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State Inheritance Tax on Foreign-Held Bonds or Notes Secured by a Mortgage on Land in the State

MELBER B. CHAMBERS*

I.

For many years inheritance tax laws have loomed increasingly large in the lawyer's practice. Numberless cases have arisen involving their construction and constitutionality. Here as in other parts of the law of taxation the courts have been trying to chart their way through a myriad of intricate problems. Taking one step at a time, aided by a few tried principles, they have attempted to describe the jurisdiction of a state to tax.

One of these problems of jurisdiction which has not yet been before the Supreme Court is whether a state can tax the inheritance of foreign-held bonds or notes which are secured by a mortgage on land in the state. Has a state power to levy such a tax or would it run afoul of the Fourteenth Amendment?

This question is presented under the inheritance tax statute of practically every state.[1] It cannot be avoided by construction, by a decision that the legislature did not intend to include the transfer of such bonds or notes within the tax, for the legislatures have invariably made clear their intention to tax all the transfers within their power.[2]

It was early decided that a state could tax any property within the state.[3] And it has since been determined that the same test will

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[1]The following is a typical provision for a tax upon the property of a non-resident decedent: "A tax shall be and is hereby imposed upon the transfer of any property, real or personal or mixed, or of any interest therein or income therefrom * * * in the following cases: * * * (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." Statutes of South Carolina, 1922, Vol. 32, p. 800.

[2]Some statutes state that the tax shall affect all property over which the state has jurisdiction for purposes of taxation, *e. g.*, No. 188 Michigan Public Acts of 1899, § 21; New York Laws of 1892, Ch. 399, § § 1, 22; Minn. Laws 1905, p. 427, c. 288, § 1, as amended Laws of 1911, p. 516, c. 372, § 1. The typical statute as set forth in note 1, *supra*, accomplishes the same result by describing the taxable property as "all property within the state". Such a statute "is as broad as the jurisdiction of the Commonwealth". Kinney v. Treasurer & Receiver General, 207 Mass. 368, 369, 93 N. E. 586, 587 (1910).

[3]McCulloch v. Maryland, 4 Wheat. (U. S.) 316, 429 (1819); State Tax on Foreign Held Bonds, 15 Wall. (U. S.) 300 (1872); Kintzing v. Hutchinson, Fed. Cas. No. 7834, 14 Fed. Cas. 645 (1877).

tell whether a state has the power to tax the inheritance of property as will tell whether it has the power to tax the property itself. "* * * The principle that the subject to be taxed must be within the jurisdiction of the state applies as well in the case of a transfer tax as in that of a property tax. A state has no power to tax the devolution of the property of a non-resident unless it has jurisdiction over the property devolved or transferred."[4] It may also be said that the true basis of the inheritance tax is the service rendered by the state in supplying its law to govern the transfer, and that as to non-residents it renders that service only for transfers of property that is within the state. But whether or not that reasoning is accepted, the essential requisite of jurisdiction for either the direct property tax or the inheritance tax upon property of a non-resident is the presence of the property within the state.[5] This principle has become firmly fixed among the principles of the common law of Conflict of Laws and of our Constitutional Law.[6]

The general question to arise under these statutes, therefore, was whether or not this or that property belonging to a non-resident decedent was "within the state". Did it have a situs there? About immovables there of course was never any question.[7] Their *situs* was fixed. About movables there was at first some doubt. There was the long revered doctrine of *mobilia personam sequuntur*.[8] Or, as stated in many of the early decisions, "personal property having no situs of its own attends the person and domicil of its owner".[9] But the fiction was soon made to yield to the facts. When the judge could look out of the court house window and see the horse and the wagon, the furniture and the working tools—all a part of the estate of the non-resident decedent—he found some difficulty in convincing

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[4]Frick v. Pennsylvania, 268 U. S. 473, 492, 45 Sup. Ct., 603 (1925); Rhode Island Hospital Trust Co. v. Doughton, 270 U. S. 69, 80 (1926); Matter of Estate of Swift, 137 N. Y. 77, 85-86, 32 N. E. 1096, 1098 (1896).

[5]It is not necessary to state here that the "presence" must not be merely temporary but must have some permanence. The property must have a situs there. Hays v. Pacific Mail S. S. Co., 17 How. (U. S.) 596 (1854). See collection of cases in (1918) 28 YALE L. J. 525.

[6]Jurisdiction to tax the inheritance of any property having a *situs* outside the state could only be based upon the residence of the owner within the state. Fidelity & Columbia Trust Co. v. Louisville, 245 U. S. 54, 38 Sup. Ct. 40 (1917). But see Frick v. Pennsylvania, *supra* note 4. But we are not concerned here with the power of a state to impose a personal tax. Our inquiry is limited to a consideration of the inheritance tax based upon jurisdiction over the property.

[7]Hoyt v. The Commissioners of Taxes, 23 N. Y. 224, 226 (1861); 28 YALE L. J. 525, 526.

[8]"*Mobilia personam sequuntur* is a maxim of law as old as the law itself." Monidah Trust v. Sheehan, 45 Mont. 424, 123 Pac. 692 (1912); Hornthal v. Burwell, 109 N. C. 10, 13 S. E. 721 (1891).

[9]Kintzing v. Hutchinson, *et al.*, *supra*, note 3.

himself that these *mobilia* were not within his state but were following the person of the owner. So the fiction was held not to limit the taxing power of the state of actual situs. All tangibles, movable and immovable, could be subjected to a direct property tax and to an inheritance tax in the state where they were physically present.[10]

The situs of many kinds of intangibles for the purpose of taxation is still undetermined. There are few parts of the law of equal importance so unsettled. A long line of state decisions will suddenly find itself called to account by the Supreme Court and an accepted doctrine will be overturned.[11]

At first, relying upon the old maxim *mobilia*, the courts fixed the situs of all intangibles at the domicil of the owner.[12] And there alone were they taxable.

