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STATE AND LOCAL TAXATION

PAUL J. HARTMAN*

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* * *

That the field of state and local taxation is becoming much more important, as well as increasingly active, is shown by a number of recent significant major developments that are of interest and concern to taxpayers and their counsel everywhere. Ten state tax cases are already on the United States Supreme Court docket for consideration during the Term commencing October 5, 1959.[1] During the past term at least a half dozen important state tax cases were decided by the Supreme Court, including the epochal *Northwestern-Stockham*[2] decision, which threw much of the legal profession, as well as many taxpayers, into a swivet. In that case the Supreme Court decided that a state can tax the net income of a foreign corporation which is earned within its borders although the income is earned exclusively in interstate commerce. The consternation resulting from this decision galvanized Congress into such action that it passed an act to circumscribe the power of the states to tax income derived solely from interstate commerce.[3] Moreover, with most states avidly searching for more revenue to satisfy the pyramiding demands for public services, new ways for raising taxes have been explored. The fiscal pattern varies from state to state and it keeps changing constantly, with the number of items and activities taxed increasing all the while. Skyrocketing state tax collections (not counting local government taxes) in fiscal 1959 rose by nearly $1 billion over 1958, reaching a new high of $15.8 billion,[4] which

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1. 20 CCH State Tax Review, No. 35, at 1 (August 31, 1959).
2. The consolidated cases of Northwestern States Portland Cement Co. v. Minnesota and Williams v. Stockham Valves & Fittings, Inc., 358 U.S. 450 (1959), Note, 12 Vand. L. Rev. 904 (1959).
3. Pub. L. No. 86-272, 86th Cong., 1st Sess. (Sept. 14, 1959); also printed in 1959 U.S. Code Cong. & Ad. News, No. 16, at 3609.
4. 20 CCH State Tax Review, No. 35, at 1 (August 31, 1959).

was double the collections of only a decade ago.[5] Local taxes usually total about the same amount as state taxes, which means that the tax take for states and their political subdivisions was over $31.5 billion in the last fiscal year.[6] Reflecting the growing importance of the state and local tax field, the courts in Tennessee have considered a relatively large number and variety of tax cases during the period covered by this survey.[7]

I. PROPERTY TAXES

The court of appeals case of *Hale's Cut Rate Drug Store v. State*,[8] appears to be a too highly technical decision, although that court presumably felt bound by earlier decisions of the Tennessee Supreme Court. In the *Hale's* decision, the court declared illegal and void an assessment of an ad valorem tax solely because the figure representing the total tax, as shown on the tax rolls, did not bear dollar marks or decimal points. However, space was left between the second and third digits from the right in the figure representing the amount of the tax, and the heading of the ruled column in which the figure appeared bore the caption of "Total Tax."

Since the purpose of the assessment roll is to furnish the persons assessed a means of ascertaining definitely that his property has been assessed and the amount of the assessment,[9] would not the described figure inform a person even considerably below the level of a reasonably prudent man that the figure represented dollars and cents? In what other denomination would a person think the "total tax" on the tax roll was expressed if not in dollars and cents? There is no showing that the figure would be construed to mean rubles, shillings, escudos, rupees, guilders, or pounds, or even aspirin tablets (even though taxpayer was a drug store). That taxpayer was not in the dark as to the amount of the assessment is shown by the fact that the court's opinion recites that the taxpayer appeared by attorney before one board of equalization and "fully understood the amount of the assessment as made by" that board.

Since the court was of the opinion that the assessment was void, a

5. UNITED STATES BUREAU OF CENSUS, HISTORICAL STATISTICS ON STATE AND LOCAL GOVERNMENT FINANCES 1902-1953, 19 (1955).
6. 20 CCH STATE TAX REVIEW, No. 35, at 1 (August 31, 1959).
7. The privilege tax case of Union Ry. Co. v. Atkins, 321 S.W.2d 562 (Tenn. 1959), has not been commented on because the tax statute there involved has been repealed. TENN. CODE ANN. § 67-4102T (Supp. 1959). Likewise, no comment is made here on the gift tax case of Karsch v. Atkins, 313 S.W.2d 253 (Tenn. 1958), since it turns primarily upon a point of future interests law, and it has been commented upon elsewhere in this survey: Trautman, *Decedents' Estates, Trusts and Future Interests*, 12 VAND. L. REV. 1159 (1959).
8. 321 S.W.2d 262 (Tenn. App. M.S. Tenn. 1958).
9. See Illinois Central R.R. Co. v. Kentucky, 218 U.S. 551 (1910); United States v. Proctor, 286 Fed. 272 (S.D. Tex. 1923); 51 AM. JUR. *Taxation* § 673 (1944).

distress warrant based on the assessment and levied by the taxing authority (city comptroller) for the collection of the tax was likewise declared void. A garnishment proceeding based upon that distress warrant also was held void. The decision in the case at hand is supported by authority.[10]

