1959

Taxation

Joseph Curtis

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LEGISLATION

The only tax legislation enacted by the General Assembly at its 1959 extra session of sufficient general interest to warrant comment is that excluding from gross income interest upon obligations issued by educational institutions under chapter 3 of title 23 of the 1950 Code of Virginia.[1]

JUDICIAL DECISIONS

Perhaps most noteworthy of the few cases involving Virginia taxation during the current period, at least in doctrinal significance, was the United States Supreme Court's affirmance of the Supreme Court of Appeals' 1957 decision in *Railway Express Agency, Inc. v. Commonwealth*.[2]

A. *Gross Receipts as Measure of Going Concern Value*

A state franchise tax may not be imposed upon an *exclusively* interstate business for the privilege of doing such business in the state.[3] This principle, despite some prior waverings, was reaffirmed by the Supreme Court of the United States in 1954 to the temporary embarrassment of Virginia's State Corporation Commission.[4] The Commission had sought to impose upon Railway Express Agency, a Delaware corporation doing only interstate business in Virginia, an annual license tax measured by apportioned gross receipts, the taxing statute then reading that it was "for the privilege of doing business in the state." [5] The Supreme Court of Appeals was persuaded

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1. VA. CODE ANN. § 58-78(b)(5) (Additional Supp. 1959).

2. 199 Va. 589, 100 S.E.2d 785 (1957), *aff'd sub nom.* Railway Express Agency, Inc. v. Virginia, 358 U.S. 434 (1959).

3. Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951).

4. Railway Express Agency, Inc. v. Virginia, 347 U.S. 359 (1954).

5. VA. CODE ANN. § 58-547 (1950).

that it was in essence a property tax upon the intangible going concern value of the company,[6] the constitutional validity of which was well supported by United States Supreme Court precedents. However, the adverse wording of the statute, coupled with some mathematical disputations by Mr. Justice Jackson,[7] convinced five members of the Supreme Court that the tax was what the statute said it was—a tax on the privilege of doing interstate business.[8]

In 1956 the Virginia legislature amended the statute by eliminating the "privilege" purpose and specifically providing that the franchise tax was in lieu of other taxes on intangibles and rolling stock.[9] However, apportionment of gross receipts derived from transportation within the state of express transported through, into, or out of the state was retained as the measure of the tax.[10] Once again the Supreme Court of Appeals, reinforced by the more palatable amendment, found the tax to be a valid substitute for one on the company's intangible going concern value and rolling stock.[11] The Supreme Court, viewing the commerce clause question to be solely whether the tax in practical operation was on property or on privilege, affirmed. Acknowledging that the views of three Virginia agencies[12] were entitled to considerable weight, the Court found that the amendment was not a mere change of labels and that apportioned gross receipts were a constitutionally acceptable, although not the best, measure of going concern value.[13]

B. *Inheritance Taxation of Appointed Property*

Inheritance taxation of property passing by testamentary exercise of a power of appointment received further consideration from the Supreme Court of Appeals in *Commonwealth v. Davis*.[14] The Court had previously

6. Railway Express Agency, Inc. v. Commonwealth, 194 Va. 757, 75 S.E.2d 61 (1953), *rev'd sub nom.* Railway Express Agency, Inc. v. Virginia, 347 U.S. 359 (1954).

7. Mr. Justice Jackson's mathematics were directed at the huge disproportion between the initial cost of the Railway Express' assets and their assemblage value found by using gross receipts as the taxable base.

8. Railway Express Agency, Inc. v. Virginia, 347 U.S. 359 (1954); see note 3 *supra* and accompanying text.

9. VA. CODE ANN. § 58-546, -547 (Supp. 1958).

10. VA. CODE ANN. § 58-547 (Supp. 1958).

11. Railway Express Agency, Inc. v. Commonwealth, 199 Va. 589, 100 S.E.2d 785 (1957), *aff'd sub nom.* Railway Express Agency, Inc. v. Virginia, 358 U.S. 434 (1959); see Curtis, *Taxation, 1957-1958 Ann. Survey of Va. Law*, 44 VA. L. REV. 1217, 1220 (1958).

12. The General Assembly, Supreme Court of Appeals and State Corporation Commission.

13. Railway Express Agency, Inc. v. Virginia, 358 U.S. 434, 441 (1959) (dictum). This decision is likely to have a profound, national effect on state taxation of interstate commerce.

