Edwin R. A. Seligman

Essays in Taxation

Chapters VI thru VIII

The Taxation of Corporations

Edwin R. A. Seligman
Professor of Political Economy
Columbia University

Essays In Taxation

Eighth Edition
Completely Revised And Enlarged

The Macmillan Company
London: Macmillan & Co., Ltd. 1913

Copyright 1895
By Macmillan and Co.

***

Digital edition 2023
By grundskyld.dk

Chapters VI thru VIII
The Taxation of Corporations

Note:
No proofreading of text in Italian

Content:

Chapter VI—The Taxation of Corporations.
I. History ... 5
I. Early Taxation of Corporations ... 8
II. Development of the Corporation Tax ... 11
III. Bases of the Tax ... 82
Chapter VII—The Taxation of Corporations.
II–The Principles ... 85
I. The Franchise Tax ... 85
II. Economic Theory ... 103
III. Practical Reforms ... 115
IV. The Legal Situation ... 130
Chapter VIII—The Taxation of Corporations
III—Complications and Conclusions ... 138
I. Taxation of Property and of Debts ... 138
II. Taxation of Income and of Property ... 140
III. Taxation of Property and of Stock ... 143
IV. Double Taxation due to Conflicts of Jurisdiction ... 147
V. Taxation of the Corporation and of the Security Holder ... 165

Chapter VI—The Taxation of Corporations.
I. History

In a previous chapter we have considered the inadequacy and practical failure of the general property tax. In all ages and in all countries it has been found almost impossible to reach intangible personalty. What has always been a difficult task has become immensely complicated to-day through the growth of the modern corporation. At present, especially in industrial countries, the far greater part of the personalty in the hands of individuals consists of intangible property—mainly of corporate securities. The first reform of our direct taxation, therefore, is conceded by all to lie in this direction. Governments are everywhere confronted by the question, how to reach the taxable capacity of the holders of these securities, or of the associations themselves. Whom shall we tax and how shall we tax them in order to attain a substantial justice? Perhaps no question in the whole domain of financial science has been answered in a more unsatisfactory way. In the United States we have a chaos of practice—a complete absence of principle; in Europe, with the possible and partial exception of England, the situation is scarce, if at all, better. Moreover, in spite of the generally recognized need of reform, there has thus far been no comprehensive attempt, from the standpoint of theory, to evolve order out of the chaos into which the whole subject is plunged.[1]

[1] A satisfactory treatment of this subject is still lacking. The English writers have paid little attention to it. Cf. however, J. Bucham, *The Law relating to the Taxation of Foreign Income*, London, 1905, which deals in part with corporations. In the American literature there may be mentioned as the only book which treats of the subject in general, although limited to a single state, H. G. Friedman, *The Taxation of Corporations in Massachusetts* in the Columbia University *Studies in History, Economics and Public Law*, New York, 1907. Cf. also a shorter article on the same subject by C. J. Bullock, in the *Quarterly Journal of Economics*, vol. xxi. (1907), p. 181 et seq. The studies on the different classes of corporations and on the special problems will be mentioned below in their proper place, but it may be pertinent here to call attention to some of the more important recent studies on the group known as public-service or quasi-public corporations. Under the latter name see the articles by F. N. Judson and by F. C. Howe, in *Publications of the American Economic Association*, Third Series, vol. ii. (1907). Under the former name see esp. the articles by Adam Shortt and by C. C. Plehn in *Addresses and Proceedings of the First Confer-*

ence of the National Tax Association, New York, 1908, pp. 622 and 634; and by A. E. Holcomb in the *Fifth Conference*, Columbus, 1912, p. 149.

For the facts, see *Taxation of Corporations. Report on Systems employed in Various States*. Prepared under the direction of the Industrial Commission. By G. Clapperton, Expert Agent, Washington, 1901; and esp. *Taxation of Corporations. Report of the Commissioner of Corporations on the Systems of taxing Manufacturing, Mercantile and Transportation and Transmission Companies*. This comprehensive investigation has appeared in sections. Section I., devoted to the New England States, was published in 1909; Section II., dealing with the Middle Atlantic States, in 1910; Section III., treating of The Eastern Central States, in 1911; Section IV., dealing with Minnesota, Iowa, Missouri, Kansas, Nebraska, North and South Dakota in 1912. The entire work will probably be completed in seven sections. Much material will also be found in Carl C. Plehn, *Revenue Systems: State and Local Governments,* reprinted from the *Census Report on Wealth, Debt and Taxation, Washington*, 1907.

In a few of the states we find special treatises on the tax law and tax legislation, devoted in whole or in part to corporate taxation. These are: J. T. Davies, *A Compilation of Constitutional Provisions, Statutes and Cases relating to the Assessment of Taxes in the State of New York*, New York, 1886, and again in 1888; John T. Merrill, *Manual of the Taxation of Corporations by the State of New York*, New York, 1897; J. H. Hammond, Taxation of Business Corporations in New York State, New York, 1901; H. M. Powell, Taxation of Corporations in Neiv York for State and Local Purposes, Albany, 1905; the same author's *Manual of Corporate Taxation in New York for State Purposes*, New York, 1907; F. M. Eastman, *Taxation for State Purposes in Pennsylvania*, Philadelphia, 1898; the same author's *The Law of Taxation in Pennsylvania*, 2 vols., Newark, 1909; C. C. Black, *Law of Taxation with special reference to its Application in the State of New Jersey*, 2d ed., Newark, 1906; J. P. Dunn, Jr., *The New Tax Law of Indiana and the Science of Taxation*, Indianapolis, 1892; F. M. Judson, *A Treatise upon the Law and Practice of Taxation, in Missouri*, Columbia, 1900; *Compilation of Tax Laws and Judicial Decisions of the State of Illinois*, made by Albert M Kales and Elmer M. Liessmann [Springfield, 1911].

Of the general legal treatises on taxation only a few are devoted particularly to corporations. The most important is: J. H. Beale, Jr., *The Law of Foreign Corporations and Taxation of Corporations, both Foreign and Domestic*, Boston, 1904. In the ordinary treatises, however, frequent references are made to corporations. Cf. esp. T. M. Cooley, *Treatise on the Law of Taxation*, 3d ed., 1903; R. Desty, *The American Law of Taxation as determined in the Courts of last Resort*, St. Paul, 1884; W. H. Burroughs, *A Treatise on the Law of Taxation*, New York, 1877, new ed., 1883; F. M. Judson, *The Taxing Power, State and Federal, in the United States*, St. Louis, 1903. Cf. also the appropriate chapters in the encyclopædie works on *Corporation Law* by Cook (6th ed., 1908, 4 vols.) ; and by Thompson (2d ed., 1908-1910, 7 vols.).

Material on corporate taxation will be found in the histories of taxation in the various states. These are: W. M. Gouge, *Fiscal History of Texas*, 1834-1852, Philadelphia, 1852; T. K. Worthington, *Historical Sketch of the Finances of Pennsylva-*

The first requisite in any scientific investigation of this kind is to have the facts; for without a knowledge of existing conditions, any propositions for reform would be valueless. Nevertheless, the facts of corporate taxation have never been presented in their entirety. Given the laws, it is necessary next to consider the interpretation put upon them by the courts. Even then we have only the legal, not the economic view; for, unfortunately, good law is not always sound economics. It is therefore advisable to subject the legal principles in-

---

nia, Baltimore, 1887; W. P. Snyder, *Compendium and Brief History of Taxation in Pennsylvania*, Harrisburgh, 1906; N. W. Evans, *A History of Taxation in Ohio,* Cincinnati, 1906; E. W. Bogart, *History of Taxation in Ohio*, Columbus, 1912; F. A. Wood, *History of Taxation in Vermont,* New York, 1894; F. H. Noble, *Taxation in Iowa:* Historical Sketch, present Status and suggested Reforms, St. Louis, 1897; J. E. Brindley. *History of Taxation in Iowa*, 2 vols., Iowa City, 1911; E. J. Benson, *Taxation in Kansas*, Baltimore, 1900; J. E. Boyle, *The Financial History of Kansas*, Madison, 1908; R. V. Phelan, *The Financial History of Wisconsin*, Madison, 1908. The financial histories of Jones on Connecticut, Douglas on Massachusetts, Ripley on Virginia, and Schwab on New York deal with the earlier periods, anterior to the formation of corporations.

Of the earlier German literature—and there was none in any other language—there may be mentioned: Dietzel, *Die Besteuerung der Aktiengesellschaften in Verbindung mit der Gemeindebesteuerung*, Cologne, 1859; G. S. Meili, "Rechtsgutachten über die Besteuerung von Aktiengesellschaften," in *Zeitschrift für schweizerische Gesetzgehung und Rechtspflege*, 1882, p. 489 et seq.; F. Hecht, "Die staatliche Besteuerung der Aktiengesellschaften in Deutschland," in Finnnz Archiv, vol. vii. (1890), p. 37 et seq.; G. Schanz, "Die Besteuerung der Aktiengesellschaften in den deutschen Staaten," in Wochenschrift für Aktienrecht und Bankwesen, 1892, no. 20.

Since the first edition of this book a number of foreign studies have appeared. In German there may be mentioned D. Feitelberg, *Die Einkommensbesteuerung nicht physischer Personen,* Jona, 1900; Wangemann, "Die Heranzichung der Aktiengesellschaften zur Gemeindeeinkommensteuer in Preussen," in Verwaltungsarchiv, 1901, p. 489; A. Dehlinger, "Die Besteuerung der Aktiengesellschaften in Württemberg," in Finanz Archiv, vol. xxi. (1904), p. 499; F. J. Neumann, "Die Aktien- und ähnliche Gesellschaften Rechts- und als Steuersubjekte," in Annalen des Deutschen Reichs, 1905, 21, 418, 002; F. Dinglinger, *Die staatliche und kommunale Einkommens besteuerung der Aktiengesellschaften in Preussen und Baden*, Berlin, 1905; L. Blum, *Die steuerliche Ausnutzung der Aktiengesellschaften in Deutschland,* Stuttgart, 1911; E. Steinitzer, "Zur Besteuerung der Aktiengesellschaften in Oesterreich," in Conrad's *Jahrbücher,* vol. 83 (1904), p. 319; W. Gerloff, *Die Kantonale Besteuerung der Aktiengesellschaften in der Schweiz*, Bern, 1906.

In French we may mention A. Wahl, Traits du régime fiscal des sociétés et des valeurs mobilières, Paris, 1909; H. Truchy, "Les valeurs mobilières et les projets de reforme fiscale," in *Revue d'économie politique*, 1909, p. 7G3 and 1910, p. 31

volved to an analysis from the economic point of view. Only after such an examination and comparison of the facts of taxation in the United States and in Europe, will it be possible to reach any conclusions that may lay claim to scientific precision. Only such conclusions, arrived at through such a method, should be made the basis for practical reforms.

This then is the program of the present series of chapters on the taxation of corporations. The great importance of having all the facts accurately stated leads me at the outset, even at the risk of tediousness, to an examination of the history and of the actual conditions of such taxation in the United States, while the theory and criticism will be reserved for future consideration.[1]

I. Early Taxation of Corporations

During the first two decades of the nineteenth century, banks and insurance companies formed the chief examples of corporations, apart from the numerous turnpike roads and toll bridges. During the twenties and thirties the development of transportation facilities led to the creation of many canal and railway companies; and it was not long before many other forms of commercial and industrial enterprise followed in the same path of incorporation. The early tax laws made no mention of corporations. But as the general property tax was in vogue throughout all the commonwealths, it was tacitly assumed that the property of artificial as well as of natural persons was liable. Corporations were new institutions which the legislators in happy-go-lucky fashion, tried to tax under existing methods, whether they naturally belonged there or not. Our Solons had neither the leisure nor the inclination to make a more careful study of the subject.

The first commonwealth law which treated of the taxation of corporations in general was the New York law of 1823. This provided that "all incorporated companies receiving a regular income from the employment of their capital" should be considered "persons" liable to

[1] This chapter, as well as the two immediately following, will contain few direct references to the laws and the legal decisions. For a full statement of the laws as they existed in 1890 the reader is referred to the notes in the original articles in the *Political Science Quarterly*, vol. v., from which the present chapters are adapted. When the present tense is used in the following pages it refers to the conditions as they existed in 1912.

the general property tax. They were required to make returns to the county officers of all their property and their capital stock, paying the tax themselves and deducting it from the dividends of stockholders. They might, however, commute the tax by paying to the treasurers of the counties where they transacted business ten per cent on their "dividends, profits, or income," (which the legislator evidently presumed to be identical). These taxes were paid by the county officers to the state, and were then credited to the counties in proportion to the amount of stock held within each county, after deducting the state tax.

In 1825 and again in 1828 the system was slightly changed so as to conform more closely to the general property tax. The tax was made applicable to "all monied and stock corporations deriving an income or profit from their capital or otherwise." The real estate of these corporations was separately taxed; and in addition, they paid the property tax on their capital stock paid in or secured to be paid in, deducting the amount paid for real estate and the stock belonging to the state and to literary and charitable institutions. Manufacturing and turnpike companies paid on the cash value, not on the amount, of the capital stock; turnpike, bridge and canal companies, whose "net income" did not exceed five per cent of the capital stock paid in, were exempted; while manufacturing and marine insurance companies under the same conditions might commute by paying five per cent of their net income. It is thus seen that by this law corporations were divided into different classes, and that the system followed was the general property tax, with the exceptions that if a corporation had no profits it paid no tax on its stock, and that certain classes might commute by paying an income tax to the local officials. This remained the tax system, except for banks and for foreign insurance companies, until the middle of the century.

In 1853 the total exemption of non-profit-paying corporations was abolished and all companies were taxed on their real estate and on their capital stock, together with their surplus profits or their reserve funds in excess of ten per cent of the capital, with the same deductions as above. All corporations, however, whose profits did not equal five per cent on the capital stock might commute by paying five per cent on their "net annual profits or clear income." It seems that very few ever availed themselves of this doubtful privilege, and

accordingly in 1857, the law was again changed. The principle of commutation was abandoned; and since there was no distinction between profitable and unprofitable companies, so far as personal property was concerned, all corporations were taxed on their realty and on the actual value (not the amount) of their capital stock plus the surplus profits or reserve in excess of ten per cent of the capital. In addition to the previous deductions a further abatement was made for the capital invested in taxable shares of other companies. The remainder was then taxed in the same manner as the other personalty and realty of the county. This remained the law of New York, with the exception of some special provisions as to banks and insurance companies, until the recent changes in the taxation of corporations. These changes, however, affect only taxation for state purposes, leaving the local taxation still governed by the provisions of the law of 1857. Foreign corporations, however, are taxable for local purposes, under a law of 1855, on all sums actually invested in the state.

It appears, then, that the New York system was a taxation of the real and personal property of corporations by the local assessors, and that the personal property was virtually defined as the capital stock not invested in real estate. In the other commonwealths, where corporations were taxed at all they were included in the general property tax; and most of the laws lacked even such provisions as those of the New York statute in reference to the capital stock. A typical enactment of this kind is the Connecticut law of 1826, which provided simply that the personal property of a corporation should be taxed in the place where its principal business was transacted. In Massachusetts, on the other hand, where the first general law applicable to manufacturing corporations was passed in 1832, only the real estate and machinery of corporations were taxed. In lieu of the tax on personalty there was substituted the property tax on the corporate shares in the hands of individuals, a proportionate amount being deducted from each for the part of the capital stock invested in machinery and in real estate. In the other commonwealths, when the corporation was taxed, the shares in the hands of individuals were usually exempt. The only state which from the very outset broke with the principle of the general property tax was Pennsylvania, whose method we shall learn a little farther on. With this one exception, then, the early principle of corporate taxation was the assessment of all real and per-

sonal property by the local officials; corporations, in other words, were taxed by the same method as individuals. This primitive system has been retained up to the present day by many commonwealths for almost all classes of corporations; and in several states, indeed, the constitutions require that corporate property be taxed in the same manner as that of individuals. The practical defects of such a system, however, have led to numerous changes in many of the progressive states, and the tendency is everywhere away from the original plan.

In a previous chapter we have seen that the shortcomings of the general property tax were five in number; inequality of assessment, failure to reach personalty, incentive to dishonesty, regressivity and double taxation. With few exceptions, these objections are as applicable to the taxation of corporations as to that of individuals. All the facts here to be recounted set the stamp of disapproval upon the original plan. In the words of a celebrated report on taxation, this method of assessing corporations locally on their general property, is "as a system, open to almost every conceivable objection."[1]

II. Development of the Corporation Tax

As a result of these practical defects many commonwealths have abandoned in part, or altogether, the taxation of corporate property by local officials. The movement away from this original position has taken three directions: (1) the property of transportation companies, especially railroads, has been assessed separately by a special board and according to well-defined rules; (2) certain classes of corporations, beginning with banks and insurance companies, but gradually including the socalled public-service corporations and in not a few cases other corporations, have been taxed, not on their property, but on certain elements supposed to represent roughly their taxable capacity; (3) all corporations in general have been taxed by a uniform rule, according to principles varying more or less in the different commonwealths.

---

[1] *Taxation of Railroads and Railroad Securities*. By C. F. Adams, Jr., W. B. Williams and J. H. Oberly, a Committee appointed at a Convention of State Railroad Commissioners, to examine into and report the methods of Taxation as respects Railroads and Railroad Securities now in use in the various States of the Union, as well as in foreign countries; and further to report a plan for an Equitable and Uniform System of such Taxation, New York, 1880, p. 8.

The first tendency has progressed so far that there is now not a single commonwealth which applies, for both state and local purposes, the primitive method of the general property tax, locally assessed, to railroads. In 1895 there were still nine such states,[1] but in 1912 Rhode Island formed the only exception. In that year, however, Rhode Island supplemented the older system by a different method. About two-thirds of the American states[2] have broken away from the original custom so far as to have the railroad property assessed not by local officials, but by a state board known under various names.[3] The tax, it is true, is usually imposed at the customary rate of the general property tax, but many of the difficulties of local assessment of property have been obviated.

In a few states the departure from the primitive system is only very slight. Thus in Louisiana although by the constitution of 1898 a state board of appraisers assesses the property, corporate real estate continues to be taxed at the locality where situated and personal property at the domicile of the corporation. And in Texas, while the comptroller of state apportions the rolling stock to the counties, and a state board by a recent law appraises the franchise, the real estate of corporations is still assessed in the old way by local officials. In most of the states, however, the policy of centralization of assessment has proceeded much farther. In some of the states which practice this so-called ad valorem system, the state board assesses the entire prop-

[1] Louisiana, New Mexico, Oklahoma, Oregon, Rhode Island, Tennessee, Texas, Utah and Washington.

[2] Alabama, Arizona, Arkansas, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Utah, West Virginia, Washington, Wisconsin and Wyoming. Mississippi, Ohio, North Carolina, Texas and Virginia, which also use this newer method, supplement it by special taxes.

[3] It is called the board of railroad assessors in Kansas, Oklahoma and Tennessee; board of railroad commissioners in Arkansas, Kentucky and Mississippi; board of public works in Virginia and West Virginia; board of assessment for railroads in Alabama; state board of assessors in New Jersey; board of appraisers in Louisiana; corporation commission in North Carolina; state executive council in Iowa; board of tax commissioners or board of state tax commissioners in Indiana and Oregon; and board of equalization in all the remaining states except Florida (where the assessment is put in the hand of the attorney general, comptroller and treasurer) and Texas (where it is in part entrusted to the comptroller).

erty. In others it assesses the roadbed, rolling stock and all other operative property, i.e. property actually used for purposes of operation, leaving the remainder of the property to be appraised by the local assessors. In still others the state board includes over and above the tangible property the value of the so-called franchise. As soon as this is done, however, a departure is made from the principles of the general property tax. For although an individual may be assessed to the property tax on his so-called intangible property, an attempt is rarely, if ever, made to assess to an individual the good will of a business. Yet a corporate franchise, as we shall see later, is in a certain sense, in part at least analogous to the good will of a business and its value as a piece of property can be reached only through a consideration of the corporate earnings. In proportion, however, as the assessment of franchises, acquires greater importance, the simpler machinery of ad valorem assessment becomes inapplicable, and this method of taxation really merges into the one to be discussed below.

In not a few of the states which levy the ad valorem tax the so-called unit rule is followed. The first provision for this seems to have been made in the California constitution of 1879. By this is meant that instead of the property of the corporation being valued piecemeal, its entire value is appraised as a unit. If part of the property is without the state the property is none the less valued as a unit, and deductions are then made to compensate for that part of the property which is deemed to be without the state. In the case of railways relative mileage is usually taken as the criterion. The same rule is observed as between the various local divisions in the state, the property being assessed not by local assessors piecemeal but by a state board as a unit. The existence of the unit rule is entirely irrespective of the particular method employed to reach the value of the entire property. Sometimes only the realty and the tangible personalty of the corporation are added together; sometimes the value of the intangible personalty is added; sometimes the value of the so-called franchise is taken into account; sometimes the result is reached by ascertaining the value of the capital stock or again of the stock plus the bonds and either with or without certain deductions. But whatever the method of ascertaining the value, the point is that the entire value of the corporation is taken as a unit.

For the reason mentioned above, as well as for others to be discussed later, this first reform of railroad taxation has not been completely satisfactory. As a consequence a number of important commonwealths—sixteen in all—have wholly or partially abandoned property as the basis of assessment.[1] The methods adopted by them are comprised in the second of the three tendencies.

This second movement away from the property tax has consisted in subjecting particular classes of corporations to special taxes on other elements than their general property. It will be well to discuss these classes in order.

1. Banks

The direct taxation of banks dates back to the beginning of the nineteenth century. During the war with England the federal government imposed certain stamp duties on notes issued or discounted by banks. But this law of 1813 contained a further provision permitting the banks to compound for the duty by paying one and a half per cent on the amount of the annual dividends.

The first state law providing for a direct tax on banks was the Georgia act of 1805, which levied a tax of two and a half per cent on their capital stock and one-half of one per cent on their circulation. New Jersey followed in 1810, with a tax of one and a half per cent on the paid up capital stock of specified banks. The first Massachusetts law was the act of 1812 which imposed a tax of one-half of one per cent on the amount of their capital stock. A more important law was the Pennsylvania act of 1814, for Pennsylvania from the very outset assumed an attitude different from that of the other states. According to this law, banks were taxed at the rate of six per cent upon their dividends or net profits; if exempted from the national tax, the rate was to be eight per cent. In 1824 the rate was definitely fixed at eight per cent, and a few years later the principle of graduated taxation was

[1] Of these, nine states use only the new method—Connecticut, California, Delaware, Maine, Maryland, Massachusetts, Minnesota, New York and Pennsylvania. Vermont uses the new system as an alternative method. Mississippi, Ohio, North Carolina, Rhode Island, Texas and Virginia impose similar taxes in addition to the ad valorem system. Illinois uses the method only in the case of one railroad. Michigan, Washington and Wisconsin at one time employed the newer method, but subsequently reverted to the ad valorem system. North Dakota at one time employed the new method as an alternative system, until it was declared unconstitutional.

introduced. The act of 1835 imposed on banks of issue a tax on dividends, which varied from eight to eleven per cent as the dividends were under six or over eight per cent; and in 1840 banks were also subjected to the capital stock tax imposed on all corporations. In 1849 the dividend tax was increased. In 1850 a tax of four and a half mills on capital stock was substituted for the earlier general tax, but in 1852 this was repealed and the old tax reintroduced, which in 1859 was extended to banks of discount, deposit and savings institutions. In 1861 the progressive tax on dividends was increased so as to vary from eight per cent if the dividends were six per cent, up to thirty if the dividends were twenty-five. In 1866 a tax of one per cent was imposed on capital stock, in lieu of all other taxes on the capital stock of banks, and after some minor changes the whole system of taxing banks was replaced in 1889 by the method to be explained below.

Ohio and Virginia were the only other states which began, and for some time continued, to tax banks on dividends, although several states, like Vermont, in chartering special banks sometimes inserted a provision in the charter, reserving a portion of the profits or dividends. In Ohio a tax of four per cent on dividends was imposed in 1815, but in 1816 the general banking law obliged the banks to set aside profits which at the expiration of the charter would amount to four per cent of the total stock. In 1825 this charge was commuted into a tax of from two to four per cent on dividends, and in 1831 the rate was raised to five per cent. In 1845 banks were required to pay, in lieu of the tax on dividends, six per cent on the profits, deducting expenses and ascertained losses. Five years later the taxation of profits or dividends was abolished, and the banks were henceforth taxed at the rate of the general property tax on the amount of their capital stock and contingent fund. In Virginia the dividends tax did not begin until 1846, when the banks were required to pay one and a quarter per cent on dividends. This rate was gradually changed until during the Civil War it reached seventeen per cent. In 1870 a new system was introduced, based partly on capital stock, partly on income or dividends above $1,500; but in the following year the present method was adopted.

While Pennsylvania and Virginia were the only commonwealths to retain dividends as the basis of taxation, a few states taxed banks

on their capital stock. Thus the Massachusetts tax of 1812, changed in 1828 to a tax of one per cent on the amount of the capital stock actually paid in, remained in force practically without change until the Civil War, when the state banks were superseded by the national banks. This tax was in addition to that levied on the individual stockholders but, curiously enough, it applied only to the chartered, not to the free banks.[1] In Louisiana a tax was imposed in 1813 on the "stock in trade" of all banks; and in Kentucky a tax was levied in 1818 on the capital of the branches of the Bank of the United States. In other states, again, a special tax was levied only on the proportion of the capital stock owned by non-residents, as in the first Connecticut law of 1830, which imposed such a tax at the rate of one-third of one per cent. In most of the commonwealths, however, the special state taxation of capital stock came much later, since the principle of the property tax prevailed. When the capital stock was taxed at all, it was simply as representing the personal property, and hence it was taxable locally at the general rate of the property tax. The real estate was taxed separately, as in New York, where the personal property tax was levied on bank stock and was payable by the corporation. According to the law of 1823,[2] the tax was assessed on the par value of the stock, but in 1847 the basis was changed to the actual market value of the stock, without deduction for debts. It is worthy of note that in North Carolina, where the taxation of capital stock did not come until 1859, the rate of the tax varied with the dividends.

Since the inception of the national banking system most of the commonwealths have again changed their methods of taxing banks. The history of this change can be well traced in the legislation of New York. According to the laws mentioned above, banks were taxable on so much of their capital stock as represented their personal property. Under these acts the banks claimed exemption for that part of their capital invested in United States bonds; but their claim was disallowed by the court of appeals, on the ground that no unfriendly discrimination was thereby shown to the United States as a borrower.

---

[1] For a discussion of this point see W. B. Stevens, *The Taxation of State Banks*. Boston, 1865.

[2] One of the earliest discussions of the bank tax is to be found in S. M. Hopkins, *Speech on the Subject of taxing Bank Stock*. Albany, 1822,

In 1862, however, the national government provided by law for the total exemption from state taxation of all stocks, bonds and other securities of the United States. The court of appeals then held that this provision applied only to stock and bonds issued after the date of the law, but that all securities issued prior thereto were still taxable, according to the state statute. This decision was reversed by the federal Supreme Court, which held that any "stock of the United States constituting a part or the whole of the capital stock of the bank is not subject to state taxation." The legislature then sought to evade this decision by enacting that banks should be taxable "on a valuation equal to the amount of their capital stock," with similar deductions and exemptions as in the law of 1857; and the court of appeals pronounced this law valid, on the ground that the tax was on capital stock, and not on property. This decision was in turn reversed by the Supreme Court, which held the tax to be levied on the property of the bank, and therefore subject to deduction for non-taxable investments. In 1864 the national banking act was passed, which permitted the taxation of national bank shares in the hands of individuals, but not at a greater rate than other moneyed capital. This gave the New York legislature the desired opportunity, and in 1865 it enacted a law providing that all shares in national banks should be included in the valuation of the personal property of individuals. The court of appeals held this to be valid. It must be remembered, however, that the state banks were still taxed on their capital. The Supreme Court of the United States now upheld the principle of the taxability of shares, on the ground that a tax on the shares in the hands of individuals was not a tax on the capital of the bank. Nevertheless it reversed the New York decision on a minor point, namely, that since the capital of state banks invested in national securities was exempt, a tax on the capital was not equivalent to a tax on the shareholders, and hence to tax state banks on their capital and shareholders of national banks on their shares constituted a discrimination against national banks. This decision led to the New York law of 1866, which abolished the taxation of bank capital and provided for the taxation of shareholders of both state and national banks in the same way, i.e., on the value of the shares, with deductions for the capital invested in real estate. The banks were no longer taxed on their capital, but were required to retain the dividends from the stockholders until the tax was paid. The

Supreme Court sustained this law, holding that no deduction should be made from the value of the shares for any part of the bank's capital which might consist of United States bonds. Later it decided the state tax on shares to be valid, even if it were collected from the banks. The question then arose whether it was competent for the shareholder to deduct the value of his debts, as was the case in the taxation of all other personal property. The court of appeals decided in 1867 in the negative, holding that there could be no deduction of debts from the assessment of bank shareholders. This case slumbered for thirteen years; but in 1880 a decision involving this precise question was reversed by the United States Supreme Court on the ground that "the prohibition against the taxation of national bank shares at a greater rate than that imposed upon other moneyed capital could not be evaded by the assessment of equal rates of taxation upon unequal valuations." The consequence was an alteration in the New York law, which now in 1880 permitted the same deductions as in all other taxable property and which provided for the assessment of shares, whether owned by residents or non-residents, at the place where the bank was located.[1]

The result of this development was that bank shareholders paid a large proportion, and in some towns the greater part,[2] of all the taxes on personal property, and that they alone were unable to evade the otherwise so laxly executed tax on personalty. A later attempt of the banks to remedy this obvious inequality was frustrated by a decision of the Supreme Court that the words "moneyed capital," in the revised statutes, are practically confined to banks and private money lenders, and that the imposition of a lower rate of taxation on other corporations does not invalidate the bank tax.[3]

---

[1] For contemporary views see *The State and National Banks*. *The Question of Taxation*, Albany, 1864; *Report of the Committee of Bank Officers of the City of New York in relation to Bank Taxation*, New York, 1S75; T. J. Hillhouse, *Taxation of Banks of the State of New York,* New York, 1880; C. P. Williams, *The National Banks and State Taxation*, New York, 1887; [Seven] *Reports of the American Bankers' Association upon Bank Taxation,* New York, 1875-1889.

[2] In Albany the banks paid fifty-eight per cent of all taxes on personalty. *New York State Assessors' Report*, 1878, p. 16.

[3] The cases in their order are as follows: 23 N. Y. 192; 26 N. Y. 163; 2 Black, 870; 2 Wall. 200; 33 N. Y. 1(51; People vs. Weaver, 3 Wall. 573; 4 Wall. 244; 9

The system of taxing banks that had been reached in New York by the close of the nineteenth century is now general throughout the United States. It may be summed up as the separate taxation of the real estate owned by the bank together with a tax paid by the bank and then withheld from dividends,[1] levied sometimes by local, but more frequently by state, officials on the value of the shares, less the value of the real estate and other exempt property. In only a few states, like Maine, Maryland, New Hampshire, New Jersey, Oregon, Texas and Vermont, is the primitive method followed of attempting to assess the shares to the owner where they reside; and even in many of these instances an exception is made in the case of national banks and of non-resident stockholders, when the tax is assessed to the bank itself. In most states the same method is applied to state and national banks. In the eyes of the law, the tax although assessed at the bank, is generally considered to be a tax on the shareholders, advanced by the bank. As a matter of fact the tax is in most cases assessed in the name of the shareholder, and has even been declared invalid if the law does not grant in specific terms the right to collect the tax again from the shareholder.[2] Practically, of course, it is not a tax on the shareholders, because of the familiar fact that new purchasers of bank shares will escape the tax through the operation of the principle of capitalization of taxation.[3]

The shares are generally taken up at market or book value; but in some cases book value is not admitted and in others, arbitrary methods of ascertaining the value are prescribed. Thus in New Jersey the assessors until recently added the capital stock, surplus and undivided profits; deducted the value of the nontaxable securities and of the real estate; and then divided the remainder by the number of shares. The result was an assessment which is in few cases even ap-

---

Wall. 353; 36 N. Y. 59; Van Allen vs. Assessors, 100 U. S. 539; Mercantile National Bank vs. New York, 129 U. S. 138.

[1] The Supreme Court has repeatedly held that the tax on the shareholder may be required to be paid by the corporation. Aberdeen Bank is. Chehalis County, 166 U. S. 440; Merchants' Bank vs. Pennsylvania, 167 U. S. 461; Cleveland Trust Company vs. Lander, 1S4 U. S. 111.

[2] Home Savings Bank vs. Des Moines, 205 U. S. 503.

[3] See infra, chap, viii, sec. vi.

proximately equal to either the market or the par value.[1] So in Idaho by a law of 1912 the surplus and undivided profits are added to the face value of the shares and the amount of the capital invested in real estate is then deducted. In some cases again, where it is customary to assess property at only a portion of its real value, the law provides that a definite percentage of the market value of the shares be put into the assessment list. In Iowa, for instance, it is twenty per cent; in Idaho forty per cent.

In most of the states, even where the assessment of bank shares is fixed by a state official, the proceeds are distributed to the localities in which the shareholders reside. Some commonwealths have enacted more detailed provisions to avoid the confusion arising from the taxation of non-residents' stock. The Massachusetts law, for example, which dates from 1868, provides that the assessors of a town where a national bank is located shall omit from the town valuation all shares held by non-residents, and that the taxes paid by the bank on these shares shall be credited to the state.

The system sketched above is the one generally found in the United States. Since the commencement of the twentieth century, however, a number of states have substituted a special corporation tax on banks at a fixed or flat rate, in lieu of the older method. Thus in New York the law of 1901, as amended in 1903, provides for the imposition of a tax of one per cent on the value of the bank stock, which is arrived at by adding together the capital stock, surplus and undivided profits and dividing the result by the number of shares. Owing to the lower rate there is no deduction for the value of the real estate, nor is the shareholder entitled to any deduction for debts, as is the case in the general property tax.[2] The tax is payable to the county officers and is then distributed to the localities. In California a similar tax of one per cent was imposed in 1910, with the difference that the amount of the real estate locally taxable is deducted, and that the tax is payable to the state. The California tax is in lieu of all other taxes and licenses, state and local, except the local tax on real estate.

---

[1] By a recent decision the New Jersey method has been altered so that the market value less the non-taxable is taken for assessment purposes.

[2] A New York case involving the right to deny a shareholder deduction for debt is now [1912) in the United States Supreme Court.

In Connecticut since 1901 the banks pay to the state a tax of one per cent on the market value of the shares, less the amount of the real estate, but the tax is then returned to the towns in proportion to their shareholdings. The tax on non-resident shares, however, goes to the town where the bank is located. In Pennsylvania by somewhat earlier legislation (namely, the laws of 1879 and of 1881 as amended in 1889, 1891 and 1897) the banks may pay the so-called four mills tax on the actual value of their shares or a ten mills tax on the par value of their capital stock. In the four mills tax the value of the shares is ascertained by adding together the paid in capital, surplus and undivided profits and dividing the result by the number of shares, whereupon the bank is exempted from the state tax on personal property and from local taxation on so much of its capital and profits as is not invested in real estate, but including in the exemption any bonds or mortgages whether of individuals or corporations held by them.[1] If, however, they elect to pay the ten mills tax on par value they are not relieved from the payment of the tax on mortgages. Accordingly, virtually all the banks choose the four mills tax. National banks are in any case exempt from the state tax on mortgages. A three per cent net earnings tax, changed in 1901 to a gross earnings tax, applies only to unincorporated banks without capital stock. In Delaware there is a tax of one-fifth of one per cent on the book value of the bank shares, paid to the state in lieu of all state taxes except franchise taxes; and there are also special taxes on seven of the older banks in the state. In some of the Southern commonwealths, as North Carolina and Florida, we find in addition to the tax on bank shares a license or occupation tax fixed according to the capital or the business transacted. Again, in a few states, especially in New England where it is customary to tax the deposits of savings banks, we find special taxes on bank deposits in general. So in Connecticut bank deposits are taxed in the same way as savings bank deposits, described below; and in Maine banking companies pay one-half of one per cent on average amount of interest on time deposits and deposits bearing interest of three per cent and over, deducting the value of federal,

[1] This was decided in Commonwealth vs. Clairton Steel Co., 222 Pa. 293 (1898); and People's Savings Bank vs. Monongahela Consolidated C. and C. Co., 29 Pa. Superior Ct. 153 (1908).

state and local bonds. In Vermont national bank deposits bearing more than two per cent interest are taxed at a special rate of three-twentieths of one per cent.

Finally there are a few cases of special taxation on foreign banks. New York, for instance, levies a tax of five per cent on the interest of money loaned or employed within the state, and Maine taxes the branches of foreign banks at the rate of three-quarters of one per cent on the amount of business transacted within the state. California, on the other hand, taxes branches or agencies of foreign banks on their capital employed within the state at the same rate as domestic banks; while some states like Idaho tax foreign banks at the ordinary rate on the general average of moneys used.

Since the advent of trust companies, the bank tax has frequently been extended to them, as in New York, in other states as in many of the New England commonwealths, loan and trust companies are taxed like savings banks, rather than like banks in general. In other cases again, as in California, the same methods apply to banks, savings banks, and loan and trust companies. Occasionally also, as in Idaho, surety and fidelity companies are included in the system of bank taxation.