The fact that the taxpayer had failed to appeal to the State Board of Equalization from the city tax equalization board's increasing the tax was held not to estop the taxpayer from questioning the legality of the assessment and distress warrant. This point, of course, raises the problem of when will judicial review be denied to a taxpayer who has not exhausted his administrative remedies? The recognized principal of administrative law that a party will be denied judicial review, unless he has exhausted his remedies before the administrative body empowered to correct the error, is applicable to tax matters. The failure of a taxpayer to resort to administrative remedies may preclude resort to judicial relief.[11] Where the action of the taxing authority is "void," troublesome problems arise, however. In most instances where the action is void, it is not necessary to exhaust administrative remedies before seeking judicial relief.[12] That is not always true, however. There are instances where the action of the taxing authority is regarded as totally void, and yet a failure to exhaust the administrative remedies has estopped the complaining taxpayer from resorting to judicial relief. This is a judicially spawned doctrine and is not based upon statute. One well-known writer has labelled this the "doctrine of administrative impregnability by estoppel."[13] At least two practical reasons support this doctrine of estoppel. It insures prompt complaint by taxpayers who are aggrieved by illegal taxes, in order that public treasuries may not be embarrassed by deferred depletion of anticipated revenues. Also, this doctrine relieves the courts of the burden of passing upon errors which can be passed upon competently by administrative appellate boards.

While the gnide lines of the estoppel doctrine are not clear, there are a large number of cases where erroneous taxes classed as "void" have not been subject to judicial attack because all administrative appeals had not been taken.[14] An authority, who analyzed the cases

10. State *ex rel.* Bonner v. Andrews, 131 Tenn. 554, 175 S.W. 563 (1915); Hunter Glover Co. v. Harvey Steel Prod. Corp., 3 F.2d 634 (W.D. Tenn. 1924); See 51 AM. JUR. *Taxation* § 673 (1944).

11. Security-First Nat'l Bank v. County of Los Angeles, 35 Cal.2d 319, 217 P.2d 946 (1950), *cert. denied* 340 U.S. 891 (1950).

12. *Ibid.*

13. See Stason, *Judicial Review of Tax Errors—Effect of Failure to Resort to Administrative Remedies*, 28 MICH. L. REV. 637 (1930).

14. First Nat'l Bank of Greeley v. Board of County Comm'rs, 264 U.S. 450 (1924); Gorham Mfg. Co. v. Tax Comm'n, 266 U.S. 265 (1924); Apartments Bldg. Co. v. Smiley, 32 F.2d 142 (8th Cir. 1929); Union Nat'l Bank v. Board of Comm'rs, 75 Colo. 298, 225 Pac. 851 (1924); Wilson v. Green, 135 N.C. 343, 47

where the taxpayer has been estopped, concludes that the taxpayer has been estopped only in those cases in which the complaint of the taxpayer was that he had been grossly, fraudulently or intentionally overvalued or discriminated against.[15] He thinks the estoppel doctrine should be limited to cases involving those questions of *fact* which require a measure of expertness for their determination, and should not be applied to cases in which the errors complained of involve primarily questions of *law*.[16] In the *Hale's* case, the question was one purely of *fact*, to-wit, whether the figures on the tax roll were dollars and cents. Under the view just set forth, therefore, an estoppel could properly have been invoked against the taxpayer.[17]

II. Privilege Taxes

A. Taxation of Income Earned Outside Tennessee by Domesticated Foreign Corporation

In *Brookside Mills v. Atkins*,[18] a franchise tax levied upon corporations was called into judgment before the Tennessee Supreme Court. For the privilege of doing business in Tennessee, a taxing statute, under which the tax in question presumably was levied, imposes an excise tax measured by a percentage of the net earnings from business done within the state.[19] Tennessee uses a three factor formula for apportioning the net earnings attributable to Tennessee.[20]

Because of the paucity of information in the opinion, it is quite difficult, if not impossible, to get a clear and complete picture of the case. Certain facts are set forth, however. The taxpayer was a foreign corporation, domesticated in Tennessee, with a manufacturing plant located at Knoxville, Tennessee, at which it carried on its business of manufacturing textiles. The taxpayer maintained an executive office in New York from which sales were made, and it carried its principal bank account in a Chicago bank. The taxed income resulted from profits resulting from a purchase and sale of cotton futures in Rhode Island. Supposedly, this entire transaction took place in Rhode Island.

S.E. 469 (1904). See Stason, *Judicial Review of Tax Errors—Effect of Failure to Resort to Administrative Remedies*, 28 Mich. L. Rev. 637, 655 (1930) for a collection of cases.

15. See Stason, *Judicial Review of Tax Errors—Effect of Failure to Resort to Administrative Remedies*, 28 Mich. L. Rev. 637, 663 (1930).

16. *Ibid.*

17. The case of Nashville Labor Temple v. City of Nashville, 146 Tenn. 429, 243 S.W. 78 (1922) is relied on by the *Hale's* opinion to show that taxpayer was not estopped to question the validity of the assessment. That case involved a pure question of law, however. The issue there was whether the property was exempt from taxation.

