State Taxation of Income

STATE income tax legislation, in effect or in contemplation in wide areas throughout the Union, is rapidly becoming a problem of universal concern. What are the limits, self-imposed or enjoined by a higher authority, upon the power of the states to levy this species of taxation? With one minor exception it is to this jurisdictional problem rather than to questions of construction arising under particular state statutes that this paper is addressed. Conclusions respecting these matters must be revised from time to time in the light of new principles, or new applications of old principles, discernible in the constantly augmented flow of judicial opinion relating to this subject. This consideration constitutes the reason, and it is hoped, a justification for the present review of a topic to which earlier commentators have contributed much enlightenment.

In the following discussion a classification which has been found convenient for purposes of analysis, but which may be in some respects arbitrary, has been followed.

I. CONSTITUTIONAL LIMITATIONS ON POWER OF STATES TO TAX INCOME

The power to levy income taxes is inherent, requiring no special constitutional grant, and when restricted to residents of the taxing state or income from sources arising within it, violates no provision of the Federal Constitution. The recent case of Colgate v. Harvey, reaffirms the familiar principle that the states may make reasonable classifications for tax purposes. Watson v. State
involving the right of the state of Vermont to tax one of its own residents, holds: (1) that Vermont might tax income derived from dividends earned without, while exempting that derived from dividends earned within, the state, where the business from which the latter originated was subject to a franchise tax deemed roughly equivalent to the income tax burden on the former; (2) that less favorable personal exemptions may be validly accorded income derived from interest-bearing securities than from other sources; but (3) that the privileges and immunities clause of the Fourteenth Amendment prevents discrimination by a state even in the case of a resident in favor of income derived from money loaned within the state. 7

The cases thus far referred to deal with questions in connection with which the Federal Constitution has been invoked. Aside from these issues, various state courts have found within the constitutions of their own states limitations upon or prohibitions against this species of taxation, arising in most instances out of the almost universal constitutional requirement that property taxes be equal and uniform. 8 This constitutional provision gives rise to three inquiries: (1) Is income "property" in such sense that a tax thereon is required to be levied in accordance with provisions relative to property taxes generally? (2) Assuming that income is not itself property, is a tax on income derived from property a tax on the property itself, thus bringing an income tax, in so far as it is thus derived, within constitutional requirements governing property taxes? (3) Does the uniformity requirement preclude the graduation of taxes or the granting of varying exemptions dependent on family status?

1. Is Income "Property"?

This presents no federal question. The answer depends upon the construction which the various states through their courts adopt as to the meaning of the relevant provisions of their own constitutions. The divergence of opinion is wide and the answer doubtful. 9


7 Justices Stone, Brandeis and Cardozo dissent as to the third point.

8 See constitutional provisions referred to in cases cited infra notes 9, 10 and 11.

Is a Tax on Income Derived from Property a Tax on the Property Itself?

The point now under consideration relates only to income derived from property, not to income generally. Here again the authorities are not in agreement.\[^10\]

If in any particular jurisdiction income is itself held to be property, it must be valued and assessed according to standards of uniformity and equality applicable to all property subject to the taxing jurisdiction; in default of the application of those standards the tax will fail.\[^11\] Application of the doctrine that a tax on income derived from property is a tax on that property seems to lead to the result that an income tax will be held a species of double taxation. This, while not prohibited by the United States Constitution\[^12\] is contrary to many state constitutions.\[^13\]

Must an Income Tax, to be Uniform, Tax All Incomes at the Same Rate and Grant Identical Exemptions to All Taxpayers?

Applying somewhat mechanically the uniformity test, some courts have answered this question in the affirmative.\[^14\] Others, less committed to literalism, have found the uniformity requirement satisfied if all taxpayers coming within the same income brackets or having the same family status, as the case may be, are treated alike.\[^15\] If, as has been


\[^13\] See Burke v. Badlam (1881) 57 Cal. 594; 61 C. J. 137.

\[^14\] Kelley v. Kalodner; Jensen v. Henneford, both supra note 1.

\[^15\] Reed v. Bjornson (1934) 191 Minn. 254, 253 N. W. 102; State ex rel. Haggart v. Nichols (N. D. 1936) 265 N. W. 859; Standard Lumber Co. v. Pierce (1924) 112 Ore. 314, 228 Pac. 812.
authoritatively declared, the constitutional provision in question goes no further than the Fourteenth Amendment, it would seem that taxpayers are not required to be regarded as one group for taxation purposes, but that reasonable classifications within the taxpaying body, based on ability to pay or other relevant circumstances, may be made.

It is apparent from the foregoing that in those jurisdictions in which the point has not been adjudicated there is always the possibility that an income tax act may be held invalid in whole or in part on one or the other of the theories just stated because it does not conform to standards applicable to property taxes. Where there is express constitutional authority to levy income taxes the first two, at least, of the questions discussed will not ordinarily arise.

II.
WHAT INCOME (1) OF RESIDENTS, AND (2) OF NONRESIDENTS, CONSIDERED IN EACH CASE WITH REFERENCE TO ITS SOURCE, IS IT WITHIN THE COMPETENCE OF THE STATES TO TAX?

(1) Income of Residents Subject to Tax—From What Sources Derived.

It was held in Lawrence v. State Tax Commission that as to a resident of Mississippi, that state has power to tax income earned through the construction of highways in Tennessee. That case shows, certainly, that income derived by a resident from personal services performed, and apparently, that income arising from a business conducted, in a foreign state is subject to taxation at the domicile.

