Chapter 8: State and Local Taxation

Michael B. Elefante


CHAPTER 8

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MICHAEL B. ELEFANTE

§8.1. Introduction. Probably the most noteworthy event of the 1973 Survey year in the area of state and local taxation was the rejection once again, by the voters of the Commonwealth, in November of 1972, of a constitutional amendment designed to authorize the Legislature to enact a graduated income tax.1

But although no change as fundamental as the enactment of a graduated income tax resulted from the efforts of the Legislature or the courts during the Survey year, there were nevertheless several interesting developments in the area of state and local taxation. The first portion of this article will deal with the changes in the Massachusetts income tax rules concerning the computation of the basis of property subject to income taxation in the state. These changes, which are part of a comprehensive technical revision of chapter 62 of the General Laws,2 represent the Legislature's attempt for the first time to reconcile a number of the differences in basis computation between Massachusetts and federal income taxation law. The second portion of this article will consider the decision of the Supreme Judicial Court in Frost v. Commissioner of Corporations & Taxation,3 in which some interesting constitutional questions were raised regarding the application of the so-called estate "sponge" tax4 to intangible property located in Massachusetts owned by non-residents of the United States.

§8.2. Recent revisions in Massachusetts income tax basis rules. In 1971 the Legislature attempted for the first time to correlate the computation of Massachusetts and federal taxable income in a comprehensive way.1 Although the effort was commendable, several ambiguities were

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§8.1. 1 For an analysis of First Nat'l Bank of Boston v. Attorney General, 1972 Mass. Adv. Sh. 1711, 290 N.E.2d 526, in which the constitutionality of legislation apparently attempting to influence the vote was considered, see the student comment in §14.5 infra.

2 The changes are contained in Acts of 1973, c. 723, §7.


4 G.L. c. 65A, §1.

§8.2. 1 Acts of 1971, c. 555.
created, and various areas requiring attention were simply ignored. With the assistance of the State Tax Committee of the Boston Bar Association, the Legislature has now enacted legislation dealing with many of the problems left unsolved by its earlier effort. One important area that had been left in uncertainty by earlier legislation was that of the relationship between the basis of property for Massachusetts income tax purposes and the basis for federal income tax purposes. In the new law the Legislature attempted to move toward a system under which the differences between Massachusetts and federal law, except as they relate to fundamental differences in tax treatment, will disappear. This section will describe the system for relating federal and Massachusetts bases devised by the Legislature and will point out some remaining areas of uncertainty.

Chapter 728 of the Acts of 1978 takes into account the existing differences in the basis of property for Massachusetts and federal purposes to a limited extent in determining the “Massachusetts initial basis” of property. The intent of the statute is to eliminate to the greatest extent possible the differences between the Massachusetts initial basis of property and the federal initial basis, without completely doing away retroactively with all pre-existing differences. Under the new law the two bases will differ only for (1) property held by the taxpayer on December 31, 1970 and subject to Massachusetts income tax on that date and (2) property acquired after December 31, 1970, but with respect to which the “federal basis is determined in whole or in part by application of the basis of prior property.” In the cases of property (1) acquired by purchase after December 31, 1970 and (2) held on December 31, 1970 but becoming subject to Massachusetts income taxation after that date, the Massachusetts initial basis is determined by reference to the federal initial basis.

In determining, for Massachusetts income tax purposes, whether the basis of property held on December 31, 1970 is to be calculated under prior Massachusetts law or under federal rules, the new statute applies prior state law only to “property as to which, if it had been sold on

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2 I would like to acknowledge the assistance of George A. Page, Jr., Chairman of the State Tax Committee of the Boston Bar Association. Mr. Page was kind enough to provide me with the materials developed by the Committee before they were generally available. Those materials are now available to the public together with a brief, but comprehensive, article about Acts of 1973, c. 723 in McGee & Page, Massachusetts Income Tax—1973 Revisions, 17 Boston Bar J. 5 (Dec. 1973). That article includes the extremely useful technical explanation of the bill prepared by the Committee. I would also like to acknowledge the assistance of a number of the trust department employees of Hemenway & Barnes.