18. 322 S.W.2d 217 (Tenn. 1959).

19. Tenn. Code Ann. §§ 67-2701, 2706 (Supp. 1959).

20. The formula for the apportionment of manufacturing earnings is found in Tenn. Code Ann. § 67-2707 (1956); and the formula for the apportionment of dealers' earnings is contained in § 67-2708.

Taking the position that this type of transaction had no connection with its business operations in Tennessee, the taxpayer resisted the excise tax on this income. The Tennessee Supreme Court held, however, that such profits were taxable by Tennessee.

There are two facets of this case which need some comment. While it does not clearly appear from the opinion, it seems that the tax statute in controversy is the one that imposes an excise tax on the net earnings of a corporation "from business done within the state."[21] The opinion of the court, nevertheless, says that the measure of the tax can reach "all the net earnings of a corporation, without regard to the source from which they were derived."[22] There are not enough facts given in the opinion to show whether there was any sufficient nexus between Tennessee and the out-of-state sale of the futures so as to bring it within the scope of the taxing statute. That is to say, can this out-of-state sale be said to meet the statutory requirement of "business done within" Tennessee. It seems doubtful. Nor do the facts show a sufficient connection of the taxed transaction with Tennessee to satisfy the substantive due process requirement of the fourteenth amendment of the United States Constitution. When a state reaches beyond its borders and fastens its tax talons upon an event having no sufficient connection with a transaction within the state, the tax, as thus applied, offends due process.[23] The *Brookside* opinion, therefore, goes way beyond permissible due process clause bounds when it declares that "all net earnings of a corporation, without regard to the source from which they were derived" can be included within "the measure of the excise tax."[24]

A state does have constitutional power to tax the entire net income of its residents and apparently domestic corporations, irrespective of the source of the income.[25] However, the complaining taxpayer in the

21. TENN. CODE ANN. §§ 67-2701, 67-2706 (Supp. 1959).
22. Brookside Mills v. Atkins, 322 S.W.2d 217, 218 (Tenn. 1959).
23. Due process is concerned with whether the tax in practical operation has relation to opportunities, benefits, or protection conferred or afforded by the taxing state. See Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169, 174 (1949); Wisconsin v. J. C. Penney Co., 311 U.S. 435, 444 (1940). If a state has afforded nothing for which it can ask return, the taxing statute offends due process. Connecticut General Life Ins. Co. v. Johnson, 303 U.S. 77 (1938) (reinsurance business done outside the state where domesticated foreign corporation taxed for privilege of doing business could not, consistent with the due process clause, be included in the measure of the privilege tax); James v. Dravo Contracting Co., 302 U.S. 134 (1937) (mechanical work performed beyond bounds of the state which imposed upon a domesticated foreign corporation a tax for the privilege of doing business, not properly includable in the measure of the privilege tax); *cf.* McLeod v. J. E. Dilworth Co., 322 U.S. 327 (1944) (Arkansas not permitted to tax a sale consummated in Tennessee because of insufficiency of connection of Arkansas with the transaction).
24. Brookside Mills v. Atkins, 322 S.W.2d 217, 218 (Tenn. 1959).
25. New York *ex rel.* Cohn v. Graves, 300 U.S. 308 (1937) (rent from extrastate land); Lawrence v. State Tax Comm'n, 286 U.S. 276 (1932) (compensa-

case at hand was a foreign corporation, although it had become domesticated. The only apparent peg upon which the state could reach this out-of-state income would be the fact of domestication. That alone does not appear to be a sufficient nexus between Tennessee and the taxed income to satisfy due process requirements of the fourteenth amendment of the United States Constitution.[26]

It is not possible to determine from the *Brookside* opinion whether there was any other connection between Tennessee and the taxed out-of-state sale of the cotton futures sufficient to satisfy due process requirements. The burden is upon the taxpayer to establish the lack of connection so as to upset the tax on due process grounds.[27] There is nothing in the *Brookside* opinion to indicate what, if anything, the taxpayer did by way of carrying that burden.

B. Inheritance Taxation of Trusts Reserving Income to Settlor for Life

Among the privileges that are taxed in Tennessee is the privilege of receiving property from a deceased person. This tax is imposed by the Tennessee "inheritance tax" statute.[28] It is clear that the tax im-

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tion for personal services rendered outside taxing state); Maguire v. Trefry, 253 U.S. 12 (1920) (net income from bonds held in trust and administered in another state).