There remains the subject of savings banks. These, when incorporated, as is usually the case in the western states, are taxable in the same way as banks proper. This is true also in Pennsylvania, even when they are not incorporated, for in that state they pay the same special taxes as banks in general. In New York they are taxable only on surplus. In New England, however, the custom is, and has for a long time been, to tax savings banks, which are almost always unincorporated, on their deposits. In Massachusetts, where up to that time, the deposits had been nominally taxable as the personal property of the individual depositors, the new system came into use in 1862; in Vermont, not until 1878; in the rest of New England, in the interval. The rate of tax is, however, in every case far below that on property in general;[1] and it is customary to allow various deductions. Thus in Massachusetts the rate is one-half of one per cent on deposits, less the amount invested in taxable real estate, mortgages and

[1] Cf. in general W. G. Abbott, *Objections to the Taxation of Savings Banks*. New York, 1880.

state bonds. In New Hampshire the rate is three-quarters of one per cent on deposits, deducting the amount invested in real estate, mortgages bearing not more than five per cent interest, and state and local bonds. In the case of special deposits, however, the rate is one per cent. In Vermont there is a tax of seven-tenths of one per cent on the deposits and accumulations less the amount invested in real estate or in federal bonds (if not more than ten per cent of the assets), and excluding also individual deposits over $2,000, provided these are listed to the depositors where they reside.[1] In Maine a tax of five-eighths of one per cent is imposed on the deposits, reserve fund and undivided profits, with deductions for the assessed value of real estate, the amount invested in federal bonds or in shares of corporate stock which are tax-free to stockholders by law, and deducting also two-fifths of any other assets which are invested in the state. In Connecticut there is a tax of one-quarter of one per cent on deposits exclusive of the surplus over $50,000 and over the amount invested in real estate, in state or local bonds issued to aid railway construction or in the stock of banks, trust, insurance, investment and bridge companies. In Rhode Island the tax is at the rate of four-tenths of one per cent on deposits and undivided profits.

Outside of New England the tax on savings banks deposits is found only in Maryland where the franchise tax on savings banks amounts to one-quarter of one per cent on the deposits, three-fourths of the tax going to the place where the bank is located, and one-fourth going to the state. In many states outside of New England, however, deposits in savings banks are nominally taxable to the owner as part of his personal property. In New York, however, such deposits are exempt by statute.

In the matter of bank taxation, therefore, we are beginning to reach uniformity, with the exception of savings banks in the New England states. Two points are especially to be emphasized in the present situation. One is that bank taxation has been comparatively successful in proportion as we have attempted to apply to the property tax what in the case of the income tax is usually called the stoppage-at-source system. That is, not the income receiver, or in this case not the owner of the property, is taxed, but the corporation which pays out

[1] Deposits under $2,000 are exempt from any taxation.

the income or which, in this case, represents the owner of the property and deducts the tax from the income of the property. The second point is that the uniformity which has been attained has been to a large extent imposed upon the states by national law. Were it not for the existence of the national banks and the provision of the national banking law of 1864 as to equal taxation, mentioned above, the system of taxation of banks in general would probably be as little satisfactory as is at present the taxation of other intangible property. The real progress that has been made is the result of federal pressure, not in the sense of deciding what must be done, as in Germany or Switzerland, but in the sense of affirming what cannot be done. The mere fact of a national prohibition has sufficed to bring order into the state systems. This is a lesson which has not yet been learned in most of the other corporation taxes with which we shall have to deal.

2. Insurance Companies

The next corporations to break away from the general property tax were the insurance companies. At first only foreign companies[1] were taxed. The earliest law was that of 1824 in New York, which provided that foreign fire insurance companies should pay ten per cent on all premiums for property insured within the state. In 1829 the law was extended to foreign marine insurance companies, and in 1837 the rate was reduced to two per cent. Domestic companies were taxable on their capital stock, like all other corporations, according to the general law of 1828. Ohio started out by taxing insurance companies as well as banks, assessing them in 1830 four per cent on their dividends. But this form of taxation was soon abandoned. In Pennsylvania, where domestic companies were included in the general law of 1840, foreign insurance companies were not specially taxed until 1849, when the law imposed a tax of one per cent on the gross premiums of foreign life insurance companies. In Maryland the custom dates from 1839, when a tax of two per cent was imposed on the premiums received by the agents of foreign insurance companies. In Vermont foreign fire insurance companies were taxed eight per cent

[1] The use of the term foreign corporations in the American statutes is confusing. Generally it designates companies incorporated in another of the American commonwealths. In only a few cases does it refer to non-American states. In these chapters it will be used in the former sense unless otherwise indicated.

on their premiums in 1825; but the law was repealed five years later. In Massachusetts where domestic fire and marine insurance companies were first taxed in 1862, and domestic life insurance companies not until 1880, a tax on foreign companies was first levied by the law of 1832, which is of special interest as the prototype of what is known in several of our commonwealths to-day as the "reciprocal acts." The act provided that if any commonwealth taxed the agents of Massachusetts insurance companies, the insurance companies of such commonwealth were to pay one-half of one per cent on the whole amount insured by such companies in Massachusetts. At present the reciprocal acts go somewhat further and prescribe that foreign insurance companies are to be taxed at the same rate (if higher than the home rate) that is imposed on home insurance companies by the commonwealth chartering the foreign company. Such reciprocal acts are found in over two-thirds of the American states; and in a few states like Connecticut, Illinois and New Jersey they still constitute the only form of taxation of foreign insurance companies. The Kansas court calls them "an appeal for comity," "a demand for equality;"[1] but in reality they are retaliatory, rather than reciprocity, laws,[2] and are even so called in some of the states.

This premiums tax on foreign companies was gradually extended to domestic companies, until at present it is found in almost every commonwealth, only a few of the Western states clinging to the original custom of taxing them on their property. Occasionally the tax is known as an insurance license or an insurance fee. In some of the Southern states the companies must pay both fees and taxes. In most cases the laws apply to all kinds of insurance companies, of which the chief examples are fire and life insurance companies. In several states casualty companies are included and in a few states others as well are specifically mentioned, such as plate glass, indemnity, accident, surety, fidelity and employers' liability companies in Florida; plate glass and boiler insurance companies in North Carolina; river, security and indemnity companies in Louisiana; live stock, plate glass, lightning and tornado companies in Mississippi;

[1] Cf. 29 Kan. 672.

[2] Alabama declared them unconstitutional for this reason; 60 Ala. 217. In the other states they have been upheld.

storm and lightning companies in Texas; and marine companies in quite a number of states. The taxes are in general the same on the various classes, although not infrequently somewhat lower rates are imposed on life insurance, and especially mutual companies. Yet in a very few cases the reverse is true. Thus in Louisiana the graded tax rises to $4,500 in the case of fire insurance companies, but to $5,250 in the case of life insurance companies; and in Texas life insurance companies may be taxed up to 3% on premiums, other companies only ½ of 1%. These are, however, exceptions to the general rule. Fire and life insurance companies, again, are usually taxed not only at the same rate but in the same manner. Yet exceptions to this rule are occasionally found. In Pennsylvania, for instance where fire and marine companies pay three mills per dollar of capital stock, life companies (except mutual) pay on gross premiums. In New Jersey insurance companies, other than life, are taxed one per cent on premiums, while domestic fife insurance companies pay one per cent on their surplus plus thirty-five hundredths of one per cent on their premiums; but the payments from the foreign companies are credited to the domestic companies. New Jersey, however, is one of the very few states where the (net) assets of domestic life insurance companies are in addition subject to local taxation.

On the other hand, it is customary to make a distinction between domestic and foreign companies. In nine states[1] domestic life insurance companies are not taxed at all, while foreign companies pay on gross receipts or, as in Nevada, are subjected to a license tax. In six states, domestic life insurance companies are taxed at a lower rate than foreign companies—Alabama 1% as against 2%, Iowa 1% as against 2½%, Mississippi 2¼% as against 2½%, Pennsylvania 8 per mill as against 2%, South Dakota 2% as against 2½%, and Tennessee 1½% as against 2½%. Yet in a few cases the situation is the reverse. Thus in Maine foreign life insurance companies pay 1½% on gross receipts, while domestic companies pay not only 2%, but in addition a tax on surplus after deducting the value of the real estate owned in the commonwealth. So in Vermont while all insurance companies pay 2% on premiums, domestic life, fire and casualty insurance

[1] Indiana, Kansas, Kentucky, Maryland, Nevada, North Dakota, Oklahoma, South Carolina and West Virginia.

companies pay in addition 1% on the surplus above the necessary reserve of 4%, although with a deduction for the real estate locally taxed. In Wisconsin foreign life companies pay a license fee of $300, but domestic companies are subject to a tax on gross receipts. Here, however, as in not a few of the other states the retaliatory law is in force. In some states, again, like Rhode Island, mutual insurance companies are taxed at a lower rate than others. New York takes perhaps the palm in the matter of complexity of rate of insurance taxation. Life insurance companies, whether domestic or of any other American state, pay one per cent on premiums, while life insurance, health and casualty companies of foreign countries pay under the insurance law two per cent. On the other hand, while domestic fire and marine insurance companies pay one per cent on premiums, similar companies of other American states pay two per cent, and similar companies of foreign countries pay one-half of one per cent to the state treasurer and in addition two per cent to the local fire department or superintendent of insurance respectively. In addition all foreign companies are subject to the retaliatory tax.

In some states, again, foreign and domestic companies are taxed on a different basis. Thus in Delaware, District of Columbia, Michigan, Missouri, Ohio and Oregon, foreign companies are taxed on their premium receipts while domestic companies are taxed on either surplus or net premiums. Finally in Connecticut, Illinois and New Jersey foreign life companies are taxed only by reciprocal laws, while domestic companies are taxed either on assets or on surplus.

Although the premiums tax is the general tax we find not a few cases where the tax is based on a different element. Some of the Southern states impose license or privilege taxes of a fixed amount, frequently in addition to the tax on premiums. In North Carolina insurance companies pay licenses from ten to two hundred and fifty dollars together with a tax of 23½% on gross receipts; in Florida from fifty to two hundred dollars together with a tax of 2% on gross receipts. In Mississippi they pay both fixed licenses and taxes on premiums, but the latter tax is not imposed when the ad valorem tax is levied. In Louisiana life and accident insurance companies pay a fixed license tax based on gross premiums, divided into 69 classes, the tax being graded from $150 to $5,250. In Illinois, Michigan, Missouri and Ohio, the tax on domestic life insurance companies is im-

posed on surplus. In Connecticut the tax is imposed on assets at the rate of ¼ of 1%. In Wisconsin the tax on domestic life companies is at the rate of 3% on gross income excepting that derived from the rents of real estate, and excepting also premiums collected outside of the state on policies held by nonresidents.

Other states combine various taxes. Thus Maine levies on domestic life insurance companies a tax of 2% on gross receipts in addition to a tax of ½ of 1% on surplus after deducting the value of the real estate owned within the commonwealth. Massachusetts imposes on life insurance companies a tax of 2½ mills on each dollar of insurance, as compensation for the state valuation of policies and an excise tax of ¼ of 1% on the net value of all policies in force. Other domestic insurance companies, including fire, marine, and real estate title companies, pay an excise tax of one per cent on premiums and assessments; while foreign companies pay two per cent, or as much more as is necessary according to the retaliatory law—which law applies also to life insurance companies. Non-American companies pay four per cent on premiums (or two per cent if there is a guarantee fund of $200,000), while non-American accident, fidelity and guarantee companies pay two per cent. It need scarcely be added that when the reciprocal law is in force, as in New York and Massachusetts, there is a highly diversified system of insurance taxation.

The tax on premiums is generally levied on gross premiums or gross receipts. In only a few states, as in Montana, Nebraska, New Mexico and Oklahoma is the tax levied on net receipts. In Illinois, however, the net receipts of foreign insurance companies are entered as personal property, and are included in the general property tax; whereupon the companies are then free of all local taxes, except for the benefit of the fire departments which may impose a tax not exceeding two per cent on gross receipts. In many states where the tax is imposed on gross premiums certain deductions are made. Thus in the case of fire companies return premiums and reinsurance premiums are deducted in eleven states,[1] and losses and return premiums in a few others. In the case of fife insurance companies the deductions are more diversified. In Indiana losses are deducted; in Okla-

[1] Georgia, Kentucky, Maine, Michigan, New Hampshire, Ohio, Pennsylvania, Rhode Island, Vermont, Virginia and Wisconsin.

homa, South Carolina, Vermont and Washington dividends are deducted; in Idaho losses and dividends; in Arkansas losses and commissions; in Maine dividends to domestic policy holders only; in Mississippi death claims, matured endowments and cash dividends paid under contracts in the state; in Iowa losses, matured endowments, dividends, increase in reserve and amounts paid in cancelled policies; and in Utah the property tax paid on any real or personal property. Moreover, it has been decided in many states including Kentucky, Louisiana, Minnesota, Nebraska, New York, Pennsylvania and Tennessee, either by the courts or by the administrative authorities, that the words "gross premiums" or "premiums received" do not mean the premiums stipulated for, but that the so-called rebates or dividends paid to policy holders should be deducted, as they diminish to that extent the premiums actually received by the companies.[1]

The rates of taxation are now exceedingly varied, being from ½ of 1% to 3% in the case of life insurance companies, and from ½ of 1% to 3½ % in the case of fire insurance and other companies. In the case of life insurance companies the rates have tended to increase during the past few decades. Toward the middle of the eighties of the last century the average rate in all the states was a little over one per cent on gross premiums. By 1892 the average had risen to one and a half per cent. By the end of the century it was over two per cent, and at present it is still higher—about 2.08 per cent.[2] It must be remembered further that insurance companies are in almost all cases also taxable locally for their real estate, and that six states, chiefly in the south, permit the counties or municipalities or both to levy additional taxes on premiums;[3] while not a few of the Southern states like Florida levy in addition fixed licenses, state or local or both.

The growing burdens on life insurance have led in recent years to a discussion as to their propriety. In view of this and of the further

[1] A full account of the law and practice on this point will be found in the Memorandum on Interpretation of Secs. 65 and 7S of Chap. 77, Acts of 1907 of the Slate of West Virginia relating to the Tax on the premiums of Life Insurance Companies. By Alfred Hurrell, Attorney of the Association of Life Insurance Presidents. [1910.]

[2] Cf. J. F. Dryden, *Taxation of Life Insurance Companies in the United States*. An Address, New York, 190S, pp. 11-12

[3] These are Alabama, Georgia, Kentucky, Montana, South Carolina and Virginia.

fact that life insurance companies differ in important respects from the other corporations treated in these chapters we shall depart from the general order of treatment and discuss briefly in this place the principle involved.

On the one hand it is claimed that life insurance companies, or at least mutual life insurance companies, should not be taxed at all. For such companies it is said, are not profit-making organizations. A tax on them is really a tax on the policy holders, and thus in effect a tax on thrift and foresight, constituting an interference with a socially most commendable and beneficent practice.[1] Other writers do not go quite so far as this, but make a plea for great leniency of treatment and suggest that a tax be imposed in the nature of a license fee for the privilege of doing business, the amount of the tax to be restricted to a sum just sufficient to cover the necessary cost of supervision. For life insurance companies, according to these authors, enjoy no special privilege, but constitute primarily a means of co-operation to distribute the cost of providing for dependent widows and children and of saving a fund for old age.[2]

To this view, however, several objections may be urged. In the first place, modern life insurance companies are often utilized, in part at least, to afford a safe means of investment as well as insurance

---

[1] The fullest statement of this position will be found in Willard Morrill, *Taxation of Life Insurance Companies*. Argument before the Wisconsin Tax Commission at Madison, Oct. 2, 1900, esp. pp. 3-11, 41. See also a monograph bearing the same title by Charles E. Dyer, giving the argument submitted on Oct. 23d, 1900. For a more recent statement see Robert Lynn Cox, *The Impropriety of taxing Returns to Life Insurance Policy Holders*, Boston, 1909, pp. 5-6. Cf. the addresses at the Tax Conference held in New York in Dec, 1908, under the auspices of the Association of Life Insurance Presidents; and the Proceedings of the Annual Meetings of the Association [six to 1912].

[2] This view is emphasized in the "Report of the Committee on Uniform Insurance Taxation" in the *Addresses and Proceedings of the Fourth Conference of the International Tax Association*, Columbus, 1911, pp. 291-294. A plea for leniency is also made by S. S. Huebner, "The Taxation of Life and Fire Insurance Companies" in ibid., First Conference, New York, 1908, p. 595. Cf. also *Injustice and Inequality of Life Insurance Taxation*. Report of Committee adopted by National Convention of Insurance Commissioners at Detroit on August 24, 1908; E. E. Rittenhouse, Taxation of Insurance Premiums, An Address, Atlantic City, 1908; J. A. De Boer, *Taxation of Level Premium Life Insurance,* 1909; and the chapters devoted to taxation in F. L. Hoffmann, *Insurance Science and Economics,* New York, 1911.

against death. Why, it may be asked, should such investments be treated more tenderly than others. But, secondly, there is a broader ground for dissent from the claim for great leniency. The demand that the amount of the tax should be put in some relation to the cost of supervision is untenable because the modern basis of taxation, as we know, is not benefits received or the cost of the advantage conferred, but ability to pay. While it is indeed true that public-service corporations which enjoy special privileges may reasonably be asked to pay a special tax because these privileges enhance their ability to contribute to the common burdens, the absence of special privilege does not justify exemption or remission from ordinary taxation, whether in the case of corporations or in that of individuals. Moreover, the mere fact that the property or the income on which the tax is imposed is the result of thrift or foresight cannot be regarded as constituting a valid objection. As long as the general test of ability to pay is found in property, as in the United States, or in income, as in Europe, it is impracticable to avoid the taxation of thrift or of any of the other qualities which are responsible for the accumulation of capital or the enjoyment of income. For all capital is the result of saving. To abandon the taxation of life insurance savings would logically lead to the abandonment of all taxes on savings in general, and that would be tantamount to the taxation of expenditure which, as we know,[1] represents a bygone stage in the evolution of fiscal policy. As it has been well put:

> "This system of taxing savings and accumulated wealth has been deliberately adopted and will not be abandoned. The civilized nations of the world have committed themselves to the general policy of levying taxes, so far as possible, in proportion to ability, not disability; according to strength, not weakness; and as the thrifty man is usually the able and the strong man, he will continue to pay most of the taxes. One of the incidental disadvantages of this ability principle is the fact that it does to a degree tend to discourage thrift. But you cannot build a system on incidentals. The proposal to build a system of taxation on sumptuary principles—penalizing waste and thriftlessness, rewarding thrift and industry—has been repeatedly made in the past and deliberately re-

[1] Cf. supra, pp. 8-10.

jected. It is impracticable, for one thing, because the more it succeeds, the less revenue it yields."[1]

On the other hand, it is equally true that life insurance companies should not be subjected to an exceptionally high rate of taxation. Owing to the ease with which they can be reached, it has become customary in the United States to put them almost on a plane with public-service corporations, and virtually to tax the capital invested in insurance policies at a considerably higher rate than other intangible property, most of which in fact practically escapes taxation. Not only are life insurance investments taxed more severely than others, but life insurance companies in the United States are taxed at a higher rate than anywhere else in the civilized world.[2]

Moreover, the life insurance companies have undoubtedly a just ground of complaint in the heterogeneity of burdens to which they are subjected.[3] The evils of unequal and double taxation, which as we have seen above[4] are great enough in general in the United States, are accentuated in this case by the remarkable decision of the Supreme Court that the business of life insurance does not constitute commerce and is therefore not subject to the restrictions governing the state taxation of inter-state commerce.

When we come to the question as to the basis on which life insurance companies should be taxed, it is not altogether easy to reach a decision. Some authorities recommend the taxation of assets or of the

[1] T. S. Adams, *Some Obstacles which delay the Reform of Life Insurance Taxation*. An Address delivered at the Fourth Annual Meeting of the Association of Life Insurance Presidents, Chicago, 1910, pp. 6-7 of reprint. Cf. also Lcstor F. Zartman, *Investments of Life Insurance Companies*, New York, 1906, and the same author's *Necessity for Reform in Life Insurance Taxation*, *An Address delivered at the second Annual Meeting of the Association of Life Insurance Presidents*, New York 1908, pp. 3-5 of reprint.

[2] In Germany, for instance, with an annual premium income of over 120 million dollars, life insurance companies paid in taxes of all kinds in 1907 only about $300,000, or less than one-quarter of one per cent of the premium income as over against the two per cent and more, which is the average in America. Cf. J. F. Dryden, Taxation of Life Insurance Companies in the United States, 1908, p. 10.

[3] Cf. W. J. Graham, *Life Insurance Taxation. An Address before the North Dakota Tax Association*. Grand Forks [1910].

[4] Supra, chap. iv.

income from assets.[1] This is, however, impracticable in most of the commonwealths because a large part of the insurance is written by foreign companies whose assets it is impossible to reach. It is largely for this reason that most of the states have had recourse to the taxation of gross premium receipts within the state. In principle, however, this is open to serious objection, for very much the same reason that taxes on gross receipts in general are lacking in equity.[2]

In addition to this general objection it may be observed that a system of taxation of premium receipts is not especially well suited, in theory at least, to a community which still continues to tax property as such. For premium receipts bear comparatively little relation to assets. Companies carrying large amounts of so-called industrial insurance collect much larger amounts in premiums in proportion to reserve assets required to meet the obligation of those contracts than in the case of the usual type of policy. The same disproportion is to be found in companies which have a large amount of paid-up and well-matured policies in force as compared with other companies.[3]

If premium receipts at all are nevertheless utilized, it should be as far as possible net, rather than gross, premiums on which the tax is imposed. That is to say, the companies should be permitted to deduct from the gross premium receipts all moneys paid back during the year by way of death losses, surrender values, endowments, etc., as well as for expenses of the local agency organizations.[4] In this way we should at least get a little closer to the relative taxable ability of the various companies. It is, however, not likely that any immediate change will be made in the policy of the American commonwealths, which are predisposed to the simpler administrative methods and which naturally prefer ease and certainty of assessment to the more

---

[1] This is the view of the Wisconsin Tax Commission in its Report for 1911, and is also upheld by G. H. Noyes, *Life Insurance Taxation. Report and Bill of the Wisconsin Tax Commission, with other Facts* (1911).

[2] Infra, chap, vii, sec. ii.

[3] Cf. George Curtis, Jr., *Life Insurance Taxation, An Address*, 1911. This is incorporated with a few changes, in the *Report of the Wisconsin Tax Commission for 1910,* chap. 5.

[4] This suggestion is forcibly urged by Robert Lynn Cox, *Taxation of Life Insurance in the United States, A Reprint from the Addresses and Proceedings of the Second International Conference on State and Local Taxation*. Columbus, 1908, pp. 14-15.

ideal ends of abstract justice. As long as this feeling prevails, perhaps the most practicable plan still remains that of a fairly low, but uniform tax on gross receipts. But this, it must not be forgotten, is only a relatively satisfactory solution.

3. Railroads

(a) History

A complete history of the development of railway taxation would occupy an entire book. It will be possible here to say only a few words about some of the typical commonwealths.[1] In Pennsylvania, railroads were included in the general tax law of 1840, and were assessed on their personalty and on their dividends. In 1844 the tax on personalty was abandoned, but the general corporation tax on capital and dividends continued with some modifications. In 1861 a special tonnage tax was levied on transportation companies at the rate of two, three and five cents per ton of freight carried, and an additional tax of three-quarters of one per cent was laid on their gross receipts. The former was declared unconstitutional by the federal courts, and as a result, by the act of 1874, both the tonnage tax and the gross receipts tax were abandoned. For the old tonnage tax there was now substituted a tax of three cents a ton on the number of tons of coal mined or purchased by the companies engaged in mining, purchasing or selling coal. This tax, however, ceased in 1881, after having been declared unconstitutional, because it applied to interstate tonnage, notwithstanding the fact that it was a tax on franchise, and not on business. In 1877 the gross earnings tax was re-imposed at the rate of eight-tenths of one per cent and with slight amendments in 1879 and 1889 is still in force. In 1879 a law was passed imposing a tax on the capital stock of corporations in general, which with some

[1] There is no general history of railway taxation in the United States. For the period from 1890 to 1902, however, we now have the admirable compilation by the Interstate Commerce Commission entitled Railways in the United States in 1902. *A Twenty-two Year Review of Railway Operations; a Forty-Year Review of Changes in Freight Tariffs; a Fifteen-Year Review of Railway Regulation; a Twelve-Year Review of State Railway Regulation; and a Twelve-Year Review of State Railway Taxation. Part V. State Taxation of Railways and other Transportation Agencies. Prepared by the Statistician to the Commission.* Washington, 1903. This is a folio volume of 462 pages.

amendments is in force to-day.[1] In the meantime railroads were subjected to the tax on loans which was first imposed in 1864. In 1868 an attempt was made to extend this tax to securities held by non-residents, but the act was declared unconstitutional, as was a later act of a similar nature in 1881. It was not until 1885 that an effective tax on corporate loans, now in force, was introduced.

In New York, railroads were subject to the general property tax until 1880, when a law was enacted substituting for state purposes a tax on the capital stock of corporations in general, which will be discussed later in detail[2] and which with some modifications is still in force. In 1881 an additional annual "franchise tax" was imposed at the rate of one-half of one per cent on the gross earnings of all transportation and transmission companies. In 1886 the organization tax was imposed on all corporations in general and in 1895 the license tax on foreign corporations. Finally in 1899 the special franchise tax, to be explained later, was introduced. All these laws are, with some modifications still in force.

In Connecticut, the law requiring certain stock companies to make returns of the stock owned by individuals was extended in 1846 to railroads. Three years later every railroad that had paid a dividend in the preceding year was required to pay one-half of one per cent on the market value of the shares held by non-residents; but if the railroad was partly out of the state, the tax was to be proportioned to the mileage in the state. This system worked so well that in 1850 it was extended to resident stockholders, and was made one-third of one per cent in lieu of all other taxes. In 1862 the rate was increased, but the provision was inserted that the stock should not be assessed at less than ten per cent of the par value. In 1864 the outlines of the present system were drawn by requiring the companies to add to the valuation of the stock the market value of the funded and floating indebtedness less the cash on hand, and to pay one per cent on this valuation in proportion to the mileage in the state. In 1871 it was provided that if the railroad paid any local tax this might be deducted from the state tax. In 1881 a deduction was made from the taxable valuation for such portion of its debt as was contracted for stock taken in other

[1] Cf. infra, p. 197.
[2] Infra, pp. 200 et seq.

roads. In 1882 the funded and floating debts and bonds were to be valued at par unless the market value was below par. And in 1887 the present law, with substantially the same provisions, was enacted.

In Vermont the attempt to break away from the older methods came in 1882, when a graded gross receipts tax was imposed. On gross receipts up to $2,000 a mile the rate was 2%; on the first $1,000, or part thereof, above $2,000 the rate was 3%; on the first S1,000, or part thereof, above $3,000 the rate was 4%; and above $4,000 the rate was 5%. This law, however, was declared unconstitutional in 1890 by the state court as an interference with interstate commerce and was supplanted by the law of the same year, which, with a few modifications, is still in force and which provided for an alternative system—either a tax on gross receipts or a tax on the so-called appraisal, which is nothing but an ad valorem tax, including the value of the franchise, although at a fixed rate. The tax on appraisal was fixed at 7/10 of 1% in 1890, was increased to 1% in 1902, and to 1M% in 1908. The gross receipts tax was fixed at 2/^% in 1890, but in 1906 the present graded tax was introduced.

In Maine, a graded gross earnings tax was imposed in 1881. The rates were ¼ of 1% on gross earnings up to $2,250 a mile; 1/2 of 1% on earnings from $2,250 to $3,000; and then increasing by ¼ of 1% for every $750 until the rate reached 3¼%. In 1893 the rates were altered by providing that on earnings of $1,500, or under, the rate should be ¼ of 1%, thence increasing by ½ of 1% for every $750 until the rate reached 3¼%. In 1907, the rates were further increased and the scale now in force was instituted.

In Maryland the gross receipts tax was first imposed in 1888 at the rate of ½ of 1%. In 1890, the rate was increased to 1%, and the tax was made applicable to foreign as well as domestic railways. In 1896 the tax was graduated, being 8/10 of 1% on the first $1,000 per mile of gross earnings; 1 ½% on earnings from $1,000 to $2,000 per mile; and 2% on all earnings over $2,000 per mile. In 1906 the rates were increased and the scale now in force was adopted.

Of the other Eastern states to break away from the primitive system New Jersey has had an especially interesting history partly because it still favors a variation of the ad valorem system, partly because its peculiar situation has enabled it to grapple more successfully with the problem of the adjustment of state and local taxation.

For New Jersey is economically only an adjunct to the city of New York. A small state, with a population far inferior to that of the neighboring metropolis across the river, and with correspondingly insignificant state expenses. New Jersey is traversed by some of the most important railway lines in the country and contains what are practically the New York city terminals. From an early period, therefore, the railway tax question assumed an importance which was not realized until much later in other states. In New Jersey railroads were at first subject to special taxes as fixed in their separate charters. In 1851, however, they were subjected to the general property tax system. In 1873 came the break. A tax was now imposed at the rate of one-half of one per cent on a valuation equal to their cost, equipment and appendages, and the assessment was put into the hands of a state official known as the state commissioner of railroad taxation. Three years later, as the result of a constitutional amendment of 1875 the cost tax was abandoned and a tax at the same rate was imposed on the "true value" of the road and equipment, which was now to be estimated by a board of railway commissioners. In 1884 a new and more elaborate system was adopted. A state board of assessors was created to value all railway property used for railway purposes, the non-operative real estate being still assessed locally like other ordinary realty. The property was divided into four parts, viz.: (1) the so-called main stem, consisting of the roadbed, not exceeding one hundred feet in width, and the railroad stations; (2) the rest of the real estate used for operation, ordinarily described as the second-class property; (3) the tangible personalty of the railway; and (4) the franchise. It was this last category which, as we shall see later, was the important innovation, and which constituted the real departure from the system of property taxation. On the entire valuation, as fixed by the board, a tax of one-half of one per cent was imposed for state purposes. In addition to this tax, the so-called second-class property was to be taxed at the general local rate (not to exceed one per cent), and the revenue from this additional tax was to go to the localities. This remained the system until 1897 when the state relinquished to the localities the entire tax on second-class property, reserving to itself only the tax on the main stem, the personal property and the franchise. In 1906, however, the tax rate on these three categories was considerably increased, railroad stations which had hitherto been

included in the main stem were now placed in the second class property subject to local taxation, and the present system was put into force.

Leaving the states of the Atlantic seaboard we come next to Ohio. Ohio retained the old system as the exclusive method until 1896. In that year, however, Ohio added a so-called excise tax of ½ of 1% on gross receipts for state purposes, which was increased in 1902 to 1%. The ad valorem system, however, was also continued. The same double system has been perpetuated by the law of 1910, still in force, which increased the tax on gross earnings (now limited strictly to intra-state earnings) and which at the same time confided the assessment of railway property to a state board.

Of the states further west the break with the old methods had come earlier. In Michigan a tax on gross receipts was first imposed in 1873 at the rate of 4% or 2%, according as receipts were over S4,000 or not, although a few of the most important railroads in the state were subject to special taxation as fixed in the original charter provisions. In 1891 the general tax on gross receipts was graded according to the following scale: for the first $2,000 gross receipts per mile the rate was 2%; from $2,000 to $4,000, 2½%; from $4,000 to $6,000, 3%; from $6,000 to $8,000 3½%; over $8,000, 4%. In 1897 the scale was increased, the stages remaining the same, but the rates being respectively 2½%, 3¼%, 4% and 5%, with the further addition that the gross income of all union railroad station and depot companies whose earnings were over $20,000 a mile should pay 10% on the excess gross incomes over that amount. In 1899, however, for reasons to be discussed later, the gross receipts tax was abolished and the ad valorem system reintroduced. This law was declared unconstitutional, whereupon the constitution was amended in 1900; and in 1901 the ad valorem system was reinstituted by a law still in force, the valuation to be entrusted to a state tax commission.

What happened in Michigan took place also in Wisconsin. Wisconsin's experiment with the taxation of gross receipts began considerably earlier—namely, as far back as 1854, when a tax at the rate of 1% was imposed. After some trouble with this, the tax was changed to a license fee on gross earnings, at the same rate, and in 1862 the rate was increased to 3%. In 1871 a special rate of 5% was imposed on railways indebted to municipalities, etc. In 1874, the general rate

was increased to 4%, and in 1876 a graduated scale was introduced. The so-called license fees were now fixed as follows: for receipts of less than $1,500 per mile the tax was $5 per mile; from $1,500 to $3,000, $5 per mile plus 2% on earnings in excess of $1,500; for receipts of $3,000 and over, 4%. But all railroads upon pile or pontoon bridges were taxed uniformly at the rate of 2%. In 1897 the scale was revised as follows: for receipts of less than $1,500 per mile, the tax remained at $5 per mile; from $1,500 to $2,000, the tax was $5 per mile plus 2½ on the excess earnings over $1,500; from $2,000 to $2,500, the rate was 3%; from $2,500 to $3,000, 3½%; above $3,000, 4%. The same provision as before governed pile and pontoon railroads. In 1903, however, largely for the same reasons as in Michigan, the gross receipts system was abandoned and was replaced by the ad valorem method, under strict state assessment.

While Michigan and Wisconsin have abandoned the gross receipts method, Minnesota has retained it and California, after a careful study of the problem has recently introduced it. In Minnesota the system until 1873 was that of the old general property tax. In that year it was provided that railways might commute for the property tax by the payment of a tax on gross earnings. In 1887 the gross earnings tax was made obligatory, according to the following scale: for the first three years of operation, the rate was 1%, for the next seven years, 2%, thereafter, 3%. In 1903, however, the present flat rate of 4% was introduced. When California adopted a similar system in 1910, the same rate was applied. The only other Western state to employ the gross receipts method was North Dakota. North Dakota introduced the system in 1883 the rates being graded according to the age of the road. In 1889, however, an alternative system was introduced, the roads being given the alternative of paying a tax on property in general, or on gross earnings, with a rate of 3% for the first five years after the date of the act, and of 2% thereafter. But in 1891 the gross earnings law was declared unconstitutional, and since then North Dakota taxes railroads according to the ad valorem system.

There remain the Southern states. North Carolina introduced the change in 1889, when a law was enacted providing that in case for any reason the general property tax should not be imposed on a railway, it should be subject to a tax of 1% on its gross earnings. In 1899

this alternative provision seems to have been dropped, but in 1901 a so-called privilege tax on gross earnings, with a graced scale, was introduced which is still in force as a supplement to the general property tax. In Virginia the law of 1842 imposed a tax of 1½% on dividends. In 1855, as amended in 1859, this was changed to a tax of 1 mill per passenger mile plus ½ of 1% on gross earnings from freight. In 1869 the tax was again changed to ½ of 1% on tangible property and on dividends. In 1881 the property tax continued to be levied although now assessed by a state board, but was supplemented by a so-called occupation tax, levied according to net earnings. No machinery, however, was provided to enforce the law which remained a dead letter. In 1890 the requisite machinery was instituted and the law was enforced. The net earnings or income tax was at the rate of 1%, and it was provided that income should be ascertained by deducting the costs of operations, repairs and interest on indebtedness from the gross receipts. In 1902, however, the income tax was changed to a privilege or license tax of 1% on gross receipts, which is still in force and which is levied in addition to the property tax. In Texas, also, a tax on gross receipts was added to the property tax in 1895, but limited to the receipts from passenger traffic. In 1905, however, it was extended to receipts from all sources, at the rate of 1%. Finally in Mississippi a law of 1880 provided that if a railroad would pay a privilege tax of from $20 to $70 per mile it should be exempted from the general property tax for state and county purposes. The law of 1890 increased the rates in this alternative system to $50-$150 per mile. In 1892, however, a privilege tax on railroads was imposed, not as an alternative, but as an addition, to the property tax. The law divided railroads into four classes, with a tax of $2 to $20 per mile according to the class. This law, with some amendments, is still in force; as is the law of 1896 which imposed an additional privilege tax of $10 per mile on railroads claiming exemption from state supervision under the maximum and minimum provisions in the charter.

After this hasty glimpse at some of the typical forms of development, let us now study the actually existing chaos. Chaos we say, because the remark of the railroad tax committee of 1879 still holds good to-day, that "there is no method of taxation possible to be devised which is not at this time applied to railroad property in some

part of this country. A more discouraging example of general confusion could hardly be imagined."[1]

(b) Actual Conditions

As stated above[2] ten commonwealths have abandoned property, in the sense of the summation of the actual tangible and intangible assets, as the basis of the tax, and six others have abandoned property as the sole basis. Of these the majority now assess railways on earnings. Four states—California, Maine, Maryland and Minnesota—levy a tax on gross earnings only. In two of these four the tax is graded. In Maine the so-called excise tax is levied at the following rates: on gross receipts less than $1,500 per mile, ½ of 1%; from $1,500 to $2,000 per mile, ¾ of 1%; and for each additional $500 per mile or part thereof, ¼ of 1% additional until the rate equals 4½% Gross receipts are defined as the average receipts per mile for the entire system multiplied by the number of miles in the state. The cost of maintaining the railroad commission is also apportioned to the railways in proportion to their gross receipts. In Maryland the so-called franchise tax is imposed at the rate of 1/4% on the first $1,000 earnings per mile; 2% on earnings from $1,000 to $2,000; and 2½% on earnings above $2,000 per mile. In the two other states—California and Minnesota—the gross earnings taxes are not graded, being levied at the fixed rate of four per cent.

In addition to these four states, one commonwealth, Vermont, levies a graded gross receipts tax as an alternative to a property tax. The latter is called the tax on appraisal, and is a tax at the rate of 1¼% on an appraisal made by the commissioner of state taxes, consideration being taken in each case of the value of the franchise. If the corporation does an interstate business, the total valuation is divided by the number of miles of the entire main line in order to get at the average value per mile, and this is then multiplied by the mileage within the state. If, however, the railroad does not accept this, it may pay a tax on gross earnings, the rates of which are graded as follows: If the gross earnings do not exceed $2,000 per mile, the rate is 2½%; from $2,000 to $2,500, the rate is 2¾%; from $2,500 to $3,000, 3%; from

---

[1] Taxation of Railroads and Rajilroad Securities, p. 1 .