The opinion in the Lawrence case, in justifying the tax on the basis of the protection afforded the recipient of the income by the state of his domicile in his person, in his right to receive it and in its enjoyment, would seem to go far toward ignoring the source of income and looking only at those rights and privileges which are protected by, and originate

17 See cases cited supra note 6.
18 It is conceivable that income tax laws may be nullified in part at least even where there are specific constitutional provisions permitting such levies, if in any given case the permissive effect of the constitutional provision in question is not as inclusive as the tax attempted to be levied. Suppose for example the state constitution permits income taxes to be assessed only against certain classes of persons or corporations, or gives any other permission not coextensive with the state's maximum taxing jurisdiction under the Federal Constitution. In any such case inquiry may be necessary as to whether the authority conferred to tax incomes is broad enough to obviate the necessity of considering the relationships above discussed between property taxes and income taxes.
19 Supra note 5.
20 Ibid. at 281.
under, the law of his domicile. If a case were presented involving Tennessee's right to tax the same income it is impossible at this moment to say which of two divergent courses the court might take. Conceivably, applying doctrines which have become familiar since the decision in Farmers' Loan & Trust Company v. Minnesota, the court might say that the Tennessee contract for Lawrence's services created in his favor a chose in action having a situs only at his domicile, and that this chose, or the income therefrom, is taxable only in that place; that the source of the income, through the mobilia sequuntur fiction, is in Mississippi, not in Tennessee. Or, reverting to doctrines announced in Shaffer v. Carter, a rule analogous to the business situs doctrine as applied to property might be developed, permitting taxation of income derived by non-residents from the conduct of business or even the performance of personal services within the state. Manifestly, unless the tenet, newly announced but thus far rigidly adhered to, that only one state can tax is to be discarded, the state of residence must in that event forego its claim, and Lawrence v. Tax Commission be limited or overruled.

Whatever confirmation or disavowal of the observations just ventured shall be made by subsequent decisions, it seems reasonably clear that the test of taxing power found sufficient to justify the tax involved in Lawrence v. Tax Commission will not be found adequate where tangible property, real or personal—and in some cases intangible property—is concerned. There seems to be no reason to assume that the Supreme Court will look with more favor on the taxing of income from property by two jurisdictions than it has shown toward the taxing of succession to property, or the taxing of property itself, by two jurisdictions.

That the power of the states to tax income is subject to restrictions not applicable to the federal government is indicated by Cook v. Tait where the Supreme Court, following an earlier case, points out that a state's power to tax is encountered at its borders by the taxing power of other states and is limited by them, at the same time holding the federal government free from these limitations. The Cook case holds that so far as the federal government is concerned, the requirement even of residence within the United States may be dispensed with as a basis of

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21 (1930) 280 U. S. 204.
22 Supra note 3.
24 Union Refrigerator Transit Co. v. Ky. (1905) 199 U. S. 194. Various authorities on this and cognate questions are cited in the present writer's article: Nossaman, State Taxation of Intangibles (1930) 18 Cal. L. Rev. 347.
25 (1924) 265 U. S. 47.
taxation and that citizenship is enough to enable the federal government
to tax the income of one of its citizens residing in Mexico derived from
real and personal property located there. To what extent citizenship in
a state confers in its favor such benefits in an international sense as
were deemed by the Supreme Court sufficient in the *Cook* case to justify
the imposition of a tax, is an open question; and the question as to the
extent to which residence is a jurisdictional factor where no conflicting
rights of other states are involved will be noticed later. For the moment
we are concerned only with limitations upon the power of the states in
tax competition with other American, not foreign, states.\footnote{26}

(a) *Taxation of Income from Foreign Real Estate.*

As to income of this character the New York court held in *Pierson v.
Lynch*\footnote{27} that rental received by a resident of New York from real prop-
erty owned by her in Ohio is not subject to the New York income tax.
The Appellate Division placed the decision upon the somewhat debatable
ground that a tax on the income from real estate is the same as on the
real estate itself.\footnote{28} It would seem sufficient to say that the income was
not derived from a source within the state. The same case holds, how-
ever, that profit realized by the same New York resident on a sale of
real estate located in Ohio is taxable, applying the doctrine of *Willcuts v.
Bunn*\footnote{29} that "the tax upon profits made upon purchases and sales is an
excise upon the result of the combination of several factors, including
capital investment and, quite generally, some measure of sagacity; the
gain may be regarded as the creation of capital, industry and skill."

Although as the cases already cited show, a state may tax its residents
upon gains attributable to their industry and skill wherever exercised,
the *Pierson* case and others support the view advanced above, that income
from real estate situated in another state is not taxable by the state of
residence.\footnote{30} The most recent and in some respects the most significant

\footnote{26} See discussion *infra*, II (2) (b).
\footnote{27} (1933) 237 App. Div. 763, 263 N. Y. Supp. 259; *aff'd* without opinion (1933)
\footnote{28} The court cites *Pollock v. Farmers Loan & Trust Co.* supra note 10. See
authorities cited *infra* supra note 10.
\footnote{29} (1931) 282 U. S. 216. *Held*, gains on sales of municipal bonds subject to
federal income tax though interest on such bonds is exempt. Compare with the
*Pierson* case, *Appeal of Siesel* (1935) 217 Wis. 661, 259 N. W. 839, holding Wis-
sconsin had no jurisdiction to tax capital gain resulting from sale by Wisconsin
resident of stock given him by a non-resident and immediately sold at an advance
over the donor's cost. The fact constituting the apparent basis of the decision, that
the increase in value occurred in the hands of the non-resident donor, seems in-
adequate to justify the result, since the "sagacity" which converted a paper profit
into an actual one was exercised by a resident, and within the taxing jurisdiction.
pronouncement of the Supreme Court of the United States bearing upon this topic is Senior v. Braden,\(^{31}\) which involved a statute of Ohio imposing a tax on investments, these being defined as including equitable interests in land and rents and royalties divided into shares evidenced by transferable certificates. The tax, though apparently regarded by the Court and counsel as a property tax, was at the rate of 5% of income yield and bears a close resemblance to an income tax.\(^{32}\) Transferable certificates evidencing a beneficial interest in seven trusts were involved, each trust covering one piece of property, some located within Ohio, some without. Treating the taxpayer as the beneficial owner of foreign real estate, the court held the tax invalid so far as the foreign trusts were concerned as amounting in substance to an attempt to tax property outside the jurisdiction,\(^{33}\) and in addition, in an expression which seems obiter, cast doubt on its previous holding in Maguire v. Trefry.\(^{34}\)

(b) Taxation of Income from Personal Property of Residents Having its Situs Elsewhere.