4 The effective date of Acts of 1971, c. 555, was Jan. 1, 1971.


December [31, 1970] in the course of business, a gain realized on such sale would have been taxable under this chapter to its then owner . . . ."? Despite this apparently narrow language, however, this standard was meant by the draftsmen to be "inclusive." That is, the standard was intended to describe any property the disposition of which by the taxpayer on December 31, 1970 would have been taxable under chapter 62 as then in effect or would have been so taxable if sold by the taxpayer in the ordinary course of business. The statute in this respect is not meant to apply only to property in fact held in the course of business on December 31, 1970. However, a superficial reading of the statute suggests such a meaning and there is some reason to think that the unintentional ambiguity of the standard will cause confusion among tax preparers and auditors.8

If the ambiguity of section 7(c)(1)(A) is resolved in the manner suggested by its authors, the Massachusetts initial basis of property held by the taxpayer on December 31, 1970 should be determined under the new statute by reference to the basis of the property under chapter 62 on that date as to all property except: (1) property held by non-residents who have come into the Commonwealth after December 30, 1970, except real or tangible personal property having a situs in Massachusetts on December 31, 1970; (2) the property of all corporate trusts (partnerships, associations or trusts the beneficial interests of which are represented by transferable shares) except of those which exercised the pre-1971 election to be taxed; and (3) real property located outside the Commonwealth.9

As to all other property held on December 31, 1970 the statute deems Massachusetts initial basis to be, for purposes of computing gain, the adjusted basis of the property under chapter 62 as then in effect, and for purposes of computing loss, the lower of that basis or the federal adjusted basis.10

The draftsmen of the legislation intentionally chose to eliminate the generally higher Massachusetts basis in computing loss, even though it is to be preserved for computing gain. They viewed the allowance of loss as a matter of legislative grace and apparently concluded that the allowance of loss in these circumstances is not a matter to which that grace should extend.11 In making the choice of basis turn on whether a gain or loss is being computed, the statute creates a rather unfortunate gap which will have to be resolved by regulation or further legislation. This gap appears in a situation in which the basis of property computed under

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9 Technical Explanation at 24.
11 Technical Explanation at 23.
chapter 62 as it formerly existed is higher than both (1) the federal adjusted basis of the property and (2) the net proceeds received in disposition of the property where such proceeds exceed the federal adjusted basis. In such a situation there is obviously a gain under federal rules. However, if the transaction is thus characterized as one producing gain and the higher Massachusetts basis is chosen as required under the new law, the result is a loss. Yet the statute also requires that in computing loss, the lower of the Massachusetts and federal bases is to be chosen. If the lower federal basis is chosen, however, a gain is produced; but in computing gain the higher Massachusetts basis must be used. There seems to be no solution in the statute to the circularity of this computation.

The rules regarding the determination of the Massachusetts initial basis of property acquired after December 31, 1970 work rather well. If the taxpayer's federal basis of such property is determined without regard to the "basis of prior property," the Massachusetts initial basis is the initial federal basis without regard to the adjustment for gift tax paid. Where the taxpayer's federal basis is determined with regard to the "basis of prior property," the difference between the federal and Massachusetts bases of prior property is preserved only if the acquisition transaction was not one producing a federal gain or loss. Where the acquisition produced a federal gain or loss, the difference in the federal and Massachusetts bases of prior property will have been taken into account by section 2 of the statute in the computation of the Massachusetts income tax result of the transaction. Thus, in such cases the Massachusetts initial basis is the federal initial basis of the acquired property.

Once the Massachusetts initial basis of property is determined, that basis is adjusted by applying the same adjustments made to federal basis with certain enumerated exceptions. These exceptions are limited
to those areas in which there is a genuine difference between the Massachusetts and federal income tax treatment of item.\textsuperscript{19} A number of differences under prior law in federal and Massachusetts rules regarding the adjustment of basis, such as the differing Massachusetts and federal rules on the allocation of basis to stock rights received in a nontaxable distribution, seem to have been eliminated. For the foreseeable future at least, the changeover to the federal system of adjustments to basis will cause some rather anomalous results,\textsuperscript{20} but such a situation is the price to be paid if conversion to a system of substantial Massachusetts-federal equality is to be achieved without completely disregarding past differences.