[2] Supra, p. 151

$3,000 to $3,500, 3¼%; from $3,500 to $4,000, 3½%; from $4,000 to $4,500, 3¾%; and for receipts over $4,500 the rate is 4%. In practice virtually all the railroads pay the gross earnings tax.

Three commonwealths—Massachusetts, New York and Pennsylvania—include railroads in the general corporation tax. New York and Pennsylvania, however, levy an additional tax on intra-state gross earnings (one-half and eight-tenths of one per cent respectively); while Massachusetts also levies a commission tax on gross earnings in proportion to mileage, and in the case of corporations to construct railroads in foreign countries substitutes a tax of one-twentieth of one per cent on capital stock, while foreign corporations engaged in constructing railroads pay a tax of one-fiftieth of one per cent on capital stock. In Pennsylvania railroads are therefore now subject to the general corporation tax on capital stock as measured by dividends, to the tax on corporate loans at the rate of four mills, and to the tax on gross receipts at the rate of 4/10 of 1%. They are also subject to the payment of the so-called bonus on charters.[1]

In Connecticut, railroads are required to pay a tax of one per cent on the valuation of their capital stock and on the par value (or on the market value, if below par) of their funded and floating debt above the amount in the sinking fund. If only part of a railway is in the state, the company pays on such proportion of the above valuation as the mileage in the state bears to the total mileage, omitting the value and length of such branch lines as are of less than one-quarter the average mileage value of the trunk line.

There remains one commonwealth—Delaware—which levies six separate taxes, viz., on capital stock (one per cent), net earnings (ten per cent), locomotives ($100 each), passenger cars ($25), freight cars ($10) and passengers (ten cents each). The companies may, however, pay a gross sum in commutation of the passenger tax.

In addition to the commonwealths which have broken entirely with the attempt to tax railways on tangible and intangible property, six states which retain the property tax as the main feature add other taxes not based on property. In North Carolina the privilege tax on gross earnings, levied in addition to the general property tax, is fixed as follows: for gross earnings of $1,000 or less per mile, $2 per mile;

---

[1] Cf. infra, p. 215.

$1,000 to $2,000 earnings per mile, $3 per mile; $2,000 to $3,000 earnings per mile, $4 per mile; for earnings over $3,000 per mile, $5 per mile. Mississippi imposes additional privilege taxes at a fixed sum per mile, according to the reputed wealth or earning capacity of each road. There are five classes: first, second, third, narrow gauge and levee district roads, the tax varying from $2 to $22.50 per mile. Ohio levies, in addition to the property tax, four per cent on the gross earnings from intra-state business only. Rhode Island levies, in addition to the tax on tangible property, a tax of one per cent on the proportionate part of the gross earnings within the state, as fixed by relative mileage. Texas levies a tax of one per cent on the gross receipts from passenger earnings. Virginia imposes a state franchise tax of one per cent on gross receipts within the state. Virginia also, like Alabama and a number of other states, levies a tax to defray the expenses of the railroad commissioner, apportioned to the railways according to gross receipts. Again, in some of the Southern states we find special licenses levied on railroads, as in Florida where a license tax of $10 per mile is imposed, the proceeds being divided between the state and the counties, with additional local flat licenses of from $10 to $250 according to population; or in South Carolina where a "license fee" of three mills is imposed on the "gross income" of railroads. Finally we find in a few commonwealths, like Delaware, Illinois, Maryland, New Jersey, North Carolina and Pennsylvania special taxes levied on special railways.

In considering the newer methods of railway taxation we should in reality add many states which, although included under the head of the ad valorem system, yet attempt to assess the value of the franchise. The term ad valorem system is in fact deplorably inexact. As commonly understood it means a system of ascertaining the value of the railway as a piece of property, so that it may be put on a par with other property. A valuation reached by adding together the real and the personal property of the railway is without doubt an ad valorem method. A valuation reached by taking into account also the value of the stock and bonds would likewise generally be considered an ad valorem method. Yet a tax like that of Connecticut where only the value of the stocks and bonds is admitted is called a specific and not an ad valorem tax. So again the tax on receipts is termed a specific tax; yet when an attempt is made to ascertain the value of the fran-

chise and to estimate it on the basis of gross receipts, it is sometimes included in the ad valorem system simply because the franchise is treated as property. The whole subject of franchise taxation will be discussed later; but it may be affirmed here that when the value of the franchise is reached by considering only or chiefly the earnings, as is the case in New Jersey, Michigan, Wisconsin and several other states, we are really departing from the ad valorem tax considered as a tax on property. For a tax upon property, as based upon or measured by earnings, is really a tax on, or according to, earnings. For instance, in New Jersey the assessors at one time endeavored to estimate the franchise by taking sometimes an arbitrary proportion (sixty per cent) of the surplus of the value of the capital stock and total indebtedness over the value of the tangible property, sometimes a percentage (twenty per cent) of the gross earnings.

In Michigan, as we shall see later, after the tangible property had been assessed, the so-called Cooley-Adams method sought to reach the value of the franchise by a laborious computation designed to ascertain the actual net earnings, which were then capitalized at various rates for the different railways. It is evident that a tax on franchise reached by capitalizing earnings is nothing but a tax on earnings. We are not here discussing which system is preferable. We desire simply to point out that a tax on the property value of the franchise, measured by earnings, is really an indirect tax on earnings; and that a so-called ad valorem tax based on earnings is therefore scarcely distinguishable in theory from a specific tax on earnings.

An important point in the treatment of railroads is the extent to which these new methods of state taxation have superseded local taxation. In North Carolina, the special railroad tax is declared to be in lieu of all other taxation, state or local. This is virtually, though not technically, true in Connecticut; for if the real estate not used for railroad purposes is taxable locally, the valuation on which the state tax is based is reduced by the amount of local taxes. It was also true of Washington, when it had a gross earnings tax, and until 1895 of Minnesota. In five cases—Delaware, Maine, Maryland, Massachusetts and New York—the local bodies may also tax railroad property, but in some cases with restrictions. In Maine, only the buildings of the railroad and the lands and fixtures outside the located right of way are taxable locally. Each city or town, however, in which any

stock of the railroad is held is entitled to an amount equal to one per cent of the value of such stock as determined by the state board. In Massachusetts, the railroads are taxable locally only on their real estate (except a belt of land adjoining the roadbed with the structures connected with it) and machinery. But as the value of this property is deducted from the total valuation for the commonwealth tax, Massachusetts belongs, strictly speaking, in the preceding category. In Mississippi, only cities and towns have the privilege of taxing railroad property in general, but all local divisions may tax that part which is not used for railroad purposes. In New York, under the general corporation tax law, the real estate of railroads is taxable for state purposes; and both realty and personalty are taxable for local purposes according to the primitive methods of the locally assessed property tax. Railways are also subject to the special franchise tax,[1] which, although assessed by a state board, accrues to the locality. Finally, in California, Minnesota, Pennsylvania and Vermont—the railroads are subject to a local tax only on that part of their property not used for railroad purposes. In California the operative property which is not subject to local taxation is expressly defined in the law of 1910.[2] In Pennsylvania, all property necessary to the successful operation of the railroad including stations, water tanks, etc., but not city offices, has been held to be a part of the franchise, and therefore not locally taxable. But in Pittsburgh all real estate, and in Philadelphia all real estate except the superstructure of the roads and the water stations, are locally taxable. Attention has also been called above to the New Jersey system whereby all operative real estate except the main stem, and all non-operative realty pay the full local rate. Summing up the

[1] Infra, p. 225.

[2] The operative property in the case of railroad companies includes: the franchises, roadway, roadbed, rails, rolling stock, rights of way, sidings, spur tracks, switches, signal systems, cranes and structures used in loading and unloading (cars, fences along the right of way, poles, wires, conduits, power lines, piers used exclusively in the operation of the railroad business, depot grounds and buildings, ferry boats, tugs and car-floats used exclusively in the operation of the railroad business; machine shops, repair shops, round houses, car barns, power houses, substations, and other buildings used in the operation of the railroad business, and so much of the land on which said shops, houses, barns, and other buildings are situated as may be required for the convenient use and occupation of said buildings.

American system of railroad taxation we see that there are five principal methods:

1. The primitive system of the general property tax, with local assessment. Although this has well-nigh disappeared for state taxation in general, at least as the exclusive system, it is still found for purposes of local taxation in many states, including New York.

2. The ad valorem system, including at least a valuation of the tangible property, but involving assessment by a state board. This is the system in a majority of the states.

3. The ad valorem system, including a valuation of the franchise based in whole or in part on one of the two following methods. This is becoming the rule in a large number of states.

4. The system of specific valuation through the stock-and-bond method or some modification of the same. This is found in only a few states.

5. The taxation of earnings—either gross earnings or net earnings or income. This is found in about a third of the states.

This survey will suffice for a picture of the existing chaos. The theory and criticism must be left to a subsequent section.

4. Other Public-Service Corporations

Next in order after the railroads to break away from the general property tax were the corporations which it has become the custom in recent years to call the public utilities or the public service corporations. Sometimes the term transportation and transmission companies is applied to them. In the broadest sense this term is defensible, as including all corporations engaged in the transportation of passengers and freight and in the transmission of light, heat, power, sound, or intelligence. In some states, however, transportation and transmission companies are considered only a part of the broader category of public-service corporations. For Instance in New York the "additional franchise tax" on transportation and transmission companies applies only to "railroad, canal, steamboat, ferry, express, navigation, pipe line, transfer, baggage express, telegraph, telephone, palace car or sleeping car" and "other transportation" companies, while a separate tax is imposed on the other public-service corporations which are specifically designated as "elevated railroads, surface railroads not operated by steam, corporations for supplying water or gas, or for electric or steam heating, lighting or power purposes." The latest definition of public-service corporations is contained in the Rhode Island law of 1912, which taxes "express, steamboat or ferryboat companies; steam and electric railroads; street railways; dining, sleep-

ing, chair or parlor car companies; telegraph, cable and telephone companies; companies for selling gas, water or electricity for light, heat or power purposes." A slightly different definition is that of the Nebraska law, which includes among the public-utility corporations "street railway corporations, street railways, water works, electric light and gas works, natural gas, mining and all other like corporations." Another definition of public-utility companies, apart from transportation companies is afforded by the Wisconsin law of 1911. They are defined as companies: (a) generating and furnishing gas for lighting or fuel or both; (b) supplying water for domestic or public use or for power or manufacturing purposes; (c) generating, transforming, transmitting or furnishing electric current for light, heat or power; (d) generating or furnishing steam or supplying hot water for heat, power or manufacturing purposes; (e) improving the navigation of public streams or other public waters; (f) conserving and regulating the height and flow of water in public reservoirs.

South Carolina also has a definition of public-service corporations which includes in addition to some of those mentioned above " navigation companies." In some of the other states, with less inclusive lists, other public-service corporations are occasionally mentioned, like oil pipe lines, bridge companies, toll road companies, messenger companies, press despatch companies, sewer companies, elevator companies, signal companies, dockage or cranage companies, heating and cooling companies, freight line and equipment companies, and terminal companies. All these corporations are deemed to differ from ordinary business corporations in the possession of some special privilege in the use of the land, or in the right of constructing pipes beneath the land or laying wires above the land.

In many of the states these corporations are still taxed according to the ineffective methods of the general property tax with local assessment. In several states they are now taxed according to the ad valorem system by a state board and not infrequently according to the so-called unit rule.[1] In not a few states, however, specific taxes are imposed on such companies. In a few states, like South Carolina, all these public-service corporations are subject to a special tax of the same kind and amount. In other states, like California, the method is the same but the rates differ. In most of the states, however, both rates and methods vary. On the whole, more progress has been made

[1] Cf. supra, p. 150.

here than in the case of the railroads which were the first of the public-service corporations to break away from the old system. We shall mention them in the order in which they have begun to assume importance from the fiscal point of view.

The taxation of telegraph companies has undergone an evolution similar to that of railroads, but in some respects more complicated. In a large number of commonwealths telegraph property is still included by the local assessors in the general tax list, and pays the regular rate of the property tax. In a smaller number of states, like Indiana, Illinois, Iowa, Kansas, Kentucky, New Hampshire, Tennessee and Wisconsin, the ad valorem system, administered by a state board, is employed, frequently according to the unit rule. In a few cases again, like Nebraska, where the value of the franchise is separately assessed, the calculation is made on the basis of gross receipts, so that the system ought really to be likened to that now to be mentioned. About one-half of the states, however, have broken away from the ad valorem or property system and have substituted one based on gross receipts or on mileage.

The gross receipts system is found in nineteen states, in two of which the tax is graded. The rate of the gross receipts tax is 3 mills in South Carolina, 5 mills in New York, 8 mills in Pennsylvania, one per cent in Arizona and New Mexico, two per cent in Maryland, New Jersey, Ohio, Oklahoma, Oregon, Rhode Island and Virginia; two and a half per cent in North Carolina; two and three-fourths per cent in Texas; three per cent in Louisiana, Michigan and Vermont; and three and one-half per cent in California. In Louisiana the tax applies only to foreign companies, domestic companies, if any, being taxable on their property. In Maine the rates are one and one-fourth per cent if gross receipts are between $1,000 and $5,000; one and one-half per cent between $5,000 and $10,000; one and three-fourths per cent between $10,000 and $20,000; two per cent between $20,000 and $40,000; with an increase of one-fourth of one per cent for each additional $20,000 of receipts until the rate reaches six per cent. The Maine tax is in lieu of all taxes on property except the local tax on real estate. Moreover, in Maine it is provided that the state should apportion to the respective localities a sum equivalent to one per cent on the value of the corporate stock held by resident owners. In the above list, eight states—Louisiana, Ohio, Oregon, New Jersey, New

York, North Carolina, South Carolina and Virginia—add to the gross receipts tax a tax on property; and two—New York and Pennsylvania—add the general corporation taxes on capital stock or on stock and bonds. In Vermont the tax on receipts is alternative—at the option of the corporation—with the tax on mileage, to be mentioned in the next paragraph.

As contrasted with the states that levy a gross receipts tax, nine states impose a tax proportioned to mileage. In five of these the tax is a fixed amount: in Connecticut 25 cents per mile; in Florida 50 cents; in Vermont 60 cents per mile of poles and one line of wire, and 40 cents per mile of each additional wire; in Virginia $2 per mile of poles and conduits and in West Virginia (for foreign companies) $1 per mile. In the other four states the tax is graded: in Alabama the tax is $1 per mile if the fine is not over 150 miles, and $500 plus $1 per mile if over 150 miles. In Delaware the tax is 60 cents per mile for the longest wire, 30 cents for the next longest, and 20 cents for any other. In Mississippi the tax is 25 cents per mile if the line is under 1,000 miles, but $250 if over that length. In Tennessee the tax is $20 for 20-100 miles of wire, $200 for 100-300 miles, $700 for 300-1,000 miles; $20 for each 100 miles over 1,000, for a mileage from 1,000 to 6,000; and $10 for each 100 miles over 6,000.

Of these eight states three—Alabama, Tennessee and West Virginia—also levy a tax on property; Delaware, as stated above, also levies a tax on gross receipts; while Virginia imposes all three taxes—a property tax, a gross receipts tax and a mileage tax. Vermont, as stated above, has an alternative system—a tax on gross receipts or on mileage.

In addition to the gross receipts and the mileage systems we find in a few cases other methods. Thus in Montana there is a tax of 75 cents for each instrument used. In a few of the Southern states we find a flat license, as in Florida where it is fixed at $500. Finally, in Massachusetts telegraph companies are included in the general corporation tax.

In a very few cases only has any state abandoned the gross receipts tax. In Minnesota a mileage tax was first imposed in 1867, but was replaced in 1887 by a gross receipts tax. In 1891, however, the ad valorem system was introduced. So Wisconsin replaced the gross receipts tax by the ad valorem system in 1905. In Ohio there was a

net receipts tax in 1862, changed to a gross receipts tax in 1865. In 1893 this was abandoned and the ad valorem system was introduced; but in 1902 this was supplemented by the excise tax on gross receipts. In Georgia there was formerly a gross receipts tax, imposed whenever the property tax did not amount to two and one-half per cent of gross receipts. This method was, however, declared unconstitutional. On the other hand, Alabama and Connecticut, which formerly imposed a gross receipts tax, substituted, as we know, a mileage tax. The general tendency on the whole has been toward the gross receipts tax.

Telephone companies have naturally been subjected to special taxation only much more recently. With the passage of time the tendency has been for the rate of the tax to increase. For instance, in Wisconsin the gross receipts tax was one per cent in 1883, one and one-half per cent in 1885, two and one-fourth per cent in 1891, two and one-fourth to three per cent in 1897 and two and one-half to four per cent in 1905. In Minnesota a two per cent gross receipts tax was imposed in 1887; in 1891 this was abandoned for an ad valorem, tax; but in 1897 the gross receipts tax was restored at a higher rate—three per cent. In Ohio telephone companies were, like telegraph companies, subjected to a net receipts tax in 1862 which underwent the same changes as those mentioned in the last paragraph, except that the supplemental gross receipts tax which was imposed at the rate of 1% in 1902 was increased to 1.2% in 1910.

At present, the tax on telephone companies is the same as that on telegraph companies in a few states; but in many commonwealths either the rate or the method is different. The gross receipts tax is found in twenty states. The rate of the tax is as follows: 3 mills in South Carolina; 5 mills in Louisiana, New York and Oklahoma; 8 mills in Pennsylvania; 1% in Arizona; 1.2% in Ohio; 1½% in Texas; 2% in Maryland, New Jersey, Oregon, and Rhode Island; 2½% in North Carolina; 3% in Michigan, Minnesota and Vermont; and 3½% in California. In three states the tax is graded: in Maine the grades and rates are the same as in the case of telegraph companies, explained above. In Virginia the rate is 1% when (a) gross receipts do not exceed $50,000 a year, and (b) when the pole-mileage is not above 400; otherwise (c) the rate is 1% on gross receipts to $50,000

and 2% on receipts in excess of that sum. In Wisconsin the so-called license fee is 2½% if gross earnings are under one million dollars and 4% if over that sum; and it is provided that 15% of the revenue should accrue to the localities. In North Carolina the rate of tax is reduced if a certain proportion of the assets of the corporation is invested in state or local bonds of North Carolina: if the proportion is one-quarter, the rate is reduced to 1½%, if one-half, the rate is 1%; and if three-quarters of the total assets are so invested, the rate is only ½ of 1%. This reduction does not apply to the similar tax on telegraph companies.

Of the above states, four—New Jersey, Ohio, Oregon and South Carolina—add to the receipts tax a tax on property; and Virginia adds a tax on property and a tax on mileage. Two states—New York and Pennsylvania—add the general corporation taxes on capital stock or on stock and bonds; while Vermont permits as an alternative tax the tax on mileage.

As contrasted with these twenty states, seven commonwealths impose a tax on mileage, several of them combining with the mileage tax other taxes. Alabama levies a privilege tax of 50 cents a mile if the length of the wires is less than 200 miles; but otherwise imposes in addition a flat rate of $250; and in each case also levies the property tax and local licenses from $5-25. Connecticut imposes a tax of 25 cents per mile, in addition to a tax of $1.10 per transmitter. Delaware levies a tax of 60 cents per mile of wire, for the longest wire, 30 cents per mile for that next in length, and 20 cents per mile for all others; together with a tax of 25 cents per transmitter. Mississippi levies a flat tax of from $2.50 to $250 on each telephone exchange, graded according to the number of subscribers and to the number of miles of poles. Virginia imposes a tax of $2 per mile, in addition to the property tax and to the receipts tax. Vermont levies a tax of 30 cents per mile upon the average mileage of all telephone wires owned or operated within the state, in addition to a tax of 40 cents per transmitter, and permits in lieu of this the gross receipts tax mentioned above. West Virginia levies a tax of $1 per mile in addition to the property tax. In a few states we find taxes apportioned to the instruments used. Thus Florida imposes a tax of 123/2 cents per transmitter; Montana a tax of 75 cents per transmitter; and Tennessee a tax of from 20 to 50 cents per transmitter, graded according to the

population in each case in addition to the property tax. Moreover, as intimated above, Connecticut and Delaware also employ this method in part.

In the case of express companies the states have as a rule departed from the property tax system to an even greater extent than in the preceding cases. Only a few states have reverted to the ad valorem system, and there frequently because of a constitutional defect in the particular method employed. For instance, Iowa started in 1868 with a tax on the personal property of express companies which was declared to be equal to 40% of their gross receipts. In 1870 Iowa reverted to the general property tax, but in 1896 again imposed a gross receipts tax at the rate of 1%, which was increased in 1898 to 2%. In 1900, however, this tax was overturned by the Supreme Court, and Iowa now adopted the ad valorem system with the unit rule. In Georgia also the alternative gross receipts tax, first levied in 1901, was abandoned in 1908 owing to a court decision. In Michigan the gross receipts tax was replaced by the ad valorem system in 1901 and in Wisconsin this occurred in 1899.

Ohio levied a net receipts tax in 1862, and changed in 1865 to a gross receipts tax. But in 1893 the ad valorem system was established, coupled, however, with a gross receipts tax at 2%, changed in 1902 to 1%, and again raised to 2% in 1910.

Many more states, however, have on the contrary during recent years abandoned the older methods for the gross receipts tax. No less than twenty-four states now tax express companies according to gross receipts. The rate is as follows: 3 mills in South Carolina; 5 mills in New York and Virginia; 8 mills in Pennsylvania; 1% in Arizona, Louisiana and Ohio; 1¼% in Missouri; 1½% in West Virginia; 2% in California, New Jersey and New Mexico; 2½% in Maryland and Texas; 3% in Maine, North Carolina, Oregon and Rhode Island; 4% in Kansas; 5% in Connecticut (except that companies transacting business on electric lines and street railways are taxed only 2%) Delaware, Washington, and Wyoming; and 6% in Minnesota. Where the high rates are levied, the gross receipts tax is sometimes in lieu of all taxes on property, as in the case of Connecticut and Minnesota. In Kansas, Rhode Island and Washington, however, the corporations are taxable also on their tangible property. In California they are

taxable only on their local real estate. In most of the other states they are subject also to the property tax, either for local purposes, or for both local and state purposes, as in Missouri, Ohio, South Carolina and West Virginia; or on the property excluding the franchise, the franchise being deemed to be taxed through the receipts tax. In New York and Pennsylvania express companies are also subject to the general corporation taxes. In Wyoming the tax is divided in equal proportions between the state and the several counties in which the company operates. In Louisiana the tax seems to apply only to domestic companies.[1]

As compared with the states employing the gross receipts tax only six states utilize the mileage tax for express companies. Alabama levies a tax of $1 per mile where the express lines do not exceed 500 miles, but thereupon imposes a flat tax arranged in classes, the maximum tax of $5,000 being paid when the mileage is over 4,000 miles. Mississippi levies a tax of $250 plus $4 a mile in the case of first class railroad track,[2] or $2 a mile in the case of second or third class railroad trackover which the business is operated. Tennessee imposes a tax of $1,000 on all companies with lines less than 100 miles long, but $2,500 where the length is over 100 miles. Virginia levies a tax of $6 per mile in addition to both the gross receipts and the property tax. West Virginia imposes a tax of $1.50 per mile in addition to the property tax. Vermont which from 1880 to 1904 imposed a gross earnings tax now levies a tax at the flat rate of $8 per mile, in lieu of all taxes on property. This arbitrary tax was due to the refusal of the companies to furnish adequate details of their business.

In addition to these receipts and mileage taxes we find sporadic instances of other methods. Thus North Dakota taxes express companies according to the size of the station, the tax being graded from $5 to $50. This is, however, really a fee, being called a license fee, and paid in addition to the ad valorem tax. Florida levies a flat tax of $7,500 per annum in lieu of all state and county licenses, but permits in addition city or town licenses, with rates from $6 to $200. In Massachusetts express companies are subject to an excise tax, like the

[1] See State vs. Pacific Express Co., 121 La. 151. But see State vs. Hammond Packing Co., 110 La. 180.

[2] For an explanation of these terms cf. supra, p. 178.

general corporation tax on corporate excess, except that the tax instead of being computed on the basis of capital stock alone, is computed on the basis of the shares, bonds, and unfunded debt, and with the further exception that only so much of that valuation is taken as the gross receipts within the state bear to the total gross receipts. Finally in Delaware express companies pay an annual license fee of $250 in addition to the gross receipts tax.

In some states, as in Maryland and West Virginia, the gross receipts tax applies only to foreign companies, the domestic companies being subject to the general property tax. As a matter of fact, however, almost all the express companies are foreign companies.

From the fact that the large express companies are generally unincorporated, the question has recently arisen whether they are liable to the corporation tax. In Vermont and Pennsylvania joint-stock companies are expressly included. In New Jersey the tax law applies only to corporations. In New York express companies have been declared liable to the state corporation tax because the statute expressly applies to joint-stock companies;[1] but under the provisions of the revised statutes imposing a tax on "all monied or stock corporations," which still governs local taxation in New York, it has been held that the unincorporated joint-stock express companies are not liable to local taxation.[2] There is, of course, no good economic reason for their exemption. The resident shareholders, however, are nominally taxable on their respective interests in the same way that members of a co-partnership are taxable.

Parlor and sleeping car companies have been separately taxed in a smaller number of states. In some states like Georgia the ad valorem unit rule system is employed, whereby the ordinary rate of the property tax is levied on that proportion of the entire value of all the cars of the company which the state mileage over which the cars are run bears to the entire mileage. In fifteen commonwealths we find the gross receipts tax, in many of them drawing room, dining, chair and buffet cars being expressly designated as included in the general category. The rates are as follows: 3 mills in South Carolina; 5 mills

---

[1] 117 N.Y. 136.
[2] 133 N. Y. 279.

in New York; 8 mills in Pennsylvania; 1% in Rhode Island; 1½% in Delaware and Florida; 2% in New Jersey; 2½% in Maryland; 3% in California, Oklahoma and Oregon; 4% in Minnesota; 4½% in Maine; 5% in Texas; and 7% in Washington. In several of these states an additional tax on property is levied, as in Rhode Island and South Carolina. In Minnesota the tax is alternative with a property tax. In Maryland an additional tax is levied on the capital stock of domestic companies only. In Texas an additional tax of ¼ of 1% on capital stock is levied on all such companies, but they are then exempt from all other taxes.

As contrasted with these taxes on receipts, several states, principally in the South, impose so-called license fees or privilege taxes in addition to the property tax. In Alabama the tax is $1,250; in Florida it is graded from $26 to $40 per car, with additional local licenses from $12.50 to $20, all of which are paid in addition to the gross receipts tax; in Mississippi the tax is from $1.50 to $2.50 per car; in North Dakota the tax is at the flat rate of $100; in Tennessee the tax is $3,000 in lieu of all other taxes except on property.

The mileage tax is found only in Virginia, which levies a tax of $2 per mile together with an annual registration fee. Finally there may be mentioned Ohio which imposes a tax of 1% on the excess of the value of the capital stock, as proportioned to Ohio, above the value of the real estate; and Vermont which imposes a tax of 7-10 of 1% on the proportion of the capital stock invested or used in the state.

In addition to the palace and sleeping car companies tax we find separate mention made of other car companies in eight states which impose a special tax. Arkansas imposes an excise or privilege tax of 5% on the gross receipts of all private car companies. California taxes refrigerator, oil, stock, fruit and other car-loaning companies at the rate of 3% on their gross receipts. Minnesota imposes a tax of 4% on the gross receipts of freight line companies, which are defined as companies engaged in operating box, flat, coal, ore, bank, stock, gondola, furniture, refrigerator or other cars over any railroad line. Mississippi taxes car equipment companies 3% on gross receipts in lieu of the property tax. Oklahoma taxes stock car, refrigerator car, and other private car companies, car trusts and car associations at the rate of 3% on gross receipts; Oregon taxes refrigerator cars 3%; Texas taxes stock, refrigerator, fruit and other car companies 3%.

Vermont imposes a tax of 2½% on the gross earnings of car, steamboat and transportation companies as an alternative to the tax of 1¼% on appraisal.[1] Washington levies a tax of 7% on the gross receipts of car companies in addition to a tax on their tangible property.

The next class of public-service corporations which are sometimes taxed in a special way, is composed of street railways. These are specifically mentioned in twelve states. In Connecticut they are taxed like railways by the stock and bond method. In Tennessee they are taxed on mileage, the privilege tax being graded from $3 to $10 per mile of track according to the population. In the other states the tax is levied on gross receipts. The rates are as follows: 3-20 of 1% in Maine, 3-10 of 1% in South Carolina; 1% in New York, North Dakota and Rhode Island; 1.2% in Ohio; 4% in California; and 5% in New Jersey. In New York, however, they pay in addition 3% upon the dividends in excess of 4%; but where the property of such a corporation is leased to another, the gross receipts tax is omitted. In Rhode Island street railways pay in addition to the 1% tax imposed in 1912, which is deemed to be in lieu of all taxes on the security holders, a so-called franchise tax imposed in 1909, which consists of a second tax of 1% on gross receipts, together with all net earnings over 8%. Moreover street railways in Rhode Island are also liable to the general property tax, and to any other taxes that are or may be imposed on all persons or corporations. At present this means an additional tax on tangible property. In two states the gross receipts tax is graded. In Massachusetts the rate of the so-called commutation tax on street and electric railroads is 1% when gross receipts are less than $4,000 per mile; 2% between $4,000 and $7,000; 2½% between $7,000 and $14,000; 2½% between $14,000 and $21,000; 2¾% between $21,000 and $28,000; and 3% if gross receipts are $28,000 per mile or over. This tax is supplemental to the general corporation tax and also to the so-called additional corporate franchise tax which takes for the state any excess of dividends over 8% on the capital stock in the case of corporations that have paid an average dividend of 6% since their formation. In Texas interurban roads connecting cities of 10,000 inhabitants or over pay from ½ or ¾ of 1% of gross

[1] As to this cf. supra, p. 172.

receipts, according as the population is under or over 20,000. In almost all the above cases the tax applies to interurban as well as city or town street railways. The street railway tax is generally reserved for state purposes, but in some cases it is handed over in part or whole to the localities. In New York, e. g., the tax is imposed on such proportion of gross receipts as the mileage on the highways bears to the total mileage, and is distributed in the local districts in proportion to the value of taxable property of the street railways therein. In Wisconsin the gross receipts tax on street railways was replaced by the ad valorem system in 1905.

Another class of public-service corporations is composed of *gas or electric light,* heat or power companies. We find them specifically mentioned in twelve states. The usual tax again is on gross receipts. The rates are as follows: 3 mills in South Carolina (light and power companies); ¼ to ½ of 1% in Texas (gas, electric light, power and water companies); ½ of 1% in Maryland, New Jersey (unless subject to the special franchise tax of 2%) and Virginia; 1% in North Dakota and Rhode Island (gas, electric and power companies); 1.2% in Ohio (gas, electric and natural gas companies); and 4% in California (transmission or sale of gas or electricity). In Delaware the tax is 2-5 of 1% of gross earnings plus 4% on dividends over 4%. In New Jersey the tax (except when the companies are subject to the special franchise tax of 2%) is ½ of 1% of gross receipts together with 5% on dividends over 4%. In New York the tax, which applies to gas, electric or steam heating, lighting and power companies and water works companies, amounts to ½ of 1% on gross earnings together with a tax of 3% on dividends in excess of 4%. Such companies are then exempt from the general corporation tax. In Pennsylvania, on the other hand, similar companies are subject to the general corporation tax. Finally in some of the Southern states gas and electric companies are subject to privilege or license taxes. In Florida this is graded from $10 to $250, with 50% additional for the use of meters. In Mississippi it is graded from $30 to $300, and in Tennessee from $50 to $700 according to population. In Alabama gas and electric light and power and water works companies are subject to local licenses of from $5 to $100 per city or town according to population.

There still remain a few classes of public-service corporations in which we find an occasional example of specific taxation. Among them may be mentioned the following:

Water companies are taxed separately in Florida (state licenses of from $50 to $150 and local licenses of from $25 to $50 according to population); Ohio (1.2% on gross receipts); North Dakota (1% on gross receipts); New York (½ of 1% on gross receipts together with 3% on dividends over 4%); Rhode Island (1% on gross receipts in addition to the property tax); South Carolina (3 mills on capital stock in addition to the property tax); Tennessee (license tax) and Virginia (½ of 1% on gross receipts in addition to other taxes).

Oil pipe lines, or as they are sometimes called simply pipe lines, are taxed separately in Delaware (1-50 of 1% on gross earnings); Maryland (2% on gross receipts); New Jersey (8-10 of 1% on gross receipts); New York (½ of 1% on gross receipts together with 3% on dividends over 4%); North Dakota (1% on gross receipts); Ohio (4% on gross receipts); and Texas (2% on gross receipts).

Navigation companies are taxed in Florida (3 cents per net ton of registered tonnage); Michigan (river improvement companies, 1% on paid up capital); New York ½ of 1% on gross receipts and 3% on dividends over 4%) ; South Carolina (3 mills on the dollar of capital stock).

Steamboat or navigation companies are occasionally taxed separately, as in Indiana (3½ cents per net ton of registered tonnage); New York (½ of 1% on gross receipts in addition to the general corporation tax); Rhode Island (1% on gross receipts in addition to the property tax); and Virginia (½ of 1% on gross receipts in addition to the property tax.

Terminal companies or union depot companies are taxed separately in North Dakota (1% of gross receipts); Ohio (1.2% of gross receipts); Tennessee (license tax) and Texas (1% of gross receipts).

Heating and cooling companies are taxed in North Dakota (1% of gross receipts); New York (½ of 1% of gross earnings); and Ohio (1.2% of gross earnings).

Messenger or messenger and signal companies are taxed separately in New Jersey (2% of gross receipts); Ohio (1.2% of gross receipts); and North Dakota (1% of gross receipts).

Road companies are specifically mentioned in Michigan and taxed 2½% on gross earnings.

Grain elevators are taxed in North Dakota through an annual license of from $8 to $25.

Foreign bridge companies are taxed in Indiana on earnings, but the earnings are treated as personal property and put into the regular tax list.

Toll bridges and ferries, canal ditches, tram-roads and pole-roads used for transporting timber or other valuable articles of commerce are taxed in Alabama on their gross receipts at the general property tax rate.

Outside of the public-service corporations mentioned above we also find a special tax on building and loan associations in Alabama (1 per mill on the capital stock up to $100,000 and ½ of 1 per mill on sums above that figure); Kentucky (2% on gross receipts of foreign companies); Maine "capital dues" of ½ of 1%); and Vermont (building investment companies, 1% on sums loaned).

This completes the list of the special taxes levied on particular classes of corporations. We thus come to the third movement, away from the property tax which, as noted above, has been the introduction of a tax applicable to all corporations in general. In other words we have now to deal with

5. The General Corporation Tax

Here again Pennsylvania took the lead, for in that state the tax is far older than might be imagined from its recent introduction into other commonwealths. We have already seen that in 1824 Pennsylvania imposed a tax on the net dividends of banks. In 1836 the tax was extended to iron companies, at the rate of eight per cent on all dividends exceeding six per cent. In this provision can be found the germ of the later laws. The first, general corporation tax, imposed in 1840, provided that "banks and all corporations whatever" which declared a dividend of one per cent should pay "in addition to all present taxes" one-half mill for each dollar of the dividend or profit, and an additional one-half mill for every additional one per cent of dividend. In 1844, however, an act was passed which sketched in broad outline the path of future development. According to this law all domestic corporations which made or declared a dividend or profit of at least

six per cent paid' a tax on capital stock of one-half mill for each one per cent of dividend; but if the dividend was less than six per cent, the tax was three mills on the dollar. This law continued until the act of 1859 provided that the three mills tax should be paid only if no dividend was declared; but that in case of any dividend (not, as before, a six per cent dividend) the tax should be one-half mill on the capital stock for each one per cent of dividend. In 1864 it was provided that corporations not paying to the state a tax upon dividends should pay three per cent on net earnings. The consolidated act of 1868 excepted from the general corporation tax only banks, savings institutions and foreign insurance companies (all of which were separately taxed), but imposed a tax of three per cent on the net earnings or income of all corporations, except those liable to the tonnage tax, i.e. the transportation companies.

The important feature of this law, however, was that the capital stock tax was now made applicable to all companies incorporated or doing business in the state, i.e. to foreign as well as to domestic corporations. Only from 1868, therefore, was the Pennsylvania tax a general corporation tax. The general law of 1874 made no change except in respect to transportation companies as mentioned above, and with the further exception that coal companies were to pay a franchise tax of three cents per ton transported. In 1879 the line of division in the tax was again drawn at dividends of six per cent—that is, the principle of the law of 1859 was abandoned and that of 1844 reinstated. Limited partnerships, except those organized for manufacturing or mercantile purposes, were put on the same footing as corporations; and the tonnage tax on coal companies was limited to 1881, after which it was to cease. Manufacturing corporations with certain exceptions were exempted from taxation for state purposes, and a loan tax of four per cent was imposed, applicable also to the bonds of corporations. In 1885 the latter was reduced to three per cent. In 1889 the rate of the capital stock tax was fixed at one-half mill for each one per cent of dividend, if dividends amounted to six per cent, and at three mills when dividends were less than six per cent. Finally, in 1891 this plan was abandoned and the amendments adopted which, as still further altered in, 1893, are now in force.

