the stock was subjected to *ad valorem* rates, and would be a clear gain in revenue inasmuch as the stock had been completely exempt from *ad valorem* tax since 1923.⁵

An interpretation of the statute involves questions of both state and federal constitutional law. Certainly the General Assembly can

¹ N. C. PUB. LAWS (1931) c. 427, §311½. Holders of stock in foreign corporations domesticated in North Carolina and paying a tax on a proportionate part of their total income are permitted a deduction for such tax.

Since payment of the income tax is a condition precedent to exemption from the property tax, what is the shareholder's position when his stock does not yield any income? Certainly the policy of the act would not then require payment of the property tax.

Another question of construction will be presented when stock is bought between December 31, the date at which income is reckoned, and April 1, the date of listing property. At April 1, no income tax would have been paid on the stock purchased subsequent to December 1, and so the letter of the statute would require it to be listed. However, a satisfactory result might be not to require that the stock be listed, but allow the income to be reported as of next December 31.

² N. C. PUB. LAWS (1931) c. 427, §215 (g).

³ *Supra* note 2.

⁴ REPORT OF THE N. C. TAX COMMISSION (1930) p. 29.

⁵ Although final figures have not been released, it has been reported that this special income tax has yielded over \$500,000.

classify incomes.⁶ It would be perfectly valid to provide that incomes from foreign stock shall pay a flat six per cent rate whereas other income shall be taxed at graduated rates. But the present tax is in lieu of a tax on the stock itself. A question arises whether this violates the uniformity clause of the state constitution.⁷ An owner of foreign stock pays a six per cent tax on the income therefrom, and he is relieved of a property tax on the stock. However, one who owns other property, say corporate bonds, pays a property tax and in addition he pays on the income from the bonds at a rate depending on the amount of his entire income over the amount legally exempted.⁸ In the one case, the owner of stock pays a more onerous income tax;⁹ while in the other, the owner of bonds pays an onerous property tax¹⁰ and also pays a normal income tax provided his income exceeds the exemptions. If the uniform rule requires that "everything possessing value as property and the subject of ownership shall be taxed equally . . .,"¹¹ it is highly questionable whether the considered statute conforms to that rule. The Tax Commission speaks of a legal right to tax these shares but advises against following "the will o' the wisp of a technical right to tax until we have nothing left but the right to tax and no tax."¹²

The history of corporate stock taxation in North Carolina shows a curious application of the uniform rule. The uniformity clause had its origin in the 1868 Constitution.¹³ At that time and from then until 1873 corporate stock was taxed to the owner, unless the corporation paid a tax on its property. The result would be that foreign corporations probably did not pay such a property tax and consequently the proviso enured to the benefit only of holders of domestic stock. From 1873 to 1887 corporate stock was taxed in the hands of

⁶ See, *Atlantic and Pacific Tea Co. v. Doughton*, 196 N. C. 145, 150, 144 S. E. 701, 703 (1928). New Hampshire has said that the income tax rate must be uniform. *In re Opinion of the Justices*, 82 N. H. 561, 138 Atl. 284 (1927).

⁷ N. C. CONST., Art. V, §3.

⁸ See, N. C. PUB. LAWS (1931) c. 427, §324.

⁹ The normal individual income rates are graduated from two per cent to a maximum of six per cent. N. C. PUB. LAWS (1931) c. 427, §310. The corporation rate is a flat five and one-half per cent. N. C. PUB. LAWS (1931) c. 427, §311.

¹⁰ REPORT OF THE N. C. TAX COMMISSION (1930) p. 29, "—failure to report and pay it (the income tax) would constitute liability for the much heavier ad valorem tax."

¹¹ *Kyle v. Fayetteville*, 75 N. C. 445, 447 (1876).

¹² REPORT OF THE N. C. TAX COMMISSION (1930) p. 28.

