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The Problem of Multiple Inheritance Taxes on Intangible Property

By Berton T. Gobble*

At the last annual meeting of the National Tax Association, held at St. Paul October 13-16, 1941, Marriner S. Eccles, chairman of the board of governors of the Federal Reserve System, in an address to members of the association stated that "If we are to make progressive taxes the major element of our national tax structure, it will not be possible to continue the present system of having both the states and the federal government levy taxes on corporate and individual incomes and transfers at death."[1] In other words Mr. Eccles proposed that the right to levy taxes on income, gifts and bequests should be restricted wholly to the federal government which in turn would redistribute a share of such revenues to the several states. One of the main threats of such federal encroachment on the right of taxation by states was the fact that more than one state might constitutionally tax the transfer of intangible personal property of a decedent. This proposal was made before the Supreme Court of the United States handed down its momentous decision in the case of *State Tax Commission of Utah v. Aldrich and Harkness, Administrators*, on April 27, 1942.[2]

In the *Aldrich* case the majority opinion was written by Justice Douglas, and Justice Jackson wrote the dissenting opinion. The decedent, Edward S. Harkness, died a resident of New York. Among the assets of his estate were 10,000 shares of common stock and 400 shares of preferred stock of the Union Pacific Railroad Company. The certificates for such shares of stock were at all times actually in the state of New York. For many years the company had kept its stock books and records and transfer agents in New York and had not maintained any in Utah. The sole basis for the levy of a death tax on such shares of stock by the state of Utah was by reason of the fact that the Union Pacific Railroad Company was incorporated under the laws of Utah. The question had been squarely presented to the court some years before in the case of *First National Bank v. Maine*,[3] and the court had held that the state of Maine could not do precisely what the state of Utah was here attempting to do. Therefore, in order to sustain the tax the court had to overrule the prior case. This the court did in no uncertain

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[1]Proceedings of Thirty-fourth National Conference (1941) of the National Tax Association 336-337.

[2]62 Sup. Ct. 1008, 86 L. ed. 911 (1942).

[3]284 U. S. 312, 52 S. Ct. 174, 76 L. ed. 313 (1932).

terms, establishing once again the authority for more than one state to levy a succession tax on the same intangible property. By permitting the company to incorporate under its laws, Utah had bestowed a benefit for which it could ask a return. And that return could be in the form of a succession tax on the right to transfer such shares of stock to the legatees under the decedent's will. But the thing that really hurt was the fact that in the *Aldrich* case the state of New York had a statute permitting a credit against the estate tax imposed by New York of the amount of any constitutionally valid estate or inheritance tax paid to any other state within three years after the decedent's death. The effect of the case, therefore, was to permit Utah to levy a tax which had to be borne by New York.

Justice Jackson, in his dissenting opinion, indicated the effect the new decision would have on the tax program of the several states when he said:

> "The new tax we have authorized undermines the principle of graduation of tax burdens in proportion to ability to pay. No tax laid on anything less than the total net worth of the estate can be graduated even roughly according to the principle which progressive modern taxation strives to heed. The imposition of unpredictable assessments from many sources makes it impossible for the state of domicile to make intelligent use of its own taxing power as an instrument of enlightened social policy. Chaos serves no social end."

In line with the philosophy of Marriner Eccles, Justice Jackson advanced the fear of many state tax administrators when he stated, "I do not doubt that today's decision will give a new impetus to federal absorption of this revenue source and to federal incorporation of large enterprises. * * * With confidence we may anticipate that this decision will produce much confusion, some controversy between the states, and a lusty crop of litigation."

Justice Jackson went on to comment as to the probable effect the decision would have on other tax decisions of the Supreme Court:

> "Certain it is that while only corporate stock is expressly mentioned in the opinion or involved in the judgment today, the fiction of benefits and protection is capable of as ready adaptability to other intangible property. Our tomorrows will witness an extension of the taxing power of the chartering or issuing state to corporate bonds and bonds of states and municipalities (by overruling *Farmers Loan & Trust Co. v. Minnesota,* 280 U. S. 204), to bank credits for cash deposited (by overruling *Baldwin v. Missouri,* 281 U. S. 586) and to choses in action (by overruling *Beidler v. South Carolina,* 228 U. S. 1). And while today

the Court sustains only a death transfer tax, its theories are equally serviceable to sustain an income or excise tax on dividends from such stock or interest on bonds or a sales tax, or a gift tax. * * * I therefore take today's decision to mean that any state may lay substantially any tax on any transfer of intangible property toward which it can spell out a conceivable legal relationship.