Under the law as it now stands in Pennsylvania, the "tax on corporation stock" applies to all corporations, joint-stock associations and

limited partnerships doing business in the state or having any portion of their capital invested therein, except banks and savings institutions, foreign insurance companies, building and loan associations and manufacturing companies to the extent of the capital stock invested in, and actually and exclusively employed in carrying on manufacturing within, the state. Corporations engaged in the brewing or distilling of malt or spirituous liquors, and such as enjoy and exercise the right of eminent domain, are not included in this exception. Bourse companies are exempt as to a certain proportion of their capital stock. Banks and insurance companies, however, are, as we know, taxed separately, while building and loan associations pay on their matured stock a tax equal to the state tax on moneys at interest, and distilling companies pay a separate tax on capital stock at the rate of one per cent. The rate of the general capital stock tax is now uniform—namely, five mills on each dollar of the actual value of the whole capital stock of all kinds. This value, ascertained by appraisement, must not be less than the average price for which the stock has been sold during the year, nor less than the value indicated by the net earnings or by the profit in dividends or by what has been carried to the surplus or sinking fund. If any profit has been added to the sinking fund, it is treated as if it had been devoted to dividends, unless it is set apart expressly for the payment of debts. In the case of fire and marine insurance companies the rate is three mills on each dollar of capital stock.

In addition to this tax on corporation stock, there is a tax of three per cent on the net earnings of unincorporated banks and all corporations except those liable to the previous tax or to the tax on gross receipts. The only corporations which would be liable under this provision are banks and manufacturing corporations; but the latter, with the exceptions just noted as liable to the tax on corporation stock, are now expressly exempt from all taxation; and the former, by electing to pay ten mills on the par value of their capital stock, secure exemption from all other taxation except on their real estate. Thus the net earnings tax does not apply to corporations at all. It is levied chiefly on unincorporated savings banks and on trust companies without capital stock. If the banks do not elect this ten mills tax, the market value of the stock is assessed to the stockholders and taxed four mills, and the banks are further subject to local taxation. It

has already been noted above in the proper connection that transportation, transmission, electric light and insurance companies pay a tax on gross receipts or premiums in addition to the general corporation tax.

In addition to the tax on capital stock, Pennsylvania imposes a "tax on loans," which exacts four mills on the dollar of all interest paid on any scrip, bond or certificate of indebtedness issued by any private corporation, and on all public loans (except those of Pennsylvania and of the United States). The tax was first imposed in 1864 in the shape of a tax on the loans themselves. In 1868 this was altered, so far as corporate loans are concerned, to a tax of 5% on the interest paid. In 1873 the law was modified and in 1874 the tax was abolished. In 1879, however, it was restored in the shape of a tax on the corporation. But this law, like its successor of 1881, was declared unconstitutional; and it was not until 1885 that the tax was re-established at the rate of three mills on the dollar, changed in 1891 to four mills, at which it now stands. This tax must not be confused with the tax on loans or mortgages in the hands of corporations, which is a part of the general state tax on personal property. For it has been held that corporations and associations liable to the capital stock tax shall not be required to pay any further tax on mortgages, bonds or other securities belonging to them, and which constitute any part of their assets included within the appraised value of their capital stock. But if they hold these bonds in a fiduciary capacity, they are liable. On the other hand, the tax on the loans made by corporations, i.e. on corporate obligations, has been upheld as a proper exercise of the legislative authority and as not in conflict with any provision of the federal constitution. It is deemed to be in effect a tax on the bondholder, not on the corporation, although the corporation is required to advance the tax and to deduct it from the interest. The treasurers of corporations, therefore, pay the tax on all their bonds or obligations unless affirmative proof is offered that the owners reside out of the state, and then deduct the tax from the interest due. The tax is, however, not payable on bonds owned by non-residents. If the bonds are sold "free of tax," that is, without recourse to the bondholder, the right of the state to collect from the corporation is no wise affected.

Certain classes of loans have been declared non-taxable, either by special enactment or by judicial construction. These are as follows:

(1) Obligations held in their own right by corporations paying the capital stock tax; for such obligations enter into the value of the capital stock which is taxed; (2) obligations held, or notes discounted or negotiated, by trust companies, national, state and savings banks; (3) obligations held by non-residents in their own right, and by persons whose residence is unknown; (4) obligations held by institutions organized for purely charitable or religious purposes; (5) obligations of their members held and owned by building and loan associations; (G) obligations on which no interest has been paid or earned during the tax year, from which the tax could have been deducted.

This general corporation tax, it is important to note, is in lieu of all local taxation on personalty. In Pennsylvania, therefore, corporations subject to the capital stock tax are, with, some exceptions noted below, locally taxable only on real estate; while public-service corporations, which are subject to the gross earnings tax, are not taxable locally even on their real estate.

The law of 1885 exempted manufacturing corporations (with certain exceptions) from all taxation for state purposes; but it was held that only that part of the capital of a manufacturing company which was invested in the plant actually necessary for the manufacture of its products could be exempted, and that the capital of such companies invested in mines for the production of coal to be used in the process of manufacturing, or any other capital similarly invested, was taxable. The laws of 1889 and 1891, however, provide for the exemption of those companies only which are organized exclusively' for manufacturing purposes, and the law of 1893 specifically limits the exemption to that part of the stock which is exclusively employed in carrying on manufacturing within the state. If the capital is invested in property which it is merely convenient to use in connection with manufacturing operations, it is not exempt.[1] Manufacturing companies are held to be limited to those that produce material substances. Laundry companies and steam heat companies, e.g. are not considered manufacturing companies. In the case, however, of the

[1] For a discussion of these points see Eastman, *The Law of Taxation in Pennsylvania*, 1909, p. 671 et seq.

tax on loans, since, as we have just seen, it is held to be not upon the corporation but upon the moneys of the bondholder, manufacturing corporations are liable equally with others.

In New York the general corporation tax came later; for not until 1880 was a law passed which was based on the Pennsylvania act. This act levied a tax on the par value of the capital stock as fixed by the state board, making the rate 1½ mills on the dollar if the dividends were less than six per cent or if there were no dividends at all, and ¼ mill for each 1% of dividends if the dividends were 6% or more. The law has been repeatedly amended in important details, especially by the laws of 1885, 1889, 1890, 1896, 1901, 1906 and 1910; but the main outcomes remained unaltered. Among the more important recent changes are the following: In 1896 only that part of the capital employed within the state was declared taxable, although the practice had been to that effect for some time. In 1901 manufacturing companies, which had hitherto been exempt only when their capital had been exclusively and wholly engaged in manufacturing within the state were declared exempt if 40% of their capital was so invested. In 1906 several alterations were made. The rates were now further differentiated according to the amount of business and the character of the enterprise, so that they were fixed at ¼, ¾ or 1½ per mill, respectively, as will be explained below. The other important change affected foreign corporations which invest their capital in the stock of another corporation doing business in the state. These foreign companies had not been considered engaged in business in the state. In 1906 they were made taxable by the provision that the capital of a corporation invested in the stock of another corporation should be deemed to be assets located where the property represented by the stock is located. This of course also changed the reverse rule according to which a domestic corporation whose capital was invested in the stock of a foreign corporation had been taxable, but was now exempt.

At present, the tax, known as the franchise tax or the capital stock tax, applies to all corporations except the following: banks, trust companies and savings institutions; insurance, title guaranty and surety companies; elevated railroads and surface railroads not operated by steam; water, light, heat and power companies; agricultural and horticultural associations; and manufacturing, mining and laun-

dering companies, to the extent only of the capital actually employed in manufacturing, mining or laundering, provided that at least 40% of the capital is invested in the state and used by them in manufacturing, mining or laundering. All of these exempt corporations, however, except the two last categories (agricultural and manufacturing) are reached by separate specific taxes, as we have learned above.

The tax is assessed according to the capital stock. Originally the rate was just one-half of that of the original Pennsylvania prototype. At present, however, the rate of tax is determined according to very complicated rules. In reality there are in New York no less than six different classes, although the rather confused law does not clearly differentiate them. They are as follows:

1. Corporations paying dividends of six per cent or more are subject to a tax of ¼ of a mill for each 1% of dividends, the tax to be computed on the par value of the capital stock. This it will be observed is equivalent to an income tax of 2½%

2. If the corporation pays no dividends, the rate is ¾ of a mill, the tax being computed on the appraised value of the issued capital stock employed within the state.[1] The measure of the amount of capital stock employed within the state is declared to be such a portion of the issued capital stock as the gross assets employed in any business within the state bear to the gross assets wherever employed in business. For purposes of taxation the capital of a corporation invested in the stock of another corporation is deemed to be assets located where the physical property represented by such stock is located.

3. Corporations paying less than 6% dividends, whose liabilities equal or exceed their assets (i.e. which are insolvent), or the average selling price of whose stock has been below par during the year, are subject to a tax of ¾ of a mill, computed on the appraised value of the stock employed within the state.

4. Corporations paying less than 6% dividends whose assets exceed their liabilities by an amount equal to, or greater than, their capital stock, or the market price of whose stock equals or exceeds par, pay 1½ mills on the capital stock employed within the state; and it is further provided that in this case the value of the capital stock shall not be less than par, or less than the difference between the

[1] See 198 N. Y., 246.

assets and the liabilities, or (if the stock was sold) not less than the average market price at which the stock was sold. Whichever of such valuations is the highest is to be taken as the value of the stock, on which the tax is computed.

5. All other corporations, that is, corporations paying dividends of less than 6% and whose assets exceed their liabilities, but not by an amount equal to, or greater than, the capital stock, and whose stock has no market price, pay a tax of not less than 1½ mills on the actual value of the capital stock employed within the state, or 1½ mills on the average market price of the capital stock.

6. Corporations having two or more kinds of capital stock upon which the rates of dividends vary pay a tax on each kind of stock according to the respective class in which they fall, as explained in the preceding five categories.

The provisions of the law are so complicated that they have led to much litigation, which has gradually settled the principles involved. It has been decided, e.g. that when the law requires intrinsic or actual value of the stock to be ascertained, book value cannot be taken,[1] but that the liabilities must be deducted from the assets.[2] Moreover, if the good will of the business has any value, that is to be added to the net assets.[3] Corporations subject to the capital stock tax are exempted from all state taxation on their personal property; but they are liable to local taxation on their whole property, both real and personal, according to the primitive methods. The additional taxes on other corporations have already been described under the appropriate heading.

In Massachusetts, the general corporation tax dates from 1864. In 1863 indeed, a law was enacted which taxed dividends paid by corporations to non-resident stockholders; but this was pronounced unconstitutional, and was replaced by the law of the following year. This was an extension to corporations in general of the law of 1832, which as we remember[4] was applied to manufacturing corporations

---

[1] People ex rel. National Enameling Co. vs. Miller, 1 12 App. Div. 880.

[2] People ex rel. Lorena Co. vs. Morgan, 55 App. Div. 265 (1900).

[3] People ex rel. Wiebusch & Hilger Co. vs. Roberts, 154 N. Y. 101. For a more detailed account see H. M. Powell, *Manual of Corporate Taxation in New York for State Purposes*, 1907.

[4] Supra, p. 147.

only. The tax was levied on all corporations except banks and mining companies Banks were separately taxed as has been explained above. Domestic mining companies were also separately taxed by a law of 1864 at 7-12 of 1% on the value of the capital stock; and in the following year foreign companies were taxed at the rate of 1-20 of 1% (reduced in 1883 to 1-40 of 1%). In 1879 corporations engaged in building railroads and telegraphs in foreign countries were also excepted, but were then taxed by a special law at the rate of 1-20 of 1% on the par value of the capital stock, together with 4% on dividends. The general law applied only to domestic companies, and this has continued to be the case with a few exceptions. In 1865 foreign telegraph companies were included; in 1885, foreign telephone companies; in 1898 foreign street railways; and in 1906 foreign railroads.

The act of 1864 laid down the general principle which is still followed to-day. The basis of the tax was the market value of the capital stock after deducting the value of the real estate and machinery, if any, which were locally taxable. The tax commissioner, on the basis of returns made by the corporations, was to estimate the fair cash value of the shares constituting the capital stock. This was to be regarded as the true value of the corporate franchise. The excess of this value over that of the corporate property locally taxed was termed the corporate excess, and on this excess the tax was assessed. In 1864 the rate was 1.6%—the average rate of the general property tax at that time. In 1865 the rate was made to fluctuate with the average rate on property in general from year to year. The tax was paid to the state treasurer, and was by him distributed to the localities in accordance with the residence of the shareholders, to be offset against the sums due to the state from the localities for the property tax and the bank tax. The state, however, retained the amount of the tax corresponding to the value of the shares held by non-residents.

This remained the system without any changes of importance for over three decades, with the single exception that in 1865 a law was passed providing that thereafter in the case of railroads, telegraph and telephone companies only that proportion of the capital stock should be taken that corresponded to the Massachusetts proportion of the total mileage. During the last decade of the nineteenth century, however, several criticisms began to be heard. The growing importance of the street and electric railways brought about a demand for a

heavier tax on them, and at the same time for an increased revenue to the localities. Both of these objects were accomplished in 1898. The distribution of the corporate excess to the localities was changed from the basis of the residence of the stockholder to that of the location of the line. This meant of course that the whole of the tax went back to the localities. Furthermore an additional franchise tax was imposed on street railways, amounting to the entire excess of dividends over 8%, provided the corporation had paid an average dividend of 6% since its formation. In 1906 electric roads, constructed partly on private property, partly on public highways, were made taxable like street railways, with the exception that only so much of the proceeds as correspond to the length of track on public highways was to be distributed to the localities, the remainder being distributed like the ordinary tax on corporate excess.

A few years later there developed considerable dissatisfaction with the taxation of domestic business corporations, as distinguished from the public-service and the financial corporations. Domestic business corporations were taxed more severely than their foreign competitors, that is, foreign corporations doing business in the state, as well as similar corporations in the neighboring states. As to the latter we have learned that in Ne\v York and Pennsylvania manufacturing corporations are in large measure exempt; and in the other New England states there was no effective tax at all on such corporations. As to foreign corporations doing business in Massachusetts, these were liable only for their tangible property, taxed locally. The shares were indeed taxable to the shareholder if discovered; but this was an eventuality that almost never happened. This discrimination against domestic companies was removed by the law of 1903. Henceforth there were to be deducted from the value of the stock of ordinary business corporations: (1) the value of the real estate and machinery, whether located in or out of the state; (2) all other tangible property located out of the state and liable to taxation, whether taxed or not; and (3) securities which are exempt in the hands of a citizen of Massachusetts {i.e. stocks of state corporations and of other corporations taxed in the state on their franchises, mortgages or bonds exempt from taxation). Moreover, a limit—both maximum and minimum—was now set to the amount of the tax. The minimum tax payable is one corresponding to a rate of 1-10 of 1% of the market value of the

stock. The maximum limit is reached as follows: an amount is taken equal to 120% of the tax commissioner's valuation of the real estate, machinery, tangible property and securities taxable to residents of Massachusetts. From this is deducted the value of all property taxed in the state or liable to taxation outside of the state. On the remainder the tax is assessed.

A second change made by another law of the same year was the imposition on foreign corporations of a slight excise tax, at the rate of 1-100 of 1% of the par value of the capital stock, with a deduction for taxes locally paid, and with a maximum limit of $2,000.

During all these years the rate of the corporate-excess tax had been reached by dividing the taxes on property, exclusive of polls, levied in that year into the total valuation of property in the state for the preceding year. In 1906 the rule was now changed for all corporations except street and electric railways, so that in future the rate was made the average of the annual rates thus determined for the three years preceding the assessment. In 1909 this new rule was made uniform on all corporations, without exception.

During the first decade of the new century another difficulty presented itself. The distribution of the proceeds had led to much dissatisfaction on the part of places where the business enterprises were located; for the revenues went not to these localities, but to the places where the stockholders happened to reside. As the result of a long agitation the law was changed in 1910 so that in the case of ordinary business corporations, while the state still retained that part of the tax paid on account of the shares owned by non-residents, the remainder is distributed to the city or town where the business is carried on; and if the business is carried on in more than one city or town, then in proportion to the value of the tangible property of the corporation in each city or town. If, however, the business is not carried on in the state and if the corporation does not own any tangible property in the state other than ordinary office furniture, the tax is retained by the state.

The Massachusetts system of taxing the corporate excess at present may therefore may be summed up as follows. Corporations are divided into four classes: ordinary commercial and manufacturing companies; street railroads; other public-service corporations; and financial corporations.

(1) Ordinary business companies may deduct from the appraised value of the capital stock: (a) the value of the real estate and machinery locally taxed within the state; (b) the value of the property situated and taxable in another state or country; (c) the value of securities which if owned by a natural person resident in Massachusetts would not be taxable. The tax commissioner in practice takes the value of real estate, machinery, merchandise and taxable securities, adds 20%, and then deducts the three classes of property mentioned above. The tax is distributed to the localities in accordance with the ratio of the tangible property in the town or towns where the business is carried on, except that the state retains that part of the tax paid on account of shares owned by non-residents.

(2) Street railways may deduct from the value of the capital stock: (a) the value of the real estate and machinery taxable locally, and (b) the value of so much of the capital stock as is proportional to the line outside of the state. The proceeds are then distributed to the localities in accordance with relative trackage, the state retaining practically nothing. In the case of electric roads only so much as corresponds to trackage on public highways is so distributed.

(3) Other public-service corporations in general, are allowed the same deductions as street railways, but the proceeds are distributed according to the residence of the stockholders. In the case of domestic telephone companies, however, instead of deducting so much of the stock as is proportional to mileage outside of the state, the law prescribes a deduction of so much of the stock as is owned by the companies in other corporations, when the tax is paid. In the case of foreign telephone companies, in lieu of this there is deducted so much of the capital stock as is proportionate to the number of telephones used or controlled outside of the state.

(4) Financial corporations subject to the law include only trust companies and stock insurance companies. For banks, savings banks and mutual insurance companies are, as we know, taxable under different laws. Financial corporations pay the excise tax on all personal property held in trust. But as they are permitted to deduct the value of real estate and as mortgages are in Massachusetts considered an interest in real estate,[1] they may deduct all their loans on real es-

[1] Cf. supra, p. 104.

tate and thus virtually escape taxation on this account. They are, however, further taxable on their deposits (except demand deposits) at a rate equal to three-quarters of the rate on the corporate excess. This means virtually a rate of about 1% on deposits,—double that on savings banks.

The Massachusetts system is therefore a complicated, but effective one.[1] The chief criticism to be urged—namely, the failure to take account of corporate bonds in estimating the value of the capital—is somewhat attenuated by the fact that in Massachusetts, to a far greater extent than anywhere else, railroads as well as other corporations have been created on the proceeds of share capital alone. The other criticism, however, that the tax applies only to domestic companies cannot be so easily met.

The corporate-excess method of taxation has recently been extended to California, but with improvements. In California the law of 1910, which as we know[2] was designed to bring about a separation of state and local revenues, divided corporations into two classes—public-service and other corporations. All public-service corporations (except water companies) are taxed on the basis of gross receipts, according to the rates mentioned in the preceding section, and the taxes are expressly declared to be taxes upon the property and the

---

[1] Among the more important literature of the subject we may mention: James R. Garrett, "Taxation of Franchises in Massachusetts," in *Municipal Affairs*, vol. iv., p. 506; F. A. Wood, "The Massachusetts Franchise Tax and Local Distribution," ibid., p. 124; J. P. Procter, *Additional Burdens upon Street Railway Companies*, Boston, 1891; Whitney and Cummings, *Additional Burdens upon Street Railway Companies*, Boston, 1891; E. W. Burdett, *Argument for the Massachusetts Street Railway Association*, Boston, 1893; S. J. Elder, *Special Taxation for the Use of the Streets*, Boston, 1897; F. A. North, *Business Corporations in Massachusetts*, Boston, 1903; H. Winn, *The Corporation Exemptions of 1903*, Boston, 1905; A. E. Pillsbury, *Argument for the Association of Massachusetts Gas Companies*, Boston, 1903; J. M. Hallowell, *The Corporation Franchise Tax*, Boston, 1904; G. Galkins, "The Massachusetts Business Corporation Law," in Ripley's *Trusts, Fools and Corporations*, 1907; J. M. Hallowell, *The Taxation of Domestic Manufacturing Corporations in Massachusetts*, 1908; C. A. Andrews, "Taxation of Corporate Franchises in Massachusetts," in the *Yale Review*, Feb., 1911, p. 353 et seq. Cf. the book by Friedman and the article by Bullock mentioned supra on pp. 142 and 143. Much material will also be found in the numerous official reports on taxation and on corporation law, which are mentioned infra, at the close of chap. xxi.

[2] Cf. infra, chap. xi.

franchise. All other corporations, including mercantile, manufacturing and mining companies (except insurance companies and banks which are separately taxed) pay a state tax on the so-called franchise. This is however virtually a tax on the corporate excess. For the value of the franchise is held to be the aggregate value of the stock and bonds less the value of the tangible property locally taxable. On this franchise, so determined a rate of 1% is imposed.

In this new system several points are to be noticed. In the first place, the definition of the franchise includes all the three varieties of franchises, which we shall discuss later.[1] In the second place, a peculiar provision is inserted into the law, requiring in the case of ordinary corporations the deduction of the value of the good will in estimating the value of the franchise. Thirdly, bonds as well as stock are considered in ascertaining the value of the franchise. Fourthly, in the case of public-service corporations the tax on gross receipts is in lieu of all other taxes except the local tax on real estate, the state corporation license tax and such municipal charges as may be imposed for any special privilege or franchise. Fifthly, in the case of other corporations in general the only difference theoretically is that the franchise is determined and taxed by the state instead of by the locality, the remainder of the property still being subject to local taxation. Practically, however, it means that the tax is now really assessed, whereas formerly it was apt to be left in abeyance. It may also be mentioned that, evidently by some oversight, in addition to the franchise tax there is still left in California the old annual license tax of $20 on all corporations.

In New Jersey, the tax on "miscellaneous corporations" dates from 1884, and is described as a "license for the corporate franchise." As amended in 1892, it applies to all corporations except railroads and canals (both of which are taxed separately), banks, cemeteries, religious, charitable or educational associations, and manufacturing or mining companies at least fifty per cent of whose outstanding capital is invested in business in the state. If the latter have less than fifty per cent of their capital so invested, they pay the tax on capital stock mentioned below, but may deduct the assessed value of the property so used in manufacture or mining. Telegraph, telephone, cable, ex-

[1] Cf. infra, chap, vii, sec. i.

press, parlor car, gas, electric light, insurance, oil and pipeline companies, as we have seen above, are taxed under this law in a special manner, i.e. on receipts, premiums and dividends. All other companies included under the head "miscellaneous corporations," pay a yearly "license fee" or "franchise tax" of one-tenth of one per cent on the capital stock issued and outstanding up to three million dollars; one-twentieth of one per cent on the capital between three and five millions; and fifty dollars additional for each one million dollars capital in excess of five millions. This tax applies, except in the case of insurance companies, only to domestic corporations. But it is to be borne in mind that railroad companies are not included in this tax on miscellaneous corporations.

In Rhode Island corporations were not separately taxed until 1912. The new law also makes a distinction between public-service and other corporations. Public-service corporations are taxed on gross receipts, as explained in the previous section; but the system differs from that of California in that the rate is low and in that not only real estate but also the tangible personalty continues to be liable for taxation to the general property tax. The gross earnings tax therefore simply takes the place of the tax on intangible personalty. Other corporations—i.e. manufacturing, mercantile and miscellaneous corporations, wherever incorporated—pay a tax at the low rate of 40 cents on the dollar on the corporate excess, which is determined as follows: The value of all bonds and of all other indebtedness is added to the value of the stock. In the case of corporations doing a business outside of the state, only a portion of the value of the stock is taken: where they derive their profit chiefly from the sale or use of real estate or tangible personalty, the proportion taken is the ratio of the value of such property in the state to the value of all such property in and out of the state; if, on the other hand, the profits are derived chiefly from the holding or sale of intangible property, the criterion is the relative proportion of gross receipts in the state to total gross receipts. In any other case in which, as the law reads, "these proportions are not equitably applicable" the officials are to take "such proportion as is equitable." From the total value of stock and debts thus ascertained is deducted the assessed value of the realty and tangible personalty located in the state. The remainder is pronounced to be the value of the corporate excess.

To these six states with general corporation taxes—Pennsylvania, New York, Massachusetts, California, New Jersey and Rhode Island—there may be added Ohio and Maryland, although from another point of view these commonwealths might be included with those mentioned below.[1] In Maryland, the "tax on incorporated institutions" dates in a certain sense from 1841, when all domestic corporations which declared dividends were required to return the stock owned by non-residents, and to pay the state general property tax thereon to the collector of the place where the corporation or its chief office was situated. In 1842 this obligation was extended to stock owned by residents; and in 1847 the corporations were required to pay the tax, whether or not they had earned dividends. The county tax was, moreover, still collected from the shareholder. Early in the seventies the system was slightly changed; in 1878 the present method was introduced, and the office of tax commissioner created. The tax is levied on the capital stock, or, if there be none, on the property and assets of all corporations incorporated or doing business in the state, and of all joint-stock companies doing business in the state, except steam railroads and savings institutions, both of which are taxed separately. Deductions are made from this valuation for the assessed value of real property (separately taxed), for the capital invested in property which already pays taxes, for the nontaxable securities held and, in the case of building associations, for mortgages on taxable property. The corporations pay at the rate of the general property tax, on only so much of the stock as is owned by residents of the state. They were also required to pay, under a law dating from 1847, the general property tax on all interest-bearing bonds, certificates, or evidences of debt, owned by residents, deducting the amount from the interest due the bondholders. This method of taxing bonds which continued until 1896 differed from the Pennsylvania system chiefly in the fact that the tax was leviable by the local officials. As a consequence it was really not enforced.[2] The law of 1896, however, made all corporate bonds, certificates of indebtedness or other evidences of debt assessable to the owners at their place of residence and subject to a tax of 30 cents per $100 of assessed

[1] Infra, p. 213.
[2] *Code of Public General Laws of 1888*, art. 81, sec. 87.

value, in addition to the general state rate on property. The local tax must be apportioned equally between the town and county where the owner resides.[1] The state rate has been considerably increased of recent years and has been fixed for 1913-14 at 31 cents making the total tax 61 cents, which is much higher than the Pennsylvania tax, and which will therefore probably lead to much evasion. Moreover, it is to be noted that the tax on bonds is payable by the owner, not the corporation, as was formerly the case. The corporation taxes in Maryland, therefore, now have only a very limited scope.

In Kentucky, we find since 1892, in addition to the property tax, and the license tax to be mentioned below, a franchise tax on all corporations or associations "having or exercising any special or exclusive privilege or franchise not allowed to natural persons, or performing any public service." This is, however, interpreted to include only "public-service or carrier" companies and can therefore not be called a general corporation tax.

In Alabama, there was formerly a tax, dating from 1866, on the dividends of all corporations doing business in the state; but since the dividends were simply classed as personal property, the tax yielded almost nothing and was discontinued before long. There was formerly also a tax on the incomes of corporations; but this seems to have been rarely assessed and was abolished in 1884.

It may also be mentioned that Virginia had a general corporation tax for a short period. In 1843 a tax of two and a half per cent was imposed on the dividends of all corporations, except as to the stock held outside of the state; but in 1846 the tax was reduced, and was then allowed to disappear. During the Civil War, again, a tax was imposed on steamboat companies and "companies of a similar character." The law defined capital as stock subscribed, money deposited, bonds, certificates and other evidences of debt, so that the tax was thus really laid on stock plus total indebtedness.

In addition to these six—or including Maryland seven—states with a general corporation tax we find a number of commonwealths—nineteen in all—which impose a slight tax, almost in the nature of fees, on corporations in general. In a certain sense these may also be called general corporation taxes. They differ, however,

---

[1] Frederic Co. vs. Frederic City, 88 Neb. 654.

from the corporation taxes hitherto discussed in three respects. In the first place, they are in almost every case not substitutes for, but supplemental to, the general property tax. Secondly, with one or two exceptions, the charge is fixed or graduated at specific sums instead of being a percentage tax. In the third place the amount is so insignificant as scarcely to warrant the name of tax. In some cases the charge is even known as a fee, although the appellations are very varied. In ten of these states—Alabama, Arkansas, California, Colorado, Georgia, Kentucky, Oregon, Utah, Vermont and West Virginia—it is called a license tax or annual license tax. In eight states—Delaware, Kentucky, Maine, North Carolina, Ohio, Texas, Virginia and Washington—it is called a franchise tax. In Nebraska it is called an annual occupation fee. In Oklahoma it is called a "license tax or license fee." In Kentucky there is both a license tax and a franchise tax, the former being imposed on all corporations, the latter being payable in addition by public-service corporations, as explained in the preceding paragraph. In California, as we noted above, the license tax is payable in addition to the new general franchise tax. In most of the above states the license tax is supplemental to the ordinary property tax; and in several of these states, as we learned in the last section, there are additional taxes on certain classes of corporations. The character and rate of these license, or so-called franchise, taxes are as follows.

In Alabama the "License tax," imposed on all corporations, domestic and foreign, as a part of the general privilege tax system, varies from $10 if the capital is under $10,000 to S500 if the capital is over one million dollars. In Arkansas the "franchise tax" is at the rate of 1-20 of 1% upon the proportion of the subscribed or issued and outstanding capital stock employed within the state. In California the "license tax" is at the flat rate of $20. In Colorado the "license tax" on domestic corporations is 2 cents for each $1,000 if the capital is $25,000 or over. In the case of foreign corporations the tax is imposed on only so much of the capital stock as is employed within the state. In Delaware, where as we know public-service corporations as well as insurance companies and banks are separately taxed, all other corporations, i.e. all manufacturing, mining, mercantile and miscellaneous corporations with less than 50% of capital invested in business carried on in the state, or whose capital is invested wholly with-

out the state, are subject to an "annual franchise tax" on capital stock, ranging from $5, where the capital is under $25,000, to $50 where it is a million dollars, with an additional $25 for every succeeding million dollars. In Georgia the "annual license tax" is graded from $5 to $100. In Kentucky the "license tax" is at the rate of 30 cents on each $1,000 of capital. In Maine the "annual franchise tax" is graded from $5, if the capital does not exceed $50,000, to $50 where the capital exceeds a million dollars, with $25 additional for each succeeding million dollars. In Nebraska the "occupation fee" varies from $5 to $200 according as the capital is not over $10,000 or exceeds two millions.

In North Carolina the "franchise tax" is $5 where the capital stock is not more than $25,000 and rises to $500 where the capital is over one million dollars. In Ohio the tax is 1-10 of 1% on the capital. In Oklahoma the "license tax or fee," which does not apply to public-service, insurance, banking or building and loan associations, is in the case of domestic corporations*1 of 1 per mill of authorized capital stock, and in the case of foreign corporations one per mill of the capital stock employed in business done within the state. The tax, however, is in no case payable on that part of the capital employed in any business subject to the "production, income or gross receipts tax." In Oregon the "license tax" is graded from $10 where the capital is $5,000 or less, to $200 where the capital is over two millions. South Carolina imposes a 'license tax," of one-half per mill on all corporations except those public-service corporations which pay three mills. In Texas domestic companies pay from $10 where the capital is under $500,000 to $50 where the capital is over $200,000. Foreign companies pay $25 where the capital is not more than $25,000; $100 from $25,000 to $100,000; $100 plus $1 for every $10,000 where the capital is between $100,000 and a million dollars; and an additional tax of $1 per $10,000 on the excess over a million dollars. In Utah the "license tax" on all domestic corporations (except those not organized for profit, water companies for culinary purposes, canal and irrigation companies and insurance companies) and on all foreign corporations is graded from $5, for an authorized capital stock up to $10,000, to $50 when the capital stock is over $200,000. Virginia levies a small "license tax." In Vermont the "Li-

cense tax" is $10 where the capital is not more than $50,000, with $5 additional for every succeeding $50,000 until the tax reaches $50.

In Washington the "franchise tax" is fixed at $15. In West Virginia domestic companies pay a "license tax" graded as follows: where the capital is $5,000 or less, $10; from $5-$10,000, $15; $10-$25,000, $20; and $5 additional on every $25,000 to $200,000; $15 on each additional $100,000 up to $500,000; $150 from $500,000 to a million dollars; and $40 on each million dollars additional. In the case of non-resident domestic companies the grades are slightly different. If the capital stock is not more than $10,000, the tax is here $15; if $10-$25,000, $20; if $25-$50,000, $30; if $50-$75,000, $40; if $75-$100,000, $50; from $100,000 to a million dollars, 25 cents on each $1,000; from one to two millions, $275 and 20 cents on each additional $1,000; from two to four millions, $475 and 10 cents on each additional $1,000; over four millions, $675 and $50 on each additional $1,000.

Outside of the few commonwealths which levy a general corporation tax at a special rate, almost all the states, including those mentioned in the preceding list, tax the property of corporations in general precisely like that of individuals through the general property tax. Of recent years, however, some states have declared the franchise to be taxable property, to be assessed like other property. This is true of corporations in general in Illinois, Indiana, Kentucky, Michigan, Minnesota, Missouri, Montana, Tennessee and Wyoming, which states are to be added to those mentioned above where the license or other tax is called a payment for the franchise. Sometimes the corporate excess is specifically designated as property and is declared to be the excess of the value of the capital stock over that of the tangible realty and personalty. The corporate excess is specified in Alabama, Illinois, Indiana, Minnesota, Mississippi, Nebraska, North Carolina, North Dakota, South Dakota, Tennessee and Texas. In most of these cases, however, the corporate excess is taxable by the local assessors, which means in practice that it is generally not reached. In only a few of these cases, like Illinois, is the corporate excess appraised by a state board, and in that state the system does not apply to railroads, telegraph, telephone, banking and insurance companies which are separately reached, nor to companies for purely manufacturing purposes, for the mining or sale of coal, for printing,

for publication of newspapers, or for the improving or breeding of stock. As we mentioned above,[1] this attempt to include the franchise in the value of the property really involves a partial departure from the general property tax. It will be more fully discussed below.

We see then that only in Pennsylvania, New York, California and Rhode Island are there general corporation taxes, in the real sense of the term, applicable to practically all foreign as well as to domestic corporations. In Maryland the corporation tax, although nominally applicable to foreign, is in reality levied almost exclusively on domestic companies. In Massachusetts and New Jersey, the law applies in terms only to domestic corporations. In Maryland and Massachusetts, again, the tax is really a general property tax on shares of stock, although paid by the corporation. Maryland and Pennsylvania are the only states which levy taxes on corporate bonds, although virtually only on the bonds of domestic corporations in the hands of residents. In California and Rhode Island, however, bonds are considered in arriving at the value of the franchise or of the corporate excess. Finally, only in Pennsylvania is the corporation tax in lieu of the local tax on personalty, while in California and Connecticut as well as in Pennsylvania the state tax on public-service corporations carries with it exemption from all local taxation. The important questions that have arisen in connection with these various points will be discussed below.

6. The Tax on Corporate Charters

A mistake often made is that of confounding with the corporation tax what may be called the tax on corporate charters. This is in reality a license fee charged for the privilege of incorporation or of increasing the capital stock of a company, and it is generally either a lump sum, or a percentage of the amount of the capital stock. It is in most cases of very recent origin. In only a few states does it antedate the last decade of the nineteenth century and in only one or two is it found before 1870.

In Pennsylvania the earliest act is that of 1849, which provided that certain manufacturing companies on their incorporation should pay a bonus of ½ of 1% on the capital stock, payable in five annual

[1] Supra, pp. 150 and 180.

installments. In 1868 the rate was changed to ¼ of 1% but the tax bonus was extended to all corporations with a few exceptions, among which railroads were the most important. In 1889 the same rate was imposed on the authorized amount of all increases of capital stock. In 1897 the rate was increased to $^{1}/_{3}$ of 1% on the authorized capital stock, with some exceptions which were still taxable at the old rate. In 1899 the rate was made uniform on all corporations at $^{1}/_{3}$ of 1%, and the only corporations excepted from the bonus were building and loan associations and so-called corporations of the first class, i.e. those incorporated by the courts, and usually not for profit. Railroads were therefore first included in this year. In 1901 the bonus was extended to foreign corporations also and was applied to so much of the capital as might be invested in the state after the date of the passage of the act.

In Massachusetts, where the charge is called an incorporation fee, the first law—that of 1863—simply imposed a fee of $1 for recording the certificate of incorporation. In 1865 this was increased to $5. In 1870 the charge was made a percentage one and the rate was fixed at 1-20 of 1% of the capital stock. In 1871 the minimum charge was fixed at $5 and the maximum at $200. This continued to be the law until 1903 when the charges were reduced, the rate being fixed at 1-40 of 1%, but with a minimum payment of $10.

At present the tax on corporate charters is found in almost all of the states, although under widely varying names. In Alabama and in Illinois, it is called "license fees;" in Connecticut, it applies only to foreign corporations seeking a charter in the state, and is termed the "tax on corporate franchise," although quite unlike the franchise taxes in other commonwealths; in Kentucky, it is called the "tax on organization"; in Maine, the "tax on new corporations"; in Maryland, "bonus on corporations"; in Missouri, the "corporation tax" or the "tax on corporations incorporating"; in Nebraska "occupation fee on corporations"; in New Hampshire, "charter fees"; in New Jersey, the "tax on certificates of incorporation"; in New York, the "organization of corporations tax"; in Ohio, "organization fee"; in Oklahoma "incorporating fee"; in Pennsylvania and Rhode Island, "bonus on charters"; in Texas, "franchise tax"; in Vermont, "corporation license tax"; in West Virginia, "license tax on charters and certificates of corporations."

The rates of the tax are exceedingly multiform. They may be classed in five categories: flat rates; fixed percentage rates; graded rates, fixed in each grade; graded percentage rates; and graded rates, partly fixed and partly percentage.

The flat rates are found in seven states: $4 in West Virginia; $5 in Arizona and Oklahoma; $10 in South Dakota and Washington; $25 in Arkansas; and $100 in Florida.