The first weakening of the maxim is found in the cases of business situs. When a bond or note or other intangible was connected with a business in some other place than the domicil of the owner, they were said to have acquired a situs there. This localization of the debt gave a basis for taxation. Since it was property within the state, it could be made subject to the state's property and inheritance tax.[13]

A doctrine of the law merchant has also been used to break in upon the maxim when bonds or notes were the intangibles in question. The bond and the note has long been considered to be not merely evidence of the obligation but the obligation itself. They pass freely from hand to hand and have value in themselves. "It is not primitive

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[10]Coe v. Errol, 116 U. S. 517, 6 Sup. Ct. 475 (1886); American Steel & Wire Co. v. Speed, 192 U. S. 500, 24 Sup. Ct. 500 (1904); Mills v. Thornton, 26 Ill. 300 (1861); Scollard v. American Felt Co., 194 Mass. 127, 80 N. E. 233 (1907); Tobey v. Kip, 214 Mass. 477, 101 N. E. 998 (1913); John Hancock Ice Co. v. Rose, 67 N. J. L. 86, 50 Atl. 364 (1901); Lehigh & Wilkesbarre Coal Co. v. Junction, 75 N. J. L. 68, 66 Atl. 923 (1907); People v. Dunckel, 69 N. Y. Misc. 361, 125 N. Y. Supp. 385 (1910).

[11]Union Transit Co. v. Kentucky, 199 U. S. 194, 26 Sup. Ct. 36, (1905); Frick v. Pennsylvania, *supra* note 4.

[12]State Tax on Foreign Held Bonds, 15 Wall. (U. S.) 300 (1872); Kirtland v. Hotchkiss, 100 U. S. 491 (1879); Holland v. Commissioners, 15 Mont. 460, 39 Pac. 575 (1895); Small's Estate, 151 Pa. 1, 25 Atl. 23 (1892); Goldgart v. The People, 106 Ill. 25 (1883); Street Railroad Co. v. Morrow, 87 Tenn. 406, 434, 11 S. W. 348 (1888); Kintzing v. Hutchinson *et al.*, *supra* note 3. But see Joyslin's Estate, 76 Vt. 88, 56 Atl. 281 (1902).

[13]New Orleans v. Stempel, 175 U. S. 309, 20 Sup. Ct. 110 (1899); Bristol v. W. County, 177 U. S. 133, 20 Sup. Ct. 585 (1900); Metropolitan Life Ins. Co. v. New Orleans, 205 U. S. 395, 27 Sup. Ct. 499 (1907); Buck v. Beach, 206 U. S. 392, 27 Sup. Ct. 712 (1907); Liverpool Ins. Co. v. Orleans Assessors, 221 U. S. 346, 31 Sup. Ct. 550 (1910); Buck v. Miller, 147 Ind. 586, 45 N.E. 647 (1897); National Fire Ins. Co. v. Board of Assessors, 121 La. 108, 46 So. 117 (1908); State *ex rel* Langer v. Packard, 40 N. D. 182, 168 N. W. 673 (1918); People v. Smith, 88 N. Y. 576 (1882); State v. Fidelity and Deposit Co., 35 Tex. Civ. App. 232, 80 S. W. 554 (1904); Catlin v. Hull, 21 Vt. 152 (1849); *Contra* Jack v. Walker, 79 Fed. 138 (1897); Baars v. City of Grand Rapids, 129 Mich. 572, 89 N. W. 328 (1902).

tradition alone that gives their peculiarities to bonds, but a tradition laid hold of, modified and adapted to the convenience and understanding of business men. The same convenience and understanding apply to bills and notes * * *"[14] So it has been held that the obligations of bonds and notes although unconnected with any business have a situs where the bonds and notes are permanently kept, as do chattels, and they are taxable there.[15]

A third place where it has been contended that the obligation of a bond or note may be localized for purposes of taxation is at the domicil of the debtor. In the absence of a controlling Supreme Court decision much has been written concerning this contention both in the opinions of State courts and in legal periodicals. Learned jurists have arrayed themselves on each side of the controversy.[16] It is clear that the debt not represented by a tangible form cannot have a situs.[17] So attempts to seize upon the place of residence of the debtor as a means of localizing the obligation must be regarded as unsound. Let the process of localization be applied only when the obligation is represented by some tangible form or is attached to some business and then only when some good reason exists, as in the two instances already discussed.

It is true that the debt is protected by the state of the debtor's domicil, but so is it protected by every other state into which the debtor goes. There he may be sued and the debt collected. If there were some strong social interest in finding a basis for a tax on a debt at the domicil of the debtor, then consideration might be given to this

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[14]Mr. Justice Holmes in Wheeler v. Sohmer, 233 U. S. 434, 439, 34 Sup. Ct. 607 (1914).

[15]Scottish Union & National Insurance Company v. Bowland, 196 U. S. 611, 25 Sup. Ct. 345 (1904); Wheeler v. Sohmer, *supra* note 14; Walker v. Jack, 88 Fed. 576 (1898); Callahan v. Woodbridge, 171 Mass. 595, 51 N. E. 176 (1898); Kennedy v. Hodges, 215 Mass. 112, 102 N. E. 432 (1913); State v. County Court, 69 Mo. 454 (1880); Matter of Whiting, 150 N. Y. 27, 44 N. E. 715 (1896); Matter of Morgan, 150 N. Y. 35, 44 N. E. 1126 (1896); *In re* Gates Estate, 243 N. Y. 193, 153 N. E. 47 (1926); Matter of Tiffany, 143 App. Div. 327 (1911), *aff'd.* 202 N. Y. 550, 95 N. E. 1140; Hall v. Miller, 102 Texas 289, 115 S. W. 1168 (1909). *Contra:* Estate of McCahill, 171 Cal. 482, 153 Pac. 930 (1915); Howell v. Gordon, 127 Mich. 517, 86 N. W. 1042 (1901); Myers v. Seaberger, 45 Ohio St. 232, 12 N. E. 796 (1887); Orcutt's Appeal, 97 Pa. St. 179 (1881).

[16]Professor Joseph H. Beale, (1914) 27 HARV. L. REV. 107, 114 and (1919) 32 HARV. L. REV. 586, 604; Professor Charles E. Carpenter, *Jurisdiction over Debts for the Purpose of Administration, etc.*, (1918) 31 HARV. L. REV. 918; Blackstone v. Miller, 188 U. S. 189, 23 Sup. Ct. 277 (1903); Street Railway Co. v. Morrow, 87 Tenn. 438, 11 S.W. 348 (1888); Walker v. People, 64 Colo. 143, 171 Pac. 747 (1918). For limitations on the doctrine of the dictum of Blackstone v. Miller, see: Matter of Gordon 186 N. Y. 471, 79 N. E. 722, 10. L. R. A. (N. S.) 1089 (1906); Bliss v. Bliss, 221 Mass. 201, 109 N. E. 148, L. R. A. 1916 A, 889 (1916).