"And since the Due Process Clause speaks with no more clarity as to tangible than as to intangible property, the question is opened whether our decisions as to taxation of tangible property are not due to be overhauled."

Justice Roberts concurred in the dissenting opinion of Justice Jackson.

Prior to 1930 many states had been taxing the transfer of intangible property of non-residents. Colorado had a provision in its 1921 law which permitted the assessment of such a tax.[4] Such state laws were not unconstitutional in view of *Blackstone v. Miller*[5] which had "rejected the notion that there were constitutional objections to double taxation of intangibles by states which had command over them or their owner."[6]

Commencing with the case of *Blodgett v. Silberman*[7] the United States Supreme Court handed down a series of decisions which established the single death tax theory fixed in the state of domicile. *Blodgett v. Silberman* had held that bonds and certificates of stocks located in safety deposit boxes in another state were nevertheless intangible property and subject to tax in the state of decedent's domicile.

In 1930 the court decided *Farmers Loan and Trust Co. v. Minnesota*,[8] which overruled *Blackstone v. Miller*, and held that bonds issued by a state and certificates of indebtedness of cities within the state are not subject to the state inheritance tax when owned by a non-resident decedent and located without the state. In that same year the court held in *Baldwin v. Missouri*[9] that a state may not impose a transfer or inheritance tax upon such intangible personal property owned by a non-resident as credits for cash deposited in local banks, coupon bonds issued by the United States, and promissory notes constituting debts from residents to non-residents, the bonds and notes being physically present in the state, but not having obtained a business situs there. Later that same year in *Beidler v. South Carolina Tax Commission*,[10]

[4]Sec. 2 B, Ch. 144, Laws 1921, p. 410: "B. When the transfer is by will or intestate laws of property within the State and the decedent was a non-resident of the State at the time of his death."

[5]188 U. S. 189, 23 S. Ct. 277, 47 L. ed. 439 (1903).

[6]Justice Jackson in the *Aldrich* decision *supra* note 2.

[7]277 U. S. 1, 48 S. Ct. 410, 72 L. ed. 749 (1928).

[8]280 U. S. 204, 50 S. Ct. 98, 74 L. ed. 371, 65 A.L.R. 1000 (1930).

[9]281 U. S. 586, 50 S. Ct. 436, 74 L. ed. 1056, 72 A.L.R. 1303 (1930).

[10]282 U. S. 1, 51 S. Ct. 54, 75 L. ed. 131 (1930).

the court ruled that a state may not levy an inheritance tax upon the intangible assets of a non-resident estate consisting of indebtedness for advances and unpaid dividends owed the non-resident estate by a domestic corporation. The assertion that the indebtedness had a business situs within the taxing state must be supported by evidence and that requirement is not met by a mere showing that the indebtedness was an open unsecured account or that the non-resident decedent was the chief stockholder and largely interested in the company's affairs. In 1932 the court took just the opposite position from the *Aldrich* decision and held in *First National Bank v. Maine*[11] that shares of stock, like other intangibles, constitutionally can be subjected to a death transfer tax by one state only—the state of domicile.

On May 29, 1939, the Supreme Court decided *Curry v. McCanless*,[12] which definitely upset the single tax theory based solely upon the decedent's domicile. In this case the decedent, a resident of Tennessee, had transferred certain intangible property to a trustee in Alabama. Under the terms of the trust agreement the decedent had reserved a power of appointment over the corpus of the trust. By her will the decedent bequeathed the trust property to the same trustee in Alabama. At all times the trust property had an actual situs in Alabama. Under the will a Tennessee executor was named to administer the estate located in Tennessee, and an Alabama executor was named to administer all the estate located in Alabama. The court held that both Tennessee and Alabama could constitutionally impose a tax on transfer of the intangibles held by the Alabama trustee but passing under the will of the decedent, domiciled in Tennessee.