§8.3. Estate tax on intangibles in Massachusetts of decedents who were non-residents of the United States. Although many of the substantial number of decisions during the Survey year dealing with the general topic of Massachusetts taxation may be more significant, perhaps none is so interesting as the decision of the Supreme Judicial Court in \textit{Frost v. Commissioner of Corporations \& Taxation} and its companion case, \textit{Shaw v. Commissioner of Corporations \& Taxation}.\textsuperscript{1} That decision is addressed to two factual situations raising questions concerning the validity of G.L. c. 65A, §1,\textsuperscript{2} which, in certain circumstances, imposes an

\begin{itemize}
\item \textsuperscript{19} Technical Explanation at 27.
\item \textsuperscript{20} For example, in the case of a bond tax-exempt for both federal and Massachusetts purposes purchased at a premium prior to December 31, 1970, the Massachusetts basis of the bond as of December 31, 1970 will be the purchase price without regard to amortization of the premium. For years after December 31, 1970 the basis will be adjusted by reducing it by the amount of amortization taken on the federal return even though that amortization is computed on the basis of the life of the bond after purchase and not simply the life of the bond after December 31, 1970.
\end{itemize}
estate tax on the transfer of intangible personal property within the Commonwealth of persons who have died residents of other nations.

In the Frost case, the court dealt with the application of G.L. c. 65A, §1 to the estate of Timothy P. Kuhn, who had died a citizen of the United States but a resident and domiciliary of Rome. At the time of his death he left no real or tangible personal property in the Commonwealth. He did own intangible personal property consisting of interests in certain securities and cash held in brokerage accounts in Boston and cash on deposit in a Boston bank. Kuhn’s estate, under §2011 of the Internal Revenue Code of 1954,9 was entitled to a credit for state taxes in the amount of $13,060.42. Under the apportionment formula of G.L. c. 65A, §1, $10,022.57 was due the Commonwealth. No estate, inheritance, legacy or succession taxes were paid to any other state.

After paying the tax, Frost, Kuhn’s executor, petitioned for abatement, claiming that under the due process clause of the Fourteenth Amendment, it was impermissible for the Commonwealth to impose any transfer tax on Kuhn’s intangibles in Massachusetts. The petitioner also asserted that under the equal protection clause it was unconstitutional to impose a tax on the transfer of intangible assets in Massachusetts of non-residents who are domiciliaries of other countries when no such tax is imposed on the transfer of the intangible assets in Massachusetts of the decedent residents of other states.4

In the Shaw case, the court dealt with the application of G.L. c. 65A, §1 to intangibles held under an inter vivos trust. The trust had been established in Massachusetts while its settlor, Marian Lady Bateman, was a resident of Massachusetts. Subsequently, Lady Bateman became a British subject and died a resident of Monaco. From the time of its formation one of the trustees of the trust had always been a Massachusetts resident and the securities held by the trust had always been kept in Boston. Under the trust, after an annuity for her husband, Lady Bateman was entitled to the income for her life and retained a power of appointment over the distribution of the trust corpus on her death.


4 Frost also argued that as applied to him G.L. c. 65A, §1 violated Part II, c. 1, §1, art. 4 of the Massachusetts Constitution which authorizes the General Court to impose “proportional and reasonable assessments, rates, and taxes . . . .” This requirement has been interpreted as barring unequal taxes founded on immaterial differences in fact. Opinion of the Justices, 266 Mass. 596, 597 (1929). For reasons which were basically the same as those on which it relied in making its decision on the federal equal protection argument, the court rejected this contention. 1973 Mass. Adv. Sh. at 405-407, 293 N.E.2d at 874.

Frost and Shaw also argued that on the facts G.L. c. 65A, §1 violated art. 10 of the Declaration of Rights. Since this provision has been construed as providing the same protection as the equal protection clause, this contention was also disposed of by the court’s treatment of the federal equal protection argument. 1973 Mass. Adv. Sh. at 391 n.3, 293 N.E.2d at 865 n.3.
Under § 2011 of the Internal Revenue Code, the maximum federal credit for state death taxes was $254,462.37. The trustees paid that amount to the Commonwealth under G.L. c. 65A, §1, claiming the appropriate credit on the federal estate tax return, only to discover that the Internal Revenue Service took the position that no tax was payable to Massachusetts by reason of G.L. c. 65A, §1 and, consequently, that no credit against the federal tax was available.