The percentage rates are found in fourteen states as follows: 2 cents per $1,000 in Colorado and Tennessee; 15 cents per $1,000 in Nevada; 20 cents per $1,000 in New Jersey (with minor variations in detail); 25 cents per $1,000 in Utah; 1-20 of 1% (or 50 cents per $1,000) in Massachusetts, Michigan and New York (for domestic companies); 3-20 of 1% in Ohio; 1-10 of 1% in Indiana, Kentucky, and Rhode Island; $^{1}/_{8}$ of 1% in Maryland and New York (foreign companies); $^{1}/_{3}$ of 1% in Pennsylvania.

The graded rates, fixed in each class, are found in six states: Alabama ($25 when the capital is not over $50,000, to $250 when the capital is over a million dollars); Georgia ($5 to $100); Idaho ($5 when the capital is not over $25,000 to $25 when the capital is over $500,000); Oregon ($10 when the capital is not over $5,000 to $100 when the capital is over two million dollars); Virginia ($25 when the capital is not over $5,000 to $5,000 when the capital is over ninety million dollars; but when companies are incorporated under a general, instead of a special, act the rates are lower, ranging from $15 to a maximum of $600); Vermont ($10 to $50).

The graded percentage rates are found in four states as follows: Connecticut (50 cents per $1,000 where the capital is not over five millions, and 10 cents per $1,000 above that); Kansas (1-10 of 1% on the first $100,000 of capital, 1-20 of 1% on the next $400,000, and $200 for each million or fraction thereof above $500,000 of capital); Montana (50 cents per $1,000 where the capital is not over one million dollars, and 25 cents per $1,000 above that); and South Carolina (one mill on each dollar up to $100,000 of capital, ½ mill from $100,000 to a million dollars, and ¼ mill on each dollar of capital over a million dollars).

The mixed graded rates, partly fixed and partly percentage, are found in nine states as follows; Colorado ($20 if capital is not over $50,000, and 20 cents on each additional $1,000); Delaware (the

same as Colorado); Illinois ($30 where the capital is not over $2,500, $50 if not over $5,000, and $1 for each additional $1,000); Iowa ($25 plus $1 on each $1,000 where the capital is over $10,000); Minnesota ($50 for the first $50,000 of capital, $5 for every additional $10,000); Mississippi ($20 where the capital is not over $10,000, $40 to $60 where the capital ranges from $10-$50,000, and 1-10 of 1% where the capital is $50,000 and over); Nebraska ($10 and in addition 10 cents per $1,000 where the capital is over one million dollars); North Dakota ($50 for the first 850,000 of capital, S5 for each additional $10,000 or fraction); and Wyoming ($5 where the capital is not over $5,000, $10 on capital between $5-$10,000, and 5 cents on each additional $1,000).

In five states—Maine, New Hampshire, New Mexico, Texas and Wisconsin—there is a very complicated system, the rates varying with different classes.

In ten states—Alabama, Kentucky, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, Virginia and Wyoming—the rates are payable also on a subsequent increase of the capital stock.

In many of the above states the tax is now levied on foreign as well as on domestic corporations; while finally, some states follow the New York plan and impose the tax also on joint-stock companies.

These taxes have really little in common with the corporation taxes properly so called. In Pennsylvania and Ohio, for instance, the payment is held to be not a tax at all, but a price paid for the chartered privilege. The distinction between the tax on corporate charters and the corporation tax proper can, perhaps, best be expressed by saying that if the latter is a tax on the right to be, the former is a tax on the right to become.

III. Bases of the Tax

The summary just presented shows the chaos of principle in which the whole subject is involved. An analysis of the facts discloses no less than thirteen important methods of taxing corporations, not counting the various combinations of method which are practised in some states. The bases on which the taxes are assessed are as follows:—

1. *Value of the property,* i.e. the realty plus the visible and invisible personalty. This was originally the universal method and it is still the practice in the great majority of cases.

2. *Cost of the property.* This was the general rule in New Jersey from 1873 to 1876 as to all railroad companies, and is still the rule in isolated cases, as in New York in the local taxation of telegraph companies.

3. *Capital stock at par value.* This is true of the general corporation law in New Jersey, of mining companies in Massachusetts, and of banks and savings institutions in Pennsylvania.

4. *Capital stock at market value*. This is true of the general corporation law in Massachusetts and in New York when applied to corporations where the dividends are less than six per cent. It was true of railroads in Connecticut between 1849 and 1864. It is also the custom in local taxation in many states.

5. *Capital stock plus bonded debt at market value.* This is true of all corporations in Pennsylvania and of railroads in Georgia and in Illinois. In the case of railroads in New Jersey and of corporations in general in Illinois and several other states, only the surplus of this valuation over the value of the tangible property is made the basis of the tax.

6. *Capital stock plus total debt, both funded and floating*. This is true of railroads in Connecticut, and in a measure true of corporations in general in California and Rhode Island. It was true of steamboat companies and of similar corporations in Virginia during the Civil War.

7. *Bonded debt or loans.* This was true of railroads and canals in Virginia from 1872 to 1874, and is now true of all corporations in Pennsylvania. In this case, however, it is only supplementary to the tax on capital stock.

8. *Business transacted*. This is true in several of the New England states of savings banks taxed on their deposits; in California, Maine and New York of foreign banks; in New Hampshire and Vermont of trust companies taxed on deposits; in Connecticut and Massachusetts of insurance companies taxed on the amount insured; in Montana of telegraph companies taxed on the instruments; in Connecticut, Florida, Montana and Tennessee of telephone companies taxed on the number of telephone transmitters; in several Southern states of sleep-

ing-car companies taxed according to the number and mileage of cars; in Delaware of railroads taxed on the number of locomotives and passengers. It was also true in Pennsylvania from 1868 to 1874 of railroads; from 1868 to 1881, of coal companies taxed on tonnage; and from 1870 to 1889 of boom companies taxed on the number of logs rafted.

9. *Gross earnings*. This is true in many states of insurance companies taxed on gross premiums, and of transportation and other public-service companies taxed on gross receipts.

10. *Dividends*. This is true of gas and electric light companies in Delaware, New Jersey and Now York, and of turnpike companies in Kentucky. It was formerly true of banks and iron companies in Pennsylvania, and of banks and insurance companies in Ohio and Virginia and of corporations in general in Alabama.

11. *Capital stock according to dividends*. This is true in New York of all corporations, when the dividends are at least six per cent. It was formerly true of banks in North Carolina and of all corporations in Pennsylvania.

12. *Net earnings*. This is true of railroads in Delaware; of street railroads in Massachusetts and Rhode Island; of insurance companies in a number of states and of mining companies in Massachusetts.

13. *Franchise*. This is true of a large number of cases; but the term franchise, as we shall see, denotes nothing definite, and the value of the franchise is measured by each one of the preceding twelve tests except that of properly.

All the above methods may really be reduced to three: taxes on property (nos. 1-7 and 11); taxes on business (no. 8); and taxes on earnings (nos. 9, 10 and 12). Virtually, as we shall see, the choice lies between taxes on property and taxes on earnings.

From this survey of the existing confusion, it is plain that we are still groping in the dark and that no one method has yet pre-eminently commended itself to the American sense of justice and expediency. In the next chapter we shall learn the judicial interpretation put upon these various methods, and shall attempt to analyze the situation from the economic point of view. That some change is imperative seems evident; precisely what the change should be can be ascertained only after careful consideration. It is a complicated problem that confronts us.

Chapter VII—The Taxation of Corporations. II–The Principles

In the preceding chapter we traced the history and actual condition of the corporation tax in the United States. The whole subject was shown to be 'involved in almost inextricable confusion, amid which, however, some twelve different bases for levying the tax might be distinguished. These, it will be remembered, were the value of the property, capital stock at par value, capital stock at market value, capital stock plus bonded debt, capital stock plus total debt, loans, business, gross earnings, dividends, capital stock according to dividends, net earnings and franchise. In the attempt to analyze these methods it may be well to begin with the last, on account of its obscurity as well as of its importance.

I. The Franchise Tax

At the outset we are confronted by the question: what is a franchise tax? The matter was first brought squarely before the public by the provisions of the California constitution of 1879, and since then by tax laws of several states which prescribe that franchises of corporations shall be separately assessed. Before we can discuss the franchise tax, however, we must attempt to ascertain what a franchise really is.

Blackstone defines a franchise as "a royal privilege or branch of the King's prerogative subsisting in the hands of a subject." His definition is obviously too vague for our purposes. The Supreme Court of the United States has given this definition:

> A franchise is a right, privilege or power of public concern which ought not to be exercised by private individuals at their mere will and pleasure, but which should be reserved for public control and administration, either by the government directly or by public agents acting under such conditions and regulations as the government may impose in the public interest and for the public security.[1]

[1] California vs. Southern Pacific R. R. Co., 127 U. S. 40.

This definition, however, is somewhat too narrow, since it emphasizes unduly the element of public control and public interest. These are indeed very desirable adjuncts, but they scarcely seem to be indispensable parts of the conception. Nothing is more common than the possession by a purely private corporation of a franchise—for example, the mere privilege to act as a corporation. Furthermore, a privilege of a public character, like that possessed by a railway, is not necessarily confined to corporations. Thus, there is nothing to prevent the grant of the right of eminent domain to private persons. We therefore conclude that a franchise in the wider sense is simply a right conferred by government of conducting an occupation either in a particular way or accompanied with particular privileges. The motive may be either public welfare or public revenue. This can be clearly seen by tracing the historical development of the franchise.

One of the chief sources of royal income in mediæval Europe consisted in the so-called "fines for licenses, concessions, and franchises." These were payments by individuals or associations for all kinds of special privileges, such as to secure the general favor of the crown, to retain or to quit office, to obtain the right of exporting commodities, to conduct some business in a particular way, to obtain special jurisdictional privileges, to possess the right of *firma burgi*, and so on.[1] A most common instance can be found in the trading privileges of the guilds, granted chiefly for the sake of the accruing emoluments. Similar to these mediaeval concessions are the modern licenses, especially in the Southern commonwealths, which are conferred on individuals and corporations alike, and in most cases for purely fiscal reasons. What are called franchise taxes elsewhere are included in the South in the privilege or occupation taxes. A franchise of an individual or of a corporation is, therefore, simply a privilege—something over and above the value of the property, and in a measure analogous to the "good will" of a firm. It is the indefinite something which gives vitality to the enterprise and makes its business worth having.

---

[1] A characteristic example of a fine or franchise hard to classify is this: The wife of Hugo de Neville paid the king two hundred hens "eo quod possit jacere una nocte cum domino suo" (who happened to be in prison). Rotuli Finium, 6; quoted in Madox, *History of the Exchequer*, i., p. 471.

In the case of a corporation this indefinite something is the privilege that individuals possess to act as one, with legal individuality and immortality, and with divisible share capital. This is a privilege which corporations share equally with joint-stock companies; accordingly, the corporation tax is frequently made applicable to such associations. A modern stock corporation indeed possesses another privilege, which is exclusive to it, namely, limited liability. The corporate franchise therefore is really the privilege of juristic personality and limited liability; it is the right to exist as a corporation.[1] Since it is something separate and apart from the property of the corporation, it is capable of being taxed.[2]

What has been said applies, however, only to domestic corporations. In the case of a foreign corporation, the state which has not given the franchise cannot tax it. With a domestic corporation the franchise or right to exist is an empty right if the corporation may not transact business; the right to exist is therefore inextricably bound up with the right to carry on the business. But as regards a foreign corporation, the two things are distinct, and the state can tax only the privilege of carrying on the business within its borders. The corporate franchise has no existence apart from the laws of the state which created it. In order to avoid trouble, therefore, the corporation tax is usually imposed on "the corporate franchise or business;" and the New York tax has been upheld as applicable to foreign corporations as a tax on their business, not on their franchise.[3]

The denial of the right to tax the franchises of foreign corporations applies equally to corporations chartered by the United States which are not legally foreign corporations. But where the corporation, as in the case of a railroad, exercises additional privileges in the state, it is held that it enjoys a state franchise as well as a federal franchise and that a state tax may be imposed on the former franchise without be-

---

[1] "By the term corporate franchise we understand is meant the right or privilege given by the state to two or more persons of being a corporation, that is, of doing business in a corporate capacity." Home Insurance Co. vs. State of New York, 134 U. S. 594. Cf. Western Union Telegraph Co. vs. Mayer, 28 Ohio State, 521.

[2] "Nothing is better settled than that the franchise of a private corporation … is property and of the most valuable kind, as it cannot be taken for public use without compensation." Wilmington R. R. Co. vs. Reed, 13 Wall. 264, 2G8.

[3] People vs. Equitable Trust Co. of New London. Conn., 96 N. Y. 396.

ing an attack upon the privilege granted by the federal government.[1] This, however, does not apply to national banks which cannot be subjected to license or privilege taxes.[2] Some recent cases in Pennsylvania have even held that the tax on capital stock is invalid as to stock invested in a patent right, because such taxation involves a property right which depends for its existence exclusively on the federal constitution and on an act of Congress.[3] This seems to be an extreme application of the general principle which, if persisted in, will render a great part of our corporation tax laws practically nugatory. For almost every corporation utilizes something covered by a patent; and if it is held that the capital stock represents in whole or in part this patented property, the corporation would to that extent escape taxation. Later decisions in other states, like New York and Maryland, seem to take the proper view. For in New York it has been held that even if the entire capital of a corporation is invested in patent rights, it is none the less subject to the capital stock tax."[4] And the same rule has been extended to trade-marks.[5]

Subject to these qualifications and to the principle, to be discussed below, that no commonwealth may impose a franchise tax to interfere with interstate commerce, the taxation of corporate franchise has no limitation, except the discretion of the taxing power.[6]

The franchise that has been discussed thus far is the privilege of doing business. When, however, we analyze a little more closely the concept of a corporate franchise we see that there are other aspects to the problem. In order to do business, the corporation must first come into being; and even after the corporation has been created, it does not necessarily follow that it will do business. Consequently we must

---

[1] People vs. Central Pacific R. R. Co., 105 Cal. 576; and California vs. Pacific Railroad Companies, 127 U. S. 1.

[2] Mayor vs. National Bank of Macon, 59 Ga. 648; City of Carthage vs. Bank of Carthage, 71 Mo. 508; National Bank of Chattanooga fs. Mayor, 8 Heiskell, 814.

[3] Commonwealth vs. Westinghouse Co., 151 Pa. State, 265; Commonwealth vs. Air Brake Co., id. 265; Commonwealth vs. Philadelphia Co., 157 Pa. 527; Commonwealth vs. Lehigh C. and I. Co., 162 Pa. State, 603.

[4] People ex rel. U. S. Aluminum Plate Co. vs. Knight, 174 N. Y. 475 (1903); Crown Cork and Seal Co. vs. State, 87 Md. 687.

[5] People e.t rd. Spencerian Pen Co. vs. Kelsey, 105 App. Div. 133 (1905).

[6] Delaware Railroad Tax Case, 1S Wall. 231; California vs. Southern Pacific R. R. Co., 127 U. S. 41.

distinguish between the creation of a corporation and the exercise of its powers. If the latter is termed the franchise to do or to act, the former might be called the franchise to be or to become. For this privilege to be, as we have learned, virtually all the states make a charge; and while ordinarily called a fee, it is not infrequently termed a franchise tax.

In addition to the franchise to be and the franchise to do, there is, however, still a third kind of franchise, which it has become usual of recent years to call a special franchise. This is the right accorded to certain corporations to possess privileges not enjoyed by corporations in general. The most important of such special privileges is the right to use public highways, and it is for this reason that the corporations enjoying this right are generally called public-service corporations. This special franchise was first brought into prominence in New York. In that state it is permissible to deduct debts from personalty, but not from real estate. It was accordingly easy for corporations to escape taxation on their capital, which as we know is still locally taxable in New York. For when the bonded indebtedness exceeded the capital stock, there would be nothing left on which to levy the tax except the real estate. When an attempt was made later to assess the value of the franchise over and above that of the personal property, the attempt was frustrated by the same facility of deducting the value of the bonds. Hence an ingenious plan was devised. A franchise in general, if it be any kind of property, is personal property. But it was now suggested that a franchise enjoyed by some corporations only, to use the streets, on the surface or above or below the level, might properly be termed an interest in real estate; and if so, there could not, under the New York system, be any set-off on account of mortgage bonds. Accordingly by the law of 1899 a new category of real estate was created in New York, to be known as a special franchise. The law added to the definition of taxable real property the following:—

> "The value of all franchises, rights or permission to construct, maintain or operate the same [surface, underground or elevated railroads] in, under, above, on or through streets, highways or public places; … and the value of all franchises, rights, authority or permission to construct, maintain or operate in, under, above, upon, or through any streets, highways or public places, any

mains, pipes, tanks, conduits or wires, with their appurtenances, for conducting water, steam, heat, light, power, gas, oil or other substance, or electricity for telegraphic, telephonic or other purposes. … A franchise, right, authority or permission specified in this subdivision shall for the purposes of taxation be known as a 'special franchise.' " A special franchise shall be deemed to include the value of the tangible property situated in, upon under or above any street, highway, public place or public waters in connection with the special franchise in 1907.[1]

Under this ingenious definition of a special franchise all public-service corporations in New York have now been compelled to bear a far greater burden of taxation than was previously the case.[2]

The new conception soon spread to other states, although in most cases the special franchise is either measured by a certain proportion of gross receipts as in New Jersey, or is treated as a separate constituent of property without any decision as to whether it is realty or personalty. Only a few states, like California, follow New York in treating the special franchise as an interest in real estate.

Thus we see that there are now in the American system of corporate taxation three kinds of franchises—the franchise to be, the franchise to do, and the franchise to act in a particular way or to enjoy a special privilege. It is interesting to observe that in the California law of 1911 all three species of franchises are included in the definition.[3]

---

[1] An amendment adopted later, provided that "the term 'special franchise' shall not be deemed to include the crossing of a street, highway or public place outside the limits of a city or incorporated village where such crossing is less than 2.50 feet in length, unless such crossing be the continuation of an occupancy of another street, highway or public place." Under this, in practice, ordinary railroad crossings were not treated as special franchises. But a later amendment, in 1907, made a steam railroad crossing in a city or village assessable as a special franchise. As special franchises are assessed by a state board, while ordinary real estate is assessed by local officials, this has caused much confusion in the actual administration. Cf. the interesting monograph by Benj. E. Hall, one of the New York State Tax Commissioners, *Administrative Difficulties of the Special Franchise Tax Law. Address before the State Conference on Taxation held at Utica*, Albany, 1911.

[2] Cf. Seligman, "The Franchise Tax Law in New York," in *Quarterly Journal of Economics*, vol. xiii. (1S99), p. 445 et seq.

[3] "These franchises shall include the actual exercise of the right to be a corporation and to do business as a corporation, under the laws of this state and the actual

It must further be observed, however,—although it is an observation that has hitherto eluded the attention of well-nigh all writers on the subject—that amid the multiplicity of meanings attached to the word franchise two leading ideas are discernible in its relation to taxation. We refer here not to the distinction just discussed between a franchise to be, a franchise to do, and a franchise to act in a particular way; but to the distinction between franchises based on their assumed relation to property. Here there are two fundamental conceptions. The one is the conception of a franchise as a part of property; the other is the conception of a franchise as something distinct from, or even opposed to, property. The first conception leads to the idea of a franchise tax as something of the same nature as a tax on physical, tangible property, but superadded to it. This is the case in all the states which include the value of the franchise in the ad valorem tax, as in Michigan, Wisconsin, Illinois, or even New York in the case of the special franchise tax. In all these cases the franchise tax is thought of as a property tax; but it is a tax on intangible property or on an intangible something of which the concept of property is predicated, whether in the eyes of the law it be treated as real property or as personal property. The other conception leads to the franchise tax as something distinct from, or opposed to, a property tax, as in the case of the capital stock tax in New York. Let us elucidate these conceptions?

If we take up first that conception of a franchise which leads to the franchise tax as a property tax, the question at once arises as to how the value of the franchise as a piece of taxable property is to be ascertained. It is obvious that here we are face to face with great difficulties.

---

exercise of the right to do business as a corporation in this state when such right is exercised by a corporation incorporated under the laws of any other state or country, also, the right, authority, privilege, or permission to maintain wharves, ferries, toll roads and toll bridges, and to construct, maintain or operate in, under, above, upon, through, or along any streets, highways, public places, or waters, any mains, pipes, canals, ditches, tanks, conduits, or other means for conducting water, oil, or other substances." Statutes of California, 1911, chap. 335. Cf. the article by Professor C. C. Plehn, "The Taxation of Franchises in California," in the *National Municipal Renew,* vol. i. (1912), p. 337 et seq.

We have seen that there are not less than twelve separate methods of taxing corporations and that each of these methods, with one exception, is declared to involve a franchise tax. There are yet other methods of measuring franchise, such as the value of the capital stock less the value of the property, the value of the stock less the value of the tangible property, the value of the stock less the value of the realty, the value of the stock and bonds less each or all of these items, etc. There is a total lack of uniformity. Each commonwealth measures the franchises of its corporations in its own way; and frequently a given commonwealth measures the franchises of different corporations in entirely different ways. There is an utter absence of any common standard of measurement. Capital stock, stock minus property, stock minus realty, bonded debt, business, gross earnings, dividends, profits, etc., are each declared to be the value of the franchise. The result is hopeless confusion. It would be useless to examine the methods of all the states; a few examples will suffice.

The state board of assessors of New Jersey have published since 1884 annual reports in which they discuss the details of corporate assessment. In the case of railroads they adopted the following plan.[1] The market value of the stock is added to the market value of the debt; from this aggregate the total value of the tangible corporate property is deducted, and the remainder is declared to be the "adventitious value of the entire road, its privileges included." Sixty per cent of this is taken as the value of the franchise, to which is added the value of the real and tangible property, known as the "abstract value" of the road, making a total which is termed the entire value of the railway for purposes of taxation. This, however, is not all; for if the value of the tangible property exceeds the value of the stock and debt, the board declares the franchise to be twenty per cent of the gross earnings. It will be readily perceived that this measurement of a franchise, which may give a result less than nothing, is rather awkward. Indeed, the courts of New Jersey have overturned this portion of the assessors' standard by pronouncing the estimate based on gross

---

[1] *Report of the State Board of Assessors of New Jersey*, 1884, p. 26; 1885, p. 11; 188G, p. 28; 1888, p. 6.

earnings unconstitutional;[1] but the main element in the method of valuation was upheld on the easy-going principle that no substantial injustice was done. It is this absence of "substantial injustice" to which is due the chaotic condition of franchise taxation in this country to-day.

In Illinois and in California, the method of taxing franchises is not far different from that of New Jersey. In Illinois, the board of equalization adds the cash value of the stock to that of the debt (excluding current debt), and pronounces the result to be the fair cash value of the capital stock including the franchise. From this the board deducts the equalized value of all the tangible property, and declares the remainder to be the value of the capital stock and franchise subject to taxation. This method was upheld by the Supreme Court of the United States as being "probably as fair as any other."[2] In California, the value of the franchise is determined by subtracting from the actual value of the capital stock or of the stock and bonds the value of all the items of property.[3] In some cases only a fraction of the remainder is declared to be the value of the franchise. The only change introduced by the law of 1911 is that in the case of ordinary corporations, exclusive of public-service companies and banks, the good will is no longer to be included in the value of the franchise—a curious provision in view of the fact that in many corporations the good will of the business constitutes the major portion of the franchise value. In Kentucky, the assessors deduct from the amount of the capital stock the assessed value of all tangible property taxed in the state, and declare the remainder to be the value of the franchise. In the case of foreign companies, however, they take that proportion of the capital that the gross receipts in the state bear to the total gross receipts, and then deduct the value of the tangible property assessed in the state. In the case of transportation companies they take only that

[1] Case of Railroad Tax Law, N. J. Court of Errors and Appeals, decided May 29, 1886. The case may be found in full in the *Third Annual Report of the State Board of Assessors*, 1886, pp. 79-173.

[2] State Railroad Tax Cases, 2 Otto, 575. Cf. Railway vs. Backus, 154 U. S. 421.

[3] Approved as to public-service corporations in Spring Valley Water Works vs. Schottler, 62 Cal. 69, 118; Burke vs. Badlam, 57 Cal. 594; San José County vs. January, 57 Cal. 614; and as to corporations in general in Bank of California vs. San Francisco, 142 Cal. 276.

proportion of the capital stock which the length of the line within the state bears to the total length.[1] In Indiana, if the full value of the franchise is represented by the capital stock, the franchise is not taxed; but when the franchise is of greater value than the capital stock, it is provided that the franchise "shall be assessed at its full cash value," and that the capital stock shall not be taxed.[2]

Of considerable interest are the methods that have been employed by Michigan and Wisconsin, especially after the abandonment of the system of specific taxes on the earnings of public-service corporations and the reversion to the ad valorem system. In Michigan, after the passage of the law of 1901 which authorized the ad valorem system in the case of railroads, the appraisal of the so-called non-physical or immaterial elements in the value of a railroad was entrusted to Professor Henry C. Adams. We quote from his report:

> "The rule submitted for the appraisal of the immaterial values of railwa}'^ properties, or what I prefer to term the capitalization of corporate organization and business opportunity, is simple, as follows:
>
> "1. Begin with gross earnings from operation, deduct therefrom the aggregate of operating expenses and the remainder may be termed the 'income from operation.' To this should be added 'income of corporate investments' giving a sum which may be termed 'total income,' and which represents the amount at the disposal of the corporation for the support of its capital, and for the determination of its annual surplus.
>
> "2. Deduct from the above amount—that is to say 'total income' as an annuity properly chargeable to capital—a certain per cent of the appraised value of the physical properties.
>
> "3. From this amount should be deducted rents paid for the lease of property operated and permanent improvements charged directly to income. The remainder would represent the surplus from the gross earnings from the year's operations, and for the purposes of this investigation may be accepted as an annuity which, when capitalized at a certain rate of interest, gives the true value of immaterial properties."

---

[1] Ky. Laws of 1892, chap. 102, art. iii., § 3.

[2] Ind. Law of Mar. 6, 1891, § 74; now R. S. 1908, § 10324.

Professor Adams himself added that the above rule failed to appraise the speculative element in railway property.

As a matter of fact, however, this rule was applied only in part. It was soon realized that the calculation might easily result in a minus quantity. When this turned out to be the case, the awkwardness of the situation was relieved, in part at least, by entirely disregarding the non-physical element in the property, and taking only the valuation of the physical property. We are told that in only 20 of the 123 railroads appraised at the time was a non-physical value placed on them.[1]

At present, the method actually followed in Michigan, as in most of the other states which attempt to tax the franchise as a piece of property, is very different. The laws refrain from laying down any rule at all and leave the matter entirely to the discretion of the assessing body, which refuses to state in what its precise method consists. In California, e.g. the law of 1911 declared "franchises taxable at their actual cash value, in the manner to be provided by law." But the law simply placed the whole matter in the hands of the state board. As one of the Michigan assessors frankly stated, if the board were to reveal the grounds of their valuation, they would simply invite endless criticism and objection on the part of the corporations which they are required by law to assess.[2] It is an open secret, however, that the chief reliance of the Michigan board is upon earnings, so that the value of the franchise represents in great part a capitalization of earnings. In Wisconsin, again, while nothing definite is divulged, it is generally understood that the valuation is made by a combination of the "stock and bond method" with the "capitalization of earnings" method. But to what extent other criteria are actually taken into account, no one knows. Under such circumstances we are confronted by what is the chief objection to the whole method, namely, the danger of arbitrariness and the lack of any precise directions to guide the assessors or to enlighten the public. In such a complicated matter as

---

[1] See the address by Robert H. Shields, a member of the Michigan State Board of Assessors, entitled, "Railroad Taxation Problems," in *Addresses and Proceedings of the Fourth Conference of the International Tax Association*. Columbus, 1911, p. 238.

[2] See the admission in the *Report of the Ontario Commission on Railway Taxation.* Toronto 1905, p. 48.

that of appraising the value of a franchise, which has no market value because it is not the subject of purchase and sale, no two people, however expert, will agree. As one of the Michigan commissioners states: "When it comes to a question of the ultimate valuation, each member of the board has his own opinion." The result has been in Michigan as everywhere else, a sort of compromise which differs very materially from the valuation of the original experts.

It is clear from the above review that the attempt to tax the franchise as a piece of property is highly unsatisfactory. If the value of the franchise is measured by any one criterion such as earnings, or dividends, or stock and bonds, there is nothing gained by the attempt to differentiate a franchise tax from a tax on earnings or on dividends or on stock and bonds. If, on the other hand, an attempt is made to reach the capital value of the franchise by a method of appraisal, without resort to any specific criterion, it becomes mere guess work. We may agree with the authors of the most discriminating of recent reports on the subject that when all factors contributing to value are supposed to be taken into account and when in this way the board of assessors entirely avoid the responsibility of saying how their ultimate assessment is made up, even assuming it to be known to themselves, such a system obviously has the fatal defect of making it impossible either for the railroads or the general public to distinguish between the most accurate and conscientious valuation and mere ignorant guess work or quite prejudiced and even dishonest returns. Certainly one cannot imagine a more complete departure from the fundamental basis laid down by the [Michigan] tax commission for the administration of the new system."[1]

Such is the difficulty encountered in attempting to levy a tax on the franchise as a piece of property. As we saw above,[2] however, the other conception of a franchise tax is that not of a property tax, but of something different from a property tax. Let us now proceed to consider the meaning of this other kind of a franchise tax.

What is the real significance of the franchise tax in this broader sense? Why is it desirable that such a hard and fast line should be

---

[1] Report of the Ontario Commission, etc., p. 53.

[2] Supra, p. 227.

drawn between the property tax and the franchise tax? What is the meaning of the distinction?

The answer is very plain. In the first place, according to the constitutions of several of the states, the taxes on property must be uniform. If, however, the corporation tax is held to be a franchise tax, there is no necessity of such uniformity between the tax on individuals and that on corporations. Secondly, according to the principles of the property tax, deductions are allowed for certain classes of exempt or extra-territorial property. If the tax is a franchise tax, such exemptions cannot be claimed. Thirdly, if the tax is a franchise tax, and not a tax on property or earnings, it may be upheld as not interfering with interstate commerce. Finally, if the tax is a franchise tax, many of the objections to double taxation would, as we shall see later, be removed. Every commonwealth imposing a franchise tax, for instance, could assess the entire capital of a corporation,—or at all events of a domestic corporation—although only a very small portion might be located or employed within the state. We can hence readily understand the persistence with which the corporations seek to uphold the distinction and to have the charge declared to be not a franchise, but a property tax.

The question has arisen almost exclusively in connection with the taxation of deposits, capital stock or earnings. In the case of deposits of savings banks the decisions are almost uniform that the tax is one on the franchise and not on the property;[1] among the few commonwealths that tax such deposits, Connecticut, Maine, Maryland and Massachusetts accept this view. Moreover, since there is no necessary relation between the amount of the deposits and the extent of the property, the tax is valid even if the deposits are invested in United States securities. Only one commonwealth, New Hampshire, has held out against the general tendency and pronounced the tax on deposits to be a property tax.[2]

---

[1] Maryland vs. Central Savings Bank, 72 Md. 92; Coite vs. Society for Savings, 32 Conn. 173, affirmed in 6 Wall. 594; Provident Institution vs. Massachusetts, 8 Wall. 611. See also Commonwealth vs. Savings Bank, 123 Mass. 493; Jones vs. Savings Bank, 66 Me. 242.

[2] Bartlett vs. Carter, 59 N. H. 105.

In the case of capital stock the matter is more complicated and the decisions are more divergent. That capital stock is in one sense property will of course be denied by no one; but whether the tax on capital stock is tantamount to a tax on general property is an entirely different question. In several commonwealths it has been held that capital stock practically represents the property, and that the two are to all intents and purposes interchangeable terms.[1] As regards the tax on capital stock in general, other commonwealths, however, have decided, and the federal courts have affirmed the decision, that it is not a tax on the property. Thus, it has been held that the Delaware railroad tax of one-quarter of one per cent on the actual cash value of the capital stock is a tax not on the property or on the shares of individuals, but on the corporation, measured by a certain percentage on the value of its shares.[2] In like manner the Massachusetts taxes on the corporate excess, i.e. on the whole value of the corporate shares and on the capital stock in excess of the value of the real estate and machinery, have been pronounced taxes on the franchise.[3] In a later case it has been held that this tax, although nominally upon the shares of capital stock, is in effect a tax upon the organization on account of property owned or used by it, and therefore valid. It is an excise tax, not a property tax, and therefore not limited by the constitutional restrictions as to the uniform taxation of all property.[4] On the other hand, the Connecticut courts have held that the tax on capital stock and debt is a tax not on franchise, but on property;[5] and the older cases in Alabama and Missouri were similarly decided.[6]

Secondly, in the case of capital stock as measured by dividends, the courts of Pennsylvania and New York have arrived at diametri-

---

[1] Jones vs. Davis, 3 Ohio, 474; Burke vs. Badlam, 57 Cal. 594; New Orleans vs. Canal Co., 29 La. A. R. 851; Whitney vs. Madison, 23 Ind. 331; County Commissioners vs. National Bank, 48 Md. 117. But see Wilkens vs. Baltimore, 103 Md. 293, reversing the former doctrine.

[2] The Delaware Railroad Tax Case, 18 Wall. 206.

[3] Hamilton Co. vs. Massachusetts, 6 Wall. 632; Commonwealth vs. Hamilton Manufacturing Co., 94 Mass. 298; Manufacturers' Insurance Co. vs. Loud, 99 Mass. 14G; Portland Bank vs. Apthorp, 12 Mass. 252 (1815), the basis of all subsequent decisions.

[4] Western Union Telegraph Co. vs. Massachusetts, 125 U. S. 530.

[5] Nichols vs. Railroad Co., 42 Conn. 103.

[6] State vs. Insurance Co., 89 Ala. 335; State vs. Railway Co., 37 Mo. 265.

cally opposite conclusions. In Pennsylvania a long series of cases has consistently maintained the doctrine that the tax is one on property.[1] The court has endeavored to lay down this rule:—

> "The test whether the tax in any given case is a franchise as distinguished from a property tax, would seem to be that a tax according to a valuation is a tax on property, whereas a tax imposed according to nominal value or measured by some standard of mere calculation—as contrasted with valuation—fixed by the law itself may be a franchise tax."[2]

The New York and New Jersey courts, on the other hand, have held the tax on capital stock to be a franchise tax.[3] The New York case was carried in last instance to the federal court. Of course the fact that the statutes of Massachusetts and New York expressly declared the tax to be a franchise tax was of no weight; for it was justly contended that no importance should attach to mere nomenclature. But the United States Supreme Court had already shown the tendency of its thought in the Massachusetts and Delaware decisions just cited. In a subsequent case, the court said, although indeed obiter, that the New York tax was "a franchise tax in the nature of an income tax."[4] Finally, in a later case, the tax was definitely pronounced to be on franchise, the court holding that the tax was not upon the capital stock nor upon any bonds of the United States composing a part of that stock; but that reference was made to the capital stock and dividends only for the purpose of determining the amount of the tax to be exacted each year.[5]

This decision may be defended on economic, as well as on legal, grounds. It may be granted, and in fact it is difficult to dispute the contention, that the tax is in one sense a tax on capital stock. Nevertheless, it does not follow that the tax is a property tax; for from the economic point of view capital stock is not necessarily identical with

---

[1] "Fox's Appeal, 112 Pa. 359; Commonwealth vs. Standard Oil Co., 101 5Pa. 1 19; Phoenix Iron Co. vs. Commonwealth, 59 Pa. 104; Catawissa Appeal, 78 Pa. 59.

[2] 101 Pa. 127.

[3] People vs. Home Insurance Co., 92 N. Y. 328; Singer Co. vs. Heppenheimer, 25 Vroom, 439.

[4] Or, as it was said in another place, "a tax upon its franchise based upon its income." Mercantile Bank vs. New York, 121 U. S. 158, 160.

[5] Home Insurance Co. vs. State of New York, 134 U. S. 594.

the property of a corporation. In the first place there is the question of the market or par value of the stock. Some of the commonwealths, as we know, tax corporations on the amount, i.e. the par value, of the capital stock. Yet manifestly, where the market value of the stock may be double or half the par value, it cannot be maintained that the latter is identical with, or an index to, the value of the property. In no sense, therefore, can capital stock at its par value be declared equivalent to the whole property. Even if we take the market value of the stock, we are not in a much better position, for many of our corporations, especially railroads, are created on the proceeds of the bonds. In such cases, although the property may be great, the profits are devoted mainly to meeting the interest on the bonded debt, and since there may be no dividends, the value of the stock may be very slight. Yet the property which produces these profits may be enormous. Evidently the capital stock and the whole property are not identical. But we may go still farther. Even in the case of corporations without a bonded debt, but whose property does not pay good dividends, the capital stock at its market value is no index of the value of the property. Thus, a model-dwellings company may have property worth a million dollars; yet if it is so managed as to pay no dividends, the stock will sell in the market for a very small sum. The value of this depreciated stock is evidently not the same as that of the company's real property. They are not interchangeable terms. Hence, from whatever point of view we regard it, capital stock is not identical, economically speaking, with the total corporate property; a tax on capital stock is not a tax on the entire property.

The courts of New Jersey, New York and the United States are then quite right in their decisions; and the Pennsylvania cases seem to be incorrect both in law and in economics.

The third case in which the question of a franchise tax is of importance is in connection with the subject of interstate commerce. The growth of the interpretation put upon the principle that no state may levy a tax interfering with interstate commerce will be more fully discussed hereafter.[1] It may be stated here, however, that in a large number of cases it has been held that a tax on the franchise of a domestic corporation is valid even though the value of the franchise is

[1] Infra, pp. 264 el seq.

measured by the gross receipts, a part of which are derived from interstate commerce.[1] Were the tax not a franchise tax, it might be invalid as a tax on interstate business.