26. The fact that the foreign corporation is licensed to do business in the taxing state is not enough to satisfy the due process clause requirement so as to permit a state to include in the measure of a privilege tax income earned outside the state. Connecticut Gen. Life Ins. Co. v. Johnson, 303 U.S. 77 (1938) (state not permitted to measure a privilege tax for privilege of doing local business by receipts from business having no sufficient connection with taxing state); James v. Dravo Contracting Co., 302 U.S. 134 (1937) (to same effect). Where the commerce clause is involved, the mechanical "subject-measure" ritual of the tax statute does appear to be most important, and the legislatures seemingly are given a pretty free rein in selecting a measure once a valid subject of the tax is chosen. Thus, the Supreme Court of the United States apparently will permit the states to include items in the measure of the tax that could not have been used as the subject. See Baltic Mining Co. v. Massachusetts, 231 U.S. 68, 87 (1913); Home Ins. Co. v. New York, 134 U.S. 594, 600 (1890). There is language in some Supreme Court opinions, however, that seems to indicate that the Court is condemning the tax because the legislatively designated measure is an infringement of the commerce clause. *E.g.*, Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434, 438-40 (1939); New Jersey Bell Tel. Co. v. State Board of Taxes, 280 U.S. 338 (1930).

27. Butler Brothers v. McColgan, 315 U.S. 501 (1942); Hans Rees' Sons v. North Carolina *ex rel* Maxwell 283 U.S. 123 (1931).

28. Tennessee imposes an inheritance tax upon transfers, in trust or otherwise, upon certain property. The property encompassed by the reach of the statute is as follows: when the transfer is from a resident of Tennessee, the tax is imposed upon (a) real property located within the state; (b) tangible personal property which has not acquired an actual situs outside the state; (c) all intangible personal property; and (d) proceeds of insurance policies, with certain exceptions. When the transfer is from a nonresident of Tennessee, the tax is imposed upon (a) real property located within the state; and (b) tangible personal property which has an actual situs within the state. Tenn. Code Ann. § 30-1601 (1956). Under other provisions of the inheritance tax statute, transfers of the foregoing property are taxable if made by will; descent and distribution; gifts made in contemplation of death; transfers by

posed by this type of death tax statute is not levied upon the property of the decedent, whether real or personal, but is levied upon the privilege of *receiving* property by will or succession or by an inter vivos transfer operating as a substitute for a testamentary disposition.[29] Such a tax is to be distinguished from an "estate tax" which is imposed upon the estate of the transferor for the privilege of transferring or transmitting property at death.[30]

Included in the many transfers that are taxable under the Tennessee inheritance tax statute is "property transferred by the decedent prior to death by gift or grant intended to take effect in possession or enjoyment at or after death."[31] The Tennessee Supreme Court was called upon to construe and apply that section of the inheritance tax statute in *Hickox v. Boyd.*[32] The transfer there in question was a trust which provided that income in the amount of $5000 was to be paid to the settlor of the trust for life and that any trust income above that amount should be added to the principal; and on the death of the settlor the income of $5000 was to be paid equally to his children until each child reached twenty-five years, at which time each child was to be paid his share of the principal.[33] After the settlor died there arose a dispute as to the amount of his estate that should be taxed under the Tennessee inheritance tax statute set forth above.

The specific controversy in the *Hickox* case was whether the inheritance tax should be imposed upon only that portion of the trust estate

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gift or grant to take effect in possession or enjoyment at or after death; and powers of appointment. TENN. CODE ANN. § 30-1602 (1956). The Tennessee statute also designates as taxable those interests created by revocable trusts; interests vesting by way of dower or curtesy; and decedents' interests in jointly owned property. TENN. CODE ANN. §§ 30-1605, 30-1603, 30-1607 (1956). For a general survey of Tennessee Death Taxes, see Cosner, *Tennessee Death Taxes*, 2 VAND. L. REV. 294 (1949).

29. See Mitchell v. Carson, 186 Tenn. 228, 209 S.W.2d 20 (1948); Murfreesboro Bank & Trust Co. v. Evans, 193 Tenn. 34, 241 S.W.2d 862 (1951); *In re* Kohr's Estate, 122 Mont. 145, 199 P.2d 856 (1948).

30. See *In re* Harbord's Estate, 201 Misc. 358, 105 N.Y.S.2d 123 (1951), *aff'd* 279 App. Div. 914, 110 N.Y.S.2d 916 (1952), *aff'd* 305 N.Y. 622, 111 N.E.2d 736 (1953) (estate tax); *In re* Kohr's Estate, 122 Mont. 145, 199 P.2d 856 (1948); 28 AM. JUR. *Inheritance, Estate, and Gift Taxes* §§ 9, 10 (1940).

31. TENN. CODE ANN. § 30-1602 (1956).

32. 321 S.W.2d 549 (Tenn. 1959).

33. The pertinent provisions of the trust instrument, as appear from the court's opinion in the *Hickox* case are as follows:

"[T]o pay the said income to an amount not to exceed $5000.00 in any one year in quarterly installments, to the Party of the First Part (settlor of trust). All income over and above the amounts of the payments hereinabove mentioned to be added to and form a part of the principal of the trust estate.