The majority opinion was written by Justice Stone. Justice Butler wrote the dissenting opinion, concurred in by Chief Justice Hughes, Justice McReynolds, and Justice Roberts. The court recalled that

> "From the beginning of our constitutional system control over the person at the place of his domicile and his duty there, common to all citizens, to contribute to the support of government have been deemed to afford an adequate constitutional basis for imposing on him a tax on the use and enjoyment of rights in intangibles measured by their value. In cases where the owner of intangibles confines his activity to the place of his domicile, it has been found convenient to substitute a rule for a reason, by saying that his intangibles are taxed at their situs and not elsewhere, or, perhaps less artificially, by invoking the maxim *mobilia sequuntur personam*. But when the tax payer extends his activities with respect to his intangibles, so as to avail himself of the protection

[11] 284 U. S. 312, 52 S. Ct. 174, 76 L. ed. 313, 77 A.L.R. 1401 (1932).
[12] 307 U. S. 357, 59 S. Ct. 900, 83 L. ed. 1339 (1939).

and benefit of the laws of another state, in such a way as to bring his person or property within the reach of the tax gatherer there, the reason for a single place of taxation no longer obtains, and the rule is not even a workable substitute for the reasons which may exist in any particular case to support the constitutional power of each state concerned to tax. Since Alabama may lawfully tax the property in the trustee's hands, the court perceives no ground for saying that the Fourteenth Amendment forbids that state to tax the transfer of it or an interest in it to another merely because the transfer was effected by decedent's testamentary act in another state. In effecting her purposes, the testatrix brought some of the legal interests which she created within the control of one state by selecting a trustee there and others within the control of the other state by making her domicile there. She necessarily invoked the aid of the law of both states; and her legatees, before they can secure and enjoy the benefits of succession, must invoke the law of both."

While *Curry v. McCanless*[13] did not expressly overrule any of the prior decisions of the court adopting the single tax theory, many legal commentators believed that by inference the cases of *Farmers Loan & Trust Co. v. Minnesota,*[14] *First National Bank v. Maine*[15] and *Wachovia Bank & Trust Company v. Doughton,*[16] the latter case involving the right of a state to tax the exercise by a resident donee of a power of appointment created by a non-resident donor, had been overruled. All agreed that *Curry v. McCanless* showed a definite trend which would permit double taxation of intangibles and in some cases triple taxation.

On that same day the Supreme Court handed down its decision in *Graves v. Elliott,*[17] the facts of which were that decedent, while domiciled in Colorado, transferred to a Colorado bank certain bonds under a revocable trust agreement. Afterwards decedent became a resident of New York and died while domiciled in that state. Following her death the taxing authorities of Colorado assessed a tax on the transmission at death of the trust fund. The court held that New York also could constitutionally levy a transfer tax upon the relinquishment at death of the power of revocation, measured by the value of the intangibles, based upon the authority of *Curry v. McCanless.*[18]

After the New York Surrogate Court had handed down a decision holding in effect that the *Wachovia* case was still law and had

[13]*Supra* note 12.
[14]*Supra* note 8.
[15]*Supra* note 11.
[16]272 U. S. 567, 47 S. Ct. 202, 71 L. ed. 413 (1926).
[17]307 U. S. 383, 59 S. Ct. 913, 83 L. ed. 1356 (1939).
[18]*Supra* note 12.

not been overruled by *Curry v. McCanless*, the United States Supreme Court granted a writ of certiorari in the case of *Graves v. Schmidlapp*,[19] and on March 30, 1942, expressly overruled the *Wachovia* case. In the *Schmidlapp* case decedent had died a resident of New York, where his will had been probated and letters testamentary issued. Decedent's father had previously died a resident of Massachusetts, where his will had been probated. By his will the father bequeathed his residuary estate in trust to divide the trust fund into as many shares as he should leave children surviving. To his son, the New York decedent, he gave a life estate in one share and a general power to dispose of that share "by will". By his will decedent appointed his share of the trust fund to his widow, and the New York tax authorities, in computing the tax, included in the decedent's gross estate the intangibles bequeathed to her under the power. The court held that