The trustees filed a petition for instructions seeking a determination of whether or not the tax was owed to the Commonwealth. The United States declined to waive its sovereign immunity and to become a party to the case. As a result, in order to avoid double payment, the trustees, like the executor in the Frost case, argued that Massachusetts could not properly impose a tax under G.L. c. 65A, §1, on the ground that the imposition of such a tax on intangibles located in Massachusetts and owned by non-residents of the United States but not on intangibles located in Massachusetts and owned by residents of other states was a denial of equal protection of the laws under the Fourteenth Amendment.

The court held first that the imposition of an estate tax on the Massachusetts intangibles owned by Kuhn did not violate the due process clause of the Fourteenth Amendment. The court reasoned that the line of cases beginning with Farmers' Loan & Trust Co. v. Minnesota, including Baldwin v. Missouri, which established the principle that the Fourteenth Amendment prohibited multiple state taxation of intangible per-

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5 Apparently, the assets of the inter vivos trust made up the entirety of Lady Bate-\man's federal gross estate. See 1971 Mass. Adv. Sh. at 392, 293 N.E.2d at 865.

6 The inability to include the United States as a party meant, of course, that one of the real parties in interest was not a participant. Under the Internal Revenue Code and G.L. c. 65A, §1, at least so long as conflicting determinations are avoided, the taxpayer is indifferent to whether he pays the tax to the United States or partially to one or more states since the aggregate tax paid remains the same. This results in the inequity of forcing an indifferent party to the expense of arguing the case for the federal government. Moreover, since the United States was not a party, the decision of the court that a tax might properly be levied under G.L. c. 65A, §1 would not necessarily be conclusive on the question of the eligibility of such payments for the federal credit. 1973 Mass. Adv. Sh. at 393 n.5, 293 N.E.2d at 866 n.5. To help resolve the dilemma, the court ordered that the final decree in both cases provide that it might be reopened in the event the United States Supreme Court decided that the payment made was not eligible for the federal credit.

7 Apparently the refusal of the United States to waive sovereign immunity followed an informal discussion between Shaw's counsel and the Solicitor General in which the Solicitor General agreed that it would make good sense for the United States to remain a party so that the matter might be finally resolved. Brief of the Petitioner at 4, Shaw v. Commissioner of Corporations & Taxation, 1973 Mass. Adv. Sh. 389, 293 N.E.2d 862.

8 Shaw did not raise a due process argument since under Curry v. McCanless, 307 U.S. 357 (1939), Massachusetts clearly could impose an estate tax without violating the due process clause. 1973 Mass. Adv. Sh. at 394 n.7, 293 N.E.2d at 867 n.7.

9 280 U.S. 204 (1950).
sonal property, had been effectively overruled by subsequent cases, particularly *Curry v. McCanless*,\(^{10}\) and *State Tax Commission v. Aldrich*.\(^{11}\) Having concluded that no due process limitation barred the application of G.L. c. 65A, §1, the court was faced with the question of whether its application violated the equal protection clause of the Fourteenth Amendment. Following the principle that in cases dealing with economic regulation a classification will not be found to violate the equal protection clause so long as it has a fair and rational relation to the object sought to be accomplished, the court decided that the taxation of the transfer of intangibles owned by non-residents of the United States, but not residents of other states, was constitutional. Emphasizing the fact that the imposition of the tax would not result in a larger tax payment, the court held that the Commonwealth stood in sufficiently different relation to non-residents of the United States than to residents of other states, to justify the difference in classification.\(^{12}\)

The holding of the court in the *Frost* case on the due process issue seems to be generally justified. The history of the United States Supreme Court's treatment of the application of the due process clause of the Fourteenth Amendment to the taxation of intangibles by a state is a peculiar one. Within a relatively short period of time there have been several obvious shifts in position. Initially, the Supreme Court held, in effect, that any state with a sufficient relationship to the owner of intangible personal property, to its issuer, or to the property itself might levy a tax upon its transfer.\(^{13}\) It was assumed that inheritance taxes on intangibles could be imposed both by the state of the domicile of the decedent and by other states having a relationship to the property. In the early 1930's the Supreme Court changed its view on the taxation of intangibles. The change seems to have been inspired by the incongruity between the holding of the Court in *Frick v. Pennsylvania*,\(^{14}\) that death taxes on tangible personal property might be imposed only by the state in which the property was situated and not by the state of the domicile

\(^{10}\) 307 U.S. 357 (1939).