That tangibles permanently or for an indefinite time deposited in a foreign jurisdiction,\(^{35}\) or intangibles when they become an integral part of a foreign business,\(^{36}\) may acquire a situs separate from the owner's domicile is familiar doctrine. Though the Supreme Court in First National Bank v. Maine\(^{37}\) states that this question, so far as taxation of intangibles is concerned, is reserved for disposition under circumstances which at date of the present writing have not arisen, it seems that, conceding taxability in one jurisdiction only, the logical development of the Court's own theories will require the same divorcement of actual from fictional

\(^{31}\) Supra note 12.

\(^{32}\) People ex rel. Cohn v. Graves, supra note 27; see (1935) 49 Harv. L. Rev. 159.

\(^{33}\) Rather singularly, the tax was held invalid as to the Ohio trusts but as this involves a question not within the scope of the present inquiry, namely, whether a tax is invalid because levied otherwise than by uniform rule according to value, it will not be pursued further than to call attention to the dissenting opinion of Mr. Justice Stone, referring to a concession by counsel for Ohio, Senior v. Braden, supra note 12, at 440.

\(^{34}\) (1920) 253 U. S. 12. For comment on the doctrine of this case and its present status, see infra IV (1).

\(^{35}\) City Bank Farmers Trust Co. v. Schnader (1934) 293 U. S. 112.


\(^{37}\) Supra note 23 at 331.
situs in the case of intangibles that it has effected in the case of tangibles.\textsuperscript{38}

(2) Income of Nonresidents Subject to Tax—From What Sources Derived.

The Federal Constitution does not prohibit the states from levying taxes upon the net income derived by nonresidents from property owned or from any business, trade or profession carried on by them within a state.\textsuperscript{39} Such taxes must not discriminate against nonresidents, as for example, by allowing them less favorable exemptions than are accorded residents.\textsuperscript{40} They must in general conform to the requirement of taxing only such income as has its sources within the state.\textsuperscript{41} Manifestly, where the converse of the situation discussed under the two immediately preceding subheadings is presented and we have either local real estate or personal property having a local situs, in either case belonging to a nonresident, the income from such property will be subject to local taxation.

A case involving a novel point is People ex rel. Whitney v. Graves,\textsuperscript{42} where the Appellate Division of the New York Supreme Court held the state had jurisdiction to tax as income profits derived by a resident of Massachusetts from the sale of an undivided share or interest in a New York Stock Exchange membership. Without citation of authority or discussion, the court holds that the income in question was derived from property within the State of New York. The Supreme Court in Citizens National Bank v. Durr,\textsuperscript{43} after a full inquiry into the nature of a seat

\textsuperscript{38} See Farmers Loan & Trust Co. v. Minn., supra note 21. A case applying the foreign business situs doctrine to intangibles to defeat a local income tax is Hill v. Carter, supra note 36. Held, income tax law of Hawaii inapplicable to dividends on stocks, interest on bank deposits and bonds and from taxpayer's undivided share of her deceased father's estate held in trust by a New York trust company where securities were in hands of New York agent with full management powers, including borrowing of money on securities, making investments and in general managing them as owner.

\textsuperscript{39} Shaffer v. Carter, supra note 3; Note (1920) 64 L. Ed. 446; see 61 C. J. 1561, 1562; Notes (1921) 15 A.L.R. 1326; 90 A.L.R. 484. But see discussion supra, II (1).

\textsuperscript{40} Travis v. Yale & Towne Mfg. Co., supra note 5.


in the New York Stock Exchange, had held it to be an intangible taxable at the domicile of the owner, a resident of Ohio. As to the Whitney case, the answer to its problem would seem to depend, first, upon whether a membership in the New York Stock Exchange is an intangible existing only at the owner's domicile or whether it is as Mr. Justice Holmes, here in the unfamiliar company of Justices Van Devanter and McReynolds, deemed it to be, localized in New York because in its essence it consists of a right of the members personally to enter the New York Stock Exchange building and do business there; and second, even if the congeries of rights represented by a stock exchange membership is in some sense localized in New York there still remains for consideration, in the case of a sale of those rights, the doctrine of Pierson v. Lynch, supra, that the sagacity whose use results in a profit is a personal attribute, existing and exercisable at the domicile. Unless the premise that only one state can tax be erroneous, the Pierson and Whitney cases seem to announce doctrines fundamentally antagonistic.

No case has been found dealing with the right of a state to tax income payable to nonresidents arising from dividends of a local corporation. The existence of that right, which would formerly have been conceded without question, would seem since the decision in First National Bank v. Maine to be open to serious debate. Property and succession taxes have been held to stand on the same footing in the respect that in order to justify either, the state must have jurisdiction of the res constituting the subject matter of the tax. The same fiction which in the case of intangibles relates situs to domicile for purposes of inheritance taxation


45 Supra note 23.

46 Rhode Island Hospital Trust Co. v. Doughton, supra note 44; Chambers v. Mumford (1921) 187 Cal. 228, 201 Pac. 588. That the similarity of these two species of taxes is not to be carried too far is indicated by numerous cases. United States v. Perkins (1896) 163 U. S. 625; Maxwell v. Bugbee (1919) 250 U. S. 525. See Blodgett v. Silberman, supra note 23; cf. Frick v. Pa., supra note 23.

