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JURISDICTION TO TAX INCOME

EDWARD S. STIMSON

*People of the State of New York ex rel. Cohn v. Graves*¹ recently decided by the United States Supreme Court involves the interesting question of what state or states may tax income. A woman in New York owned a life estate in real estate situated in New Jersey. She received rents from this property which were paid to and collected by her agent in New Jersey. She was compelled by the State of New York to pay a tax on this income pursuant to a statute imposing a tax upon the "entire net income" of residents of the state. The Supreme Court, two justices dissenting, held that New York could constitutionally impose the tax.

Only three months before this decision, the Supreme Court in *People of the State of New York ex rel. Whitney v. Graves*² held that the state which had physical power over the source of the income could tax it. A man in Massachusetts owned a seat on the New York Stock Exchange. When the number of seats or memberships was increased, he received a fraction of a seat as his share. He sold his right, thereby receiving income. The Court held that New York could tax the income without violating the Constitution.

If all states can tax persons living in their territory on income from foreign sources and persons living outside of their territory on income from domestic sources, persons deriving income from states other than that in which they live will often be compelled to pay two taxes on the same income in addition to the federal tax. In a long line of cases beginning with *Louisville and Jeffersonville Ferry Co. v. Kentucky*³ the Supreme Court has held that double taxation resulting from taxes imposed by two states of the United States, both of which would otherwise have jurisdiction to tax, is a violation of the due process clause of the Fourteenth Amendment.⁴

In the principal case and in its opinion in *Lawrence v. State Tax Commission of Mississippi*,⁵ an earlier decision on which it relied, the Court took the position that a state having power⁶ over an individual could tax him for

¹57 Sup. Ct. 466 (March 1, 1937). [See note (1937) 22 CORNELL L. Q. 93 on the decision in the New York Court of Appeals.—*Ed.*]

²57 Sup. Ct. 237 (Jan. 4, 1937).

³188 U. S. 385 (1903).

⁴*First National Bank v. Maine*, 284 U. S. 312 (1932) and cases cited in STIMSON, JURISDICTION AND POWER OF TAXATION (1933) p. 4 n. 9.

⁵286 U. S. 276 (1932). In this case, a contractor who was a citizen and resident of Mississippi derived income from the construction of public highways in Tennessee. Mississippi taxed this income and the Supreme Court sustained it.

⁶Justice Stone said domicile afforded a basis for taxation. It never has except for inheritance taxes. In this field, domicile is considered a basis for imposing the tax because of a decision of the New York Court of Appeals in *Matter of Swift*, 137 N. Y. 77, 32 N. E. 1096 (1893), where the dissenting opinion by Judge Gray is the only opinion. See STIMSON, JURISDICTION AND POWER OF TAXATION (1933) pp. 76-79 and p. 6 n. 11.

the protection and benefits⁷ which he received from the government and could measure the tax by the entire net income received by him regardless of its source. As a matter of physical power, this would be equally true of a property tax, for the tax can be regarded as one imposed on an individual subject to the physical power of the state and measured by the value of his property wherever situated.⁸ When a person in one state owns property situated in another state, both states, in the absence of a supervening constitutional limitation, have the physical power to exact a tax, the one by seizing the property and the other by physical suasion of the owner.⁹ In this respect, income taxes are not different from property taxes. The state having power over the property which is the source of the income or over the payor of the income can, by seizure of the property or corporeal suasion of the payor, withhold a portion of the income; and the state having power over the person receiving the income can force him to pay.¹⁰ If it is unfair and a violation of the due process clause of the Fourteenth Amendment for two states, each having physical power to do so, to impose a property tax, then, likewise, it is unfair and contrary to due process for two states, each having corporeal power to do so, to exact an income tax.

This is exactly what the Supreme Court itself held in *Hans Rees' Sons, Inc. v. North Carolina*.¹¹ This forgotten case, the first decided by the Su-

⁷It would seem that all the Court meant here was that taxes must be for a public purpose which it is hoped will benefit those in the territory and not that it is essential that the particular taxpayer be benefited. Obviously, it did not intend to suggest that it was necessary that the tax be measured by the benefit received. See HARDING, *DOUBLE TAXATION OF PROPERTY AND INCOME* (1933) § 4.