\(^{11}\) 316 U.S. 174 (1942).

\(^{12}\) The court pointed out in a footnote that the petitioners were arguably in no position to raise the equal protection argument since they were in no way harmed by an inequality in treatment arising from G.L. c. 65A, §1. See note 4 supra. The court nevertheless decided to treat the taxpayers as if they had a valid basis for making the argument. 1973 Mass. Adv. Sb. at 394 n.6, 293 N.E.2d at 866 n.6. As a result of the position taken by the Internal Revenue Service in the *Shaw* estate tax audit, the petitioners in the *Shaw* case were at least for the moment harmed by the assessment of the Massachusetts estate tax.


\(^{14}\) 268 U.S. 475 (1925).
of the owner, and the multiple death taxation of intangibles. The
Court accomplished this by creating a rule forbidding multiple taxation
of intangibles and limiting taxation to the state of the domicile of the
owner.16 Farmers' Loan was quickly followed by a number of other cases
carrying out some of the logical conclusions of the decision. These
included Baldwin v. Missouri,14 directly on point here, which held un­
constitutional the imposition by Missouri of an inheritance tax on bonds,
notes and cash present in Missouri but owned by an Illinois decedent.

Somewhat surprisingly, within ten years the Court substantially backed
away from these holdings and returned to the law as it had previously
existed. The case which broke the Farmers' Loan rationale was Curry v.
McCanless.17 In that case a Tennessee resident had established a trust in
Alabama retaining a testamentary power of appointment and the right to
income for life. The trust assets had been held in Alabama since the
establishment of the trust. The trust at all times had an Alabama trustee.
The right of Tennessee to impose an inheritance tax on the trust assets on
the death of the settlor seemed clear under existing authority. Also clear
was the substantial relationship between Alabama and the property. The
Court was thus faced with a situation in which the application of the
single place of taxation rationale of Farmers' Loan required the denial
of the seemingly just claims of a second state. Not surprisingly, the
Court bent in Curry and held that Alabama could constitutionally im­
pose a death tax on the trust assets in addition to that which might be
imposed by Tennessee. However, the Court seemed to break the Farmers'
Loan line of cases altogether in State Tax Commission v. Aldrich,18
which expressly overruled one of the progeny of Farmers' Loan.19 In
Aldrich it was held that the state of the incorporation of a corporation
might constitutionally impose a tax on the transfer of the stock of the
corporation. In the face of a rather heated dissenting opinion20 by Justice
Jackson, the Court appeared to abandon the essentials of the rationale of
Farmers' Loan by holding that a state which has extended benefits or
protection to property or can demonstrate the practical fact of its power
over the property could tax its transfer on death.

In light of Aldrich, the court's decision in Frost on the due process
issue seems correct. However, curiously enough, the Aldrich decision has
not been followed by other decisions overruling Farmers' Loan itself and
its progeny, including Baldwin v. Missouri. The court could have read

15 Farmers' Loan & Trust Co. v. Minnesota, 280 U.S. 204 (1930).
16 281 U.S. 586 (1930).
17 307 U.S. 357 (1939).
18 316 U.S. 174 (1942).
19 First Nat'I Bank v. Maine, 284 U.S. 312 (1932).
20 Justice Jackson stated: "... I therefore take today's decision to mean that any state
may lay substantially any tax on any transfer of intangible personal property toward
which it can spell out a conceivable legal relationship." 316 U.S. at 201.
Curry and Aldrich more narrowly than it did. These cases can be read as establishing the proposition that intangibles may be taxed by any state with a sufficient relationship to a person with a legal interest in the intangibles.\textsuperscript{21} In Frost the only persons subject to control in Massachusetts were persons with what could be seen as a mere custodial interest in the property. It could, therefore, be argued that Massachusetts, even though it had extended protection to the property, nevertheless had no relationship with the legal owner of the property which would justify taxation. On the other hand, the less formalistic approach of the court in Frost seems more attuned to the general development of law in this area, which has increasingly abandoned nice legal distinctions in favor of what could be characterized as a more pragmatic approach.\textsuperscript{22} For example, the protections afforded by the laws of a state in which intangibles are held, whether they are held by a trustee or by a broker or other custodian, are substantially the same.\textsuperscript{23} Although legal forms have historically been important in this area, the relative equality of the state's relationship to the property in both cases seems to justify the same treatment for purposes of taxation.