47 No distinction is made for present purposes between residence and domicile. See Ness v. Comm'r (1932) 279 Mass. 369, 181 N. E. 178, 82 A. L. R. 977, holding "inhabitancy" the equivalent of domicile within the meaning of the Massachusetts income tax act. See Note (1932) 82 A. L. R. 982. The distinction drawn between residence and domicile in Bowring v. Bowers (1928) 24 F. (2d) 918, cert. den. (1928) 277 U. S. 608, though valid under federal statutes, would seem to have only a restricted application to state enactments, limited—except possibly as to nonresidents of the United States—by the conflicting demands of other states. See Cook v. Tait, supra note 25. If taxation of income is to be limited to one state, it would seem necessary to select domicile as the test rather than residence strictly so called, as in a certain sense it is possible to have more than one residence. An
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seems to require a like reference for purposes of income taxation. To say that income from property can be taxed only where the property is in legal contemplation situated is not necessarily to adopt the view that the tax is on the property itself, but this tax partakes so strongly of the latter character that there seems to be less difficulty in taxing income from intangibles, including stocks, at their fictionally assigned situs, and in limiting taxation to that place, than has been experienced in the case of inheritance taxes; and where taxes on income derived from property are regarded as a tax on the property itself the conclusion stated seems unescapable.

(a) Income Arising from Obligations of Resident Obligors Held by Nonresidents.

Unless they have acquired a business situs within the taxing state, it seems clear that the latter has no power to tax interest paid by resident obligors upon such obligations since their situs is at the domicile of the creditor. The principle stated would seem to apply even where the obligee is not a resident of the United States unless the physical evidences of the incorporeal rights, income from which is sought to be taxed, are within the taxing state.

(b) Income from Intangibles Held Locally Belonging to a Nonresident of the United States.

So far as the federal government is concerned, its power to tax the income from such securities physically present within the United States is established by DeGanay v. Lederer. The facts of the DeGanay case and in particular the business situs cases cited by the court in support of its conclusion seem to place it within the business situs category, but instance of the latter, expensive in the extreme to the taxpayer, is shown in Hill v. Martin (1935) 296 U. S. 393. A procedure possibly adequate to determine the conflicting claims of different jurisdictions in respect of domicile has now been devised. See Worcester County Trust Co. v. Long (D. Mass. April 27, 1936).

48 Newport County v. Wis. Tax Comm., supra note 41; State ex rel. Manitowoc Gas Co. v. Wis. Tax Comm. (1915) 161 Wis. 111, 152 N. W. 848. Held, nonresident bondholders could not be taxed on interest on bonds of a Wisconsin corporation, such income not arising from sources within the state, the tax being a burden on the recipient and not a property tax, and the property in question here, namely, the bonds, having situs at the domicile of the creditor. But see State ex rel. Fraedtert G. & M. Co. v. Tax Comm. (Wis. 1936) 265 N. W. 672, 267 N. W. 52.

49 State ex rel. Manitowoc Gas Co. v. Wis. Tax Comm., supra note 48. The Manitowoc case is a specific application in an income tax case of doctrines implicit in Farmers Loan & Trust Co. v. Minn. and cases following it, cited supra note 23. Indeed, so far as property taxes are concerned, this doctrine was well settled long before the series of cases beginning with Farmers Loan & Trust Co. v. Minn., supra note 21. State Tax on Foreign Held Bonds (1872) 82 U. S. 196; see Kirtland v. Hotchkiss (1879) 100 U. S. 491.

50 See discussion, infra II (2) (b); State Tax on Foreign Held Bonds, supra note 49.

51 (1919) 250 U. S. 376.
that this is an immaterial circumstance so far as the power of the United States to tax is concerned is shown by Burnet v. Brooks, a federal estate tax case which involved only the element of physical presence of securities within the United States and none of the elements of business situs. A federal estate tax upon this property of the nonresident subject of a foreign nation was nevertheless upheld.

The California Supreme Court in Estate of McCreery held subject to the California inheritance tax stock in a California corporation belonging to a nonresident alien, represented by certificates physically present, but having no business situs in California at the time of the decedent's death. Recognizing the binding effect of the rule promulgated in Farmers' Loan & Trust Company v. Minnesota, the court deems it inapplicable where the owner of the intangibles in question is a nonresident of the United States.

Tested by the doctrine of Burnet v. Brooks, the McCreery case seems sound. It is believed that the following is a substantially accurate statement of that doctrine translated into terms applicable to the problem now under consideration: The concept of due process means one thing when applied to taxation in competition with other states of the Union, another when applied in competition with possible levies by foreign governments; in the latter case it imposes no burden on the states under the Fourteenth Amendment to which the federal government itself is not subject under the Fifth Amendment, while in the former there is added to the historic concept of due process a further requirement, namely, that any exercise of taxing authority is dependent not only upon jurisdiction, but jurisdiction is itself limited by the requirement that its exercise must not disturb the good relations existing between the states.

The Washington court, not citing the McCreery case, reached the same result in Estate of Lloyd. Aside from these, there seems to be no decision applying the doctrine of Burnet v. Brooks to state inheritance taxation, nor has the writer found any state income tax case relating to the power of a state to tax income payable to a nonresident of the United States derived from securities physically located within the state. It is believed that state taxation of such income does not infringe upon the concept of jurisdiction which the United States Supreme Court has

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52 (1933) 288 U. S. 378.
53 (1934) 220 Cal. 26, 29 P. (2d) 186.
54 See Burnet v. Brooks, supra note 52, at 401; Farmers Loan & Trust Co. v. Minn., supra note 21; Notes (1934) 23 CALEF. L. REV. 93; (1933) 47 HARV. L. REV. 307; (1933) 33 COIL. L. REV. 925.
55 (Wash. 1936) 52 P. (2d) 1269.
adopted in the cases referred to and that consequently a state may tax the income from such securities under the conditions stated.\(^\text{56}\)

III.