"Upon the death of the Party of the First Part (settlor), the Trustee shall pay the income to an amount in aggregate not to exceed $5000.00 in any one year, in quarterly installments, in equal shares to (children) until each child shall reach the age of twenty-five years, at which time the Trustee shall deliver and pay over to such child reaching the age of twenty-five years, his share of the trust estate, both principal and interest."

which was required to produce the life income reserved to the settlor, or should the tax be imposed upon the entire trust estate? The executor of the estate paid a tax on the entire estate under protest and sued to recover the tax on all the estate except that portion of the trust estate which was required to produce the life income reserved to the settlor. The executor took the position that the only transfer that was taxable to the beneficiaries under the trust was that portion required to produce the $5000 life income to the settlor, and that the residue of the estate was not subject to the inheritance tax because it had passed in enjoyment and possession to the beneficiaries at the date of the establishment of the trust, which was approximately thirty-five years before the death of the settlor.

In affirming the chancellor, the Tennessee Supreme Court held that the entire estate was subject to the inheritance tax and not merely that portion thereof required to produce life income to the settlor, since the entire gift made by the settlor to the taxed beneficiaries took effect in possession and enjoyment at or after the settlor's death.

Perhaps it might produce a better and clearer understanding of the court's holding in the *Hickox* case if we first sketched in a little background in the inheritance tax picture. We might first ask what is the purpose of subjecting to an inheritance tax inter vivos transfers "intended to take effect in possession or enjoyment at or after the death" of the transferor? The courts are in what appears to be complete unanimity on this point. The purpose of the statutes making such transfers subject to an inheritance tax is to reach substitutes for testamentary disposition and thus prevent avoidance of inheritance taxes.[34] The objective of such a tax is to tax successions occurring as a result of the death of the owner of the transferred property in situations where the owner has enjoyed the economic benefits of his property until the moment of his death, although he has made some sort of an inter vivos transfer of it. The realization of that objective required that something more be taxed than transfers by will or transfers under the laws of intestate succession. An inheritance tax statute restricted to transfers by will or by the laws of intestate succession would be an open invitation to inheritance tax avoidance by resorting to various types of inter vivos transfers in terms enabling the owner not only to enjoy the property until his death but also enabling him to determine how his property should be disposed of thereafter.[35] To barricade such roads of inheritance tax avoidance, the legislatures at

34. See *e.g., In re* Sayres' Estate, 245 Iowa 132, 60 N.W.2d 120 (1953); Commonwealth v. Switow, 307 Ky. 432, 211 S.W.2d 406 (1948); *In re* Kohr's Estate, 122 Mont. 145, 199 P.2d 856 (1948).

35. See Rottschaefer, *Taxation of Transfers Taking Effect in Possession at Grantor's Death,* 26 Iowa L. Rev. 514 (1941).

an early date began imposing inheritance taxes on transfers intended to take effect in possession or enjoyment at or after the death of the transferor.[36]

Since such is the purpose for imposing inheritance taxes on transfers intended to take effect in possession or enjoyment at or after the death of the transferor, what then is the test for determining when a transfer takes effect in order for it to fall within the purview of such a statute? In brief, a transfer intended to take effect in possession or enjoyment at or after death, so as to be taxable, is a disposition in which the transferor retains the economic interest or enjoyment of the property during his life.[37] The important question, then, is whether the shifting of enjoyment and possession of the subject matter of the succession is dependent upon the transferor's death. That is to say, is his death a determinative factor in the devolution of the possession and enjoyment of the economic benefits of the estate transferred, irrespective of the time when title is to vest in the transferree?[38]

Perhaps the two most common instances where the question arises are: (1) where the inter vivos transfer creates a remainder in the transferee by trust or by some other device reserving to the transferor a life estate; (2) where the transferor transfers property in trust to pay income to himself for life with remainders over. In the case at hand the transferor employed this last mentioned device. The courts are in apparent virtual accord in holding the transfer to be taxable where the life estate is reserved,[39] as well as where the right to receive the income for life is reserved, if the reservation by the transferor is contained in the same document which creates the remainder.[40]

The rationale for holding such transfers subject to the inheritance tax is that the transferor retained for his life the enjoyment of the economic benefits of the transferred property.[41] In an effort to avoid

36. For the origin of such provisions and some of their early history, see Note, 56 YALE L.J. 176 (1946) and Commissioner v. Church's Estate, 335 U.S. 632, 637 (1949).

37. See People v. Schallerer, 12 Ill.2d 240, 145 N.E.2d 585, 587 (1957); *In re* Kohr's Estate, 122 Mont. 145, 199 P.2d 856 (1948).

38. See Shroeder v. Zink, 4 N.J. 1, 71 A.2d 321 (1950).

39. Harber v. Whelchel, 156 Ga. 601, 119 S.E. 695 (1923); *In re* Sayres' Estate, 245 Iowa 132, 60 N.W.2d 120 (1953).

40. *In re* Kohr's Estate, 122 Mont. 145, 199 P.2d 856 (1948) (tax rate in effect when property vested in possession, rather than rate in effect when trust created, applied); Bosworth v. Commonwealth, 313 Ky. 279, 231 S.W.2d 36 (1950); Kimball v. Potter, 89 N.H. 234, 196 Atl. 272 (1938); *In re* Green's Estate, 153 N.Y. 223, 47 N.E. 292 (1897). *In re* Harbord's Estate, 201 Misc. 358, 105 N.Y.S.2d 123 (1951), *aff'd* 279 App. Div. 914, 110 N.Y.S.2d 916 (1952), *aff'd* 305 N.Y. 622, 111 N.E.2d 736 (1953) (estate tax).