[17]Street Railway Co. v. Morrow, *supra* note 16.

protection given there, or emphasis might be laid upon the better protection given there where physical presence of the debtor is not necessary for enforcement of the debt. But, on the contrary, the demands of a fair system of taxation are against it. Taxation of a debt at the domicil of the debtor would duplicate the tax at the domicil of the creditor. The power of the creditor's domicil to tax the debt has already been upheld by the Supreme Court—not because of the old maxim *mobilia*, but because the creditor himself is subject to the power of that State.[18] So small distinctions and degrees of protection should not be searched out to support a second tax.

Is there to be still another place suggested for the localization of the bond or note? If there is security, if the obligation is secured by a mortgage, may the state where the land is situated claim the situs? Can it say the security ties the obligation down and makes it property within its bounds and thus subjects it to its taxing power? Let us see how the courts have dealt with this problem.

II.

There are three pertinent decisions of the Supreme Court. The first, the leading case of *State Tax on Foreign Held Bonds*,[19] arose under a Pennsylvania statute which directed every domestic corporation which paid interest to its bondholders and other creditors to deduct "a tax of five per centum upon every dollar of interest paid as aforesaid * * *" The question before the court was whether the statute, so far as it applied to the interest on bonds of the Cleveland, Painesville and Ashtabula R. R. Co., issued to and held by non-residents of the State of Pennsylvania and secured by mortgage on land in Pennsylvania and Ohio, was a valid and constitutional exercise of the taxing power of the state. The court held that it was not.

At first blush it would appear that the court rested its decision upon one ground alone, that of the contract clause of the Federal Constitution. If that were true, then the decision would be of little moment and would have been little heard of since. That it did rely in part upon that ground is undoubtedly true.[20] But the greater

[18]Kirtland v. Hotchkiss *supra* note 12; Fidelity & Columbia Trust Co. v. Louisville 245 U. S. 54, 38 Sup. Ct. 40 (1917); Kintzing v. Hutchinson *et al supra* note 3. See Bullen v. Wisconsin 240 U. S. 625, 631, 36 Sup. Ct. 473 (1915); Maguire v. Trefry 253 U. S. 12, 40 Sup. Ct. 417 (1919).

[19]*Supra*, note 12.

[20]"It is a law which interferes between the company and the bondholder, and under the pretence of levying a tax commands the company to withhold a portion of the stipulated interest and pay it over to the State. It is a law which thus impairs the obligation of contract between the parties." (Page 320).

part of the opinion deals not with the contract clause but with the principal point in the decision: the extraterritoriality of the Pennsylvania statute.[20a] So we have the often quoted passage:[21]

> "The power of taxation, however vast in its character and searching in its extent, is necessarily limited to subjects within the jurisdiction of the State. These subjects are persons, property, and business. * * * Corporations may be taxed, like natural persons, upon their property and business. But debts owing by corporations, like debts owing by individuals, are not property of the debtors in any sense; they are obligations of the debtors and possess value only in the hands of the creditors. With them they are property, and in their hands they may be taxed * * * The bonds issued by the railroad company in this case are undoubtedly property, but property in the hands of the holders, not property of the obligors. So far as they are held by non-residents of the State, they are property beyond the jurisdiction of the State * * The law * * * is not, therefore, a legitimate exercise of the taxing power."

The court then referred to the Pennsylvania case of *Maltby v. Reading & Columbia Railroad Co.*, cited by counsel to support the tax. It disagreed with and refused to adopt the reasoning of the Pennsylvania court that the bond of the non-resident was itself property in the State because secured by a mortgage on property there. This it considered unsound.

Bonds have no taxable situs at the domicil of the debtor; the fact that bonds are secured by a mortgage on land in the state does not give them a taxable situs there—these are the two principles for which the case stands and which have caused the decision to be regarded as one of the first landmarks in the law of taxation.

But, it has been urged, this case has been so cut down by later decisions that it has been practically overruled.[22] Of course it must be recognized that the dictum in the case that the bonds are taxable only at the domicil of the owner is unsound and has since been quite

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[20a]This doctrine of extraterritoriality soon became swallowed up in the verbiage of the due process clause as the Fourteenth Amendment outgrew its narrow Civil War significance.

[21]P. 319, 320.

[22](1918) 31 HARV. L. REV. 905. In this article Professor Carpenter cites Savings & Loan Society v. Multnomah County, Blackstone v. Miller and Bristol v. Washington County. The first two of these will be treated in the text. In the third case a tax on notes owned by non-residents and secured by mortgages on land within the state is sustained on the ground that the notes and mortgages had a situs within the state, being kept there for the owners by a resident agent. In other words, this is a case of "business *situs*," and is clearly distinguishable from State Tax on Foreign-Held Bonds. The court quoted with approval the following words of the Minnesota Court: "The creditor, however, may give it (a credit) a business *situs* * * * as where he places it in the hands of an agent for collection or renewal, with a veiw to reloaning the money and keeping it invested as a permanent business."

properly disregarded. The discard of that dictum was but a part of the gradual decay of the fiction *mobilia personam sequuntur*. And it must also be noted that another dictum in the opinion concerning the mortgagee's interest in land was an incorrect statement of the Pennsylvania law of Mortgages and was subsequently justly criticised and disregarded by the Court.[23] But considering the actual decision in the case, stripped of all dicta, it is submitted that the case remains unshaken by subsequent Supreme Court decisions.