> "For purposes of estate and inheritance taxation the power to dispose of property at death is the equivalent of ownership. Intangibles, which are legal relationships between persons and which in fact have no geographical location, are so associated with the owner that they and their transfer at death are taxable at the place of his domicile where his person and the exercise of his property rights are subject to the control of the sovereign power. His transfer of interests in intangibles by virtue of the exercise of a donated power instead of that derived from ownership, stands on the same footing. In both cases the sovereign's control over his person and estate at the place of his domicile and his duty to contribute to the financial support of government there, afford adequate constitutional basis for the imposition of a tax. * * * *Wachovia Bank & Trust Co. v. Doughton*, on which respondents rely, denied the constitutional power of a state to tax the effective exercise of a testamentary power in circumstances like the present. The only grounds for the decision were that the intangibles held in trust in another state, which were the subject of the power, had no situs in the state where the domiciled testator had exercised the power by his will; that its exercise was subject to the laws of Massachusetts where the will donating the power and establishing the trust had been probated, and that no 'right' exercised by the donee was conferred by the state of his domicile where it was exercised. The conclusion there reached and the reasons advanced in its support cannot be reconciled with the decision and the reasoning of the *Bullen*, the *McCanless* and the *Elliott* cases. It is plain that if appropriate emphasis be placed on the orderly administration of justice rather than blind adherence to conflicting precedents, the

[19] 62 S. Ct. 870, 86 L. ed. 761 (1942).

> *Wachovia* case must be overruled. There is no reason why the state should continue to be deprived of revenue from a subject which from the beginning has been within reach of its taxing power; a subject over which we cannot say the state's control has been curtailed by the due process clause of the Fourteenth Amendment. No interest which could be served by so rigid an adherence to *stare decisis* is superior to the demands of a system of justice based on a considered and a consistent application of the constitution."

The evils of double taxation around which the citizen is entwined again recalls the statement made by Calvin Coolidge, while President of the United States:

> "A share of stock represents a most conspicuous example of multiple inheritance taxation. It is possible that the same share of stock, upon the death of its owner, may be subject to taxation, first, by the federal government, then by the state where its owner was domiciled; then by some other state which may also claim him as a citizen; again in the state where the certificate of stock was kept; in the state where the certificate of stock must be transferred on the corporation's books; in the state or states where is organized the corporation whose capital stock is involved; and finally, in the state or states where the corporation owns property.
>
> "All this means not only an actual amount of tax which may, under particular circumstances, exceed 100 per cent of the value of the stock, but the expense, delay and inconvenience of getting clearances of the states who claim a right to tax the property is a serious burden to the heir who is to receive the stock. Particularly is this expense disproportionate to the tax paid by a small estate which has but a few shares of stock. In many cases the expense alone must exceed the total value of the shares which it is sought to transfer."

Where do all these tax decisions place the citizen today? He is confronted with the threat of double and possibly triple taxation of his intangibles upon his death. If a resident of state *A* dies leaving stock, the certificates for which are in state *B*, and the company is incorporated in state *C*, his estate faces the possibility of paying three death taxes on the same property, in addition to the estate tax levied by the federal government. The citizen faces the possibility of double taxation if he dies possessed of bonds issued by municipalities of a state other than the state of domicile, once by the domicilliary state and again by the state in which the municipalities are located. He cannot be sure that if he dies siezed of real estate in another state that his estate won't have to pay a succession tax to the state in which the real estate is located and a duplicate tax to his own state which conferred benefits upon him during his lifetime. Even during his lifetime the citizen must be careful in

making gifts of corporate stock of corporations organized under a state other than his own, for fear of encountering a double gift tax in addition to the federal gift tax. In this connection I wish to call attention to the wording of Colorado's gift tax statute regarding the applicability of the tax. Section 2, Chapter 75 A, 1935 Colorado Statutes Annotated, reads as follows:

> "*When tax shall apply.*—The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; and shall apply to all transfers of property within this state or within its jurisdiction whether by residents or non-residents; and to all transfers by residents of intangible property wherever situated and of tangible personal property which shall not have acquired a bona fide permanent situs without this state."