41. See *In re* Sayres' Estate, 245 Iowa 132, 60 N.W.2d 120, 121-23 (1953). There was a period of time when such transfers were held not taxable under the federal estate tax law. The court adopted the theory that when the initial transfer of legal title is irrevocable the remainderman's interest in the remainder after the life interest vests and when the remainderman comes into possession of the property after the death of the life tenant he is taking

inheritance taxes, however, the transferor's retention of the economic benefits of the transferred property may be by devices that are more devious. He may make an unrestricted transfer in one document and the transferee may then, in another document, immediately lease the property back to the transferor for life at a nominal rental, or create a trust for the transferor for life. While this sort of a device has given some courts trouble, it should not. The use of any device by which the transferor secures those benefits for his life ordinarily will be held to bring the transfer within the reach of the inheritance tax statute covering inter vivos transfers of property intended to take effect in possession or enjoyment at or after the death of the transferor.[42]

Returning now to the *Hickox* case, it is clear that the settlor through the trust instrument creating the remainders also secured for himself the economic benefits of the property for his life. By the same token the trust instrument postponed the remaindermen's right of enjoyment until the happening of the event of the settlor's death. They could not receive any part of the principal or income until after the death of the settlor. The court seems on firm ground, therefore, in holding that the original capital fund, as well as the accumulations of income (all above $5,000 annual payment to settlor), is subject to the inheritance tax. Moreover, it has been held elsewhere that the succession to the remainder of the whole of the transferred property is taxable where the instrument of transfer provided for the payment of the income to the grantor even though it was also provided that any part of the annual income not distributed should be added to the principal.[43] Such decisions conform to the policy and purpose of the inheritance tax statutes. The effect of adding the undistributed income to the principal was to increase the fund whose income was distributa-

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the estate that vested in him at the time of transfer and his interests are not enlarged by the death of the life tenant. The case of May v. Heiner, 281 U.S. 238 (1930) represented that view. After Commissioner v. Church's Estate, 335 U.S. 632 (1949), the *Heiner* case construction is no longer controlling. The states uniformly rejected the view of the *Heiner* case. See *In re* Sayres' Estate, 245 Iowa 132, 60 N.W.2d 120, 122 (1953). See Rottschaefer, *Taxation of Transfers Taking Effect in Possession at Grantor's Death,* 26 Iowa L. Rev. 514, 516-17 (1941).

42. In *In re* Schuh's Estate, 66 Mont. 50, 212 Pac. 516 (1923), the mother transferred to her children stocks, bonds, mortgages, and certificates of deposit, and on the same day the children executed a trust agreement whereby they delivered the property to a trust company, the agreement providing the income was to be paid to the mother as long as she lived. The court held that the two agreements were to be construed together and, when so construed, the transaction "falls within the exact provisions of the statute relating to transfers to take effect in possession or enjoyment at the death of the donor," and was therefore subject to the tax. In Moore v. Bugbee, 3 N.J.Misc. 435, 128 Atl. 679 (1925), *aff'd* 102 N.J.L. 720, 135 Atl. 919 (1927), the transferor made an absolute conveyance under an arrangement by which the grantee immediately leased the property to the grantor for the latter's life. This was held taxable.

43. *In re* Toy's Estate, 220 Iowa 825, 263 N.W. 501 (1935).

ble to the transferor, being limited in the *Hickox* case to $5,000 annually. Although such accumulations ultimately increased the amount receivable by the remainderman, nevertheless the remainderman's enjoyment thereof was deferred or postponed until the transferor's death. Consequently, the tax on the remainderman should be measured by the value at the time of the transferor's death of both the original principal fund and its accumulations, since each accumulation was in essence and effect a part of the total property disposed of by the original transfer,[44] but the enjoyment of which was postponed until the transferor's death.