14. 200 Va. 308, 105 S.E.2d 819 (1958).

resolved that the exercise of a power is a taxable event, but the appointed property is not to be coupled with the donee's own property, although both pass to the same legatee, in determining the applicable exemption and rate bracket.[15] However, the Virginia statute taxes only such property as is "within the jurisdiction of this Commonwealth," [16] and the question before the Court in *Davis* was whether the intangible corpus of a New York trust created by a New York settlor was within the jurisdiction of the Commonwealth when appointed by a donee domiciled in Virginia. The issue was somewhat complicated by the fact that at the time of its creation the power of appointment was general and the donee a resident of New York. Subsequently the donee became a resident of Virginia; thereafter she converted the general power into a special one by releasing all her rights to appoint the trust corpus to herself, her creditors or the creditors of her estate. The lower court had held that the trust property was not brought within the jurisdiction of Virginia by reason of the donee becoming domiciled in this state and here exercising the power by will.[17] The trial judge thought this conclusion conformed with that of the Supreme Court of Appeals in *Commonwealth v. Morris*,[18] in which the New York settlor of a New York trust was held not to have brought the trust intangibles within the Commonwealth's jurisdiction by reason of his having reserved a life interest in the trust and subsequently becoming domiciled in Virginia.[19] The Court of Appeals, however, distinguished the *Morris* case on the ground that Morris, the settlor-life beneficiary, had divested himself of all control over the trust properties when he became a resident of Virginia. On the other hand, the Court pointed out that in *Davis* the donee's control over the trust corpus was so substantial that it was tantamount to ownership of it. Therefore, the doctrine of *mobilia sequuntur personam* applied. It is difficnlt to reconcile the Court's conclusion that for purposes of tax imposition the power to dispose of trust property at death is the equivalent of ownership but that for the purpose of determining tax exemptions and rate brackets the appointed property is to be taxed independently of the donee's own property.

Together *Commonwealth v. Carter*[20] and *Commonwealth v. Davis*[21] would

15. Commonwealth v. Carter, 198 Va. 141, 92 S.E.2d 369 (1956).

16. VA. CODE ANN. § 58-152 (1950).

17. Davis v. Commonwealth, In the Circuit Court of the City of Richmond, Order Book No. 66, p. 297, entered July 17, 1957. For a discussion of the circuit court decision, see Curtis, *Taxation, 1956-1957 Ann. Survey of Va. Law*, 43 VA. L. REV. 989, 992 (1957).

18. 196 Va. 868, 86 S.E.2d 135 (1955).

19. If the settlor had been a resident of Virginia when the trust was created as well as at the time of his death, the settlor's reservation of a life interest would have clearly rendered the trust taxable at his death under VA. CODE ANN. § 58-152(4) (1950).

20. 198 Va. 141, 92 S.E.2d 369 (1956).

21. 200 Va. 308, 105 S.E.2d 819 (1958).

seem to establish the following inheritance tax treatment for powers of appointment. The creation of a power by the settlor-donor is not a taxable event;[22] the exercise of the power by the donee is a taxable event; nevertheless the common law relation back theory, *i.e.*, the appointed property passes directly from the donor to the appointee, applies for determination of exemptions and rate brackets; jurisdiction over appointed intangibles is acquired through domicile of the donee. Not yet conclusively resolved is how these results might be varied depending upon whether the power is general or special. The Court in *Davis* directed little or no attention to this point.[23]

C. *Property Tax on Bonds of Public Service Corporations*

Virginia Code section 58-524 requires that railway companies report annually to the State Corporation Commission "all personal property . . . which would be taxable if the same belonged to an individual," [24] and section 58-516[25] imposes a tax on such companies' intangible personal property. Southern Railway and another railroad owned bonds issued by states other than Virginia on which taxes were assessed and paid pursuant to section 58-516. The companies sought refunds, contending that they were not required to report the bonds to the Commission because the bonds were no longer taxable in the hands of individuals since section 58-406, as amended,[26] provides that for years subsequent to 1953 taxes on net incomes shall be in lieu of a specific property tax on all bonds. The railroads further argued that the excepting clause in section 58-406 which serves to continue the intangible property tax on "bonds, notes and other evidences of debt of public service corporations" should be construed to mean only such bonds as are *issued by* such corporations and not those *held by* them. The Supreme Court of Appeals rejected both contentions in *Southern Ry. v. Commonwealth*.[27] Justice I'Anson, writing for the Court, pointed out that certain classes of individuals are not relieved from the property tax on bonds and that as they continue to be taxable in the hands of some indi-

22. Although the Court had no occasion to pass upon this proposition in either *Carter* or *Davis*, VA. CODE ANN. § 58-173 (Supp. 1958) imposes the tax upon a future interest only when it vests in possession. Since the appointee of a power has no interest in the property subject to the power of appointment until it is exercised in his favor, the statute lends some support to the argument that no tax is imposed when a power is created.

23. VA. CODE ANN. § 58-157 (1950), in which the Court found statutory authority for application of the tax to interests coming "into possession of beneficiaries by the exercise or relinquishment of powers," makes no distinction between general and special powers.

24. VA. CODE ANN. § 58-524(11) (Supp. 1958).

25. VA. CODE ANN. § 58-516 (1950).

26. VA. CODE ANN. § 58-406 (Supp. 1958).

27. 200 Va. 431, 105 S.E.2d 814 (1958).

viduals, they remain reportable by railway companies. The word "of" as used in the clause of the statute excepting "bonds . . . of public service corporations" was given its dictionary definition, "belonging to" or "denoting possession or ownership." Accordingly, the tax was sustained. The Court found additional support for the result reached in the clear intent of the General Assembly not to relieve public service corporations from the payment of taxes on bonds and notes issued by states other than Virginia.