It will be seen from the above review that the entire treatment of this kind of a franchise tax is based largely on a legal fiction. The conception is legal, not economic. It was devised by the legislatures and extended by the courts in order to evade the evil results of the general property tax.[2] It is remarkable that in the state of New York, where the commonwealth tax on capital stock is held to be a franchise tax, the local tax on capital stock, which is levied in almost the identical way, is held to be a property tax. In the local tax a deduction must be allowed for any non-taxable property in which the capital may be invested; in the state tax no such deduction is permitted.[3] Such a distinction is economically incorrect, however defensible it may be on the legal ground that in the one case we are dealing with a tax on property and in the other with a tax on privilege. Except in so far as corporations may be made to pay for their charters, there is no reason why they should be put on a different footing from joint-stock companies or other associations. The ability of an association to pay—its earning power—is not changed a whit by the simple fact of incorporation. The privilege of limited liability, however important it may be to the individual stockholders and however great the amount that may be demanded for the privilege as a condition precedent to organization, does not alter the taxable capacity of the association after it has once become a corporation. If the corporate franchise, in the sense of the privilege of being a corporation, itself constituted the

---

[1] State Tax on Railway Gross Receipts, 15 Wall. 284; Maine vs. Grand Trunk R. R. Co., 142 U. S. 217; People vs. Wemple, 117 N. Y. 136, and other cases cited below.

[2] This is apparent from the New York law of 1866, chap. 761, which declared the privileges and franchises of savings banks to be personal property, and taxable to an amount not exceeding the gross sum of the surplus earned. In Monroe County Savings Bank vs. City of Rochester, 37 X. Y. 36.5, the law was upheld, although the bank had a portion of its property invested in United States bonds. The court held that since the tax was upon a franchise it was unimportant in what manner the property of the corporation was invested. "The reference to property is made only to ascertain the value of the thing assessed."

[3] People vs. Barker, 139 N. Y. 5.5; People vs. Commissioners, 72 Hun, 126; People vs. Coleman, 126 X. Y. 433.

only justification of a tax, how would it then be possible to tax unincorporated companies in the same way? And yet to exempt the latter would clearly constitute a glaring economic inequality.

The value of the franchise from the economic point of view consists in the earning capacity of the corporation. That is the real basis of all taxation and can best be gauged by the amount of business done. It will be remembered that the court says: "Whether the tax upon a domestic corporation be called a tax upon franchise or upon business is wholly unimportant."[1] We may go farther and say that from the economic standpoint it is wholly immaterial whether the tax upon any corporation be called a tax on franchise or a tax on business. In an economic sense the franchise tax means nothing at all. It is so utterly indefinite that it defies exact analysis. However valuable it may be to the lawyer in the effort to evade certain constitutional restrictions, to the student of the science of finance it is a useless conception.

If we sum up the above discussion as to the two kinds of franchise tax which we have been studying—the franchise tax as a property tax and the franchise tax as a non-property tax—we are in a position to gauge its real value. The first kind of a franchise tax, as we now know, was devised in order to fit a concept based primarily upon earnings or income into a system of taxation based on property or capitalized income. The second kind of a franchise tax was devised, as we have seen, to overcome the still remaining difficulties of a property tax. The objection to the first kind of a franchise tax is that as a property tax it is a mere piece of guess work, leading to arbitrariness and furnishing no opportunity for effective redress on the part of the taxpayer. The objection to the second kind of a franchise tax is that it is a mere makeshift or legal subterfuge. Both kinds of franchise taxes furnish eloquent testimony to the shortcomings of a tax system where the criterion of ability to pay is still made to reside in property rather than in product or income. For all the manifold complications and mitigations that attend the American franchise tax are unknown elsewhere in the world where the general test of faculty in taxation is considered to be income rather than propert3\ The problem of the franchise tax is a part of the problem of the general

[1] 96 N. Y. 396.

property tax; if we ever shake off the incubus of the general property tax theory, as we are bound to do in the not distant future, the entire problem, and the conception itself, of the franchise will disappear from the realm of taxation.

II. Economic Theory

Let us therefore leave this whole subject of franchise taxation and attempt to analyze the economic principles underlying the taxes actually in vogue, irrespective of the question whether they are called franchise taxes. It will be best to take them up in the order adduced above.[1]

The general property tax, or the taxation of the corporate realty plus its visible and invisible personalty at its actual value, assessed piecemeal by the local assessors as in the case of individuals. It will not be necessary to show the inadequacy of this primitive plan; all the actual reforms are moving away from it. With the variation of this system known as the ad valorem tax, assessed by a state board under the unit plan, we shall deal below. But so far as the general property tax with local piecemeal assessment is concerned, we may conclude with the railroad tax commission of 1879, that as a system it is open to almost every conceivable objection[2]

The cost of the property. As a basis for taxation this is even less defensible than the value of the property. For no one would assert that the original cost of corporate property bears any necessary relation to the present value, much less to its present earning capacity. This method is so obviously unjust as to deserve no further mention.

The capital stock at its market value. This plan is open to several vital objections. The idea is that the market value of the stock will be practically equivalent to the value of the property, or, as it is put by some of our state courts, that the entire property of a corporation is identical with its stock. As has already been observed, heavily bonded corporations would in this way entirely escape taxation; because in such cases—and they are the great majority—the capital stock alone would not represent the value of the property. Secondly, even in the case of corporations without any bonded debt, the tax is

[1] Supra, pp. 219-220.

[2] *Taxation of Railroads and Railroad Securities*, by C. F. Adams, W. B, Williams and J. H. Oberly (1880), p. 8.

unjust, because it does not necessarily bear any relation to the earning capacity. If a company without bonded debt pays dividends, the value of the stock is indeed a fair index to earning capacity; its value would represent the capitalized earnings. But if there are no dividends, the value of the capital stock is wholly uncertain and largely speculative, depending on the manipulations of the stock exchange. It frequently happens that non-dividend-paying stock fluctuates in value from thirty to fifty per cent within one year. A standard of taxation which in such large classes of cases bears no proportion to the earning capacity or productiveness of the property clearly cannot be successfully defended. We can again agree with the railroad tax commission in their conclusion that the tax on the value of the capital stock is "clumsy and devoid of scientific merit," that it "would admit of evasions in a most obvious way," and that "it is impossible of any general application."[1]

The New York statute which governs the taxation of corporations for local purposes requires the capital stock to be assessed "at its actual value in cash." In determining the "actual" value, the assessors may take "book value," i.e. a value obtained by estimating the assets separately and deducting from the aggregate the total amount of the liabilities, actual or contingent.[2] The latter method is employed when the market value of the stock is fictitious or artificially inflated, but in principle is open to precisely the same criticism as the other method. In fact, the objections are rather stronger; for, whereas in the case of the tax on capital stock according to market value the bonded indebtedness is not taxed at all, in this case the bonded indebtedness is actually deducted. Under the New York law it has been decided that "capital stock" does not necessarily mean share stock, but the capital owned, the fund required to be paid in and kept intact as the basis of the business enterprise. When the capital is undisclosed, the assessor may consider the market value of the shares as an aid in discovering the capital, but not as the thing to be valued and as-

[1] Report, etc., p. 7. Cf. the *Report on the Valuation and Taxation of Railroads*, to the Pennsylvania Tax Conference, 1894, written by Mr. Joseph D. Weeks.

[2] 107 N. Y. 541.

sessed.[1] In the state franchise tax, however, whenever the law requires the " intrinsic or actual value " of the stock to be ascertained, it has been held that book value does not govern the valuation, but that the good will is also to be included.[2]

According to the Pennsylvania law of 1891 the capital stock on which the tax is assessed is to be appraised "at its actual value in cash, not less however, than the average price which said stock sold for during said year and not less than the price indicated or measure by net earnings, or by the amount of profits made and either declared in dividends or carried into surplus or sinking funds." This has led to much litigation. It has been decided, for instance, that the price at which the shares sell in the market is not conclusive;[3] and in a more general way that the actual value in cash is to be determined by considering the value of the tangible property, the amount of its business, the rate of dividends declared, and the extent and value of its good will, franchises, and privileges, as indicated by the evidence bearing upon those subjects at that particular time.[4] The result is that in practice the taxation of capital stock, by such a method of appraisal, does not differ much from the ad valorem system mentioned below.

The capital stock at its par value. This method is open to all the objections of the preceding and to many more in addition. Moreover, it is peculiarly liable to evasion. For example, in New York it was a common practice, before the recent reduction of the rate to a minimum, for corporations to evade the organization tax by issuing a nominally small capital, but selling it to the stockholders at a premium of several hundred per cent; the market value of the stock thus being many times the par value. The sole recommendation of this plan is the facility of fixing a basis for assessment; but this does not compensate for its obvious defects. The par value of stock is certainly no gauge either of the real worth of the property or of its earn-

[1] People vs. Coleman, 12G N. Y. 43.3, distinguishing many preceding cases. See also People vs. Commissioners, 72 Hun, 126 (1994).

[2] People ex rel. J. B. Co. vs. Roberts, 37 App. Div. 1 (1899); and People ex ref. Johnson Co. vs. Roberts, 1.59 N. Y. 70 (1899).

[3] Com. vs. Philadelphia Co., 104 Pa. 284 (1894).

[4] Com. vs. John W. Haney Co., Lim.. 1 Dauph. Co. Rep. 184 (1895); cf. Com. vs. Del., Susq. &. S. R. R. Co., 165 Pa. 44 (1894).

ing capacity. This is perhaps the least defensible of all the methods. The capital stock plus the bonded debt at the market value. The justification for adding to the value of the stock the value of what the company owes, in the shape of its funded debt, is the simple fact that the existence of this indebtedness makes the stock worth just so much less. The sum of the two elements is a far better index to the value of the property than the capital stock alone. This method is preferable to any that has hitherto been discussed, because it prevents the exemption of heavily bonded companies; and yet it is not entirely free from objections. Owing to the complications of interstate polity, the proceeds of the tax, in all cases where the stock and bonds of a corporation are owned outside of the commonwealth, will accrue not to the state of the owner's residence, but to the state where the corporate property is situated. Secondly, the market value of bonds depends not only on the rate of interest but also on the life of the security. Two companies may have raised exactly the same amount from the sale of 6% bonds, and yet at any given time the bonds of the one corporation may have a long time to run and those of the other corporation only a short time. If the normal rate of interest has fallen to let us say 4%, the market value of the bonds of the first corporation will be far higher than that of the bonds of the second corporation. Yet the discrepancy represents not any difference in the value of the respective corporate properties, but simply the difference in the amortization quota of the two classes of bonds. Thirdly, when the tax is on bonds as well as on stock it will be inadequate, because applicable only to the bonds owned by residents of the state. If the tax is, however, levied not on the bonds, but on a valuation equal to the stock plus bonds, this objection may be obviated. Both these points will be discussed more fully below. Fourthly, in all those cases where the corporation pays no dividends and its stock nevertheless possesses a speculative value, the tax, for the reasons adduced above, will not necessarily bear any relation to the earning capacity of the company. In short, while this method is far better than the taxation of capital stock, it does not avoid all the objections that have been urged against the latter.

There remain thus only the taxes on earnings, on business, on dividends and on profits.

The gross earnings. This tax was the one recommended by the railroad tax commission. It possesses many undeniable advantages. It is certain, easily ascertained and not susceptible of evasion. But it has one serious defect;—it is not proportional to the real earning capacity, it takes no account of the original cost, nor does it pay any regard to the current expenses, which may be necessary and just. For example, when the cost of building a railroad is great, its gross earnings must be correspondingly large in order to enable its owners to realize any fair return on the investment. A tax on gross earnings does not recognize this distinction. It discriminates unfairly between companies, and makes a line built at great expense and with great risk pay a penalty for the enterprise of its constructors. Again, a gross earnings tax takes no account of expenses. Of two corporations which have equally large gross receipts, one may be in a naturally disadvantageous position which unduly increases the cost of operation or management. Clearly its ability to pay is not so great as that of its rival in possession of natural advantages. Above all, the gross earnings tax makes no allowance for good management. If a corporation is managed with such ability that its business increases greatly, this will ordinarily mean a great increase in gross receipts; while, on the other hand, the net receipts or profits, although also larger, will almost surely increase not indeed in a smaller ratio, but to a smaller actual extent, than gross receipts. For with a larger business there come greater expenses. The prospect of increased net receipts is of course the stimulus to activity on the part of the owner; but if the tax is imposed on gross I receipts, that stimulus will be *pro tanto* weakened. Thus a tax on gross receipts is really a tax on enterprise and foresight, and a premium on supineness or inactivity. In short, the gross receipts tax is like the old tithe, the most primitive of all land taxes.

These defects in the proportional earnings tax are so apparent that several commonwealths, as we know, have introduced, in the case of railroads at least, the graded gross earnings tax, the rate per cent increasing with the earnings. But this system removes the objection only in part; for the graduation takes place only up to a certain point. Above all, there is no guarantee that the increase of net receipts will correspond to the increase of the gross receipts. There is no necessary connection between them. A corporation with gross receipts of

five thousand dollars per mile may have actually less net receipts than one with four thousand dollars per mile. In such a case a graded earnings tax would intensify the disadvantages of the first line and augment the injustice. To tax gross earnings is, therefore, in theory at least essentially a slip-shod method. In practice, however, as we shall see, its administrative advantages are so, marked as to render the gross earnings tax under certain circumstances desirable.

The business transacted. This tax, while closely analogous to the gross earnings tax, does not possess all its advantages. The business may be large but not lucrative. An extensive business does not mean even proportionally extensive gross earnings. The business transacted is an exceedingly rough way of ascertaining the prosperity of a corporation. It affords no accurate test of profits, and fails to take account of the personal equation which may make all the difference between good and bad management. Clearly, the tax on business is but a clumsy device.

The dividends or the capital stock according to dividends. Economically speaking these taxes are the same; but from the legal point of view, at least according to the opinion of the Supreme Court, there is a decided difference. The distinction is brought out in connection with the subject of extraterritoriality, and will be fully discussed below. We are here dealing only with the economic problem.

The dividends tax, it may be said, is good so far as it goes; but it does not go far enough. It is indeed true that some of the objections are slight. Thus it has been contended that this tax fails to reach the profits which are not divided but which are simply put into a reserve fund; and some commonwealths have even sought to obviate the supposed difficulty by providing that the tax should apply to the dividends, whether declared or merely earned and not divided. This objection, however, is not of great importance; for even if the undivided earnings are not taxed, they go into the reserve or surplus fund; and as this increases the corporate capital, it must in the long run lead to increased earnings on the larger capital. Since the surplus cannot be increased indefinitely, it will ultimately find its way to the shareholders as dividends, and thus become liable to the tax.

Another objection which might be urged is that a corporation may devote a portion of its earnings to new construction or to new equipment. This expense may be defrayed out of profits, instead of from

the capital or construction fund. The dividends in such a case, it might be said, do not represent the actual earning capacity of the enterprise. While this is true temporarily, the improvements made by the corporation necessarily enhance the value of the property and ultimately lead to increased dividends, so that in the long run a tax on dividends would still reach the corporation.

The real objection to the dividends tax is of quite a different character. It is inadequate when applied to those corporations which have bonded indebtedness. Thus one corporation having no bonds may earn enough to pay dividends of five per cent on its stock, while another, with the same earnings, may have devoted half to the payment of interest on bonds, and only half to the payment of dividends. A tax on dividends, while nominally just, would be actually most unjust, for one corporation would pay just twice as much as the other. The objection has been recognized in American legislation, but only once. The United States internal revenue law of 1864 provided for a five per cent tax (raised from three per cent in 1862), which, in the case of railroads, canals, turnpike, navigation and slack-water companies, was imposed on all dividends, as well as on all coupons or on all interest, on evidences of indebtedness and on all profits carried to the account of any fund. In the case of those companies which were not presumed to have any bonded debt, like banks, trust companies, savings institutions and insurance companies, the tax was imposed only on dividends and surplus. The federal law, indeed, violated strict consistency in imposing a gross earnings tax also on transportation and on certain insurance companies; but the correct implication in the law was the inadequacy of a tax on dividends alone. On the other hand, the federal law of 1909 imposing an excise tax of 1% on the "net income" of corporations is open to serious objections. For it permits among the deductions from gross income all interest actually paid in the year on bonded or other indebtedness up to an amount of debt equal to the paid up capital. That is, since interest on the bonds is not taxable, the tax is virtually levied on dividends, or at all events on the sums available for dividends. In fine the objections to the dividends tax are closely analogous to those which we found in the capital stock tax as compared with the tax on stock plus debt. Its great defect is that it reaches only a part of the corporate earning capacity.

We thus come finally to the tax on net earnings, or rather on net receipts, profits or income. This is the most logical form of corporate taxation. The tax is not, like the gross earnings tax, unequal in its operation. It holds out no inducement, like the general property tax, to check improvements. It is just; it is simple; it is perfectly proportional to productive capacity. In short, it satisfies the requirements of a scientific system.

Several objections, however, might be raised to a tax on net receipts. One is that the accounts may be "cooked" by paying unduly large salaries to the officers; that is, the profits may be divided as nominal expenses, thereby leaving very insignificant net receipts or none at all. This objection, however, would not apply at all to the vast majority of corporations, whose stock or bonds are held by outside parties, that will not consent to see their dividends or interest curtailed by any practices of this nature. The danger can be real only in respect to the few corporations in which the stock is owned entirely by the managers. But these are chiefly manufacturing corporations, which, as we know, are usually exempted from the general corporation tax. Even here, however, the danger is not very great. We hear of no complaints on this score in the American commonwealths where the net receipts tax prevails; and in Europe, where this method of taxation is well-nigh universal, the objection has never been raised. It may thus be pronounced of httle importance.

Secondly, it may be contended that the tax is impracticable in the case of great railroad corporations which, having leased lines in other states, are interested in so manipulating the traffic that the heavily mortgaged leased lines will earn little or nothing above fixed charges. Such cases are very common. The commonwealths in which such leased lines are situated will, it is argued, be robbed of the whole benefit of the tax; since the proceeds accrue to the state of the parent company. In reality, this objection arises simply from a quibble about words. Of course net receipts must be strictly defined. The logical basis of corporate taxation is the total annual revenue from all sources minus all actual expenditures except interest and taxes. The reason for not deducting fixed charges, i.e. interest on the bonds, is the same as that which leads some of the states to levy the railroad tax on capital plus debt, and which made the federal government in 1864 tax coupons as well as dividends. Both together represent earn-

ing capacity.[1] Although the interest on the funded debt is known by the name of fixed charges, it is really part of the profits which, in the absence of funded debt, would go to the shareholders as dividends. It would obviously be suicidal so to frame the definition of net receipts as to exclude this interest on bonds. Net receipts of a corporation mean gross receipts minus actual current expenses. Any other definition would confuse the whole conception.

In several commonwealths some very dubious and arbitrary distinctions have been attempted. The Minnesota courts have held that "earnings" means only receipts from operation.[2] Under the New York law it has been held that "income" means gross income, and that "profits" means gross profits, not clear profits;[3] but this decision was owing to some peculiarities of the statutory phraseology. From the standpoint of the science of finance we understand by "income," net income, and by "profits," only net profits. So in Pennsylvania and Alabama it has been held that income, gains or net earnings means the whole product of the business, deducting nothing but expenses.[4] In Pennsylvania it has been well settled that net earnings are the excess of gross earnings over the expenditures incurred in producing them and the amount incurred in necessary repairs, but not including the amount expended in enlarging or extending the works.[5] The Thurman law, indeed, which regulated the relations of the federal government to the Pacific railroads, defined net earnings in a different way, viz., as the gross earnings, deducting "the necessary expenses actually paid within the year in operating the lines and keeping the same in a state of repair," and also deducting "the sums paid by them in discharge of interest on their first mortgage bonds," but "excluding all sums paid for interest on any other portion of their

---

[1] Cf. supra, pp. 106-107.

[2] State vs. Railroad Co., 30 Minn. 311.

[3] People vs. Supervisors of Niagara, 4 Hill, 20; People vs. Supervisors of New York, 18 Wend. 605.

[4] Commonwealth vs. Pa. Gas Coal Co., 62 Pa. 241 (1869); Board of Revenue vs. Gas Light Co., 64 Ala. 269. In the case of mines, "net proceeds" have been defined; Montana Code, ñ 1791.

[5] Com. vs. Minersville Water Co., 13 Pa. C. C. 17 (1893); and Com. vs. Sharon Coal Co., 164 Pa. 284 (1891).

indebtedness."[1] The explanation of this arbitrary definition lies not in any economic principle but in a particular legislative provision whereby the first mortgage bonds were given precedence over the government liens. The Supreme Court has held that "net earnings" as here used exclude expenditures for new construction and new equipment.[2] In Virginia the taxable net income of corporations was formerly ascertained by "deducting from gross receipts the costs of operation, repairs, and interest on indebtedness." So also by the federal law of 1909 the excise tax is virtually levied only on corporate dividends; but this, as we have seen, is economically incorrect. Interest on bonds should not be exempted.

If it be desired to obtain in the case of railroad companies a more exact definition of net receipts or income, the following would be a sound method of procedure: Gross receipts consist of all earnings from transportation of freight and passengers, receipts from bonds and stocks owned, rents of property and all miscellaneous receipts from ancillary business enterprises or otherwise. From these aggregate gross receipts we should deduct what are classified by the Interstate Commerce Commission as operating expenses.[3] No deduction should be made for fixed charges, i.e. for taxes or for interest on the debt, or for the amount used in new construction, in betterments, in investments, in new equipment, or for any of the expenditures that find their way into profit and loss account.

The method here suggested would lead to the abolition of one of the serious abuses of American railway management—that of putting all possible expenses into the construction account. The railways, for example, formerly often failed to charge the maintenance and repair of their rolling stock to current expenses. When the equipment has become unserviceable, new stock is bought and charged to the construction or to the profit and loss account. In the meantime the nomi-

---

[1] Act of May 7, 1878, 45th Cong., 2d Sess., chap. 96, sec. 1.

[2] Union Pacific R. R. Co. vs. United States, 99 U. S. 419.

[3] The operating expenses which it is permissible to deduct from the gross receipts are defined as "maintenance of way and structures" including: "repairs of roadway and renewal of rails and ties; repairs and renewal of bridges and other structures; maintenance of equipment; conducting transportation, including: salaries and wages in the operating department, supplies, car mileage, switching charges, damage for injuries, advertising, outside agencies and commissions; and general expenses."

nal earnings of the railway seem large, and the managers reap whatever temporary benefit they may desire. The taxation of net profits in the sense that has been indicated would tend to check this practice, since deductions would be allowed for maintenance, but not for new equipment. A tax on net receipts, thus, properly defined, would possess not only a financial, but also a wider economic advantage.

The federal corporation tax of 1909 gives a definition of net income which is clear and satisfactory, with the exception, as noted above, that it permits deductions for taxes and for interest on debt. Omitting these two points, the definition is as follows:

> "Such net income shall be ascertained by deducting from the gross amount of the income received within the year from all sources: (First) All the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance companies, the sums other than dividends paid within the year on policy and annuity contracts and net addition, if any, required by law to be made within the year to reserve funds: [(third) and (fourth) omitted as representing taxes and interest]; (fifth) all amounts received within the year as dividends upon stock of other corporations, etc., subject to the tax herein imposed."[1]

So far as intra-state carriers are concerned, most of the state commissions now follow the system prescribed by the federal commission. As to other public-service corporations less progress has been made, although the public-utility commissions in some important states like

[1] In an interesting memorandum by a number of prominent accountants attention is called to the fact that it would have been far more in consonance with modern accounting methods to substitute for the words "expenses actually paid" the words "expenses actually incurred"; and for the words "losses actually sustained" the words "losses actually ascertained". See *The Corporation Tax Law of 1900. A Letter to the Members of the American Association of Public Accountants together with Copies of Correspondence with the Attorney General.* New York, 1909.

New York, New Jersey and Wisconsin have laid down equally minute rules applicable to these. With every year, therefore, the objections to the net earnings rule based on inability to define net earnings are losing force.

A final objection, occasionally urged, is that the net earnings tax is inadequate for the reason that corporations sometimes have no net earnings while the government always needs a revenue. This objection, however, is without much weight. For if the accounts are carefully prescribed, the absence of net earnings will be far less frequent than is commonly feared; and if it nevertheless happens that in any particular year a given corporation actually earns nothing, there is no reason why it should be called upon to pay the tax. If the rule—no net earnings taxation because of the possibility of no net earnings—were strictly followed, it would render impossible any general income tax on individuals; and yet, as we know, the tendency throughout the world is towards an income tax. The fact that individuals here and there fail to secure an income from their business or otherwise is not considered any valid objection to the imposition of an income tax in general. Corporations, like individuals, normally make profits; and where losses are incurred by some, they are more than compensated by the profits of others. The public revenue continues because of the balance of profit makers. Moreover it must not be forgotten that under a proper system of taxation, a corporation even without any net earnings would still be subject to taxation on its real estate for local purposes. But to tax a corporation for state purposes on its property when the property yields nothing, or on its gross receipts when the receipts are all swallowed up by necessary expenses, is assuredly not to be defended on any principle of equity, as a permanent rule. Above all, however, if in the exceptional case of no net earnings it is still desired to secure a revenue it is easy to adopt the simple solution of the problem, as practised in Austria.[1] The tax there is levied on net earnings, but in no case is permitted to be less than a certain percentage of the corporate capital. In this way net earnings are reserved as the normal basis of the tax, and yet some revenue is assured to the government.

---

[1] Cf. infra, p. 263.

III. Practical Reforms

It is clear from the above discussion that the various methods that have been reviewed, have both advantages and drawbacks. Practically, however, there are two fundamental questions: (1) Shall we choose a tax on property in preference to a tax on earnings? and (2) If the first question is answered in the negative, shall we choose a tax on gross earnings in preference to one on net earnings?

The problem involved in the first question is the advisability of the ad valorem system. This system, it will be remembered, differs from that of the general property tax discussed above,[1] in that the assessment of corporate property is made as a unit by a state board.

There is no doubt that the ad valorem system constitutes a decided advance over the primitive methods of the general property tax, not only because a valuation according to the unit rule, conducted by a state board, is at once more effective and more equal than the disjointed system, or lack of system, involved in the piecemeal assessment by local officials; but also because the ad valorem system now usually includes the value of the franchise, which it is well-nigh impossible to reach by local methods. So much can freely be admitted. But what shall be said of those states, like Michigan and Wisconsin, which have reverted from an earnings to an ad valorem system? Are we to consider this a step forward or a step backward?

The reasons for this reversion were twofold. In the first place, the earnings tax was imposed on gross earnings and some dissatisfaction was manifested with the lack of equality as between the corporations. We are told that "the principal objection was the inequalities produced in the relative amount of taxes paid by the different companies. The plan provided for a certain per cent of the gross earnings per mile and was graduated. It may have been the fault of the graduating, but the fact remains that the tax was not an equitable one and the system was abolished."[2] As a matter of fact, however, this was not the principal objection. Of far greater weight was the second reason for the change, namely, the desire for so-called equal taxation as between individuals and corporations.

---

[1] Supra, pp. 145-148.

[2] Cf. *Sixth Report of the Board of Tax Commissioners*. Lansing, 1911, p. 55.

It was claimed, and the claim was undoubtedly well founded, that the property of the public-service corporations was not taxed at the same rate as that of individuals. It was pointed out that these corporations were practical monopolies, and it was alleged that their charges were extortionate, their profits inordinate, and their owners, while enjoying special privileges, unwilling to bear their fair share of the public burdens. This cry of equal taxation won the day, and the simplest method of carrying out the mandate of the people seemed to be to make all corporate property liable equally with that of individuals.

It will at once occur to the critic to ask: if the gross earnings tax was objectionable chiefly on the ground of inadequacy, why would it not have been better simply to increase the rate of the tax and to leave all the machinery unaltered? It appeared, however, to those in charge of the movement in both Michigan and Wisconsin that an increase in the rate of the gross receipts tax would be difficult to accomplish in the face of the powerful interests engaged, and that a far more effective and more easily understood battle cry would be that of the equal taxation of all property. This argument prevailed, and it is not to be denied that it may have been the part of political wisdom in those states; although it must be borne in mind that both in Minnesota at the time and in California a few years later the other argument proved equally effective as a political shibboleth, and that the desired equality was brought about simply by the imposition of higher gross earnings taxes.

Moreover, from the point of view of tax reform in general, this demand for "equal taxation" of property must be pronounced regrettable and even mischievous. No one of course will dispute the desirability of equality in taxation; but it is necessary to define more exactly what this really implies. If a satisfactory norm of taxation, or criterion of ability to pay, is selected, equality in the application of this norm is assuredly to be desired. But, as we have seen in an earlier chapter, property in general is no longer an adequate test of ability to pay. Equal taxation, so far as property is concerned, is supposed to mean the continuation of the general property tax, undifferentiated and unclassified. This theory, which is still so widely held by the average American, is really responsible for all our troubles. As we have seen, progress is taking place here, as it took place elsewhere, through a splitting up of the general property tax, through a

classification of property and through a differentiation of taxation. Moreover, it is none the less true that equality does not necessarily mean the identical tax at the same rate on every particular piece of property. But if this is so, and if, as is now not infrequently the case, we select certain kinds of property and tax them in a different manner or at a different rate, why, it may be asked, is not the same method applicable to corporations also? The cry for "equal taxation" reflects credit on the general intuition or instinct of the partisans of the ad valorem system, but it does not reflect the same credit on their knowledge. For a more adequate acquaintance with fiscal theory would have brought them to the conclusion that the equal taxation of property in modern times does not necessarily mean the equal taxation of the property owner; or to put it in another way, that the equal taxation of the taxpayers—whether individuals or corporations—does not necessitate an equal taxation of their property. The test of equality under modern conditions is as we now know no longer to be found in the undifferentiated mass of property. It is instructive to note, moreover, that in the very state where the battle for ad valorem taxation was won on the plea that corporate property was undertaxed, the old principle should be thrown overboard, in the face of the well-founded complaints on the part of some corporations that they are now overtaxed. We read in a recent report of the special commission in Michigan the following:

> "This complaint (of inequality) must be considered in connection with the fact that the properties to be assessed by the state board of assessors forms a class different from that assessed under the general tax law. Where it is possible to separate property into classes for purposes of taxation, it is permissible to impose varying rates upon the different classes.
>
> "It is not the purpose of this system to make a discrimination between the two classes, but if, incidentally in the process of administration, discrimination through a difference in rates arises, that fact does not even make a *prima facie* case against the equality of the tax levied through such a board of assessors or against the validity of the law."[1]

---

[1] *Report of Commission of Inquiry into Taxation.* Lansing, Michigan, 1911, p. 53."

In other words, "equal taxation" is to be invoked when it means a remedy for the relative over-taxation of individuals; but it is not to be invoked when it means the relative over-taxation of corporations.

We may go still further and say that, entirely irrespective of the question of the basis of taxation, the attempt to put corporations and individuals on precisely the same plane in matters of taxation is based upon an essentially erroneous theory and that it fails to distinguish between the principles applicable to natural and to artificial personalities. For a corporation, after all, is a fictitious entity whose economic power consists of that of its stockholders and bondholders. The fundamental point of our whole contention is that corporations should not be treated like individuals, but should be subjected to special forms of taxation. It is gratifying to see that the truth of this contention is now being recognized by the specialists in Germany and Switzerland—the two countries where the most active discussion of these topics, outside of the United States, has taken place[1]—as well as by those of this country[1] and Canada.

---

[1] "Gewiss ist bei den Aktiengesellschaften eine besondere Steuerkraft vorhanden, aber dieselbe kann durch die allgemeinen Subjektsteuern von Vermögen und Erwerb nicht in geeigneter Weise in Anspruch genommen werden. Unser Wirtschaftsleben ist so kompliziert, dass die Subjektsteuern allein zur Verwirklichung der Prinzipien der allgemeinen und gerechten Besteuerung nicht ausreichen. Dazu ist ein System verschiedenartiger Steuern notwendig . . und in einem solchen Steuersystem darf eine spezielle Aktiengesellschaftssteuer nicht fehlen. Denn auf die Aktiengesellschaften müssen, dem Wesen dieser Korporationen entsprechend, besondere Steuergrundsatze Anwendung finden."—Dr. W. Gerloff, *Die kantonale Besteuerung der Aktiengesellschaften in der Schweiz.* Bern, 1906, p. 190.

A similar conclusion is reached by the chief German writer on the subject. "Fassen wir das Ergebnis unserer kritischen Betrachtung der Besteuerung der Aktiengesellschaften durch die deutschen Personalsteuern zusammen, so müssen wir als den Grundfehler der deutschen Gesetzgebung bezeichnen, dass sie sich an die juristische Persönlichkeit der Aktiengesellschaft klammert, den wirtschaftlichen Charakter der Unternehmungsform aber in keinerlei Weise berücksichtigt. Von diesem rein formalen Ausgangspunkte aus gelangt sie dazu, die Aktiengesellschaften den physischen Personen nicht blosz in handelsrechtlicher, sondern auch in steuerlicher Beziehung gleich zu stellen (italics mine). Dass aber dieses über einen Kamm Scheren nicht ohne Gewaltanwendung und ohne Hintansetzung der Prinzipien der Personalsteuern möglich ist, zeigen schon die mannigfaltigen Modifikationen die an den Steuergesetzen vorgenommen werden mussten um den für physische Personen bestimmten Steuerrock auch für die Aktiengesellschaften einigermaszen passend zu machen."—

The Canadian commission which was instituted to probe this question to the bottom puts the matter so clearly as to deserve quotation in detail. After a comprehensive statement of the actual facts and after pointing out the various distinctions of fiscal importance between individuals and corporations, the commission proceeds:

> "In the light of the facts here pointed out it is quite obvious that the popular belief and claim that corporate property can and should be assessed and taxed on exactly the same basis as private property is quite impossible of realization. A survey of the actual practice of taxation in different states and provinces reveals the fact that, where both corporations and private individuals are professedly taxed on the same basis of real and personal property, the greatest inequality actually prevails. Thus, if the tax is levied on tangible property … corporations are found to be taxed very lightly as compared with individuals. But where the so-called *ad valorem* or general property tax has been applied to corporations, in such a way that their real and personal property is valued by capitalizing the income which the corporations derive from their

---

L. Blum, Die steuerliche Ausnutzung der Aktiengesellschaften i7i Deutschland. Stuttgart, 1911, pp. 132-133.

[1] Cf. the conclusion of Dr. G. E. Snider in his careful study, *The Taxation of Gross Receipts of Railways in Wisconsin, Publications of the American Economic Association*, Third Series, vol. 7, no. 4, 1906. After quoting the statement of the Wisconsin commission that "The safety of all interests rests on the principle of uniformity between all classes of property … there must be equality between the classes as well as between the property in the same class," Dr. Snider remarks (p. 120): "Such a program fails to recognize modern industrial conditions and patent fiscal practices. … The tendency and necessity have been for segregation and classification rather than aggregation and unification of property. The industrial organization is now so complex that uniformity between classes of property is an indefinite, indefinable and unattainable 'ideal.' What the Wisconsin and Michigan experience shows, what is made evident by the history of taxation in this country, is the selection of classes of property for special taxation. Real property has been the bearer in the past, corporations are having especial attention at present, and especially corporations receiving special privileges from the state. A frank recognition of the true state of affairs would do much to clear away the debris in our tax systems. … Had the Wisconsin commission frankly recognized this principle and said 'we believe that the railways are able to contribute more revenue to the state, and that it is desirable to levy a heavier rate upon them,' the present system, based upon a false premise, with its possibilities of political corruption, would not have been substituted for the tax on gross earnings."

whole business, as in the case of the new valuations in Michigan and Wisconsin, and, in milder form, in several other states, the result has been to very considerably overtax corporations in proportion to private property. … To place the capitalized income of corporations upon the same basis as the general property of private individuals is plainly neither an accurate nor an equitable adjustment of taxation, as between corporate and private property.

"Since then it is impossible to equitably tax private property and corporate property on the same basis, there is no necessary injustice or inequality in taxing them upon different principles or by different public authorities. In fact, it is the attempt to tax them both upon the same principle which works injustice and inequality, and it is only by taxing them upon different principles suited to each form of property that it is possible to attain to approximate justice and equality."[1]

We see then that the cry of "equal taxation" is really not an adequate reason for the introduction of the *ad valorem* system. For in the first place "equal taxation of property" is in modern times not real equality of taxation; and secondly, the equality of taxation so far as it is desirable at all can be brought about as well by an earnings tax as by an *ad valorem* tax. It is entirely a question of the rate.

So much for the negative side of the argument—namely that *ad valorem* taxation is not needed in order to achieve equality. We now come to the positive side of the argument—that the earnings tax is preferable.

As we have seen above, if the basis of the corporation tax is to be put in terms of property, corporate property includes more than merely the physical property. The franchise or the immaterial elements in the property must be included. As soon, however, as an attempt is made to measure the value of the franchise, recourse must be taken, as we have learned, to earnings. It is a commonplace of modern economics that capital is nothing but capitalized income; or, to put it in terms familiar to every business man, a business or a piece of property is worth what it will earn. As the Wisconsin commission puts it:

[1] *Report of Ontario Commission on Railway Taxation*, Toronto, 1905, pp. 11-12.

"It is the financial rule in the markets of this country and all over the world, that the worth of property is determined by what it will produce in income. If the permanency of the income is assured from past results in operation, the risk of investment is less and the value more stable. The earnings in the opinion of financiers is the final test of the value of corporate securities, and the estimate of the earning capacity of railroads formed by such men and acted upon in buying and selling of the securities in the market generally establishes the market price."[1]

Where individual pieces of property are subject to purchase and sale in the market, the property or capital value is as readily ascertainable as the earning or income value. But where, as in the case of large corporations, there is no market or no regular purchase and sale, the only possible method of ascertaining capital value (or so-called property value) is by capitalizing the earnings, present and prospective. Hence the ad valorem system cannot satisfy itself with the inventory method, or the mere appraisal of the physical property of a corporation. It has been found necessary to add the valuation of the franchise; and as soon as this is done, the earnings method which has been abandoned is brought in again by a back door.[2] The various boards of assessment as we have seen, generally refuse to divulge the exact method, for fear of an attack on their assessments. But that earnings is the chief factor in their appraisal is an open secret.[3] It is not a matter for pride to read in a foreign commentary:

---

[1] *First Biennial Report of the Wisconsin Tax Commission*, Madison, 1903, pp. 18.5-186. In a later report the commission states: "As to nearly all such properties, this capacity to produce income will ordinarily be the dominant factor in ascertaining values." Fifth Report, 1911, p. 53. But the conclusion that therefore the *ad valorem* system should be continued by no means follows.