The decision of the court on the due process issue made its decision of the equal protection question more difficult. Under the court's reasoning the Commonwealth could constitutionally have enacted legislation imposing a "sponge" tax on intangible property in Massachusetts of both residents of other states and non-residents of the United States. This clearly raised the equal protection question of whether there was a permissible reason for choosing to tax the intangibles of non-residents of the United States, but not those of residents of other states. The equal protection standard applicable to a case such as this can be variously phrased,\textsuperscript{24} but as the court was candid enough to admit, in a situation

\textsuperscript{21} Northwest Airlines v. Minnesota, 322 U.S. 292, 311 (1944) (dissenting opinion).
\textsuperscript{22} See, e.g., Connecticut Ins. Co. v. Moore, 333 U.S. 541, 548 (1948) (New York could escheat unclaimed insurance proceeds if it had "sufficient contacts with the transactions ... to justify the exertion of the power ... "). See also the dissent of Justice Jackson in State Tax Comm'n v. Aldrich, 316 U.S. 174, 185 (1942).
\textsuperscript{24} The constitutional standard imposed by the equal protection clause in cases dealing with economic regulation is a good deal more flexible than the standard applicable to cases dealing with racial classifications and the like. See generally Developments in the Law, Equal Protection, 82 Harv. L. Rev. 1065, 1076-1131 (1969). But whether phrased positively ("Differences of classification for purposes of state taxation must be based upon real and substantial underlying differences of fact having some reasonable relation to the purpose for which the classification is made . . . .") Brief of the Petitioner, Frost v. Commissioner of Corporations, at 17, citing Wheeling Steel Corp. v. Glander, 337 U.S. 562, 572 (1949)) or negatively ("... A statutory discrimination will not be set aside if any state of facts reasonably may be conceived to justify it . . . .") McGowan v. Maryland, 366 U.S. 420, 426 (1961)), the standard requires that there be some rational explanation for the differences in classification.
like this, where a clear distinction is drawn, the question becomes whether there "is some logical justification for the classification." 25

The primary justification found by the court was that in the case of residents of other states it was possible that the state of domicile would apply a "sponge" tax to all the intangibles of a decedent. Thus, there would be a possibility of double "sponge" taxation of intangibles. This possibility, according to the court, would not exist in the case of residents of other nations whose domiciliary jurisdictions would not attempt to impose such a "sponge" tax. 26 The court also pointed out that some of the risk of double death taxation of intangible property, however denominated, in the case of residents of other countries was eliminated by tax conventions to which the United States was a party and by the credit allowed by §2014 of the Internal Revenue Code for death or estate taxes paid to another country with respect to assets includible in the decedent's federal gross estate. 27

In the narrow context of the cases before it, the court's decision on the equal protection question seems proper. The "sponge" tax imposed by G.L. c. 65A, §1 relates to a credit for taxes paid only to other states, United States territories or the District of Columbia. No foreign jurisdiction could therefore attempt to take advantage of §2011 of the Internal Revenue Code by enacting its own "sponge" tax. Since the jurisdiction of other domiciliary states to impose a "sponge" tax on intangibles of their domiciliaries located in Massachusetts is clear, the Legislature might assume that such taxes would in fact be imposed by sister states. To avoid the double taxation of intangibles resulting from the imposition of a "sponge" tax by both the state of domicile and Massachusetts in cases in which intangibles are located in the Commonwealth, the Legislature might choose to exercise less than its full jurisdiction by deciding not to impose a "sponge" tax on intangibles in Massachusetts owned by residents of other states. The same concern for the double taxation resulting from the imposition of a "sponge" tax on intangibles by the jurisdiction of domicile would, of course, not apply in the case of residents of other countries. 29