¹³ Amendments designed to permit classification of property for taxation have been submitted by the General Assembly, but were defeated at the polls.

the individual shareholder. In 1886 the Tax Commission recommended that the collection be made through the corporation.¹⁴ Accordingly, in the Revenue Act of 1887 the individual owner of shares of corporations taxable in North Carolina was not required to list his shares, but the stock was taxed to the corporation.¹⁵ This policy continued until 1917 when it was extended so as not to require holders of foreign stock to pay a tax on the shares if two thirds of the corporation's property were taxed in North Carolina, and the corporation paid a franchise tax on its entire capital stock.¹⁶ And in 1919 the policy applied to foreign stock was further extended by exempting the stock in the individual's hands if the corporation had assets within this state assessed for taxation at a value exceeding the par value of the total stock owned by citizens of North Carolina, and the corporation paid a franchise tax on its entire capital stock.¹⁷ The result is that except for the period from 1873 to 1887 domestic stock was not taxed in the individual's hands, nor was foreign stock so taxed from 1917 to 1923 if the foreign corporation itself paid sufficient taxes in this state. Notwithstanding the firm disapproval of Chief Justice Clark, this policy, as applied to domestic corporations, was sanctioned in *Person v. Watts*¹⁸ as being entirely consistent with the uniform rule: for it was considered that the shares of stock were actually taxed through the corporation. In 1923 complete exemption was given to stock in foreign corporations without any condition that the corporation own property or pay taxes in this state.¹⁹ As to domestic stock the same conditional exemption of 1887 has continued to the present.

Whatever validity there may be to Judge Clark's position that the stock in the hands of the shareholder is his individual property, distinct from the capital stock of the corporation, and should be taxed although the corporation has paid on its capital stock, in view of the emphatic contrary position taken by the majority, there would seem

¹⁴ REPORT OF THE N. C. TAX COMMISSION (1886) p. 9. "Instead of pursuing the numerous stockholders, who return their shares at varying values, and in some instances make no returns at all, it is much easier to require the corporations to become paymaster for all."

¹⁵ N. C. PUB. LAWS (1887) c. 137, §14.

¹⁶ N. C. PUB. LAWS (1917) c. 231, §4.

¹⁷ N. C. PUB. LAWS (1919) c. 90, §4.

¹⁸ 184 N. C. 499, 115 S. E. 336 (1922). The opinion was written by Judge Adams. Judge Stacy wrote a concurring opinion. Chief Justice Clark wrote a dissenting opinion.

See, Matherly, *Taxation of Stock in North Carolina Corporations* (1923) 1 N. C. L. REV. 203.

¹⁹ N. C. PUB. LAWS (1923) c. 4, §4.

to be little question of the constitutionality of the present method of taxing domestic stock. *Person v. Watts* involved a petition for a writ of mandamus to compel the commissioner of revenue to have listed for taxation as personal property of the shareholders all stock in domestic corporations held by residents of North Carolina. The petition was made upon the ground that the statutory exemption violated the uniformity clause. The writ was denied for the court considered that issuance of mandamus here would be exercising legislative functions. Thus the constitutionality of the exemption was not before the court. However, because of the importance of the question the court expressed its opinion, and said the act was valid. In *Person v. Doughton*,²⁰ decided one year later, the exemption of foreign stocks was similarly presented. Again mandamus was denied, but constitutionality received only this remark: "Even if the above clause in the Revenue Act of 1923 be unconstitutional—which it does not seem to be, though the question is not before us for decision—still the plaintiffs would not be entitled to the relief demanded, for the judiciary is without power to levy assessments or to devise a scheme of taxation."²¹ Economically, and from the viewpoint of the state's revenue, stock in foreign corporations may be in a situation different from domestic stock. The corporation may or may not be taxed in this state depending on whether it does business or owns property within the state. Since foreign stock owned by residents of North Carolina is property taxable in this state,²² and it may not have the ground for exemption which the court recognized in domestic stock, *i.e.*, that the property has already been taxed in North Carolina through the corporation, the unconditional exemption accorded foreign stock between 1923 and 1931 is thought by some to have contravened the uniform rule. If so, the present tax policy in regard to this stock seems to be only a more lucrative violation of uniformity. Such a result is reached by reasoning along this line: the constitution requires that all property be taxed by a uniform rule. In the case of domestic stock, the property, according to the dictum in *Person v. Watts*, is taxed when the corporation pays a tax on the capital stock. But it may be that foreign corporations do not pay to North Carolina

²⁰ 186 N. C. 723, 120 S. E. 481 (1923). Opinion by Judge Stacy. Chief Justice Clark again wrote a dissenting opinion.