[2] "Thus, though earning power had been expressly discarded as a basis of taxation, and the *ad valorem* system adopted in its place, yet the more the Commissioners studied the subject in its practical operation, the more they were driven back to income as the leading factor in value."—*Report of Ontario Commission on Railway Taxation,* 190.5, p. 49.

[3] See the statement by one of the officials himself that in West Virginia "the element of value which is chiefly relied upon in valuing all the different classes of public service corporations is the earning power of the property." *Addresses and Proceedings of the Fourth Conference of the International Tax Association,* 1911, p. 259.

"We see why it is, then, that though on almost every hand, even in the states which believed themselves forced to abandon it, the earning power of corporations is held to be the only reliable and satisfactory basis of taxation … practically none of the American states find themselves able to frankly and fully accept it. Where it is employed, it is under some disguise or legal fiction, and commonly with the tacit consent of the taxpayer and taxing authority that the fiction shall not be called in question."[1]

If, however, the *ad valorem* method necessarily means in practice the indirect use of the earnings method, the question arises: why not use directly what you are compelled to use indirectly? We may go further and affirm that nothing is gained, but much is lost, by electing the indirect, rather than the direct, earnings method. For, as we have seen, the direct earnings method is susceptible of reduction to a mathematical rule; whereas the indirect earnings, or ad valorem, method is open to the objections of secret, irresponsible, star-chamber methods. We may again agree with the Ontario commission in thinking that:

---

[1] *Report of Ontario Commission*, p. 17. On another page the Commission sums up its estimate of the *ad valorem* system—an estimate, in which every impartial judge will concur: "The state of Michigan in determining to change from the gross earnings to the *ad valorem* system of taxing its railroads, made the most elaborate and perfect attempt on record to determine what the physical property of the railroads was worth on the basis of cost of reproduction, less the normal depreciation for wear and use. But when at a cost of $60,000, this very elaborate and accurate appraisal was made, what was the practical value of it for taxation purposes? Virtually nil. The real valuation was determined on quite other grounds and mainly, as was admitted by those making the assessment, on the basis of earnings. The result was that some roads were valued considerably above the cost of reproduction, while others were valued very much below it and where the valuation was much the same as that of appraisal it was a mere coincidence. Where the valuation was above the appraisal the difference was called the intangible or franchise value, but where it was below the appraisal the difference was not named, though more or less intangible also. But, though somewhat costly for Michigan, the experiment tried there has been exceedingly valuable for the rest of the world, and therefore, by us at least, the outlay need not be regretted. The experiment has demonstrated that, however serviceable such a valuation may be in affording an independent and scientific basis for judging the cost of production of modern railroads, under the varying conditions of such a state as Michigan, it is quite futile as a means of getting at the commercial value of a railroad as a going concern, or as a basis of taxation.—Ibid., p. 14.

"The essential fairness of taking earnings as a basis for taxation of corporations is based on the general principle that the taxes vary with the capacity of the company to pay them, whereas taxation on the basis of general property results in all manner of inequality. The amount of tangible property required by the various corporations has, in the first place, no necessary relation to their relative earning power, and in the second place, bears no accurate relation to the earning power of the same company at different periods. The capital stock tax has something of the same defect in addition to those already mentioned, yet it has a certain amount of flexibility. Only the tax on earnings follows automatically the capacity of the corporation to pay, and while even it has inequalities, yet it is very much more equitable than any other practical system."[1]

The difference between the earnings system and the *ad valorem* system is the difference between publicity and secrecy, between certainty and arbitrariness, between simplicity and complexity, between precision and guess work—in short, between modernism and mediævalism.[2]

---

[1] Op. cit., p. 23.

[2] For an instructive comparison in detail between the *ad valorem* and earnings methods see the work of Snider, mentioned supra, page 253. For other material and discussion on this question see the *Report of the Commission on Revenue and Taxation of the State of California*, Sacramento, 1906, chaps, iii. and iv.; *First Biennial Report of the Minnesota Tax Commission*, Saint Paul, 1908, chaps, vi. and vii.; and *Second Biennial Report* of the same, 1910, chap, xviii.; *Report of the [Special] Virginia Tax Commission*, Richmond, 1911, appendix. The Virginia report terms the *ad valorem* system "complicated, confused and uncertain"; op. cit., p. 256.

For an interesting contemporary discussion of the Wisconsin agitation see L. W. Bowers and F. P. Crandon, *Argument submitted to the Slate Tax Commission of Wisconsin on behalf of the Chicago and Northwestern Railway Company*, Chicago, 1901; F. P. Crandon, *Railway Taxation in Wisconsin*, Chicago, 1901; J. M. Dickinson, *Railway Taxation in Wisconsin, Argument made before the Joint Committee on Assessment and Collection of Taxes at Madison*, Marcli 5th, 1901; G. R. Peck and A. S. Dudley, *Should the present System of Railway Taxation in Wisconsin be changed? Suggestions to the Honorable Tax Commission,* Chicago [1901].

For later arguments in favor of the earnings taxation of railways see *Railway Assessment and Taxation in the Province of Ontario. Arguments presented by Messrs. Hellmuth and MacMurchy to the Ontario Commission or Railway Taxation, Oct., 1904; Railroad Taxation, Remarks before the Minnesota Academy of Social Science at Minneapolis*, Dec. 6, 1907, by W. W. Baldwin of Burlington, Iowa.

If then the earnings tax is to be preferred to the *ad valorem* tax the question remains, shall it be gross earnings or net earnings? As a matter of principle it is conceded by all writers that net earnings approach more closely to the ideal method. "It is plain," we are told by the Ontario commission, "that the only true estimate of a railroad property is its earning power or its income. Its income, therefore, would appear to be the proper and indeed the ideal basis for taxation, if," they add, "it is found to be capable of discovery and definition without too elaborate or costly a mechanism." It is owing to the doubt expressed in the last sentence that not a few authorities prefer gross earnings. For the ascertainment of gross earnings presents none of the difficulties which are deemed to be inseparable from that of net earnings. This is the position taken by the Ontario commission of 1895, by the California commission of 1906, and by the Virginia commission of 1911.

It is necessary, however, to bear in mind two points. One is the marked progress that it is being made in the matter of corporate accounting in the United States, thus annually bringing us nearer to the time when the ascertainment of net earnings will be subject to far less difficulty than is the case at present. The other is the fact that the California commission itself, which reported in favor of gross receipts, recommended the utilization of net earnings as a necessary means of ascertaining the proper rate of the gross earnings tax.[1] Furthermore, as we have seen, many of the states which levy either a gross receipts or a franchise tax require from the corporations returns which enable the board to compute the net earnings, and which then lead to a valuation of the property through a capitalization of the net earnings. If net earnings are thus utilized indirectly, why should they not be utilized directly? The argument in this respect as to the choice between gross and net earnings is precisely the same as the one advanced above as to the choice between property and earnings taxation.

As a matter of practical wisdom it may be conceded, however, that in not a few of the American states simplicity and convenience of administration are preferable to more ideal but more difficult methods. In such states the taxation of gross earnings may be recom-

[1] Op. cit, p. 95.

mended as an easy solution of the problem for the time being.[1] It must, however, not be forgotten that with the improvement of administrative methods and with a fuller appreciation of the modern principles of accounting, the time is fast approaching when the net earnings system will be applicable to all corporations in general by the states, as it is now applied without difficulty by the federal government in the United States, and by most of the leading countries abroad.

One objection still remains. It has sometimes been urged that a tax on corporate property is more just than a tax on corporate earnings, because the value of a corporate security is fixed not only by its present, but also by its prospective, productiveness. This is, however, a specious objection, since under a system of earnings taxation the future product will be taxed when it ultimately appears. If productiveness be accepted at all as the standard of capacity—and this is tacitly assumed in the above objection—the most logical and defensible method is the taxation of the product as it appears. But consideration for the individual producer makes it necessary, as has been pointed out above, to regard net, not gross product; and, therefore, if any one principle be accepted as the basis of the general corporation tax, it should be net profits, and not gross earnings or property.

European experience all points to taxation of net earnings as the best system. One country, indeed, still assesses corporate property in some form or other. Switzerland, as we have seen, is the only European state which has retained the mediaeval system, once common to all countries. The reasons, as was pointed out, are the comparative equality of conditions and the survival of the primitive villages and agricultural communities with their placid and homogeneous eco-

---

[1] Mr. Allen Ripley Foote makes an ingenious suggestion designed to accomplish the results of a net earnings method through the medium of a gross earnings method. His proposition is to levy on railroads at least, a flat rate tax on gross operating revenue plus a differential on the margin between operating revenue and operating expenses. Cf. "Taxation of Railroads in the United States," in *Addresses and Proceedings of the Fifth Annual Conference of the National Tax Association*, Columbus, 1912, p. 193 et seq. Cf. the suggestive and practical discussion in Alfred E. Holcomb, *The Assessment of Public Service Corporations*, Richmond, 1911, reprinted from the *Proceedings of the Fifth National Tax Conference;* and the same author's. *One Assessment—One Levy. Address delivered at the Second State Tax Conference held at Buffalo*, Jan., 1912.

nomic life. It is significant, however, that many of the Swiss commonwealths, in which we notice a gradual industrial development and a consequent differentiation of property, have attempted to remedy some of the obvious defects of the general property tax by supplementing it with an income tax. Thus some cantons, like Schaffhausen, Zürich, Basel, Aargau and others, tax corporations on their capital or their reserve fund; or, if the net receipts exceed a certain percentage of the capital, on their income.[1] This system resembles, although in a very slight degree, those of New York and Pennsylvania. Other cantons, like Bern, have abandoned the general property tax, and assess corporations only on their real estate and their income. Finally, some cantons, like St. Gall and Neuchatel, tax corporations directly only on their income. Even in Switzerland, with its fondness for mediaeval customs, we see, therefore, that the tendency is almost everywhere away from the taxation of corporate property. In the other European states this tendency has passed into accomplished fact.

In England, all corporations are held to be "persons" within schedule D of the income tax, and consequently they pay a tax on their net annual profits or gains. A series of important cases has elaborated the principles that should determine the exact nature of net profits.[2] The rules laid down are analogous to those described in the definition of net receipts just given. The tax, moreover, is paid before the dividends are declared. Railroads are also subject to the special passenger duty of five per cent on receipts from passengers, which is merely a survival of the old tax on stage coaches, and to a corporation duty, which is intended to take the place of the "death duties" on individuals. Even in the matter of local taxation or rates the railways are taxed on what amounts roughly to net receipts. In theory the real estate of railways like that of individuals is rated on the basis of rental value, i.e. in the case of railways the property is locally taxable on the basis of what a hypothetical tenant would give for it if renting

[1] The facts stated in this paragraph are accurate as of 1895, the date of the first edition of this book. For the few changes that have taken place since that date see the details in W. Gerloff, *Die Kantonale Besteuerung der Aktiengesellschaften in der Schweiz*, Bern, 1906.

[2] Ellis, *A Guide to the Income Tax Acts*, 2d edition, pp. SO, 92-101.

it. In practice the gross receipts are taken and certain rough deductions permitted. The difficulty arises from the fact that each local stretch of line or piece of real estate is separately assessed by the local officials, as is still the case in New York state. In Scotland on the other hand the unit rule is observed under the name of cumulo-value rating—i.e. a valuation of the line as a whole. From the gross receipts 73% are deducted for working expenses and tenants' allowances, separated under distinct heads. The remainder—roughly the net earnings—is divided between stations and running line, and the rates due on the latter item are then distributed or "allocated" to the separate local divisions on the basis of relative mileage. In Ireland where the unit rule is also observed, the distribution to the localities is made on the basis of train mileage.[1]

In France, all corporations pay a tax on net profits in the shape of a three per cent tax on dividends, coupons and profits, known as the tax "*sur le revenu des valeurs mobilières*." The tax is also applicable to joint-stock companies and to commercial enterprises,[2] while mutual insurance companies and similar associations have by judicial interpretation been exempted. Like individuals, corporations are also subject to real estate taxes and to the license taxes (*impôts des patentes*) on occupations. In the case of railroads, however, we still find a partial tax on gross receipts. The five per cent tax on gross receipts from freight, which was imposed after the Franco-Prussian war, proved to be so vexatious and so obstructive to industrial development that it was abolished a few years later.[3] But the old "tax on public conveyances"—a percentage on the fare—, which dates from the last century, was extended in 1855 to the receipts from passengers and from express traffic. In practice, this "public conveyance" or

[1] For details of the system in the three countries see the *Final Report of the Royal Commission on Local Taxation*, 1901.

[2] The tax is imposed on "les intérêts, dividendes, revenus et tons autres produits des actions de toute nature" of stock companies, and on "les interets, produits et bénéfices annuelles des parts d'intérêt et commandities" of all associations, etc., without a divisible share capital. Law of June 29, 1872, art. 1. Cf. Tanquerey, *Traite theorique et pratique de l'impôt sur le revenu des valeurs mobilières*, pp. 23, 51, 143, etc.

[3] Levied in 1874; abolished in 1878.

transportation tax[1] is not a direct tax on the corporations, but an indirect tax on passengers and on consignors of express packages; for the tax is added to the price of the ticket or receipt and is paid by the individual. The only direct tax is thus laid on net earnings. Corporations also pay the indirect taxes, like the stamp tax (*droit de timbre*) and the transfer tax (*droit de transmission*) on shares and bonds; but, simply to facilitate the administrative procedure, they may and generally do commute for these by paying an annual tax of one-twentieth and one-fifth of one per cent respectively on the amount of their capital stock. In Italy corporations are taxed on their income or net earnings by the *imposta sui redditi della ricchezza mobile*. This "revenue of personal property," as it is called, is declared to consist, so far as corporations are concerned, in "all interest or dividends paid.[2] To make the term dividends still clearer, the law provides that "in the estimate of income are included all sums, under whatsoever title, distributed among the shareholders or added to capital, surplus or sinking fund or otherwise used in cancelling debts."[3] The Italian system is thus as comprehensive as the English.

In Germany the taxation of corporations varies widely in the different commonwealths.[4] A few of the smaller states tax corporations for state purposes only on their realty and on their occupation

[1] Droit sur les voitures publiques. Cf. Vignes, *Traite des impôts en France*, 4th edition, i., p. 192.

[2] "Sono considerati come redditi di ricchezza mobile esistenti nello stato . . . gli interessi e dividendi pagati . . . dell compagnie conimerciali, industriali e di assicurazione." Law of August 24, 1877, art. 3, b.

[3] "Nel reddito dello societd anonime ed in accomandita per azioni, comjirescvi le societii d'assicurazione mutua od a prcmio fisso saranno computate indistintamente tutfe le somme rijiartite sotto qualsiasi fitolo fra i soci e quelle portat'e in aumento tlel eapitale o del fondo di riserva ed ammortizzazione, od altrim(>nte imi)iegate anohe in estinzione dei debiti." Ihid., art. 30. Cf. in general, Oronzo Quarta, L'itnposta sulla RiccJiezza Mobile, 2 vols. (Turin). See also Alessio, Saggio std Sistema Tributario in Italia, i., p. 345; and the various authorities mentioned in Seligman, *The Income Tax*, 1910, p. 339.

[4] For full details as to corporate taxation in each of the German states in 1888 see Antoni, "Die Steuersubjecte in Zusammenhalte mit der Durch-führung der Allgemeinheit der Besteuerung nach den in Deutschland geltenden Staatssteuergesetzen," in Finanz-Archiv, v. (1888), pp. 382-499, especially 475 et seq. For the details brought down to date see L. Blum, *Die steuerliche Ausnutzung der Aktiengesellschaften in Deutschland.* Stuttgart, 1911.

(*Gewerbe-steuer*) , and not on their income or net profits, because the shareholders are individually taxed on their income from the corporations. This point will be discussed in detail in the following chapter. In most of the states, however, corporations are now taxed on their income. In a few cases, indeed, they are also subject to the supplementary and very slight property taxes that have been imposed in the last few years. The local taxes vary exceedingly throughout the empire. But whenever corporations are taxed at all on receipts, it is on net income. Corporations were formerly exempt from the local income tax, but they are now usually subject to it wherever it exists.[1] In only one instance are corporations taxed on their capital stock—in the case of mutual insurance companies, whose so-called dividends merely return in part the premiums paid by policy holders. On account of the difficulty of ascertaining the exact profits, Baden has therefore levied the income tax on an assumed amount of net profits, fixed at five per cent of the capital stock.[2] A detailed statement of the German situation is unnecessary, because, according to the confession of the German experts themselves, Germany is still backward in its system of corporate taxation, in that it does not yet recognize the necessity of special corporation taxes and still clings in great measure to the principle of "equal taxation" with individuals, which the scientists concede to be a mistake.[3]

In Austria, on the other hand, all corporations are subject to a special tax of ten per cent on net profits (including interest on bonds), but with two interesting variations: first that if dividends exceed 10%, the rate is higher; and second, that if there are no profits at all the tax must be at least one per mill of the stock and bonds.[4] The net receipts tax may thus be declared applicable in theory to all corpora-

---

[1] Cf. Meier, "Ueber die Frage der Communalbesteuerung" (in *Zehn Gutachten und Berichte über die Communalsteuerfrage, veröffentlicht vom Verein für Social-politik*), p. 104.

[2] Lewald, "Die direkten Steuern in Baden," in Finanz-Archiv, iii., p. 807.

[3] See the explanation of the "Rückständigkeit" of the German states in Blum, op. cit. p. 139.

[4] Steinitzer, Die jüngsten Reformen der veranlagten Steuern in Österreich, Leipzig, 1905; and the same author's "Zur Besteuerung der Aktiengesellschaften in Österreich," in Conrad's Jahrbücher, dritte Folge, vol. xxviii. (1904), p. 319 et seq.

tions. Some peculiar limitations arise, it is true, from the clashing of commonwealth laws, but these will be discussed in the next chapter.

IV. The Legal Situation

Our conclusion that the taxation of receipts is without doubt the best system brings us face to face with the facts of American constitutional law. Is a tax on receipts unconstitutional? Is it in conflict with the constitutional inhibition of state interference with interstate commerce? This is an important question. Let us, then, consider the legal as well as the economic aspects of the problem.[1]

The earliest important case involving this question construed the Pennsylvania law which imposed a tax on each ton of merchandise carried, and an additional tax of a certain percentage on the gross receipts of railroad companies. The tonnage tax was declared unconstitutional.[2] The same principle was later applied to a tax of one cent for every message sent by a telegraph company. This also, was held to be void as a tax on interstate commerce.[3] On the other hand, a state tax on the gross receipts of a domestic railroad company was upheld chiefly on the ground that the tax was laid upon a fund which had already become property. The gross receipts were said to be the fruits of transportation after they had become intermingled with the other property of the carriers.[4] The court, however, also contended that this was a tax on the franchise, measured by the amount of the business transacted, so that it was not clearly decided what was

[1] See in general, Professor Goodnow's articles on "Taxation of Railway Gross Receipts," in Political Science Quarterly, vol. ix. (1894), p. 233, and "State Taxation of Interstate Commerce," in Publications of the American Economic Association, vol. v. (1904), p. 153 et seq. Cf. also H. J. Davenport, "The State Taxation of Interstate Commerce," in Political Science Quarterly, vols. xxv. and xxvi. (1911-1912).

[2] State Freight Tax Cases, 15 Wall. 232 (1872).

[3] Telegraph Co. vs. Texas, 105 U. S. 460 (1881).

[4] State Tax on Railway Gross Receipts, 15 Wall. 284 (1872). This was in imitation of the case of Brown vs. Maryland, which held that articles lost their character of imports after they had left the original package or the hands of the original importer, and had then become a part of the general property of the state. But see the second note following. See also Baltimore and Ohio R. R. Co. vs. Maryland, 21 Wall. 456 (1874), which held that a charter stipulation that a railway should pay a part of its earnings to the state as a bonus, was not a tax, and was perfectly valid.

taxed, the franchise or the property.[1] Later the Supreme Court limited this general principle and decided that when the gross receipts, even of a domestic corporation were derived entirely from interstate or foreign commerce, they could not be taxed.[2]

In the case of foreign companies, the rule seemed at one time to be more strict; for a tax on the gross receipts of a foreign corporation, even if derived only in part from interstate commerce, was declared void to the extent that the receipts were derived from such interstate commerce.[3] A tax on the gross receipts from business done wholly within the state was, however, upheld.[4]

This distinction between foreign and domestic companies seemed to be maintained in a later leading case. The Maine tax on gross receipts was upheld as being a tax not on receipts, but on the privilege of exercising the corporate franchise, the resort to receipts being made simply to ascertain the value of the business. But although this action was brought nominally against a foreign corporation, the facts show that the tax was due from a domestic corporation leased by this foreign corporation.[5]

The reason for the distinction between domestic and foreign corporations, if there was such a distinction, in the view of the court, seems to be that in the case of a domestic corporation the thing taxed is the franchise, which may be measured at the discretion of the legislature (except that when all receipts are from interstate commerce the tax is invalid); while in the case of a foreign corporation the franchise cannot be taxed, but only the business. Since the thing taxed in the latter case is the business, the constitutional provision is violated

---

[1] In Fargo vs. Michigan, 121 U. S. 210, the court emphasizes this side of the Railway Gross Receipts Tax decision. For a recent case, see People ex rel. R. R. Co. vs. Campbell, 74 Hun, 210.

[2] Philadelphia S. S. Co. vs. Pennsylvania, 122 U. S. 326 (1886). In this case the court showed that the case of Brown vs. Maryland was really no authority for the decision in the case of the State Tax on Railway Gross Receipts, decided fifteen years before.

[3] Fargo vs. Michigan, 121 U. S. 230 (1886); Western Union Telegraph Co. vs. Alabama Board of Assessment, 132 U. S. 472 (1889). Cf. Coe vs. Errol, 116U. 8.517(1885).

[4] Ratterman vs. Western Union Telegraph Co., 127 U. S. 411 (1888).

[5] Maine vs. Grand Trunk R. R. Co., 142 U. S. 217 (1891). The real party to the case was the Atlantic and St. Lawrence R. R. Co.

whenever that business is so extended as to include interstate commerce.[1] The same distinction which is observable in the Gross Receipts Tax cases has been maintained in others. Thus a license tax on foreign companies doing an interstate business is held invalid because it is a tax on the privilege of doing interstate commerce;[2] but a license on a domestic corporation for boats used in interstate commerce is valid.[3] So, too, a privilege tax upon every sleeping car belonging to a foreign corporation has been declared unconstitutional as a regulation of interstate commerce;[4] but when the sleeping cars are run wholly within the state over the line of a domestic corporation, the tax is valid.[5] Again, a tax proportioned to capital stock and dividends is valid as to domestic corporations even though they be engaged in interstate commerce;[6] but if the business of a foreign corporation is interstate commerce exclusively, the tax on capital stock is void.[7] On the other hand, even though the tax be imposed on a foreign corporation, if it is assessed not on the business itself, but

---

[1] Cf. Horn Silver Mining Co. vs. New York, 143 U. S. 305.

[2] United States Express Co. vs. Allen, 39 Fed. Rep. 712; Leloup vs. Port of Mobile, 127 U. S. 640; Krutcher vs. Kentucky, 141 U. S. 47.

[3] Wiggins Ferry Co. vs. East St. Louis, 107 U. S. 365 (1882). Cf. Osborn vs. Mobile, 16 Wall. 479 (1872), where a license fee was imposed on an agent of an express company doing business in Mobile.

[4] Pickard vs. Pullman Southern Car Co., 117 U. S. 34 (1886). It was distinctly held that the cars in question had no situs in the state (Tennessee) imposing the tax.

[5] Gibson County vs. Pullman Southern Car Co., 42 Fed. Rep. 512 (1890). Whether the counties ma}levy such a tax depends entirely upon the authorization which must be express, given them by the state law.

[6] People vs. Wemple, 117 N. Y. 136 (1889).

[7] People ex rel. Pennsylvania R. R. Co. vs. Wemple, 138 N. Y. (1893). This was the case of a railroad corporation whose line terminated without the state, but which had terminal facilities within the state for the delivery of passengers and freight, the sale of tickets and the collection of dues. A somewhat similar case was that of Gloucester Ferry Co. vs. Pennsylvania, 1 14 U. S. 196 (1885). Here the state attempted to impose a tax on the capital stock of a New Jersey company having no property in Pennsylvania except a wharf in Philadelphia. This tax was held void, as an interference with interstate commerce. Another similar case was that of Norfolk and Western R. R. Co. vs. Pennsylvania, 136 U. S. 114 (1890). The railway had no line in the state, but had an office there, and traffic contracts which made it a part of a system doing interstate business. A tax on capital stock of this corporation was held invalid, as interfering with interstate commerce.

on the capital stock or property according to mileage, and if the corporate property is actually situate in the state, it will be upheld.[1]

The law, therefore, seemed to distinguish in part between foreign and domestic companies. Yet in the Maine case, the tendency of the court, although it was expressed only in a dictum, seemed to be opposed to this distinction; and the reasoning of the court would tend to uphold a gross receipts tax, whether imposed on domestic or on foreign corporations, provided any of the receipts be earned within the state.[2] This legal reasoning was also economically sound, for from the economic point of view the distinction between domestic and foreign corporations is entirely indefensible. Strictly carried out, it would render substantial justice in taxation almost impossible. If a foreign corporation cannot be taxed where its earnings are received, because it is a foreign corporation; and if it cannot be taxed by the state of its domicile, because the earnings are not received there, it would manifestly evade its due share of the burden. But if every state could tax the receipts of any corporation, so far as they are actually earned within the state, no corporation could escape under the plea of its foreign origin, and the foundations would be laid for an equitable system based on interstate agreement. The force of the constitutional provision would, moreover, still be sufficiently strong to prevent unjust discriminations against foreign commerce or foreign business.

---

[1] Pullman Car Co. vs. Pennsylvania, 141 U. S. 18 (1890); Pullman Palace Car Co. vs. Assessors, 5.5 Fed. Rep. 206 (1893). Cf. Telegraph Co. vs. Massachusetts, 125 U. S. 5.30 (1890).

[2] "The privilege of exercising the franchises of a corporation within a state is generally one of value, and often of great value and the subject of earnest contention. It is natural, therefore, that the corporation should be made to pay some proportion of the burdens of the government. As the granting of the privilege rests entirely in the discretion of the state, whether the corporation be of domestic or foreign origin, it may be conferred upon such conditions, pecuniary or otherwise, as the state in its judgment may deem most conducive to its interests or policy. . . . The character of the tax or its validity is not determined by the mode adopted in fixing its amount for any specific period or the times of its payment. … The rule of apportioning the charge to the receipts of the business would seem to be eminently reasonable, and likely to produce the most satisfactory results both to the state and the corporation taxed." Justice Field, in Maine vs. Grand Trunk R. R. Co., 142 U. S. 217 (1891).

More recent cases have now definitely settled both the untenability of the distinction between foreign and domestic corporations in this matter and the precise extent to which gross receipts taxation is constitutionally permissible. In the Wisconsin case a tax was sustained which made the income of a railroad company within the state, although including interstate earnings, the measure of the value of the property. The court said:

> "In form the tax is a tax 'on the property and business of such railroad corporations operated within the state,' computed upon certain percentages of gross income. The *prima facie* measure of the plaintiff's gross income is substantially that which was approved in Maine vs. Grand Trunk Railway Co."[1]

Shortly afterwards, in the Texas case, a tax of 1% on the gross receipts of a domestic company was declared invalid on the ground that the tax was imposed on the receipts as such. Justice Holmes attempted to distinguish this case from the Maine case on the ground of a difference between a tax on property and a tax on commerce.[2]

> " 'By whatever name the exaction may be called, if it amounts to no more than the ordinary tax upon property or a just equivalent therefor, ascertained by reference thereto, it is not open to attack as inconsistent with the Constitution.' Telegraph Cable Co. v. Adams, 155 U. S. 688, 697. See New York, Lake Erie & Western R. R. Co. v. Pennsylvania, 158 U. S. 431, 438, 439. The question is whether this is such a tax. It appears sufficiently, perhaps from what has been said, that we are to look for a practical rather than a logical or philosophical distinction. The State must be allowed to tax the property and to tax it at its actual value as a going concern. On the other hand, the State cannot tax the interstate business. The two necessities hardly admit of an absolute logical reconciliation. Yet the distinction is not without sense. When a legislature is trying simply to value property, it is less likely to attempt to or effect injurious regulation than when it is aiming directly at the receipts from interstate commerce. A practical line can be drawn by taking

[1] Wisconsin & Michigan Railway Co. vs. Powers, 191 U. S. 379.
[2] Galveston, Harrisburgh & San Antonio Ry. Co. vs. Texas, 210 U. S. 217.

the whole scheme of taxation into account. That must be done by this court as best it can."

In the meantime, this distinction between a tax on property and a tax on commerce was strengthened by a number of cases which upheld the legitimacy of a tax on property, even if some of the property was used in interstate commerce.[1]

Finally, however, in 1912 the whole controversy was laid to rest, in principle at least, by two cases decided on the same day. In the Oklahoma case,[2] a gross receipts tax of 3%, levied in addition to the general property tax, was declared invalid because clearly a tax on the gross receipts as such, and therefore on the receipts from interstate commerce. On the other hand, in the Minnesota case,[3] a tax of 6% on the gross receipts was upheld because declared to be in lieu of all taxes on the property of the corporation. The decision quotes a dictum of Justice Peckham with approval:

> "When it is said, as it is in this act, that the tax collected by this method shall be in lieu of all other taxes whatever, it would seem that it might be claimed with great plausibility that a tax levied under such circumstances and by such methods was not in reality a tax upon the gross earnings, but was a tax upon the lands and other property of the company, and that the method adopted of arriving

---

[1] The case of Western Union Telegraph Co. vs. Mass., 125 U. S. 530 (1887), which upheld a tax on that proportion of the capital stock of a corporation that the state mileage bore to the entire mileage, was applied to a railroad in C. C, C. & St. Louis Ry. Co. vs. Backus, 154 U. S. 439; and to an express company in the Express Cases, 1G5 U. S. 194 (1896). These cases upheld the legality of the so-called unit rule. Again while a license tax on each Pullman car was declared invalid as an interference with the privilege of engaging in interstate commerce in Pickard vs. Pullman Southern Car Co., 117 U. S. 34, a tax on the capital stock of a similar company in proportion to the mileage of the cars run in the state as compared to the total mileage was upheld in P. C. C. Co. vs. Pa., 141 U. S. 18; and a tax levied by Tennessee upon "each sleeping car doing business within the state" for purely intra-state business was upheld on the ground that there was no compulsion to do this business. Allen vs. Pullman Co., 191 U. S. 171 (1903). On the other hand, the Kansas tax of 1/10 of 1% on the authorized capital stock of a similar company was declared inadmissible as a burden on interstate commerce. Pullman Co. vs. Kansas, 216 U. S, 56 (1910).

[2] Meyer, Auditor, vs. Wells, Fargo & Co., 223 U. S. 298.

[3] U. S. Express Co. vs. Minnesota, 223 U. S. 3.35.

> at the sum which the company should pay as taxes upon its property was by taking a percentage of its gross earnings."[1]

The court furthermore held that the Minnesota tax came within the principle laid down in the Postal Telegraph case[2] cited on the preceding page, and concluded:

> "Upon the whole we think the statute falls within that class where there has been an exercise in good faith of a legitimate taxing power, the measure of which taxation is in part the proceeds of interstate commerce, which could not, in itself, be taxed, and does not fall with that class of statutes uniformly condemned in this court, which show a manifest attempt to burden the conduct of interstate commerce."

Under this decision the constitutionality of any kind of earnings tax—gross or net—is henceforth indisputable, provided only that the earnings tax takes the place of the property tax and be not levied as an addendum to it. We may indeed criticize from an economic point of view a decision which declares a tax on earnings to be a tax on property or equivalent to it. But we must none the less applaud the ingenious way in which the Supreme Court has extricated itself from a difficult position. It must be remembered that the Supreme Court was dealing with a situation where the ordinary tax—on individuals and corporations alike—was the general property tax; and the problem presented was if possible to uphold a state earnings tax in terms of a property tax "or its equivalent." This problem the court has successfully solved, and the way is thus open for the development of a proper system of corporate taxation un-trammelled, in one important respect at least, by the fancied limitations of a federal constitution.

A tax on corporate earnings, according to a law properly drawn, is therefore not only economically correct but legally unassailable.

The only question that still remains is whether, under these decisions a local tax on the real property of corporations will be permissible contemporaneously with a state tax on earnings. It is to be hoped—and may we add to be expected—that when this question is presented the court will take the view that a local tax on real estate is

---

[1] McHenry vs. Alford, 168 V. S. 651.

[2] Postal Telegraph Co. vs. Adams, 155 U. S. 697.

in no way to be confounded, or to be regarded as inconsistent, with a state tax on earnings. When once this question is decided correctly, the progress of corporate tax reform will be assured.

This, therefore, is our general conclusion; but it does not yet exhaust the problem of corporate taxation. We are, in fact, only on the fringe of the difficulties. Let us proceed in the next chapter to study some of the more complicated questions.

Chapter VIII—The Taxation of Corporations
III—Complications and Conclusions

The discussion of the taxation of corporations would be incomplete without an examination of the various phases of double taxation. This is the more necessary for the reason that no attempt at a thorough analysis has ever yet been made. Yet the problems that hinge upon this particular question are so especially important in the United States as to demand the most serious attention.

In a former chapter[1] we have already discussed some of the general aspects of double taxation. Let us now attempt to develop the principles in the light of actual practice.

There are in reality no less than five different forms of double taxation in the case of corporations:—

1. Double taxation of property and of debts, or of income and of interest on debts.
2. Double taxation of property and of income.
3. Double taxation of property and of stock.
4. Double taxation arising from conflicts of jurisdiction.
5. Double taxation of the corporation and of the holders of stock or bonds.

I. Taxation of Property and of Debts

This first case need not detain us long. The only illustrations in the United States are found under the general property tax, which we have discarded as the basis of corporation taxation. In many of the states corporate debts must be considered in estimating the value of the capital stock. In New York, as regards local taxation, the indebtedness must be taken into account in assessing the capital stock; but after the valuation has been fixed, the amount of the indebtedness cannot be deducted.[2] If the capital stock is of no value because the indebtedness exceeds the assets, it should not be assessed.[3] In the case of foreign corporations, however, which are taxable on the

---

[1] Supra, chap. iv. 271
[2] I Thomp. and C. 635; 100 N. Y. 597; 112 N. Y. 565.
[3] People vs. Commissioners, 31 Hun, 32 (1st Department).

amounts invested in the state, it has been held that the law does not contemplate the deduction of debts.[1]

We have already pointed out that there is really no injustice in not exempting corporate indebtedness.[2] The mortgage bonds of a corporation are really a part of the working capital. Correct policy demands the taxation of corporate bonds as well as of stock, of loans as well as of share capital. To tax corporate debts may, indeed, be called double taxation in so far as the tax on both stock and debt is paid out of the same income; but if so, it is double taxation of a perfectly legitimate kind. It is here that the principles of individual and corporate taxation diverge.

Some of the American commonwealths, as California, Connecticut, Maryland and Pennsylvania, recognize this distinction between the taxation of individuals and that of corporations, by permitting the deduction of indebtedness from the property of individuals but refusing a like deduction in the case of corporate property. In California, the courts held distinctly that what would be double taxation in the case of individuals is permissible in the case of corporations.[3] Some of the Swiss cantons, like St. Gall, Zurich and Ticino, observe the same distinction.[4]

Perhaps more interesting and probably of greater future importance in the United States is the other phase of this question of the taxation of indebtedness—double taxation of income and of interest on debt. While the true theory of income taxation in the case of individuals demands the deduction of interest on debts, it has already been shown that in the case of corporations the interest paid on mortgage bonds must be included in the taxable income. Taxation of interest on corporate debt is not double taxation, because the coupons, like the dividends, are integral parts of the income; because both bonds and stock together form what is really the working capital from which the income is derived. This question has already been discussed; but the difference in economic significance between most

---

[1] People vs. Barker, 141 N. Y. 118.
[2] Cf. supra, p. 106.
[3] Central Pacific R. R. Co. vs. Board of Equalization, 60 Cal. 35.
[4] Schanz, *Die Steuern der Schweiz*, ii., p. 338; ii., p. 435; iv., p. 281

corporate bonds and ordinary individual debts must be continually borne in mind.

II. Taxation of Income and of Property

This second form of double taxation, like the first, involves no very complicated question; nor does the solution present many difficulties. Is it permissible to tax a corporation both on its property and on its net receipts or income? If corporations are put upon the same plane as individuals, the simultaneous taxation of the property and of the income from the property works no injustice. As we have seen above,[1] if all are treated alike and if the tax is uniform, there is really no cause for complaint.