⁸STIMSON, *JURISDICTION AND POWER OF TAXATION* (1933) p. 2 n. 6. In *Fidelity and Columbia Trust Co. v. Louisville*, 245 U. S. 54 (1917) at p. 58 Justice Holmes said: "The present tax is a tax upon the person, as is shown by the form of suit, and is imposed it may be presumed for the general advantages of living within the jurisdiction. These advantages, if the state so chooses, may be measured more or less by reference to the riches of the person taxed." Dissenting in *Safe Deposit and Trust Co. v. Virginia*, 280 U. S. 83 (1929) he said at p. 97: "Taxes generally are imposed upon persons for the general advantages of living within the jurisdiction, not upon property, although generally measured more or less by reference to the riches of the person taxed, on grounds not of fiction but of fact. . . . The notion that the property must be within the jurisdiction puts the emphasis on the wrong thing."

⁹Prior to *Delaware, Lackawanna & Western Railroad Company v. Pennsylvania*, 198 U. S. 341 (1905) and the better known case of *Union Transit Company v. Kentucky*, 199 U. S. 194 (1905) both the state in which tangible property was situated and the state in which the owner was located could impose a property tax. STIMSON, *JURISDICTION AND POWER OF TAXATION* (1933) pp. 9-10 and 18-20.

¹⁰Maguire, *Relief from Double Taxation of Personal Incomes* (1923) 32 *Yale Law Journal* 757, pp. 760-769; STIMSON, *JURISDICTION AND POWER OF TAXATION* (1933) p. 86.

¹¹283 U. S. 123 (1931). The same result reached in *Senior v. Braden*, 295 U. S. 422 (1935) seems to have been due to the admission of counsel for the state of Ohio that if the Ohio cestui had an interest in the Illinois lands held in trust, a tax on the income which he received from the trust would be a tax on land situated without the state which was prohibited by the due process clause of the Fourteenth Amendment.

preme Court of the four here discussed, was not cited in the opinions subsequently rendered. The facts were that a foreign corporation was doing business in North Carolina and, therefore, according to well accepted principles, was subject to its power. All of its manufacturing operations were carried on in North Carolina, but sales were made throughout the United States, Canada, and Europe. North Carolina imposed an income tax on a proportion of the corporation's net income determined by the ratio of the value of its real estate and tangible personal property in the state to the value of all of its real estate and tangible personal property.

So calculated, the assessments for the years in question were 66% to 85% of the corporation's entire net income. The corporation introduced evidence to show that its income was derived from three sources, to wit, (1) buying profit, (2) manufacturing profit, and (3) selling profit, and that not more than 21% of its earnings could be attributed to North Carolina. The Supreme Court held that the application of the statutory method was arbitrary and unreasonable "in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted" there.

Since North Carolina had power over the corporation, it had, in the absence of a supervening constitutional limitation, power or jurisdiction to tax the entire income.¹² The decision is, then, that a state having power over the receiver of income is prohibited by the due process clause of the Fourteenth Amendment from taxing income derived from sources outside of the state. It is not only a decision that only one state can tax but also a choice of the state having power over the source of the income as the one entitled to impose an income tax instead of the state having power over the person receiving the income.

It is submitted that the Supreme Court should follow its decision in this case not only in holding that the due process clause of the Fourteenth Amendment prohibits the taxation of income by more than one state but also in choosing the state which is the source of the income as the one which may tax it.¹³

¹²Maguire v. Trefy, 253 U. S. 12 (1920); STIMSON, JURISDICTION AND POWER OF TAXATION (1933) pp. 86-90; Horn Silver Mining Co. v. New York, 143 U. S. 305 (1892); Pembia Consolidated Silver Mining and Milling Co. v. Pennsylvania, 125 U. S. 181 (1888); STIMSON, JURISDICTION AND POWER OF TAXATION (1933) p. 14.

¹³Professor Harding thinks so too. HARDING, DOUBLE TAXATION OF PROPERTY AND INCOME (1933) pp. 209-210; *State Jurisdiction to Tax Dividends and Stock Profits to Natural Persons* (1937) 25 CALIF. L. REV. 139, 169. So does Mr. Tuller. TULLER, THE TAXING POWER—STATE INCOME TAXATION (1937) c. 14.