**TAXATION OF INCOME OF CORPORATIONS**

A state may tax the income of foreign corporations derived from sources within its borders but not in such a manner as to lay a burden on income earned outside the state disproportionate to that earned within it.\(^\text{57}\) *A fortiori* there can be no doubt as to the power of a state to tax income of domestic corporations derived from business done or property located within it.

To what extent may a state levy exactions upon income of domestic corporations wherever originating? That it is not restricted to intrastate income but may include that derived from interstate business is settled.\(^\text{58}\) If a state undertakes to exempt from income taxes domestic corporations doing no business except holding stockholders meetings within the state, it must accord to its corporations which do part of their business within the state a similar exemption as to income from foreign business.\(^\text{59}\)

Though the power of states to tax their domiciled corporations upon all income, including that derived from sources without the borders of the domiciliary state, has been broadly affirmed,\(^\text{60}\) an issue which must be regarded as not fully determined until further judicial consideration has been given to it, is whether the limitation apparently applicable to natural persons applies here, namely, that income will be deemed localized for taxation purposes in foreign jurisdictions to the extent that it arises from immovable property or personal property having a permanent or business *situs* there.\(^\text{61}\)

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\(^{56}\) A query may be noted as to the power of a state to tax the income of a nonresident of the United States derived from dividends of a local corporation, the certificates not being present within the taxing jurisdiction. As already observed, the state of incorporation is believed not to have this power where the owner of the stock is a nonresident of the United States. See *supra*, II (2).


\(^{58}\) United States Glue Co. v. Oak Creek (1918) 247 U. S. 321; see also Westby v. Bekkedal (1920) 172 Wis. 114, 178 N. W. 451.


\(^{61}\) The franchise tax cases are not for the present purpose particularly enlightening. A state may exact a franchise tax measured by net income even though...
IV.

TAXATION OF INCOME FROM TRUSTS

Because of certain special considerations applicable to this class of cases they are discussed separately. The cases may be roughly classified as falling into the following categories:

(1) Taxability of Income of a Resident from a Foreign Trust or Estate.

Although the resident beneficiary of a foreign trust cannot be taxed upon the corpus\(^6\) even though he may have the right to receive the corpus if he attains a certain age,\(^6\) it was regarded as settled until recently that the local beneficiary of a foreign trust might be lawfully taxed by the state of his residence upon the income received from that trust. This is the necessary effect of *Maguire v. Trefry*,\(^6\) which held that Massachusetts might lawfully tax income received by a Massachusetts resident from securities held for her benefit by a trustee under a trust created and administered in Pennsylvania. The United States Supreme Court approved the view of the Supreme Court of Massachusetts that the protection afforded the recipient of the income by the government of the state of his residence in his person, in his right to receive the income, and in his enjoyment of it, formed a just basis for a contribution to the support of that government based upon the income.\(^6\) The interest of the beneficiary was recognized as being analogous to that of the credits—bank deposits in Missouri—owned by a resident of Kentucky which were held taxable by the latter state in *Fidelity & Columbia Trust Co. v. Louisville*\(^6\). Other cases recognizing the right of the state of residence to tax income from foreign trusts are cited below.\(^6\)

Whether *Maguire v. Trefry* is law at the present time is uncertain. As previously noted, the Supreme Court in *Senior v. Braden*\(^6\) casts doubt on the *Maguire* case by apparently placing it in the category of Black-
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stone v. Miller, which along with Fidelity & Columbia Trust Company v. Louisville, the Maguire case followed, and which Farmers' Loan & Trust Co. v. Minnesota disapproved. There seems to be no necessary conflict between the Maguire and Senior cases. Nothing in the opinion in the earlier case indicates that the beneficiary's rights were other than in personam—the equitable life estate which the income beneficiary of a testamentary trust ordinarily possesses. In the later case, the beneficial interests involved approximated rights in rem and the majority opinion regards them as entirely fulfilling the requirements of that status. Furthermore, the tax involved in the Maguire case was unmistakably an income tax while that in the Senior case, though measured by income, was in terms, and was apparently regarded by the Court as a property tax. If the Senior case by its emphasis on the beneficiary's rights as being in rem means only that a state cannot tax foreign real estate, that obvious result will occasion no dissent. Even if it goes a step further and means or implies that a state cannot tax income from foreign real estate, that result has been reached by other courts, and is supportable, as has been already shown, on the basis of decisions of the Supreme Court itself. The factual basis, therefore, upon which the Supreme Court founds the necessity of discrediting Maguire v. Trefry is not fully apparent.

Whether or not there is anything in the distinctions just suggested, there is reason to infer that a majority of the Supreme Court as it is at present constituted believe the Maguire case to have been wrongly decided. It is believed, however, that the contrary argument has not been definitely foreclosed. If the views foreshadowed in the Senior case shall be ultimately confirmed by an opinion involving the precise issue presented by the Maguire case, it would seem to follow that if Massachusetts has no jurisdiction to tax trust income derived by a resident from a trust created and administered in Pennsylvania, that right, residing somewhere, is exercisable in Pennsylvania and presumably nowhere else.

At this moment it is impossible to generalize to the extent of saying that the right to tax trust income is limited to the state in which the trust is administered. Still less, the rule itself being unknown, is it possible to state its qualifications and exceptions. In the meantime and while these doubts are being resolved, the practical consequences of whatever result is arrived at, assuming rates not too disparate, are becoming less important as state income taxes become more nearly universal.