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26 A survey conducted by the court disclosed that more than 75% of the states impose a "sponge" tax on the intangibles of deceased residents. 1973 Mass. Adv. Sh. at 404 n.16, 293 N.E.2d at 873 n.16.
28 1973 Mass. Adv. Sh. at 405, 293 N.E.2d at 873. It ought to be noted that the credit allowed by §2014 of the Internal Revenue Code applies only to property taxed by another nation and "situated within such foreign country." Even within the context of the rules of exclusion and inclusion of §§2104 and 2105, it is still possible that another country might impose death taxes on intangibles within the United States of a resident of the taxing country. These taxes could not be credited against the tax imposed by the Code.
29 There could, of course, be double "sponge" taxation of the intangibles in Massa-
Although the decision of the court on the equal protection argument may be correct in light of the distinction the court found the Legislature might have drawn between the possibility of double "sponge" taxation of the intangibles in Massachusetts of residents of other states as opposed to those of residents of other nations, interesting light is shed on the case by an analysis of what appears to have been the actual purpose of the Legislature in making the distinction. Prior to the amendment of G.L. c. 65A, §1 the state of the law was represented by the Farmers' Loan line of cases. Under those cases it was clear that a state could not constitutionally impose an inheritance tax on the transfer of intangibles located within the state owned by nonresident decedents. In 1933 the law arguably suffered a slight change due to the decision of the Supreme Court in Burnet v. Brooks. In that case the court held that the United States might impose an estate tax on the intangibles in the United States of a resident of another country. In reaching its decision, the Court indicated that the single tax rule of Farmers' Loan and its progeny was based upon considerations of federalism, rather than on concepts of jurisdiction as such. In its relations with other nations the United States was, of course, not limited by notions of federalism and could tax to the full extent of its jurisdiction, which the Court held, reached intangibles within the United States of non-resident decedents.

The decision in Burnet v. Brooks was certainly capable of an interpretation supporting the proposition that a state, as well as the federal government, may tax the intangible property within the state of a resident of another nation. Nevertheless, the Court was careful in its opinion to limit what it said to the power of the federal government. It is also true that, in other respects, different rules have continued to exist concerning the power of a state to tax property outside the country in contrast to the power of the federal government to do so. For example, although the United States in some circumstances may tax the tangible personal property of a United States citizen located outside its jurisdiction, a state may not do so. However, the language of the Court's

81 288 U.S. at 401.
82 288 U.S. at 405 ("... we in no way limit the authority of our decisions as to state power ... ").
opinion in *Burnet* certainly could be read to say that a state could impose a death tax on intangibles within the state of a decedent who was a resident of another nation. In addressing the argument that the *Farmers' Loan* cases limited the power of the federal government to tax the intangible property involved in *Burnet*, the Court stated that

the limits of state power are defined in view of the relation of the states to each other in the Federal Union. The bond of the Constitution qualified their jurisdiction. This is the principle which underlies the decisions cited by the respondents. These decisions established that proper regard for the relation of the states in our system required that the property under consideration should be taxed in only one state, and that jurisdiction to tax was restricted accordingly.86

The language of the Court certainly suggests that the considerations underlying the *Farmers' Loan* cases would not be present in analyzing the relationship of a state to the intangible property of a resident of another country. Moreover, distinctions drawn in cases involving other sorts of property may not be applicable to intangible property. For example, the power of the United States to tax the tangible personal property of its citizens located outside its jurisdiction is based upon notions of citizenship which are not applicable to state citizenship, which is not extraterritorial.87 In contrast, the power of a jurisdiction to tax intangibles located within its borders but owned by non-residents is based on physical location and the attendant protections afforded by the taxing jurisdiction, a consideration that applies to the federal government and the states alike.88 The *Burnet* decision could thus have been interpreted as supporting the extension of the tax imposed by G.L. c. 65A, §1, as it then read, to intangible property in Massachusetts owned by nonresidents of the United States.89