Moreover, the Tennessee inheritance tax statute has two additional provisions which seem expressly to cover the *Hickox* situation and on which the court properly relied. Paragraph (d) of the statute, as we have seen, expressly imposes a tax on property transfered by the decedent prior to death by gift or grant intended to take effect in possession or enjoyment at or after death.[45] Then follow the two paragraphs of the statute that seem to cover the *Hickox* matter. Paragraph (e) expressly declares that a "transfer of property subject to any charge, estate or interest, determinable by the death of the decedent or at any period ascertainable only by reference to the death of the decedent, shall be deemed to have been intended to take effect in possession or enjoyment at or after death."[46] Paragraph (g) of the statute, in referring to paragraph (e), then goes on to provide that in case of "any transfer of property specified in paragraph (e) of the section, the increase occurring to any person or corporation upon such extinction or termination of such charge, estate, or interest, shall be deemed a transfer of property taxable under the provisions of this statute."[47] As we have just seen, the trust instrument itself in the *Hickox* case provided that the surplus income should be added to the principal of the trust estate. Paragraph (g) seems to cover that and render it taxable. The trust instrument in the *Hickox* case makes no provision for the vesting in possession or enjoyment of that portion of the trust estate not needed to produce income for the settlor or of the income therefrom in anybody but the settlor until "upon the death of the" settlor. Since the taxed beneficiaries could not receive any part of the principal or income until after the death of the settlor, their right of enjoyment was postponed until the happening of the event of the settlor's death. Whatever interest the taxed beneficiaries may have had before the

44. See Rottschaefer, *Taxation of Transfers Taking Effect in Possession at Grantor's Death*, 26 IOWA L. REV. 514, 518 (1941).

45. TENN. CODE ANN. § 30-1602(d) (1956).

46. TENN. CODE ANN. § 30-1602(e) (1956).

47. TENN. CODE ANN. § 30-1602(g) (1956).

settlor's death, the right of possession and enjoyment depended upon the death of the settlor. Under the clear and plain meaning of paragraph (d) the entire "gift or grant" made by the settlor took "effect in possession or enjoyment at or after the death" of the settlor, and was properly taxed.

III. USE TAXES

In *Swartz v. Atkins*,[48] the issue was whether a taxpayer could escape penalty for failing to make a tax return and pay a certain use tax on the sole ground that the taxpayer was not aware that he owed any tax. The Tennessee court quite properly held, it seems, that such delinquency on the part of the taxpayer is not excused from the statutorily imposed penalty where the statute makes no provision for any such excuse. Although a tough decision for an innocent taxpayer, to hold otherwise would appear to open up a flood gate of would-be ignorance of tax laws. The decision reached by the court is also buttressed by the fact that the same statute did require "wilful intent" in order to penalize the taxpayer for nonpayment where the penalty was much larger, but the statute makes no mention of intent under the smaller penalty which the taxpayer was seeking to escape in the case at hand.

IV. MUNICIPALLY OWNED PROPERTY—EXEMPTION FROM TAXATION

The case of *City of Chattanooga v. Marion County*[49] raised the interesting question whether immunity from property taxation of municipally owned property should be determined by the same test as that used to determine the liability of a municipality in negligence cases. That is to say, should property held by a municipality in a proprietary capacity be taxable by analogy to the cases that refuse to extend governmental immunity to a municipality where the tort is committed by the municipality while acting in its proprietary capacity. The court refused to follow the analogy of tort liability. Instead, it granted tax immunity to property used by the municipality for a public purpose in its proprietary capacity. The City of Chattanooga's municipally owned power plant property was the subject of the tax controversy in this case.

The City of Chattanooga sold electric power to the general public from a power plant owned by the city. The plant was located within the borders of the city but its power lines extended into the taxing county, which was not the county in which Chattanooga is located. While Chattanooga supplied power both to the inhabitants of the city as well as to persons outside the city, the operations outside the city

48. 315 S.W.2d 393 (Tenn. 1958).
49. 315 S.W.2d 407 (Tenn. 1958).

were only nominal. The precise matter in controversy was whether Marion County into which Chattanooga power lines extended could validly impose a general ad valorem tax upon the electric power property owned by Chattanooga but lying within the borders of the taxing county. A relevant statute exempts from taxation municipally owned property that is used "exclusively for public . . . municipal purposes."[50]

In granting the exemption from taxation of this property, the court points out that where a municipality owns and operates its own electric light plant, it does so in a private (proprietary) and not in a governmental capacity and is liable for negligence in connection therewith. However, the court refused to carry this analogy over into the taxing field for the purpose of determining tax immunity. The court held that Chattanooga was performing a "public municipal function" and that property devoted to those purposes was within the purview of the statutory exemption from taxation. Moreover, the amount of such power operations outside the city was so small that the operations were thought incidental to the principal function of the city in performing the public purpose of supplying electric power.

Some states imply an exemption from taxation of the property of their local government subdivisions in the absence of a clearly expressed legislative purpose to subject the localities to taxation.[51] However, in many states local governments are exempt from state, county and municipal taxes only when expressly given an exemption, which usually relieves from taxation only when carrying out a "public purpose."[52] Such was the situation in the case at hand. It is often most difficult to determine whether the activity attempted to be taxed is carrying out a public purpose, and the authorities are by no means in agreement as to what constitutes such a purpose.