There are two important cases to be considered. The first of these is *Savings & Loan Society v. Multnomah County*.[24] In that case the court expressly distinguished *State Tax on Foreign Held Bonds*, clearly evidencing its intent not to disturb that decision. Mr. Justice Gray in his opinion said:

> "In that case, a railroad company, incorporated both in Ohio and Pennsylvania, had issued bonds secured by a mortgage of its entire road in both States; and the tax imposed by the State of Pennsylvania, which was held by a majority of this court to be invalid, was a tax upon the interest due to the bondholders upon the bonds, and was not a tax upon the railroad, or upon the mortgage thereof, or upon the bondholders solely by reason of their interest in that mortgage."[25]

Not only is it a fact that the court clearly evinced its desire to let the decision in the *Foreign Held Bonds* case stand, but it could not have overruled that case even if it had so desired. The facts before it called for no such decision. The court in the *Multnomah County* case was confronted with the question of the validity of a statute which levied a tax on the mortgagor's and mortgagee's interests in the land. The statute in the *Foreign Held Bonds* case levied a tax on the interest on bonds; by no feat of construction could it be considered to levy a tax upon an interest in land. The facts of the two cases are easily distinguishable and require two entirely distinct decisions.[26]

The second case supposed to have overruled *State Tax on Foreign Held Bonds* is *Blackstone v. Miller*.[27] That was a case arising under the New York Inheritance Tax Law.[28] Mr. Justice Holmes in the opinion said that the property involved "consisted of a debt of $10,692.24, due to the deceased by a firm, and of the net sum of $4,843,-

[23]Savings & Loan Society v. Multnomah County, 169 U. S. 421, 428, 18 Sup. Ct. 392 (1897).
[24]*Supra*, note 23.
[25]*Id.*, p. 428.
[26]*Contra:* (1918) 31 HARV. L. REV. 905, 929.
[27]188 U. S. 189, 23 Sup. Ct. 277 (1903).
[28]The wording of the statute was the same as that in the South Carolina statute quoted in note 1.

456.72 held on a deposit account by the United States Trust Company of New York." The decedent was a resident of Illinois and his entire estate, including the New York property had been subjected to an inheritance tax there. The court affirmed the decree of the Surrogate's Court holding the tax valid as to both the debt and the deposit. There were two grounds given for the decision: (1) The deposit should be treated like a tangible chattel since as a practical matter money in the bank is treated like coin in the pocket;[29] (2) Because of New York's power over the person of the debtor it has jurisdiction over the transfer and hence can subject the transfer to a tax.

The first ground is sound. Taxation being a practical matter, the customs of the business world should be given recognition. The man in the street treats money in the bank as money in the pocket. If he has a balance in the bank of $500. he considers that he has $500. in cash. The law properly takes into account and gives effect to this state of mind. It treats a deposit as it does a tangible chattel; each has a situs for taxation where it is located. And, it is submitted, this sufficiently explains the entire case. The second ground is not needed.[30] Of course, that would not be so if the facts were as stated in the opinion. If there were a simple debt of $10,692.24 in the case, then the second ground would be needed to support the decision as to it. It clearly appears, however, from the report of the case in the Appellate Division of the Supreme Court of New York, that the "debt due to the deceased by a firm" was the balance of a deposit account kept by the deceased with Cuyler, Morgan & Co., a firm of bankers. The Appellate Division correctly treated this as it treated the other item—as a bank deposit, and held them both to be subject to the New York tax under *Matter of Houdayer*.[31]

Thus the decision when restricted to its precise facts holds merely that a bank deposit has a taxable situs where the bank is located. It has no effect upon the situs or taxability of other forms of obligations.[32]

[29]This had been the view of the New York Courts and the ground for their decisions both in this case (69 App. Div. 127) and in Matter of Houdayer, 150 N.Y. 37, 44 N. E. 718 (1896).

[30]A criticism of this doctrine has already been given in Part I.

[31]Matter of Blackstone, 69 App. Div. 127, 74 N. Y. Supp. 508 (1st Dept. 1902), aff'd 171 N. Y. 682. The court said at page 129, "The facts as presented in Matter of Houdayer (150 N. Y. 37) involve, in principle, every question presented by the facts in this case, and arose under substantially the same circumstances. The deposits were held to be money for all practieal purposes, owned by the decedent at the time of his death, and as such taxable under the Transfer Tax Act of the State."

[32]This is recognized in the discussion of the case in Chambers v. Mumford, 187 Cal. 228, 201 Pac. 588 (1921), and in McLaughlin v. Cluff, 240 Pac. 161, 163, (Utah, 1925).

Furthermore, it should be noted that Mr. Justice Holmes specifically distinguished the case from *State Tax on Foreign Held Bonds*. His words were:

> "There is no conflict between our views and the point decided in * * * *State Tax on Foreign Held Bonds*, 15 Wall. 300 * * * Bonds and negotiable instruments are more than merely evidences of debt. The debt is inseparable from the paper which declares and constitutes it, by a tradition which comes down from more archaic conditions. *Bacon v. Hooker*, 177 Mass. 335, 337. Therefore, considering only the place of the property, it was held that bonds held out of the State could not be reached. The decision has been cut down to its precise point by later cases. *Savings & Loan Society v. Multnomah County*, 169 U. S. 421, 428; *New Orleans v. Stempel*, 175 U. S. 309, 319, 320."[33]

This distinction between notes and bonds on the one hand and other forms of obligations on the other has again been approved by the Supreme Court in a recent decision.[34]

Thus we find the law upon the point decided in *State Tax on Foreign Held Bonds* unchanged by these subsequent decisions. Rather than any waivering in the court's adherence to the decision, there has been repeated expression of approval.[35] Securing a bond by a mortgage does not localize it in the state where the land is situated and does not subject it to taxation there.

III.

The weight of judicial decision in the state courts is in full accord. Whether the tax in question be a property tax[36] or an inheritance tax[37] it is agreed with little dissent that the mortgage will not localize

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[33]*Supra* note 27.

[34]Wheeler v. Sohmer, *supra* note 4.

[35]Besides the cases already cited, see Kirtland v. Hotchkiss, *supra* note 12. For a contrary view see (1918) 31 HARV. L. REV. 905, 930, where Professor Carpenter says: "The situation is now ripe for a decision by the United States Supreme Court squarely overruling State Tax on Foreign Held Bonds."

[36]Territory v. Delinquent Tax List, 3 Ariz. 179, 24 Pac. 182 (1890); People v. Eastman, 25 Cal. 601 (1864); Arapahoe County v. Cutter, 3 Colo. 349 (1877); Goldgart v. The People, *supra* note 12; Foresman v. Byrns, 68 Ind. 247 (1879); State v. Smith, 68 Miss. 79, 8 So. 294 (1890); Crispin v. Vansyckle, 49 N. J. L. 366, 8 Atl. 120 (1887); Capital Bank v. Wallace, 45 N. D. 182, 177 N. W. 440 (1920); Grant v. Jones, 39 Ohio St. 506 (1883); Street Railroad Company v. Morrow, *supra* note 12; State v. Wisconsin Tax Commission, 161 Wis. 111, 152 N. W. 848 (1915).