²¹ 186 N. C. 723, 724, 120 S. E. 481, 482 (1923).

²² *Worth v. Commissioners*, 82 N. C. 420 (1880). Resident of North Carolina owned stock in a Virginia corporation. *Held*, the stock was taxable in North Carolina. Also, *Worth v. Commissioners*, 90 N. C. 409 (1884).

a tax on the capital stock, and so the resident holder cannot contend that his interest has been taxed already in this state. Then the constitution would require its taxation here. A contrary view, which seems to have more an economic approach than a legal one, is that the same reasoning that permits exemption of domestic stock in the shareholder's hands must also permit exemption of foreign stock in the shareholder's hands. This view identifies the shares of stock with the corporate property, and says that such identification places the stock in the state where the physical property is located,²³ in many cases the state of incorporation. If the location is North Carolina then the property would be taxed here and the shares exempt, and if the location is outside of North Carolina then the *Person v. Watts* interpretation of the uniformity clause would not, it seems, require the foreign stock to be taxed here. There is nothing in the opinion so to indicate, but this may have been the reasoning behind the dictum in *Person v. Doughton* to the effect that the exemption of foreign stock "does not seem to be" unconstitutional. Though the analysis may satisfy uniformity, it is not, in the case of foreign stock, at all satisfying to the state's revenue. The recipient of the foreign stock income might enjoy the benefits of this state and make only a normal income contribution, while owners of other property might contribute twice, through income and through property taxes. This inequality might be removed, as in the 1931 Act, by requiring of the foreign stock shareholder a heavier income tax contribution. But, to declare that the situs of shares is at the residence of the owner if the income tax is not paid is inconsistent with the theory of identity with the corporate property which must justify the exemption.

The act taxes income from foreign stock received by residents of North Carolina, and also income received by non-resident fiduciaries if held for residents of this state. This latter provision relative to non-resident fiduciaries introduces a federal constitutional question. For it is axiomatic that a state can tax only persons or things over which it has jurisdiction. If the corpus of the trust is situated outside North Carolina and the trustee is a non-resident, this state can not under *Safe Deposit and Trust Co. v. Virginia*²⁴ impose a property

²³ Cf. *Rhode Island Trust Co. v. Doughton*, 270 U. S. 69, 46 Sup. Ct. 256, 70 L. ed. 475 (1926).

²⁴ 280 U. S. 83, 50 Sup. Ct. 59, 74 L. ed. 180 (1929). A resident of Virginia transferred stocks and bonds to a Maryland trust company in trust for his two minor sons. The income was to accumulate and later, along with the principal, to be paid to the sons. The sons remained residents of Virginia. The

tax on the non-resident trustee though the beneficiary lives in this state. And though the trust fund and trustee are without the state a tax on the income received therefrom by a resident beneficiary would be valid under *Maguire v. Trefry*.²⁵ However, the questioned levy is one on income received not by the resident beneficiary, but by a non-resident trustee and held for a resident beneficiary. The beneficiary pays a tax on the income distributed to him, and the non-resident trustee is taxed only on that part which he does not distribute. The resident beneficiary has an equitable interest in this accumulating income, but this would not seem to justify a tax upon the non-resident trustee.²⁶ It is believed that, other factors being the same, a distinction between an income tax and a property tax would not distinguish the situation from the *Safe Deposit* case.

Assuming that the income levy on the non-resident trustee were valid, he may yet escape the tax. If he refuses to pay this tax he "shall be liable for the ad valorem tax on such stock at the place of residence of the owner."²⁷ He is the legal owner, and, since his place of residence is outside of North Carolina, obviously this provision does not reach him.