69 (1903) 188 U. S. 189.
70 Supra note 23.
It should be noted that in the case of revocable trusts, the state court decisions involving inheritance taxes since the decision in *Farmers' Loan and Trust Co. v. Minnesota* have been favorable to domicile rather than *situs*. In *In re Frank's Estate*,\(^{72}\) the right of Minnesota to tax at the death of the nonresident settlor the transfer of property held in Minnesota under a revocable trust was denied, although the trustee was given fairly broad powers of management, including, subject to the settlor's approval, investment and reinvestment. The court disposed of the business *situs* doctrine by saying that the trust property was not part of any local business conducted by Frank. The renunciation by Minnesota of the right to tax is based on the ground that the thing transferred is an incorporeal right attaching to the person of the owner in the state of his domicile and that the transfer, therefore, takes place there and nowhere else.\(^{73}\) In saying that the transfer was taxable at the domicile, the decision is in harmony with *Bullen v. Wisconsin*,\(^{74}\) which presented the converse situation.

(2) Taxability of Income Received by a Local Trustee for the Benefit or Paid to Nonresident Beneficiaries.

Such income has been held taxable by the jurisdiction in which the trust has its *situs*.\(^{75}\) That the state under whose laws a trust is created

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\(^{72}\) *Supra* note 71.

\(^{73}\) To the same effect, *Estate of Dillingham* (1925) 196 Cal. 525, 238 Pac. 367. See also connected case involving property taxation: *First Trust & Savings Bank v. County of Los Angeles* (1929) 206 Cal. 240, 273 Pac. 1066. Cf. *Hill v. Carter*, *supra* note 38. The caution which *Farmers Loan & Trust Co. v. Minn.* and the cases following it have induced in state courts is evidenced by *Baker v. State*, *supra* note 71, an inheritance tax case in which the Minnesota court relinquishes to New York the *situs* of a trust which it had previously fixed in Minnesota in *Thorne's Estate* (1920) 145 Minn. 412, 177 N. W. 638.

\(^{74}\) (1916) 240 U. S. 625. *Held*, state of domicile could tax transfer of property held under revocable trust in another state.

\(^{75}\) Compare with the cases just cited, the property tax case of *Commonwealth v. Appalachian Electric Power Co.* (1932) 159 Va. 462, 166 S. E. 461. *Held*, where a Virginia corporation pledged bonds to a New York trust company as security for a bond issue, such bonds were removed from the taxing jurisdiction of Virginia and given a *situs* in New York. The transaction apparently constituted something more than a pledge since title was transferred to the trustee, but power to manage and invest, generally held the criterion of business *situs*, was lacking. It seems fairly debatable whether the Virginia court did not go too far in allowing the application of the business *situs* doctrine. That a mere pledge does not give rise to a business *situs* at the residence of the pledgee, see *Stanford v. San Francisco* (1900) 131 Cal. 34, 63 Pac. 145.

\(^{76}\) *State ex rel. Wisconsin Trust Co. v. Widule* (1916) 164 Wis. 56, 159 N. W. 630. Nonresidence of two out of three trustees was held not to affect the Wisconsin *situs* of this trust established under the will of a Wisconsin resident probated in that state. *State ex rel. Wisconsin Trust Co. v. Phelps* (1920) 172 Wis. 147, 176 N. W. 863 (involving same trust as Widule case). *Harvard Trust Co. v. Commissioner*, *supra* note 27. *Situs* of trust for income tax purposes held to be in Massachusetts though
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has a certain authority to fix the *situs* of the trust for tax purposes is shown by *Hutchins v. Commissioner*,\(^7\) which though recognizing the principle that in the absence of other controlling factors, the *situs* of intangible property held in trust follows the person of the trustee, recognizes an exception where by reason of a "dominating law" the *situs* of the property is fixed in the place where the trust was created and established and is being administered under court direction. The effect of the holding is to reserve to New York, the jurisdiction to whose courts the trustees were accountable, the *situs* of the trust for income tax purposes even though the trustees or some of them resided in Massachusetts.\(^7\) The case of *Harvard Trust Co. v. Commissioner*\(^7\) shows that the Massachusetts court regards taxability as depending upon the place of residence created by probate court in Vermont under will of deceased Vermont resident. Two beneficiaries resided in Massachusetts, one in Vermont, one in Illinois. The court recognizes that it is within the power of a state creating a trust to fix its *situs* in that state for purposes of taxation. Cf. Williams v. Singer [1921] 1 A. C. 65, holding that where trustees resident in England hold shares of a foreign company on behalf of a foreign subject domiciled abroad, the fact that they themselves are domiciled and resident in the United Kingdom does not make them chargeable with income tax in respect of dividends on those shares not remitted to England but paid to the beneficiary abroad.

\(^7\) \((1930) 272\) Mass. 422, 172 N. E. 605.

\(^7\) There were three trusts involved in the Hutchins case. In number one the testator was a resident of New York and two trustees were residents of Massachusetts; in number two the testator was a resident of New York and two out of three trustees were residents of Massachusetts, the other being a resident of Connecticut. In each of these two cases a New York court had appointed the trustees and it was alleged in the complaints brought by the trustees to abate the taxes that under the laws of New York each of these trusts was a resident trust, that the trustees, irrespective of residence, became liable to the state of New York for an income tax on the income from the trust, and that the trustees were accountable for the administration of the trusts to the courts of New York. In number three the testator died a resident of the District of Columbia, one of the trustees was a resident of Massachusetts, one of New York and one of California. They were appointed by a District of Columbia court. It did not appear in any of the three cases where the property was physically kept. The income in question was gains or profit becoming a part of the remainder ultimately to vest in persons unborn or not ascertained, therefore coming within the Massachusetts statute taxing such incomes. See note to this case (1930) 71 A. L. R. 677.

See Goodsite v. Lane (C. C. A. 6th, 1905) 139 Fed. 593 and Newcomb v. Page (1916) 224 Mass. 516, 113 N. E. 458 applying the same principles to personal property taxes. See also Brewster v. Comm'r (1925) 251 Mass. 49, 146 N. E. 259. Held, Massachusetts residents, executors under a Rhode Island will, not liable to income tax in Massachusetts on income received by them from sale of intangible property of their testator.