[37]Kintzing v. Hutchinson, *supra* note 3; Chambers v. Mumford, *supra* note 32; Walker v. People, *supra* note 16; Gilbertson v. Oliver, 129 Ia. 568, 105 N. W. 1002 (1906); State v. Chadwick, 133 Minn. 117, 157 N. W. 1076, 158 N. W. 637 (1916); State v. Lewis, 256 Mo. 98, 165 S. W. 319 (1913); Matter of Bronson, 150 N. Y. 1, 44 N. E. 707 (1896); Matter of Fearing, 200 N. Y. 340, 93 N. E. 956 (1911); Matter of Preston, 75 App. Div. 250, 78 N. Y. Supp. 91, (2d Dept. 1902); Small's Estate, *supra* note 12; DeNoaille's Estate, 236 Pa. 213, 84 Atl. 665 (1912); McLaughlin v. Cluff, *supra* note 32.

the obligation. The security does not make the bond or note property within the state.[38]

Mr. Justice Lurton in *Street Railroad Company v. Morrow*[39] tersely stated the doctrine in these words:

"That these debts are secured by a mortgage upon property situated here can make no difference * * * In this State, as in Pennsylvania, the mortgagee's interest in the mortgaged land is but a security for the debt—the debt being the principal and the land only an incident. *McGann v. Marshal*, 7 Hum. 121."

It was said by Chief Justice Thatcher in *Commissioners of Arapahoe County v. Cutter*,[40] a case of trust deeds instead of mortgage:

"Although the situs of the real estate by which the notes were secured was within the jurisdiction of the taxing power, the debts evidenced by the notes were the principal things, and the trust deeds securing them were mere incidents, depending for their very existence upon what they secured. The liquidation of the debts would at once cancel the trust deeds."

The basis for the contention that the mortgage should localize the obligation would be that the creditor must resort to the law of the state where the land is situated to take advantage of his security. The same argument was found in the opinion in *Blackstone v. Miller*—there the protection afforded the debt by the state of the debtor's domicil through its control over him, here the protection afforded the debt by the state where the land is situated through its control over the land. As it was unsound there so, it is submitted, it is unsound here. The bond or note holder here as there has his right *in personam* against the debtor enforcible wherever he can obtain personal service of the debtor.

The contention was urged in *Walker v. People*,[41] but the court refused to adopt it. Mr. Justice Bailey said:[42]

"It is contended by the state that the fact that the payment of the bonds is secured upon property within the State brings them, as evidence of this debt, within its power for the purpose of taxation, on the ground, among others, that creditors are compelled to invoke local laws to enforce the obligation * * * * It will be observed that in some of the cases the domicil of the owner has been held to furnish the test of jurisdiction for the purpose of taxation, while in others this test has yielded to the actual situs of the property within the territorial limits

[38]The cases properly make no distinction between corporate and individual bonds or notes. Matter of Preston, *supra* note 37; see cases cited in notes 36 and 37.

[39]*Supra* note 12.

[40]*Supra* note 36.

[41]*Supra* note 16.

[42]Pp. 145, 150.

of the taxing authority, but in no case has the domicil of the debtor, or the location of the securities, been taken as a *situs* for the purpose of taxation in the absence of some special circumstance which the court considered gave it an actual *situs*. No such circumstance exists here * * * The conclusion must be that the bonds are exempt from taxation in Colorado."

The Court of Appeals of New York is also strongly committed to the majority view. The first and leading case, *Matter of Bronson*, arose in 1896 under the typical form of statute.[43] Although the bonds considered were secured by a mortgage of New York land,[44] the court made no mention of the fact in its opinion but treated the case as one of unsecured bonds.[45] No attempt was made in the brief of counsel for the Comptroller to sustain the tax on the ground of presence of the mortgage security.

The next [46] case to appear before the Court of Appeals was *Matter of Fearing*.[47] Counsel there laid special emphasis upon the *situs* of the mortgaged land within the state as giving a basis for the tax. Mr. Justice Gray, however, expressed the court's refusal so to hold as follows:

"The legal title to these bonds in question was transferred by force of the laws of Rhode Island. As their legal and actual situs was in a foreign state upon no theory were they within the operation of our Transfer Tax Law. I am unable to perceive the force of any argument which seeks to find in the feature of the mortgage a reason for limiting the rule of law applied by us in the *Bronson* case."[48]

In Minnesota, which has the typical form of statute, the court has taken a curious position in respect of the problem. The court in 1915

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[43]Matter of Bronson, *supra* note 37. The statute imposed a tax on all transfers "when the transfer is by will or intestate law, of property within the state and the decedent was a non-resident at the time of his death." L. 1892, Ch. 399, § 1. Another section of the statute defined the word "property" as meaning all property or interest therein "over which this state has any jurisdiction for the purposes of taxation." § 22.

[44]Matter of Bronson, 1 App. Div. 546, 37 N. Y. Supp. 476 (1st Dept. 1896).

[45]The gist of the opinion of the Court of Appeals is contained in the following excerpt: "It is obvious that the state has no jurisdiction over a right of succession which accrues under the laws of the foreign state * * * The legal title to these bonds or the debts they represent, vested in the personal representatives of the decedent by force of foreign laws * * * The legal *situs* of the indebtedness was at the creditor's domicil and as the actual *situs* of the bonds themselves was, also, there, upon no theory can it be held that the provisions of the Transfer Tax Act could reach them in its operation." p. 8.

[46]In 1902 Matter of Preston was decided by the Appellate Division. Here again the fact that the bonds were secured by mortgages on New York land was not considered. The point decided was that there should be no distinction made between corporate and individual bonds.

[47]*Supra* note 37.