There is support for the position of the taxing authority in the case at hand to the effect that property held by a municipality in a proprietary capacity, as distinguished from a governmental capacity, is not exempt from taxation under statutes exempting from taxation public property used for public purposes.[53] A great many states, however, do not draw the proprietary-governmental capacity line of demarcation between taxable publicly owned property and property that is not subject to tax.[54] At least one court has taken the view that the

50. TENN. CODE ANN. § 67-502 (1956).
51. See *In re* Taft's Estate, 110 Vt. 266, 4 A.2d 634 (1939); Collector of Taxes v. City of Boston, 278 Mass. 274, 180 N.E. 116 (1932); People v. Assessors of the City of Brooklyn, 111 N.Y. 505, 19 N.E. 90 (1888).
52. See *e.g.*, Zangerle v. City of Cleveland, 145 Ohio St. 347, 61 N.E.2d 720 (1945), in addition to the case at hand.
53. City of Cleveland v. Board of Tax Appeals, 153 Ohio 97, 91 N.E.2d 480 (1950); Commonwealth v. Dauphin County, 335 Pa. 177, 6 A.2d 870 (1939).
54. Sutter-Yuba Inv. Co. v. Waste, 52 Cal. App.2d 785, 127 P.2d 25 (1942);

publicly owned property forfeits its exemption from taxation under the "public purpose" clause if the activity is engaged in a business for profit.[55] That test for determining tax exemption does not seem completely irreproachable because it appears tantamount to saying that a publicly owned activity which is efficiently operated loses its tax exemption while one which is operated "in the red" is entitled to the tax exemption. Moreover, the cloak of immunity, under this test, could be taken on or shed by the same publicly owned activity depending upon whether it had a lean or a fat financial year.[56] Another court has declared that the test of tax immunity under such a "public purpose" exemption clause is whether the owner of the public property has stockholders or partners and that it "is a controlling factor that the owner of the property has no stockholders, or partners and any income must necessarily accrue to the general public."[57]

One factor seemingly given weight in the *Chattanooga* case is that the operations outside the city (which were the subject of the tax) were so small that they were considered incidental to the principal function of the city in performing the public purpose of supplying electric power. That test, too, is not very reliable or satisfactory. Where would the court draw the line between what is nontaxable incidental activity and presumably substantial taxable activity? The fact that the municipal operations in question were carried on outside the municipality itself is not enough, however, to destroy the exemption.[58]

The exemption granted by the court in the *Chattanooga* case is supported by authority from other jurisdictions which have treated municipally owned property as being used for public purposes where the specific property consisted of light and power plants,[59] as well as gasworks,[60] waterworks,[61] and transit systems.[62]

Saunders v. City of Jacksonville, 157 Fla. 240, 25 So. 2d 648 (1946); Town of Weaverville v. Hobbs, 212 N.C. 684, 194 S.E. 860 (1938).

55. Zangerle v. City of Cleveland, 145 Ohio St. 347, 61 N.E.2d 720 (1945).

56. The mere fact that revenue is incidentally derived from property that is otherwise used for a public purpose ordinarily does not affect its character as property devoted to a public use. But where its use is principally for producing revenue, it is subject to taxation, as no longer being put to a public use. See Annot., 3 A.L.R. 1439, 1445, 1449 (1919).

57. Saunders v. City of Jacksonville, 157 Fla. 240, 25 So. 2d 648, 651 (1946).

58. Saunders v. City of Jacksonville, 157 Fla. 240, 25 So. 2d 648 (1946); People v. Board of Assessors of the City of Brooklyn, 111 N.Y. 505, 19 N.E. 90 (1888).

59. Saunders v. City of Jacksonville, 157 Fla. 240, 25 So. 2d 648 (1946) (property used for "municipal purposes" was exempt); City of Logansport v. Public Service Comm'n, 202 Ind. 523, 177 N.E. 249 (1931).

60. Commonwealth v. City of Richmond, 116 Va. 69, 81 S.E. 69 (1914).

61. *Ibid.*

62. Collector of Taxes v. City of Boston, 278 Mass. 274, 180 N.E. 116 (1932); *contra*, Zangerle v. City of Cleveland, 145 Ohio St. 347, 61 N.E.2d 720 (1945), commented on adversely in Note, 1 W. RES. L. REV. 84 (1949).

In refusing to extend into the field of taxation the tort liability test of governmental-proprietary capacity municipal action, the Tennessee Supreme Court in the *Chattanooga* case took what is firmly believed to be a wise and prudent course of action. By and large, that test for determining municipal tort liability is but little less than a loblolly of confusion and incongruities. The difficulties and inequities in determining whether the particular function of a municipality is governmental or proprietary for the purpose of determining tort liability have long been recognized and that test has been severely criticized.[63] To have opened this Pandora's box of vexing uncertainties in the field of municipal taxation in Tennessee would have been a disservice to the legal profession.

63. Green, *Freedom of Litigation,* 38 ILL. L. REV. 117 (1943); Seasongood, *Municipal Corporations: Objections to the Governmental or Proprietary Test,* 22 VA. L. REV. 910 (1936). For a recent case criticizing this test in the tort field and repudiating it, see Hargrove v. Town of Cocoa Beach, 96 So. 2d 130 (Fla. 1957), 11 VAND. L. REV. 253.