\(^7\) See *Supra* note 76. See also Welch v. Boston (1915) 221 Mass. 155, 109 N. E. 174, applying same principle to property tax assessed against intangibles held by a Massachusetts resident as trustee under the will of a deceased resident of Maine, though intangibles were kept in Maine and beneficiaries were nonresidents of Massachusetts; City of Augusta v. Kimball (1898) 91 Me. 605, 40 Atl. 666 (property tax case).
of the trustee unless there are special circumstances such as are exemplified in the *Hutchins* case giving the trust a *situs* elsewhere.

It is not, however, universally held that a trust acquires a constructive *situs* in a state merely because it is being administered under the direction of a local court. In *Bayfield v. Pishon*, income derived from a trust created under the will of a Wisconsin resident probated in Wisconsin and administered under the supervision of one of its courts was held not to have acquired a constructive *situs* in Wisconsin merely by virtue of these facts, where a resident of Maine was trustee and the life tenants and presumptive remainder-men were all nonresidents of Wisconsin. The income from the trust was held not to be derived from a source within the state within the meaning of the Wisconsin income tax act. This case, and the *Hutchins* case in which the Massachusetts court ruled in favor of a foreign jurisdiction having a similar relationship to the trust, respecting the *situs* of a trust for income tax purposes, announce no opposing fundamental rules. It may be inferred from both cases, as well as from *Harvard Trust Co. v. Commissioner*, that the result in each case depends on the extent to which the law of the jurisdiction creating the trust reserves to itself control over the trust in such manner as to give it an exclusive *situs* in that jurisdiction.

As the cases just referred to show, the power to tax trust income is not necessarily conferred by residence of the trustee. Where no "dominating law" has referred the *situs* of the trust to another jurisdiction, the right to tax income at the trustee's residence may nevertheless be denied for the reason that the trust *res* is located outside the jurisdiction and the income therefore not derived from a source within it. This is illustrated in *State ex rel. Mariner v. Hampel*, where property of a corporation consisting of mines and lands in Michigan was transferred to trustees residing in Wisconsin, each stockholder of the corporation becoming a beneficiary of the trust and having the same interest in the trust as he had in the corporation. It was held that Wisconsin beneficiaries were not subject to tax on account of rents received from the Michigan lands, the income in question being derived from property located and business transacted without the state.

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80 (1916) 162 Wis. 466, 156 N. W. 463.
81 *Supra* note 76.
82 (1920) 172 Wis. 67, 173 N. W. 244.
83 The question of jurisdiction is not necessarily involved in the Mariner case. *Cf*., *State ex rel. Arpin v. Eberhardt* (1914) 158 Wis. 20, 147 N. W. 1016, holding that income received by a Wisconsin resident from a Texas partnership of which he was a member, doing business and having all its property located in Texas, is not subject to Wisconsin income tax, being derived from sources without the State. The case turns on a question of construction, the court construing the statute as meaning that income of residents as well as nonresidents must be from sources within
(3) To What Extent Is Trust Income Derived from Foreign Securities Held by a Resident Trustee and Payable to Nonresident Beneficiaries Taxable?

To this point we have been primarily concerned with questions of power to tax income payable to nonresidents. Under this heading it is proposed to refer briefly to a question of some practical importance which may arise in any state whose laws provide for taxation of income derived from sources within the state and payable to nonresidents, or the equivalent. The question to be considered under this type of statute is the following: Is income derived from foreign securities, that is, stocks or bonds of foreign corporations, received by a resident fiduciary and paid to a nonresident beneficiary, taxable?

There seem to be no court decisions passing squarely upon the point. The expression "sources within the state" or the equivalent as used in the various state income tax statutes is analogous to the expression "sources within the United States" used in the various federal income tax acts with relation to income of nonresident aliens.84

In 1923 the Income Tax Unit, passing upon the meaning of the corresponding section of the federal act, reached the conclusion that income received by a domestic trustee, derived from foreign securities and currently distributable to nonresident beneficiaries, was not subject to the federal income tax.85

the state in order to render it taxable. That the state has the power to tax income of its residents wherever earned, at least income arising from personal services, is indicated by Lawrence v. State Tax Comm., supra note 5.

84 See §211 (a) of the 1934 Revenue Act; §212 (a) of the 1932 and 1928 Revenue Acts; §213 (c) of the 1926, 1924 and 1921 Acts. Similar language has been used in the Federal Income Tax Acts at least since 1916. Standard Marine Ins. Co., Ltd. v. Comm'r (1926) 4 B. T. A. 853. The fact that various income tax acts have gone into some detail in specifying what constitutes gross income from sources in and without the United States (see §119 of 1934, 1932 and 1928 Acts; §217 of 1926, 1924 and 1921 Acts) does not seem important so far as the present question is concerned, since in none of these enumerations are the items constituting the subject matter of this inquiry specifically mentioned. The present question is, therefore, so far as these explanatory sections are concerned, set at large and is to be determined on the basis which would be applicable in their absence.

85 T. 1642, II-1 C. B. 81. This ruling construed section 217 (c) of the Revenue Act of 1921, providing that "(c) In the case of a nonresident alien individual, gross income means all the gross income from sources within the United States determined under the provisions of Section 217."

Under section 217 interest and dividends of foreign corporations (with exceptions not material here) were not taxable to nonresident aliens and certain others. The statute was silent as to the taxable status of such income where it passed through the hands of a resident trustee, and this latter is the point considered in the ruling in question, which follows an earlier Solicitor's memorandum holding that if the income of a trust is to be distributed annually the character of the income received by the beneficiary might be traced through the fiduciary to its source and that accordingly interest on bonds of a foreign country held by a
The ruling just referred to is still regarded as authority in the Bureau of Internal Revenue and there is reason to believe that so far as the federal government is concerned, it has acquired the force of positive law.