[48]Matter of Fearing is cited with approval in Matter of Lowell, 208 App. Div. 201, 203 N. Y. Supp. 312 (1st Dept. 1924), *aff'd.* without opinion 239 N. Y. 532, 147 N. E. 183 (1924).

passed upon the question whether unsecured notes of domestic corporations held by a non-resident decedent were subject to the state inheritance tax.[49] Following the dictum in *Blackstone v. Miller*, in basing jurisdiction on the supposed necessity for the creditor to invoke Minnesota law to enforce his claim and on the state's power over the debtor, it held such notes to be taxable. A year later the court was called upon to pass upon the taxability of registered bonds of a Minnesota corporation, owned by a non-resident, which were secured by a mortgage upon land in Minnesota and in six other states.[50] Although the debtor was a "resident" of Minnesota and subject to its power, still the court held the bond to be beyond the taxing power of the State. It distinguished the earlier case on the ground that in the case before it the debtor, being a corporation doing business in six other states, was subject to the jurisdiction of those states and the creditor could resort to any of them to enforce his right. The jurisdiction of those other states was based upon more than the accidental presence of the debtor. The same sort of reasoning was used to reach the conclusion that the mortgage security in Minnesota would not give the bonds a taxable situs there. Since the mortgaged property in the other six states could be resorted to, the bondholders would not have to invoke Minnesota law to enforce the bonds. The court declined to express an opinion whether a mortgage of Minnesota land alone would give the bonds a taxable situs within thc state. It is submitted that such a distinction illustrates the weakness of the doctrine of basing jurisdiction to tax upon power over the debtor or over the security and upon the need of the creditor to resort to the laws of a state to enforce the obligation. On the other hand, if the basis be the *situs* of the property, these troublesome questions of where the debtor or his domicil is, where he does business, where his property is, and the value of his property in various places, can be avoided.

The courts of only one state, Michigan, have reached a conclusion contrary to this bulk of authority. There are three cases of interest.

The first is *In Re Stanton's Estate*.[51] The finding of facts of the lower court showed that the decedent was a resident of New York who had left as a part of her estate promissory notes secured by mortgages on Michigan land. The decision was that an inheritance tax was

[49]State *ex rel* Graff v. Probate Court, 128 Minn. 371, 150 N. W. 1094, L. R. A. 1916A, 901 (1915).
[50]State v. Chadwick, 133 Minn. 117, 157 N. W. 1076, 158 N. W. 637, L. R. A. 1916E, 1288 (1916).
[51]142 Mich. 491, 105 N. W. 1122 (1905).

payable upon these bonds. This was one of the errors assigned in the appeal taken by the executor.

On appeal counsel for the executor argued that the inheritance tax statute measured the tax by the property which was subject to the state's general property tax, and not by the property which the state had power to tax. This argument would have exempted the notes. As is so often the case, the argument of counsel determined the appellate court's opinion. That court devoted most of its opinion to a refutation of this argument, and properly held that the statute was intended to reach all property within the jurisdiction of the state.[52] It then quite correctly stated that the state of situs has power to tax the inheritance of property. With respect to the question whether the notes had a situs and constituted property within the state and hence were subject to the state's taxing power the court said only this:

> "Courts are properly concerned only with the questions of legislative purpose and the power to give the ascertained purpose effect. In this case, both of these questions are resolved against the appellant."

The court neither considered the question on principle nor did it consider the authorities, even though the question was one of first impression in the state.

But the case cannot be cited even as a weak one against the current of authority. It is easily distinguishable. The lower court had found that the notes had been kept in Michigan by a resident agent of the decedent. They had been kept there for purposes of collection, deposit and reinvestment. Clearly, then, they had acquired a "business *situs*" within the state and were taxable there for that reason. This is pointed out in the next case to arise.[53]

In Re Stanton's Estate has been given in some detail because it is the case upon which the later Michigan cases were based and because it is often cited as apposed to the current of authority.

In *In Re Merriam's Estate* a note and mortgage were kept by the owner at his domicil, outside of Michigan.[54] The court held that this

[52]The words of the statute were those of the typical statute (see note 1, *supra*), with the following in addition: "Shall include all property or interest therein whether situate within or without this state, over which this state has any jurisdiction for the purposes of taxation." Act No. 188, Laws of 1899, § 21.

[53]*In re* Merriam's Estate, 147 Mich. 630, 631, 111 N. W. 196 (1907). "*In re* Stanton's Estate, 142 Mich. 491, unqualifiedly holds that an inheritance tax may be levied in this state upon notes and mortgages of, and contracts relating to, land in this State, owned by a resident of another State, but which notes and mortgages have always been kept in Michigan for the purpose of collection and reinvestment, though they might have been temporarily taken to New York." See also 9 L. R. A. (N. S.) 1104, note.

[54]147 Mich. 630, 111 N. W. 196, 9 L. R. A. (N. S.) 1104, (1907).

note was subject to the Michigan inheritance tax. Mr. Justice Hooker in his brief opinion said:

> "This has the sanction of the Federal Supreme Court. *Blackstone v. Miller*, 188 U. S. 203, 206, 23 Sup. Ct. 277, 47 L. Ed. 439, which applies the doctrine to a bank deposit, which it is perhaps unnecessary to say established the relation of debtor and creditor. The case does not seem to turn upon the situs of the evidence—i. e., the record of the mortgage—of indebtedness. We are not called upon to consider so extreme a case, for in the case before us the situs of the evidence of indebtedness, and the land was in Michigan, as it was also in the Stanton case."[55]

So the court here calls the record of the mortgage the "evidence of the indebtedness" in an attempt to bring the case within the decision in the *Stanton* case. It is submitted that this is unsound. The law should not seize upon still another element in this complicated legal relationship and use it to localize the obligation and subject it to taxation in one place more. Furthermore, there is no authority for such a view.

The third case to appear was *In re Roger's Estate*.[56] The facts were identical with those in the *Merriam* case which the court properly considered controlling. Rationalizing, Mr. Justice Moore pointed out certain incidents of the relationship created by the note and mortgage which might tend to show localization in Michigan. To the usual one of the need of resort to Michigan law if the debts were not paid, he added the requirements of the registry law and the need for ancillary administration in Michigan. The mere statement of these incidents is not convincing. They refer simply to the mortgage, the subordinate, not to the obligation, the principal thing in the relationship. The court proceeded merely to quote at length the dictum in *Blackstone v. Miller* with regard to power over the debtor giving jurisdiction to tax the debt.