The statute pays little respect to the minimum income exemptions²⁸ provided in the state constitution. But in answer to one who insists on his constitutional exemption, the reply might be, you do not have to pay this income tax if you prefer to pay the heavier property tax.

The imposition of full *ad valorem* rates on stock in foreign corporations in addition to the tax levied in the state of incorporation might so greatly lessen the attractiveness of this form of investment that the holders would transfer their investments into non-taxable

trust company held the securities in Maryland and paid taxes levied by that state. Virginia levied a tax upon the corpus of the trust. *Held*, that the property was without the jurisdiction of Virginia.

²⁵ 253 U. S. 12, 40 Sup. Ct. 417, 64 L. ed. 739 (1920). Trust estate of intangibles held and administered by trustee in Pennsylvania. *Held*, the income received by the beneficiary, a resident of Massachusetts, was taxable by Massachusetts.

²⁶ See the concurring opinion of Stone, J., in the *Safe Deposit* case, *supra* note 24, at 95.

²⁷ N. C. PUB. LAWS (1931) c. 427, §311½.

²⁸ N. C. CONST., Art. V, §3, requires that "there shall be allowed the following exemptions, to be deducted from the amount of annual incomes, to-wit: for married man with a wife living with him, or for a widow or widower having minor child or children, natural or adopted, not less than \$2,000; to all other persons not less than \$1,000."

securities.²⁹ Such is reported to have been a consideration that was persuasive to the General Assembly of 1923 in giving full exemption to foreign stock.³⁰ In 1930 the Tax Commission advised that this complete exemption created an unfair relationship in taxing policy as between domestic and foreign corporations, and advised the special income tax as a fair policy.³¹ Equable taxation and fiscal expediency were deemed to demand that this stock not be taxed at *ad valorem* rates. But the same is true regarding other forms of intangibles. The legal remedy lies in constitutional amendment which will permit comprehensive classification.

E. M. PERKINS.

Workmen's Compensation—Accident Arising Out of and In Course of Employment In North Carolina.*

Few sections of the North Carolina Workmen's Compensation Act¹ have called for such frequent application and construction as §2 (f),² which provides that compensable "injury" shall mean only "injury by accident arising out of and in the course of the employment . . ." With a few exceptions, the North Carolina cases have reflected a disposition toward a liberal construction of this section, but not toward the radically liberal attitude adopted by some jurisdictions. In the cases which have arisen under §2 (f), there are many in which the accident clearly either did or did not arise out of and in the course of the employment; these will be appended in footnotes at the appropriate places, and the body of the note will be devoted to a consideration of what are thought to be the more interesting and "border-line" cases.³

²⁹ Possibly only acute analysts of their investments consider the corporation's taxes in deciding where to invest their money. The investor might not look beyond the tax liability of the stock in his own hands.

³⁰ REPORT OF THE N. C. TAX COMMISSION (1930) p. 28.

³¹ REPORT OF THE N. C. TAX COMMISSION (1930) pp. 28, 29; see REPORT OF THE N. C. TAX COMMISSION (1928) 321, at 356. "It is not the exemption of foreign stock *per se* that is objectionable, but the discrimination involved in exempting stock and taxing bonds and other intangibles."

* This note is an attempt to collate the North Carolina cases decided under §2 (f) of the North Carolina Workmen's Compensation Act since the writing of an article entitled *Nine Months of Workmen's Compensation in North Carolina*, by Mr. A. K. Smith, which appeared in 8 N. C. L. Rev. 418 (1930).

¹ N. C. CODE ANN. (Michie, 1931) §8081 (h) *et seq.*

² N. C. CODE ANN. (Michie, 1931) §8081 (i) (f).

³ The decisions of both the North Carolina Industrial Commission (either of a single Commissioner or the full Commission) and of the North Carolina Supreme Court are considered. All references to the "Supreme Court" are to the Supreme Court of North Carolina.