Applying the federal law and practice outlined above to the question now under consideration and bearing in mind that the state income tax statutes generally provide for deducting, in computing the net income of an estate or trust, the amount of income distributed currently to the beneficiaries, it may be that these statutes, most of them of recent origin, have by implication adopted the conduit theory and have therefore made applicable the federal rulings under correlative provisions of the federal statutes, which in determining the source of income require the taxing authorities to look beyond the trust as an entity and to take cognizance of the source from which the income is derived. It may perhaps bear repetition that this point involves no question of power, but one solely domestic trust was not income from sources within the United States in the hands of a nonresident alien beneficiary.

General Counsel's Memorandum 9156, X-1 C. B. 166, promulgated in 1931, where the former ruling is discussed at length but was held not applicable under the circumstances, which involved the taxability of interest paid on a bank account carried in the name of a trustee for the benefit of a nonresident alien. See also General Counsel's Memorandum 11221, XI-2 C. B. 123 (1932) recognizing I. T. 1642, but holding it inapplicable to a trust for accumulation. It seems that if disbursement of the income is *discretionary* with the trustee, the Bureau does not apply the conduit theory. General Counsel's Memorandum 11221 says: "The Bureau has conceded that with respect to foreign bond interest currently distributed to the beneficiaries the trustee may be regarded as a mere conduit, with the result that the character of such interest is not changed by passing through the trustee's hands. Since section 212 (a) of the Revenue Act of 1928 provides that 'In the case of a nonresident alien individual gross income includes only the gross income from sources within the United States,' it follows that currently distributed foreign bond interest, passing unchanged through a resident trustee to a nonresident alien, is not taxable, the *taxpayer* in question in such a case being the nonresident alien and not the resident trust or trustee (A. R. M. 37, C. B. 2, 172; I. T. 1642, C. B. II 1, 81)."

(1) It was adopted by the Board of Tax Appeals in Appeal of Marine Ins. Co., Ltd. (1926) 4 B. T. A. 867; acquiesced in by Commissioner, VI C. B. -1, 4, where a foreign corporation was held not taxable on interest on Anglo-French and British Government bonds, collected by a New York trust company as trustee for the corporation. (2) Since the promulgation of that ruling, the 1928, 1932 and 1934 Revenue Acts have been enacted but Congress has made no change in the law relative to this point, though the sections dealing with this topic have been in each instance re-enacted or in other respects amended. Under the rule that the re-enactment by Congress without change of a statute which has previously received long-continued departmental construction, is an adoption by Congress of the administrative construction (McFeely v. Comm'r (1935) 296 U. S. 102; see note (1929) 73 L. Ed. 322; cf. Helvering v. New York Trust Co. (1934) 292 U. S. 455), it would seem that the practice of looking to the source of income received on alien securities held under American trusts had attained the status of law.

This principle was applied by the Wisconsin Court in State *ex rel.* Mariner v. Hempel, *supra* note 82. The question can hardly arise in New York, which with a
of construction possibly arising under various income tax acts. From the jurisdictional standpoint it presents no problem requiring special consideration.

CONCLUSION

When we consider the relative novelty of income tax laws, particularly state enactments, and when we remember that formulae based upon concepts of due process once regarded as unquestionable have had to be discarded within the last six years, it should occasion no surprise that the course of juristic thought upon this issue is at this date in large part uncharted and many important decisions still unwritten. Reverting to one special topic in this field, doubt arises, for example, when we consider to what extent, if any, other states than that of the trust situs may tax trust income to the beneficiaries. As between two competing jurisdictions, that of the settlor's residence and that of the trust situs, is the fact important that the income may be payable to the settlor or that the trust is revocable? Is it material that resident beneficiaries of a foreign trust or that foreign beneficiaries of a local trust may have a right, absolute or qualified, to terminate it? What species of, or approach to, equitable ownership in the beneficiaries of a foreign trust will enable the state of their residence to ignore the trust for this purpose and treat the income from it as fully derived from a source within the state?

May the state of the situs tax gains arising from the sale of real or tangible personal property, or has the state of the domicile the exclusive right to tax such income? If ordinarily the latter has that right, does the same rule apply in the case of intangibles having a foreign business situs? May the state in which a nonresident renders professional or other personal services, tax the income so derived? May a state, not having jurisdiction of the physical evidences of the incorporeal rights involved, tax income payable to nonresidents of the United States arising from stocks of local corporations or interest on obligations of local debtors, or from gains realized from a sale of this species of property?

Except in so far as intimations regarding these or cognate problems may be gathered from the authorities discussed, this paper makes no pretense of affording answers to these inquiries and numerous others pertinent to this subject which may occur to the student or to which chance or the vast complexity of affairs may give rise. Without intent to disparage in the least the value, manifestly great, of the theoretical view to preserving its financial preeminence (Travis v. Yale & Towne Mfg. Co., supra note 5, at 81), has framed its law and regulations in such a manner as to exclude trust income derived from intangibles and payable to nonresidents. New York Tax Law, §359; Regulations, Art. 245.
approach, it may be said that the present topic is one upon which specu-
lation is particularly unprofitable. We are often reminded that taxation
is a practical matter\textsuperscript{89}—a viewpoint which, as experience will verify,
permits the statesman and economist as well as the lawyer to play a part
in the writing of decisions. For these reasons it has seemed sufficient for
the present purpose to bring together and to be content with endeavoring
to state the more important principles thus far applied by the courts in
resolving the problems originating within this confused field and to note
the tendencies which for a moment, however ephemeral, seem to indicate
the trend of future development.

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\textsuperscript{89} Farmers Loan & Trust Co. v. Minn., \textit{supra} note 21; First National Bank v.