So the state was committed to a doctrine clearly against the weight of the judicial opinion of the time—by three short, ill-considered opinions.[57] It stands alone in holding that the mortgage gives to the bond or note a taxable situs within the state.

IV.

The approach of the courts in the cases mentioned thus far has been made clear by the form of the question to which they addressed themselves. Their eyes were focused upon the bond or note, upon

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[55]*Supra* note 53 at p. 631.
[56]149 Mich. 305, 112 N. W. 931, (1907).
[57]See comments in McCaughlin v. Cluff, *supra* note 32.

the intangible right owned by the decedent. Did that have a taxable situs within the state, was their inquiry. The genesis of this point of view was the old case *State Tax on Foreign Held Bonds*. If the statute under consideration in terms imposed a tax upon credits, debts, or bonds and notes, the approach would have been the only possible one. But that of course was not true. The statutes, as already pointed out, were general and included all property "within the State."[58] Starting *de novo*, the question would naturally arise whether, in this bundle of legal rights represented by a bond or note and mortgage, there was any property or interest in property within the state? Does the non-resident decedent own any interest in any sort of property in the state where the mortgaged land is situated—a much broader question than the one we have found asked and answered by the courts in the cases considered. Put in this way the answer to the question seems clear: the bond or note holder has by reason of the mortgage an interest in the mortgaged land. Whether the interest be security title as it is in some states or a security lien as it is in others, he has an interest in the *res*. That interest being an interest in property within the state would be subject to the taxing power and hence subject to a property and inheritance tax.

Authority for the property tax is found in *Savings and Loan Society v. Multnomah County*[59] and the numerous decisions following it.[60] Mr. Justice Gray stated the principle concisely in these words:

> "The State may tax real estate mortgaged, as it may all other property within its jurisdiction, at its full value. It may do this either by taxing the whole to the mortgagor, or by taxing to the mortgagee the interest therein represented by the mortgage, and to the mortgagor the remaining interest in the land. And it may, for the purposes of taxation, either treat the mortgage debt as personal property, to be taxed, like other choses in action, to the creditor at his domicil; or treat the mortgagee's interest in the land as real estate, to be taxed to him, like other real property, at its situs."[61]

[58]So the cases already presented and those now to be discussed cannot be reconciled by finding a difference in the statutes dealt with in the two groups of cases. Such a distinction has been suggested in a similar problem. See (1919) 32 HARV. L. REV. 587, 596.

[59]*Supra* note 23. There the court was concerned with an Oregon statute which provided that a mortgage should be taxed as land and the mortgagor and mortgagee each taxed to the value of his interest. Of the tax the court said: "The debt is not taxed separately but only together with the mortgage; and is considered as indebtedness within the state for no other purpose than to enable the mortgagor to deduct the amount thereof from the assessment upon him * * * The result is that nothing is taxed but the real estate mortgaged * * *"

[60]Allen v. National State Bank of Camden, 92 Md. 509, 48 Atl. 78 (1901); Common Council v. Assessors, 91 Mich. 78, 51 N. W. 787 (1892); Mumford v. Sewall, 11 Ore. 67, 4 Pac. 585 (1883).

[61]*Supra* note 23.

Such an approach in cases involving an inheritance tax is found in the decisions of two States—Massachusetts and Maryland. Let us consider them in that order.

The way was paved for the consideration of the problem in Massachusetts by the case of *McCurdy v. McCurdy*.[62] That was a case arising under the inheritance tax statute and involved the question whether land in Massachusetts owned by a non-resident decedent should be taxed at its full value or whether there should be deducted therefrom the value of a mortgage so as to tax the inheritance of only the equity of redemption. It was held that the equity of redemption alone constituted property of the decedent within the jurisdiction of the Commonwealth.

Four years later came the case of notes secured by mortgages on Massachusetts land, the notes being owned by a non-resident decedent—*Kinney v. Treasurer & Receiver General*.[63] The executor filed a bill in equity asking instructions *inter alia* as to whether these notes were property within the state and also as to what tax, if any, he was obliged to pay to the treasurer of the Commonwealth.[64]

The court at the outset of its opinion considered, not the notes nor the debts represented thereby, but the mortgage and the interests created in the land. It pointed out that the interest of the mortgagee was included within the general property tax.[65] It found the situation to be merely the converse of *McCurdy v. McCurdy*. After having held that the mortgagor was taxable under the inheritance tax statute only to the extent of the equity of redemption, it seemed a necessary complement to hold that the mortgagee was taxable for the residue—the value of his interest in the land, in other words, the amount of the debt.

Unfortunately, the court felt impelled to go further and tie up the note with the mortgage:

> "The debt belongs with the mortgage, and it must coexist to give the mortgage validity. For that purpose it has a situs within the jurisdiction where the land lies."

This, it is submitted, is surplusage and detracts from the strength of the opinion. The important thing in the opinion, however, is the court's approach to the problem. It is to the land and the various

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[62] 197 Mass. 248, 83 N. E. 881 (1908).

[63] 207 Mass. 368, 93 N. E. 586, 35 L. R. A. (N. S.) 784 (1911).

[64] The tax, in the words of the statute, reached "all property within the jurisdiction of the Commonwealth, corporeal and incorporeal, and any interest therein, whether belonging to the inhabitants of the Commonwealth or not." St. 1907, c. 563, § 1, as amended by St. 1909, c. 527, § 1.

[65] St. 1909, c. 490, Part 1, § § 16, 18, 45; Sullivan v. Boston, 198 Mass. 119, 124, 84 N. E. 443 (1909).

interests created therein by the mortgage that the court goes to support the tax. The land is property within the state and hence is subject to its taxing power.

That it is the interest in the land that is taxed in Massachusetts becomes apparent from the next case to be decided. In 1912 the tax statute was amended so as to restrict the inheritance tax on estates of non-residents to real estate or any interest therein. Therefore, upon no theory of localization of the debt could the state tax the inheritance of foreign held secured bonds or notes. The question arose in *Hawkridge v. Burrill*,[66] on facts identical with those in the *Kinney* case. The court merely repeated what had been said in its opinion in the *Kinney* case.