Notice that the law applies to "all transfers of property within this state or *within its jurisdiction* whether by residents or non-residents." In the *Aldrich* decision[20] the Utah statute employed substantially those words. After indicating that the inheritance tax law applied both to residents and to non-residents, the Utah act went on to say that "The value of the gross estate of a decedent shall be determined by including the value at the time of his death of all property, real or personal, *within the jurisdiction of this state* * * *." The court held that shares of a corporation organized under Utah law were "within its jurisdiction" for the purpose of a succession tax even though the stock certificates never were physically present in Utah or even transferred on the books of the company within the state of Utah.

What if revenue-hungry legislatures, realizing this new source of income, adopt laws permitting such double or triple taxation of intangibles upon death—what would be the ultimate result upon those states? It would undermine their fundamental succession tax law as regards residents, which in most cases is based upon the relationship of the recipient to the decedent, and in most states is progressive in rates which is predicated upon the ability to pay. It would affect the normal sale of corporate stocks and municipal obligations, by subjecting them to taxation in one or more states. It would prevent the normal incorporation of commercial enterprises under state law and would encourage federal incorporation or the adoption of a federal law which would permit the federal government to issue charters to all types of corporate businesses. It would further complicate the sale of all types of property by reason of the necessity of reporting to more than one state and obtaining an inheritance tax clearance before being permitted to make the actual sale. It would mean that the issuance of life insurance policies would be

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[20] *Supra* note 2.

further entailed when one considers that the state of domicile might tax it, the state of incorporation might tax it, and the state where the policy was physically located might tax it, if for example it were held in custody by a trustee in a third state. But no doubt the most disastrous effect such taxation laws would have on the states and on its citizens would be the complete adoption of the present trend toward centralization of taxing powers in the federal government, strangling the inherent right of the sovereign state to tax the property of its own citizens.

What can a state do, whose citizens are opposed to such forms of double taxation? Of course it can limit its right to tax only the tangibles and intangibles of its resident decedents. But that alone would not assure its citizens that other states would take the same measures. For this reason many states adopted so-called reciprocal statutes many years ago which became obsolete when the United States Supreme Court adopted the single tax theory. Now that the single tax theory is no longer the law of the land, many states find that their reciprocal laws are inadequate or were repealed outright. It is debatable whether legislatures will revert to reciprocal acts or whether they will attempt to tax the transfer of property on every conceivable theory proposed by the court. "The power to tax is the power to destroy"—and I believe that double taxation of intangibles is one of the sure roads toward destruction of our American system of free enterprise.

Colorado has at present on its statute books a form of reciprocal law, Section 6, Chapter 85, 1935 Colorado Statutes Annotated, which reads as follows:

> "*Transfer by resident.*—A tax is hereby imposed under the conditions and subject to the exemptions and limitations hereinafter prescribed, upon transfers, in trust or otherwise, of the following property or any interest therein or income therefrom:
>
> "(a) When the transfer is from a resident of this state—
>
> "1. Real property situated in this state.
>
> "2. Tangible personal property, except such as has an actual situs without this state.
>
> "3. All intangible personal property, wheresoever the notes, bonds, stock certificates, or other evidence, if any, thereof, may be physically located, or the banks or other debtors may be located or domiciled.
>
> "(b) When the transfer is from a non-resident of this state—
>
> "1. Real property situated in this state.
>
> "2. Tangible personal property which has an actual situs in this state.
>
> "3. Intangibles that have acquired an actual or business situs in this state; provided, no transfer or succession tax has been

levied and paid on such transfer at the domicile of the decedent; but if the transfer of such intangibles shall be taxed at the domicile, their transfer shall also be deemed taxable by this state unless, prior to payment of such tax at the domicile, the executor, administrator or trustee shall notify the Commissioner in writing by registered mail of intention to make payment at the domicile, such notice to be sent at least thirty days prior to such payment."