The history of Acts of 1933, c. 316, the legislation amending G.L. c. 65A, §1, strongly suggests that it was a result of such a reading of *Burnet*. The Act was based upon a bill submitted to the Legislature on behalf of Henry F. Long, the then Commissioner of Corporations and Taxation, shortly after the decision of the Supreme Court in *Burnet*.40 Although the official legislative history is inconclusive, contemporary commentators clearly understood Acts of 1933, c. 316 to be an attempt to extend

86 288 U.S. at 401.
87 Note, 47 Harv. L. Rev. 307, 311 n.22 (1933).
88 Id.
89 Accord, In re Lloyd's Estate, 185 Wash. 61, 52 P.2d 1269 (1936); In re Estate of McCreery, 220 Cal. 26, 29 P.2d 186 (1934).
"sponge" tax levied by the Commonwealth to the full extent thought to be allowed by Burnet.41

Thus, at the time it was amended, G.L. c. 65A, §1, rather than representing an effort to extend the tax power of the state only to cases where no possibility of double taxation existed, represented an attempt to extend the tax levied to what was thought to be the full extent of jurisdiction of the state.42 Under the view of the law represented by Acts of 1933, c. 316, the equal protection argument disappears.43 The intangibles in Massachusetts of the residents of other countries are subject to tax but those of the residents of other states are not, because the former class of property is subject to the jurisdiction of the state, but the latter is not. Thus, had the court decided the due process portion of the case by relying on Burnet, rather than by finding the whole rationale of Farmers' Loan to have been abandoned, the equal protection issue decision would have been far easier to resolve. Such an approach would also have had the virtue of deciding the case on a narrow ground consistent with the holdings of both Farmers' Loan and later cases.44 One suspects that, if the court considered it, it did not take such an approach because it was uncomfortable with the narrowness of Burnet. Moreover, a decision which recognized continuing vitality in Farmers' Loan may have seemed less than honest to the court.

Even if the court were unwilling to rely on Burnet in deciding the due process issue, the equal protection decision might have been more candid if the court recognized the process by which the Legislature drew the distinction it did in G.L. c. 65A, §1. Once the court decided the due process portion of the case on grounds which would support the extension of jurisdiction to the intangibles in Massachusetts owned by residents of other states, the court should have recognized that the rationale of the Legislature in drawing the distinction it did in G.L. c. 65A, §1 was no longer valid. That admission need not have resulted in a holding that the statute denied equal protection to non-residents of the United States. 45

41 47 Harv. L. Rev. at 514-15; Developments in the Law, Taxation-1933, 47 Harv. L. Rev. 1209, 1222 (1933).
42 Interestingly, the ultimate result of these two rather different approaches is the same if one is willing to attribute to the Legislature the purpose attributed to it by the court in Frost. In the end both approaches result in a decision not to tax the intangibles of residents of other states at the place of the physical location of the documents evidencing such property. Prior to the abandonment of Farmers' Loan this result was constitutionally mandated. After Frost and the other cases diverging from Farmers' Loan the decision is a policy decision to avoid the same evil of multiple taxation which it was once thought to be proscribed by the Constitution.
43 This is support for the proposition that this form of under-inclusion is permissible.
44 The Commonwealth did not argue this ground but the petitioners did deal with Burnet in their brief. The court was aware of the argument and expressly declined to take the route presented. 1973 Mass. Adv. Sh. at 397 n.11, 293 N.E.2d at 868-69 n.11.
The court could have held that since in its view the difference in the possibility of the imposition of a "sponge" tax by the jurisdiction of domicile was sufficient to support the distinction drawn by G.L. c. 65A, §1, it would prospectively attribute such a purpose to the distinction and uphold its validity. Such an attribution of purpose seems wholly consistent with the cases in the area of economic regulation. Additionally, although the result is the same as that reached by the court in Frost, the process by which the result has been achieved is explicit and consistent with the actual background of the statute. This explicitness may also have drawn to the attention of the Legislature the change in the law resulting from Frost and may have presented to it the question of whether the distinction drawn by G.L. c. 65A, §1 is one which still makes sense. More generally, such an approach might have more clearly raised for the Legislature the question of how to deal with the taxation of intangibles in the legal world of multiple taxation.