In Maryland the question arose in *Helser v. State*.[67] Notes left by a non-resident decedent secured by mortgages upon land in Maryland were collected by an ancillary administrator and the mortgages discharged. In as much as the administrator had paid the inheritance tax without protest, the court held that under no circumstances could it be recovered. The subsequent discussion of the validity of the tax is, therefore, *obiter dictum*, but is at least indicative of the court's attitude. Using the same method of approach that the Massachusetts court had used—looking at the interests in the land instead of the notes and the choses in action represented by them—the court pronounced the tax valid. Mr. Justice Thomas said:

> "* * * John Helser, at the time of his death, had, by virtue of the mortgages collected by the administrator, an interest or estate in lands in Washington County which was protected by the laws of this State, and * * * those laws having been invoked to enable the appellant to receive the amount of said mortgage the sum collected was subject to a collateral inheritance tax."[68]

V.

Thus the authorities consist of these two lines of decisions, two different ways of approach. The focus of the attention upon the obli-

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[66]223 Mass. 134, 111 N. E. 707, (1916).

[67]128 Md. 228, 97 Atl. 539 (1916). The statute concerned provided for a tax upon "all estates, real, personal and mixed, money, public and private securities for money of every kind passing from any person who may die seized and possessed thereof, being in this state * * * ", except where certain named beneficiaries inherited the property. Maryland Code, Article 81, § 120.

[68]*Ibid*, p. 236. The suggestion that the fact of ancillary administration and the resulting use of the laws of the state are important must, it is submitted, be regarded as unsound. If the non-resident decedent left property within the state its inheritance is governed by the law of the state and it is that service rendered by the sovereign which is the *quid pro quo* for the tax exacted. Unfortunately, the suggestion has found its way into at least one other opinion: Walker v. People, *supra* note 16.

gation, the main thing in the transaction, on the one hand, and the emphasis upon the interests in the land created by the mortgage, the subordinate thing, on the other. When the case shall be presented to the Supreme Court for decision which road will it select? Will that court follow the way marked by its early decision in *State Tax on Foreign Held Bonds* and the weight of authority in the state decisions and hold the tax invalid? Or, will it apply the principle of *Savings & Loan Society v. Multnomah County* and sustain the tax?

If the legislature intends to reach all property within its jurisdiction, which undoubtedly it does, it seems clear that the court should scrutinize the property concerned not with an historical slant, but with an eye to discovering whether there is any property of the non-resident decedent within the State. If there is, then, upon the established principles of legislative power and territorial jurisdiction, that property is subject to the state's taxing power. The conclusion seems inevitable: The principle of *Savings & Loan Society v. Multnomah County* must be applied to inheritance taxes and the inheritance of the bond or noteholder's interest in the mortgaged land must be held taxable by the state where the land is situated.

The language in the opinions of the state courts, sometimes in terms of construction of the statute, might lead one to believe that one line of cases construed the statutes as attempting to levy a tax on the inheritance of foreign held bonds or notes while the other line of cases interpreted the statutes as levying on the inheritance of the mortgagee's interest in the land. If this were true, then the decision of the Supreme Court would be determined by the circumstance whether the decision being reviewed belonged to the one line of cases or to the other. If to the first, the tax would be held invalid, if to the second, it would be held valid. The unsatisfactory condition of the law found in the state decisions would be continued.

Fortunately, however, the decisions of the state courts do not so construe the statutes. As has already been pointed out either the statutes leave no doubt of their meaning or the courts construe them as meaning to include all property subject to the taxing power of the state—and that means all property within the state. So whichever line of cases the Supreme Court is concerned with, it is free to consider the question whether the non-resident decedent owned any property within the state.

Because of their importance in the financial structure of modern industry, it will be well to mention specifically corporate bonds issued under a trust indenture. This transaction differs from that

already discussed in that a third person, the trustee, and not the bondholder is the mortgagee. Looking at the rights of the bondholder we find that he has first of all his right *in personam* against the corporate debtor; he can bring an action at law on his bond.[69] In addition, although the bondholder has no legal interest in the mortgaged land, the legal security title or lien being in the trustee, he has an equitable security interest in the land.[70] As in any trust the legal interest is held by the trustee for the benefit of the *cestui que trust*. So if the trustee improperly refuses or is unable to protect the bondholder by foreclosure, the bondholder may enforce his lien directly by a bill in equity.[71]

This equitable interest in the mortgaged land is clearly property within the state where the land is situated. Therefore, whether the bondholder's interest in the land be equitable as here or legal as in the case of the single bond or note and mortgage, it may be subjected to an inheritance tax by the state of situs.[72] The result in either case is the same: the tax is a constitutional exercise of the legislative power of the state.

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[69]Manning v. Norfolk Southern R. R. Co., 29 Fed. 838 (1887); Rothschild v. Rio Grande Western Railway Co., 84 Hun 103, 32 N. Y. Supp. 37, *aff'd.* 164 N. Y. 584, 58 N. E. 1092 (1895); Fleming v. Fairmont & Mannington R. R. Co., 72 W. Va. 835, 79 S. E. 826 (1913), and cases cited in note in 49 L. R. A. (N. S.) 155.

[70]Fortney v. Carter, 170 Fed. 463 (1909), *aff'd.* 202 Fed. 454 (1913); O'Beirne v. Allegheny & Kinzua R. R. Co., 151 N. Y. 372, 45 N. E. 873 (1897); Green v. Peoples' Gas Light & Coke Co., 118 N. Y. Misc. 1, 192 N. Y. Supp. 232 (1922).

[71]Brown v. Denver Omnibus & Cab Co., 254 Fed. 560 (1918); Cochran v. Pittsburg S. & N. R. Co., 150 Fed. 682 (1907); Seibert v. Minneapolis & St. Louis Railway Co., 52 Minn. 148, 53 N. W. 1134 (1893); Ettlinger v. Persia Rug & Carpet Co., 142 N. Y. 189, 36 N. E. 1055 (1894).

[72]*Cf* cases of shares in real estate trusts: Baker v. Commissioner of Corporations & Taxation, 253 Mass. 130, 148 N. E. 593, (1925); Priestly v. Treasurer & Receiver General, 230 Mass. 452, 120 N. E. 105 (1918); Peabody v. Treasurer & Receiver General, 215 Mass. 129, 102 N. E. 435 (1913); Kinney v. Treasurer & Receiver General, 207 Mass. 360, 93 N. E. 586 (1911).