As a matter of fact the inheritance tax department has not attempted to tax intangibles of non-residents located in Colorado if it appears that a tax has been or will be paid to the state of domicile. In not one in a hundred cases is notice given by registered mail to the Colorado inheritance tax commissioner thirty days prior to payment of the tax to the state of domicile. It follows that under a strict interpretation of the statute an inheritance tax could be levied by Colorado on the transfer of intangibles belonging to non-residents which had acquired an actual or business situs in this state, in all cases where the estate neglected to notify the commissioner within the time provided by statute. Usually the non-resident estate has paid the domicilliary tax before seeking a Colorado release and of course few are familiar with the peculiar provisions of our statute regarding notice.

So far as encouraging other states to adopt reciprocal legislation, our statute fails most miserably. This can best be illustrated by a specific example: Suppose a Utah resident died leaving intangible securities in a Denver safe deposit box. Upon being advised that Utah had taxed the transfer, the Colorado inheritance tax department would release the securities and claim no tax. But, on the other hand, should a Colorado resident die owning securities of a Utah corporation or intangibles located in Utah, the estate would be subject to inheritance taxes by both Colorado and Utah. In other words, Colorado is in the anomalous position of being reciprocal with a non-reciprocal state!

The most commonly adopted reciprocal statute is the Uniform Reciprocal Exemption Law, which provides as follows:

"No tax shall be imposed in respect of personal property (except tangible personal property having an actual situs in this state), if

"(a) The transferor at the time of the transfer was a resident of a state or territory of the United States, or of any foreign country, which at the time of the transfer did not impose a transfer tax or death tax of any character in respect of personal property of residents of this state (except tangible personal property having an actual situs in such state or territory or foreign country), or

"(b) If the laws of the state, territory or country of residence of the transferor at the time of the transfer contained a reciprocal

exemption provision under which non-residents were exempted from transfer taxes or death taxes of every character in respect of personal property (except tangible personal property having an actual situs therein), provided the state, territory or country of residence of such non-resident allowed a similar exemption to residents of the state, territory or country of residence of such transferor. For the purposes of this section the District of Columbia and possessions of the United States shall be considered territories of the United States."

Under this statute the intangibles of a non-resident decedent are not subject to a succession tax, provided the state of domicile has a similar reciprocal statute or does not attempt in any manner to tax such intangibles of non-residents. Complete absence of any succession tax in the domicilliary state is considered sufficient to invoke the exemption under such a reciprocal act. This means that if the domicilliary state had no succession tax law, as, for example, the state of Nevada, which never adopted any type of death tax, and the state where the intangibles were located or had a business situs provided for reciprocity, then in that event such intangibles would not be subject to any death tax but the federal estate tax. In some rare instances, since the case of *Curry v. McCanless,* Colorado has collected an inheritance tax on the transfer of intangibles located here but owned by a non-resident decedent domiciled in a state which levied no death tax and consequently no tax could be paid to the domicilliary state which would exempt the securities from the Colorado tax. Some legislators will want to retain this power to tax the transfer of intangibles, on any theory, provided the state of domicile claims no tax, arguing that such action does not have the onus of double taxation. But if it is believed that the state of domicile should be the only state to tax intangibles of decedents, regardless of situs, or in other words, if it is believed that the single tax theory should prevail, the legislators should not hesitate to adopt full reciprocal statutes. Simply exempting all intangibles of non-residents from the succession tax is, in my opinion, not enough. As long as there are states which insist upon double taxation of intangibles, reciprocal statutes must be adopted to force public opinion in those states to alter their taxing statutes. It is believed by many tax authorities that the trend toward adoption of reciprocal legislation, regarding the taxation of intangibles, will return to safeguard the rights of investors who are now in a quandary as a result of the *Aldrich* decision. In view of the far reaching position the court has taken, the only remedy against double death duties is the adoption of such reciprocal laws by all the states in the interest of national unity.