So far as corporations are concerned, this was until recently not a matter of practical importance. The only case in which this special question formerly arose was under the laws of Alabama, now repealed, which provided for the taxation not only of corporate property but also of the corporate income during the preceding year.[2] Such taxation was upheld on the ground that it was only apparently double taxation.[3] What the court meant was, of course, not that it was not double taxation, but that it was not invalid or economically unsound taxation. In this the court was correct, for the law applied equally to all individuals and to corporations. Now, however, under the new (1911) income tax of Wisconsin which is deemed to take the place of the tax on intangible personalty, henceforth exempted, corporations are still taxable on their real estate and tangible personalty as well as on their income, but they are permitted to deduct from their taxable income all sums paid for taxes in any part of the country upon the source from which the income is derived. Moreover, all public-service corporations (as well as insurance companies) which pay taxes directly to the state are exempt from income tax altogether.

At present in the United States apart from the situation in Wisconsin, no attempt is made to tax simultaneously both corporate property and corporate income. The nearest approach to the practice

---

[1] Supra, p. 100.

[2] Ala. laws of Feb. 22, 1866; Feb. 19, 1867; Dec. 31, 1868; March 19, 1876; March 6, 1876.

[3] Board of Review vs. Montgomery Ga.s Light Co., 6-4 Ala. 276. Cf. Lott vs. Hubbard, 41 Ala. 593.

is the system in some states like Maryland, Pennsylvania and New York of taxing the capital stock and also the gross receipts of certain corporations. No objection has been raised to these taxes on the score of double taxation; nor is it likely that such an objection will be sustained.[1] One might as well object to a combination of direct and indirect taxes as involving duplicate taxation, on the ground that all taxes are in the last resort paid (or presumed to be paid) out of annual income. So again, in some of the Southern and Western states, as we know, corporations are taxed on their business, by license or occupation taxes, and again on their receipts, and this practice is upheld as perfectly valid.[2] This second form of double taxation is entirely proper.

The classic home of double taxation of this sort is Switzerland. Baselstadt, for instance, taxes corporations one per mill on the paid up capital, a quarter of one per mill on the capital not yet paid up, and one per cent on the total net income from all sources.[3] In Baselland corporations are taxed on their general property and again on their total profits, with the exception that when any of the profits consist of interest on capital the profits are not taxed if the capital has already been assessed.[4] Many of the cantons, however, seek to avoid the simultaneous taxation of property and income by an arrangement of the following sort: While the law provides for the assessment of both property and income, a deduction is made in the case of the income tax for so much of the income as is supposed to represent the actual profits of the capital already taxed. The proportion thus deducted is fixed in accordance with the estimated current rate of interest, ranging from four per cent in Thurgau and Grisons to five per cent in Zug, Schaffhausen, Ticino, Vaud and Zurich. The federal government deducts five per cent.[5] This principle has now also been applied in Germany. In Prussia, since 1891 the income tax is as-

---

[1] In U. S. Electric Power and Light Co. vs. State, 79 Md. 63, a vigorous objection has now been made, but the objection was not sustained by the court.

[2] Cf. 95 Mo. 360, where the court holds that it is not duplicate taxation.

[3] Law of 1889, $$ 2, 3. Schanz, *Die Steuern der Schweiz*, ii., p. 84; v., p. 50. As to the Swiss conditions mentioned in this paragraph, cf. the warning, supra, p. 260, note.

[4] Schanz, op. cit., i., p. 55; v., p. 35.

[5] Schanz, op. cit., i., p. 56.

sessed on corporate income, after deducting a sum equal to three and a half per cent of the paid up capital.[1] In Baden and Würtemberg the deduction is limited to 3% and cannot exceed the amount of dividends declared.[2] Bern and St. Gallen are the only Swiss cantons which attempt to draw a sharper line by levying the property tax solely on the corporate real estate, but subjecting all the other property to an income tax.[3] In St. Gallen the real estate tax is for local, the income tax for cantonal purposes.

The solution of the supposed difficulty attempted by the Swiss and the German commonwealths is, however, not a happy one. The deduction from income of the three or five per cent, assumed to represent the earnings of property involves a misconception. It is impossible to say how much' of the income represents earnings of capital and how much represents the other ingredients of profit. We are brought face to face with complicated questions of economic theory—with the distinction between interest and profits, and the separate ingredients of profits. A discussion of these questions lies beyond the province of this essay. But it may be confidently asserted that if a railway corporation with no bonded indebtedness and a capital of one million dollars earns seventy-five thousand dollars, it is impossible to maintain that fifty thousand dollars represents the earnings of the property and the remainder the earnings of the management. From one point of view all such profits are profits on capital or property. An individual can indeed obtain a professional income without any capital; but in the case of a business with capital invested, it is impossible to say how much of the profits are due to the capital, how much to the personal management. Without the capital there would be no profits at all, because there would be no business. Therefore, in taxing profits we are really taxing property, or rather the proceeds of property. To segregate a part of these proceeds and to say, as do the Swiss cantons, that only this particular part represents the income from the property, is an entirely arbitrary proceeding.

[1] *Einkommensteuergesetz* vom 24 Juni, 1891, ñ 16.

[2] L. Blum, *Die steuerliche Ausnutzung der Aktiengesellschaften in Deutschland,* Stuttgart, 1911, pp. 48, 52.

[3] Schanz, op. cit., ii., pp. 318, 368; iii., p. 292.

Again, it cannot be contended that even this four or five per cent of income exempted by the Swiss laws represents only the interest on the capital, and that the remainder of the income represents the earnings of management. Under no theory of economic profits can the surplus above current interest be entirely dissociated from capital. Even granting that a sharp line can be drawn between interest, earnings of management and profits, it still remains incorrect to confine the proceeds of capital to interest alone. It is thus inadmissible to say that in taxing income only on the surplus above four or five per cent of the taxable capital we avoid taxing both property and income.

The Swiss system has indeed a very decided significance in connection with an entirely different matter, viz., the question of funded or unfunded income. But as regards the point now under discussion it is evident that the Swiss cantons do not really succeed in avoiding double taxation. As we have seen, however, it is a form of double taxation which is in itself legitimate if applied equally to all taxpayers.

III. Taxation of Property and of Stock

This third form of duplicate taxation must not be understood to refer to the taxation of shares of stock in the hands of individuals. That is a different problem, and falls under another heading, to be discussed below. The point here to be discussed is this: Is it permissible to tax the corporation on its property and again on its capital stock?

The answer is plain. Manifestly not, if the corporate stock can be regarded as representing actual property. We have, indeed, seen that it is a mistake, economically, to say, as do some of our courts, that the entire property of a corporation is identical with its capital stock. This point has been brought out so well in a Massachusetts case, and is so generally misunderstood, that it may be wise to make a more extended quotation from the decision:—

> "The market value of the shares of a corporation … does not necessarily indicate the actual value or amount of property which a corporation may own. The price for which all the shares would sell may greatly exceed the aggregate of the corporate property, or it may fall very far short of it. Undoubtedly the amount of property belonging to a corporation is one of the considerations which enter into the market value of its shares; but such market value also em-

braces other essential elements. It is not made up solely by the valuation or estimate which may be put on the corporate property, but it also includes the profits and gains which have attended its operations, the prospect of its future success, the nature and extent of its corporate rights and privileges, and the skill and ability with which its business is managed. In other words, it is the estimate put on the potentiality of a corporation, on its capacity to avail itself profitably of the franchise, and on the mode in which it uses its privileges as a corporate body, which materially influences and often controls its market value."[1]

While it is true, therefore, that capital stock and total property are not interchangeable terms, it cannot be denied on the other hand that the capital stock represents at all events a part of the property, or rather that the corporate property is one of the elements that contribute to the value of the capital stock. So far as this is true, the simultaneous taxation of corporate property and corporate stock involves, to this extent at least, duplicate taxation of an unjust character.

Unfortunately, there is no uniformity in the legal decisions on this point. While the majority of the commonwealths hold taxation of this kind to be unjust, Pennsylvania has pronounced it valid. In a celebrated case the court used this language:—

> "Double taxation has never been considered unlawful in this state. The real and personal property of a corporation may be taxed, although it pays a tax on the stock which purchased it. The power of the legislature is as ample to tax twice as to tax once, and it is done daily as all experience shows. Equality of taxation is not required by the constitution."[2]

Such a decision may be correct legally, but beyond all doubt it is unsound economically. Equality of taxation may not be required by the constitution of Pennsylvania, but it is one of the first laws in the science of finance. Abandon equality, and you throw the door wide open to all kinds of glaring abuses. The theory as formulated by the

[1] Commonwealth vs. Hamilton Manufacturing Co., 12 Allen, 303.

[2] Pittsburgh etc., R. R. Co. Cf. Pennsylvania, 66 Pa. State, 77. Cf. Lackawanna Iron Co. vs. Luzorno County, 42 Pa. State, 424.

Pennsylvania courts cannot possibly be upheld from the scientific standpoint.

The Pennsylvania courts, however, hold that so far as the capital stock of a domestic corporation represents tangible property outside of the state, it is not taxable.[1] Further, it has also been decided that the real estate of a corporation, being part of its capital stock and paying state taxes, is not locally taxable.[2] Finally, in another case it has been held that so far as the property of a corporation is essential to the exercise of its corporate franchise, it is included in the capital stock and is not taxable. The law will not subject it to duplicate taxation by mere inference.[3] Thus Pennsylvania is gradually abandoning its earlier decisions.

Far wiser from the very beginning were the Maryland courts, which held that all laws must be so construed as to avoid double taxation of this kind; and that, since in their opinion the capital stock of a corporation represents the corporate property, the payment by the corporation of a tax on capital stock necessarily exempts all the corporate property.[4] In this broad form the decision is perhaps open to criticism because of the complete identification of capital stock with corporate property; but as regards the point at issue here, it is correct. To tax corporations simultaneously on their stock and on their property is indefensible. A few commonwealths, like Alabama, Illinois, Indiana, Vermont and (for local purposes) New York, have now recognized this principle in their statutes, deducting from the value of the capital stock the value of the realty or of both the real and personal property taxed.[5]

On the other hand, the apparently similar statute of Massachusetts, which taxes corporations on their capital stock less the value of the

---

[1] 101 Pa. State, 119; 41 Legal Intelligencer, 125.

[2] 7 Lane, 317.

[3] 148 Pa. State, 162; 148 Pa. State, 282. See also 145 Pa. State, 96.

[4] "County Commissioners vs. National Bank, 48 Md. 117. Cf. State vs. Sterling, 20 Md. 520; State vs. R. R. Co., 40 Md. 22.

[5] Ala. Code, §453, sec. 8; 111. Rev. Stat., chap. 120, §3; Ind. Laws of 1891, chap. 4; New York Laws of 1857, chap. 456, §3, vol. 2, p. 1; Vt. Rev. Laws, §288. In New York, as we know, corporations are locally taxable on their realty and their capital stock, deducting the amount invested in real estate. The earlier Maryland provision to this effect (Public General Laws. art. 81, §§§ 84, 85, 141, 144), has now been abandoned. See 103 Md. 293.

real estate and machinery,[1] is open to criticism for another reason. According to the Massachusetts law, corporations are taxable by the local bodies on their real estate and machinery, but at a rate equivalent to the combined rate for local and state purposes. They are then taxable by the state on the value of their capital stock, deducting the value of the real estate and machinery; but this state tax is fixed at a rate equivalent to the combined local and state rate on general property. While, therefore, Massachusetts avoids double taxation of both property and stock, it does not solve the problem of affording the commonwealth government an adequate revenue. According to the theory elsewhere elaborated in these chapters, corporations should always be locally taxable on their realty; but the commonwealth tax should be levied on the total income, or on the total property, without any deductions (except those arising from considerations of interstate comity and equity, to be discussed below). The whole treatment of double taxation is here based on the assumption that the tax is levied by administrative units of the same grade, whether state or local divisions. It manifestly does not apply to cases where one tax is levied by the commonwealth, and another similar or different tax is levied by the county or city, as in Massachusetts. Otherwise we should be forced to the conclusion that the property tax always involves a double, triple or quadruple taxation so far as state, county, town and village levy different rates on the same property. This is, however, only a juggle with words; such taxation is not in the scientific sense double taxation. Strictly speaking, therefore, the Massachusetts principle, while ostensibly sound, is really incorrect. So far, however, as it attempts to solve another problem—that of the division of the tax between the place where the corporation carries on its business, and the place where the stockholder resides—the law is deserving of consideration. But that is a point which belongs properly to one of the subsequent sections. In Switzerland, we find, in the few cases where both tangible property and capital are assessed, that the value of the taxable property is deducted from the corporate capital. Thus the constitution of 1885 in Aargau provides for the taxation of the corporate real estate for both commonwealth and local purposes, the

[1] Mass. Pub. Stat., chap. 13, §40.

value of the realty being then deducted from the capital stock.[1] The same custom prevails in Schaffhausen.[2] In Germany, Saxony and two of the smaller states are the only ones which permit corporations to deduct from their taxable property not only their debts but also the par value of their capital stock.[3] The Swiss tendency, like the American, is gradually coming to be in accord with the sounder principles.

We come now to the most important aspects of double taxation—the fourth and fifth forms. Here we have the benefit of a wide European experience. In the phases of duplicate taxation hitherto treated we can learn very little from Europe, because in no European state except Switzerland and to a minor extent in Germany are corporations taxed on their property as a whole; and in both Switzerland and Germany, as we know, the entire question of corporation taxation is in a very primitive and unsatisfactory stage. But the problems that we now take up present themselves in Europe as well as in the United States, and have there received in some respects extended consideration, although they have not yet been successfully solved.

IV. Double Taxation due to Conflicts of Jurisdiction

This fourth form of duplicate taxation appears in connection with almost every method of corporate taxation. It is so comprehensive that it will be advisable to discuss the subject under four chief headings:—

1. Interstate taxation of corporate property.
2. Interstate taxation of stock and bonds or of dividends and interest.
3. Interstate taxation of non-resident stockholders or bond holders.
4. Interstate taxation of corporate receipts or income.

1. Interstate taxation of corporate property. The difficulty here arises in connection with the taxation of personal property. In the case of real estate the rule universally adopted in the United States is that the property should be taxed where it is situated, and there is accordingly

[1] Schanz, *Die Steuern der Schweiz,* ii., p. 239. Cf. the warning above on page 260, note 1.

[2] Ibid., ii., p. 170, note 1.

[3] L. Blum, Die steuerliche Ausnützung der Aktiengesellschaften, p. 128,

no chance for interstate complications. But in the case of personalty the great problem is that of *situs*. Should the personalty be taxed where it is situated or should it follow the domicile of the owner? The legal conditions in the United States are most unsatisfactory.

We have seen in another place[1] that the American states waver between the principles of *situs* and of *mobilia personam sequuntur*,—that is, some tax only the personalty actually situated in the state; while others tax all the personalty, no matter where situated, of a resident. The same piece of personal property may therefore be taxed in two states. The obvious result, of course, is double taxation of a nature which cannot possibly be justified.

In the case of corporations, we are confronted by precisely the same difficulties, for corporate property is treated in the main like that of individuals. It is entitled to the same exemptions and subject to the same conditions. It will be readily perceived, however, with what difficulties the problem is beset when, as is usually the case, the personalty of a corporation is assessed at its place of business as the legal *situs*. In many states, like Michigan, Pennsylvania and New York, it has been held not permissible to tax corporations for property—or at all events for tangible property—outside the state;[2] and in South Carolina the tax is specifically limited to corporate property within the State.[3] In other cases it has been held that the movable property of a corporation in use in other states is taxable only in the state of the corporation's domicile.[4] In Pennsylvania, it has been held that corporate property, consisting of dredges, etc., not permanently located anywhere, may be taxed in the state of the corporation's domicile as part of the stock.[5] Some states, like New York and California, apply the same rule to corporate as to individual property, and seek to avoid double taxation of this kind. In New York, in order to

---

[1] Supra, p. 114.

[2] State Treasurer ex ret. vs. Auditor-General, 46 Mich. 224; Graham vs. Township of St. Joseph, 67 Mich. 652.

[3] S. C. Rev. Stat. chap. 12, sec. 28. For other cases, see Commonwealth vs. Railroad Co., 145 Pa. State, 96, distinguishing Commonwealth vs. Dredging Co., 122 Pa. State, 3S6; Commonwealth vs. Westinghouse Air Brake Co., 151 Pa. State, 276; Commonwealth vs. St. Bernard Coal Co., 9 Southwestern Reporter, 709 (Ky.).

[4] Baltimore and Ohio R. R. Co. vs. Allen, 22 Fed. Rep. 376.

[5] Commonwealth vs. American Dredging Co., 122 Pa. State, 386.

exempt the personal property of a corporation because it is outside of the state, the change of location must be permanent and unequivocal.[1] But in most of the states the rule *mobilia personam sequuntur* is applied, and domestic corporations, at all events, are taxed on their whole property.[2] In the case of foreign corporations, however, it is fast becoming the custom, even in most of the states which levy a corporate property tax, to exempt the intangible property, on the principle that the domicile of the foreign corporation is not changed by its doing business in other states.[3]

Manifestly, if the commonwealths will still cling to the policy of taxing the actual corporate property, the only logical and just method is for each state to exempt so much of the corporate property as is already taxable in another state. The federal government has unfortunately not exercised its right—if indeed it possesses any—to compel such uniformity. Our only hope, therefore, lies in the progress of correct public sentiment and its influence on commonwealth legislation. Until then, we shall still be confronted by the present confusion.

2. Interstate taxation of corporate securities. The evils arising from the simultaneous taxation by different states of the same corporate stock or bonds or dividends and interest have been so patent as to lead to statutory changes and judicial interpretations of considerable importance. In Pennsylvania, after being long the custom, it was subsequently judicially decided to be the law, that the tax on capital stock applies not to the whole capital but only to such a proportion of the capital stock as is employed, either actually or constructively, within the state.[4] The act of 1907 applied the same principle to the

[1] People ex rel. Pacific Mail S. S. Co. vs. Commissioners, 64 N. Y. 541. As to how the realty outside the state should be valued, see 52 Hun, 93; People ex rel. Panama R. R. Co. vs. Commissioners, 104 N. Y. 240 (1887). For California, see San Francisco vs. Fry, 63 Cal. 470 (1883); San Francisco vs. Flood, 64 Cal. 504 (1884).

[2] This was formerly the case also in New Jersey, where personal property outside of the state, which was exempt in the case of individuals, was taxable when owned by corporations. State vs. Metz, 3 Vroom, 199; State vs. Huight, 6 Vroom, 279. This was however altered by subsequent legislation. Cf. the N. J. Revised Tax Act of 1903, sec. 3.

[3] Cf. Insurance Co. vs. Assessors, 44 La. Ann. 760. Cf. ibid., 765.

[4] Commonwealth vs. Standard Oil Co., 101 Pa. State, 119. As to the previous custom, etc., see Decisions of the Auditor-General, 1878-80, p. 296.

bonus on charters. In New York, the original statute attempted to follow the old rule; but the law was subsequently so amended as to provide expressly for the taxation of only so much of the capital stock as is employed within the state.[1] In a case which arose under the old statute, although decided after the passage of the amendment, the court of appeals declared itself forced to adhere to the old rule, saying that, although it was extremely hard and unjust, the court was unable so to construe the statute as to relieve the corporation from the provisions of the law.[2] The principle in both these common wealths now applies equally to domestic and to foreign corporations. In Massachusetts, however, where the franchise tax, as we have seen, is applicable only to domestic corporations, the general corporation tax is levied on the total capital stock irrespective of its employment.

So far as railroads are concerned, it has become the common practice to assess only so much of the capital stock as is represented by the proportion which the mileage in the state bears to the total mileage. This is true even in states like Massachusetts, which do not apply the principle to corporations in general, as well as in states like Connecticut, where stock and bonds are taxable. Such a standard, while not perfectly exact, is fairly accurate; and has been upheld as entirely constitutional.[3] It is applicable equally to telegraph companies and to other transportation companies; and is gradually being applied to them, although not quite so commonly as in the case of railroads, in all those states which tax: capital stock directly. The principle is sound, although it may be contended with justice that business done, i.e. receipts, is an even better test than mileage, even though mileage would have to be one of the factors employed in apportioning receipts.

For other corporations, however, it will readily be seen how vague is the New York and Pennsylvania doctrine of "capital employed within the state." What business firm or corporation with ramifications all over the country can tell exactly or even approximately how much of its capital is "employed" within any one state? Even if they

---

[1] New York Laws of 1885, chap. .501, p. 858.

[2] People vs. Horn Silver Mining Co., 105 N. Y. 76, especially 88.

[3] Delaware Railroad Tax Case, 18 Wall. 208; Erie Railroad Pennsylvania, 21 Wall. 492.

can, how many of them will tell, when concealment will enable them to evade the tax? In some of our commonwealths the state officers have the right to inspect the books of corporations and to change the assessments if they deem them too low. Even then, what guarantee is there that they will discover the real proportion? The taxation of so much of the capital as is employed within the state is extremely difficult.

Because of the fact that many states still follow the old New York practice it may be interesting to notice some New York decisions of cases which occurred before the present amendments were adopted. A Massachusetts corporation—a telephone company—was taxed in New York by assessing the whole capital in proportion to the number of telephones used in the state. Although the tax was declared invalid for quite another reason, viz., that the corporation was not technically "doing business" in the state, the court entered into a discussion, obiter indeed, of the question with which we are dealing here. Chief Justice Ruger used the following language:—

> "It is by no means clear that the mode adopted … produces a correct result. … We are quite unable to sanction a principle which would subject it [the corporation] to the liability of being taxed, not only in [the state] where it is located, as it undoubtedly would be under the law as laid down by us [in the Horn Silver Mining Company Case], on its entire capital stock and gross earnings; but also in each state of the Union in which it should own telephones on such proportion of its capital stock and gross earnings as the law-makers of such state saw fit to impose.[1]

It is difficult to see the justice of this conclusion. It happens to be true that Massachusetts still follows the incorrect and inequitable plan of taxing the whole capital. But that was no excuse for the New York court to interpret the old statute in the same way, or to assume that other states will also follow the precedent which the court itself pronounced "extremely hard and unjust." Two wrongs do not make a right. In the absence of any federal law regulating the subject, the only upright course for each commonwealth to pursue is to follow the dictates of interstate comity and the sound principles of the sci-

[1] People vs. American Bell Telephone Co., 117 N. Y. 242, especially 256.

ence of finance by taxing only so much of the corporate capacity as is, economically speaking, within its jurisdiction. As we have repeatedly said, the taxation of corporate stock is by no means the ideal method. But if the New York principle of taxing capital stock and gross earnings be nevertheless followed, it is difficult to discover any more practicable or more defensible method of ascertaining the due proportion of capital stock employed or gross profits earned within the state than by considering the number of, or royalties from, the telephones used. This is analogous to the Connecticut system of proportional mileage as applied to railroad companies. In the case of telephone companies, however, the number of instruments used is a better test than the mileage of the telephone wires; for the capital, as well as the expenditure, is far more nearly in direct proportion to the number of telephones in use than to the amount of wire employed.

In the above case the law was declared invalid because the tax was assessed on a foreign corporation. Even though this foreign corporation held stock in various domestic corporations, it was not legally doing business in the state; since before a foreign corporation can be taxed under the New York law it must not only employ a portion of its capital in that state, but must also be engaged in doing business there.[1] In the case of a domestic corporation the fact that the capital is employed within the state is a sufficient ground for taxation. So far as its capital stock is invested in the stock of foreign companies, it is not taxable because it is not employed within the state; but so far as its capital is invested in the bonds of foreign corporations taken in return for the sale of patent rights, it is taxable.[2] In another case which also arose under the old law it was held that the proportion of sales within the state to the total sales of a foreign corporation is not a fair test of the capital employed within the state. Sales may be made by sample, so that the corporation may simply keep an office in the state and employ none of its capital there.[3]

In some recent laws, as in Kentucky, the proportion of the capital stock which is taxed must bear the same proportion to the entire capi-

---

[1] People ex rel. American Construction and Dredging Co. vs. Wemple 129 N. Y. 558 (1892).

[2] People ex rel. Edison Electric Light Co. us. Campbell, 139 N. Y. 543 (1893).

[3] People ex rel. The Seth Thomas Clock Co. vs. Wemple, 133 X. Y. 323 (1892).

tal stock that the corporate receipts in the state bear to the total corporate receipts. This is a simple solution of the problem, but falls properly under the heading of double taxation of receipts, to be discussed below.

3. Interstate taxation of non-resident bondholders or stockholders. The subject of the taxation of corporate stock or bonds is complicated in another way by the question of extraterritoriality. The problem is this: Can a corporation, even though its capital be employed wholly within the state, be taxed on its capital or bonded debt if these are owned in part by residents of another state?

The federal Supreme Court has arrived at some very remarkable conclusions. So far as bonds are concerned, the above practice has been pronounced unconstitutional. In one case it has been held that a state tax on bonds issued by a railroad company and secured by a mortgage on a line lying partly in another state was void, because the state was taxing to that extent "property and interests beyond her jurisdiction.[1] A later case went further and decided in general terms that a tax on corporate bonds is invalid as to non-resident owners, because the debts are the property not of the debtor, i.e. the corporation, but of the creditors, i.e. the bondholders. They are the obligations, not the property, of the debtors. But the creditors cannot be taxed on their property because they are not within the jurisdiction of the state.[2] The particular statute in this case was the Pennsylvania law of 1868, requiring corporations to retain five per cent on the interest due on the bonds, payable to non-residents. The state courts which had hitherto entertained a different opinion were compelled to acquiesce; and in a later case, decided in the same commonwealth, the state tax on corporate loans, i.e. on bonded indebtedness, was upheld only so far as it applied to the bonds owned by the residents,[3] being declared to be a tax on the bondholder, not on the corporation.[4] This, therefore, is the accepted law of the land as to bonds.

Shares of stock, on the other hand, are treated quite differently. It has indeed been decided that a state tax on dividends is unconstitu-

[1] Railroad Company vs. Jackson, 7 Wall. 262.
[2] State Tax on Foreign-held Bonds, 15 Wall. 300.
[3] Commonwealth vs. Delaware Division Canal Co., 123 Pa. 594.
[4] Bell's Gap R. R. Co. vs. Commonwealth, 134 U. S. 232.

tional as to non-residents if the corporation be required to withhold the tax from the dividends.[1] The New Jersey courts, moreover, have held that a corporation is not liable on that part of its stock owned by non-residents.[2] The United States courts, however, have uniformly maintained that a state tax on capital stock, even though the stock be held partly by non-residents, is legitimate on the ground that the tax is laid on the corporation as a whole, and not on the individual share-holder.[3] A later case even decided that a state tax on the shares of stockholders, which the company is required to pay irrespective of dividends, is not a tax on the shareholders but on the corporation.[4] This is held to be true notwithstanding the fact that in another case a tax on dividends or interest paid by the corporation was held to be a tax on the income of the stockholder or of the creditor, and not on the income of the corporation.[5]

The present state of the law, therefore, is that the entire capital stock of a corporation may be taxed by any commonwealth, but that only so much of the bonds are taxable to the corporation as are owned by residents of the state. The mere/ statement of this proposition makes it evident how impracticable would be the otherwise defensible system of taxing corporations by a separate tax on stock and an additional tax on bonds. The Pennsylvania system, which at first blush seemed to be an excellent solution of the problem, thus appears to be shorn of its chief merits, if the present law of the land is sound. The great majority of states, the bonds of whose corporations are owned mainly outside of the state in large financial centres like New York or Boston, would find such a tax sadly inadequate.[6] Even in the state of New York, where for several years the comptroller clamored

[1] Oliver vs. Washington Mills, 11 Allen, 268.

[2] 26 X. J. 181; 3 Zabriskie, 506, 517.

[3] Delaware Railroad Tax Case, IS Wall. 208.

[4] New Orleans vs. Houston, 119 V. S. 265. Cf. also 196 U. S. 466, upholding the Maryland tax on non-resident stockholders. See Corry vs. Baltimore, 96 Md. 310.

[5] United States vs. Railroad Co., 17 Wall. 332.

[6] An investigation by the Pennsylvania Tax Conference disclosed the ' following facts as to certain Pennsylvania railroads:— (Table not reproduced)

Some of the results are very absurd: Railroad no. 4, although having $230,000 bonds, paid a tax of $1.92. Road no. 18, worth about the same amount, paid $1,200. The last road but one paid no taxes at all. The road half of whose mileage was in the state paid nothing at all on its $2,900,000 bonds.

for a tax on corporate indebtedness, the proceeds would fall far below the actual capacity of the corporations. The decisions of the Supreme Court prevent double taxation, it is true, but they do it so effectually as also to prevent just taxation.

The same difficulty applies to the taxation of bonds of foreign corporations held in the state. A recent case has decided that a state cannot impose upon a corporation chartered by another state, when paying in that other state the interest due upon bonds held by a resident of the first state, the duty of deducting from the interest so paid the amount assessed upon the bonds by a tax law of the first state.[1]

From the economic point of view, these decisions are indefensible. If the tax on capital stock is a tax on the corporation, then the tax on mortgage bonds is equally a tax on the corporation. Stock and bonds together represent the corporate property, for the value of the stock is diminished by the existence of the bonds. The bondholders, viewed from the economic standpoint, are no more creditors of the corporation than are the stockholders. They are co-proprietors, just as mortgagor and mortgagee are in economic fact co-owners of the land. It is, therefore, difficult to see any justification for taxing nonresident stockholders while exempting non-resident bondholders. The same rule should be applied to both classes, for their interests in the prosperity of the corporation are in this respect precisely the same. The original Pennsylvania decision which was reversed by the federal Supreme Court rested on an earlier case involving much the same question, known as Maltby's Case. And with all due deference to the Supreme Court, it must be stoutly maintained that to the student of political economy the original Pennsylvania decision seems sounder than that rendered by the federal tribunal. In Maltby's Case the court uses the following language:—

> "What would the plaintiff's [a non-resident] loan be worth if it were not for the franchises conferred upon the corporation by the commonwealth [of Pennsylvania, franchises which are maintained and protected by the civil and military power of the commonwealth. … It is on this ground that the legislature discriminates between corporation loans and private debts as objects of taxation. … *The loans and stocks of a railroad company resemble each*

[1] Railroad Co. v.s. Pennsylvania, 1.33 U. S. G29.

> *other in many respects.* Both are subscribed under the authority of a special law, and both are so far capital that they are employed for the same general purpose. … Although loans and stocks are distinguishable for many purposes, yet the legislature committed no very great solecism in treating loans as taxable property within our jurisdiction. … Corporation loans, though in one sense mere debts, are, like moneys at interest, taxable as property."[1]

This is perfectly sound economics, although it is not now the law of the United States.

It is remarkable that, in several cases decided since the leading case of the state tax on foreign-held bonds, the Supreme Court has applied to the relations between the federal government and foreign states a principle entirely different from that which it invoked in the case of the commonwealths. It has been held that the national tax imposed during the Civil War on the dividends, coupons and profits of transportation companies is an excise tax on the business, and that it is valid even though the dividends or interest are withheld from a foreign stockholder or bondholder.[2] Justice Field in a dissenting opinion showed the incongruity between these decisions and the earlier ones as applied to commonwealth laws. He said:—

> "If the United States can do this, why may not the state do the same thing with reference to the bonds issued by corporations created under their laws? What is sound law for one sovereignty ought to be sound law for another."[3]

This protest, however, was in vain, and the legal status of the problem continues to be anomalous. The federal government can impose a tax on the total stock and bonds, or total dividends and interest of corporations, irrespective of the residence of the holders. The separate commonwealths, on the other hand, which are treated like foreign countries in the case of corporate stock or dividends, can impose a tax on only so much of the bonds or interest as are owned by, or due to, residents. This is of course illogical.

---

[1] Maltby vs. Reading and Columbia Railroad Co., 53 Pa. State, 140.

[2] Railroad Company vs. Collector, 100 U. S. 595 (1879); United States vs. Erie Railroad Co., 106 U. S. 327 (1882).

[3] 106 U. S. 335.

A peculiarly interesting complication arises in those commonwealths where the law of mortgage has been changed for tax purposes. One of the chief grounds of the decision in the Foreign-held Bond Case was that the railroad lands on which the bonds and mortgages were issued lay in Pennsylvania, and that the non-resident bondholder had no property therein. Said Justice Field:—

> "The property in no sense belonged to the non-resident bondholder or to the mortgagee of the company. The mortgage transferred no title; it created only a lien upon the property. Though in form a conveyance, it was both in law and equity a mere security for the debt. The mortgagee has no estate in the land."

It would be interesting, if this were the proper place, to trace the law of mortgage through both the Roman and the English law, and to show that in each system the mortgagee originally had both possession and property; that in a later stage he had no property in the land but retained the possession; until finally he had neither property nor possession, but simply a lien.[1] Be that as it may, it is true that Justice Field correctly represented the American law on the subject. That the mortgagee has no estate in the land is the Pennsylvania law;[2] and similar cases have been decided in the same way in other commonwealths. Thus, in an Iowa case, a corporation mortgage held by a non-resident was declared non-taxable in Iowa because "the mortgagee has only a chattel interest. … The mortgage is personal property … and attaches to the person of the owner."[3] So also under the old constitution of California, a case of inter-municipal taxation was decided in the same way. A judgment of record in one county upon the foreclosure of a mortgage situated in that county, the owner of the judgment being the resident of another county, was held not taxable in the first county because "the thing secured by the mortgage is

[1] For the Roman law of *fiducia, pigmis and hypotheca*, see Hunter, Roman Law, pp. 262-276. For the development of the English law, see Digby, *An Introduction to the History of the Law of Real Property*, chap, v., ñ 5 (2).

[2] Riekert vs. Madeira, 45 Pa. State, 463.

[3] Davenport vs. The Mississippi and Missouri Railroad Co., 12 Iowa, 539.

intangible and has no *situs* distinct and apart from the residence of the holder. It pertains to and follows the person."[1]

It will be seen that all these cases turn upon the point that the mortgage is personal property; but in several commonwealths, as we know[2] it has been provided that the interest of the mortgagee should be considered, for purposes of taxation only, as realty. This changes the whole situation and entirely undermines the foundation of the decision in the Foreign-held Bond Case. If the interest of the non-resident bondholder, i.e., the mortgagee, is no longer personalty, it does not follow the person of the bondholder, but may be taxed by the commonwealth in which the corporation is situated. The taxation of non-resident bondholders must thus be assimilated in these states to that of non-resident stockholders, and the federal decision will therefore be applicable to one part, but inapplicable to another part, of the United States. It may even happen that the corporate property covered by the mortgage is situated in several different states, so that part of the bonds may be subject to one law, part to another. The ensuing complications may be easily imagined. It would be far better for the Supreme Court to abandon the whole contention and on purely economic grounds to reverse its decision. In assessing a tax on capital stock or bonded debt, it should be entirely immaterial whether or not some of the stockholders or bondholders live \\'ithout the state. The residence of the security holder should have nothing to do with the taxation of the corporation.

If the tax is imposed not on the corporation but on the shareholders, non-resident stockholders would naturally escape, because outside the tax jurisdiction. In some cases, however, it is provided that corporations must then pay taxes for the non-resident stockholders.[3]

From one point of view there is indeed some force in the contention that the residence of the security holder should be considered. It may often occur that the stock and bonds of a corporation lying within one state may be owned by residents of another state. If the

---

[1] People vs. Eastman, 25 Cal. 003. See also State of Nevada vs. Earl, 1 Nevada State, 397; State vs. Ross, 3 Zabriskie, 517.

[2] Supra, p. 104.

[3] Md. Rev. Code, part viii., art. xi., § 87; X. J. Rev., 1877, p. 1199 (as to banks); Ore. Gen. Laws, 1872, chap. 57, art. 1, § 6.

whole fortune of these individuals is invested in such securities, the second state would get no revenue at all if it exempted securities of taxed corporations. Yet the individuals certainly owe some duty to the state of their residence; their economic allegiance, so to speak, is partly due to the state where they live. On the other hand, it is equally clear that the corporation owes a decided duty to the state where it is situated and where its earnings are secured. How is this conflict to be avoided?

The most desirable solution of the difficulty, as we have already intimated, would seem to be the division of the tax between the state of the corporation and that of the security holder. Each party possesses taxable faculty or ability within the borders of the respective states—the corporation where it earns its money, the security holder where he resides and enjoys the benefit of government. For each state to levy the entire tax would be double taxation; hence, if one party is taxed, the other should be exempt. In order to obviate the complete loss of revenue to the one state, and to satisfy the conflicting claims, the principle of economic allegiance must be invoked, and each state must be permitted to tax that portion of the economic faculty that properly falls within this category. This of course must be arranged by interstate agreement. The plan has not yet been tried in any American state, because no serious attempt has yet been made to grapple with the difficulties; yet no final escape from the complexities of double taxation can be attained until some such method is adopted. But even though the proceeds ought to be so divided, the tax ought to be levied as a whole, entirely irrespective of the residence of the security holder. This part of the problem may be solved according to the system proposed by the Tax Conference of Pennsylvania and practised in some other states, like Illinois, Indiana and Connecticut; namely, by assessing the corporation on a valuation equal to the market value of the whole capital stock plus the entire bonded debt, with a provision that only so much of the capital shall be assessed as is economically within the state.

4. Interstate taxation of receipts or income. This phase of interstate double taxation presents far less difficulty. In regard to gross receipts the measure of faculty is very simple, viz., the gross receipts from business done within the state. In the case of insurance companies

this is fast becoming the general rule in this country. When the returns do not show the precise amount of the gross receipts, the laws often provide, especially in the case of transportation companies, that the "gross earnings within the state" should be deemed to be that proportion of the entire gross earnings which the mileage within the state bears to the total mileage. This is the definition in Maine and many other states, and it has generally been upheld.[1] Under this definition the question has sometimes arisen whether the word mileage is to be interpreted to mean miles of track or miles of line. The former is, obviously, the correct economic basis, for the more double tracks, sidings and spurs, the denser usually is the traffic. In Wisconsin mileage has been held to include side tracks.[2] The mileage principle has also been applied to street railway companies, in the assessment of lines within and without the city limits.[3] An interesting variation is found in the Virginia law imposing the gross receipts tax on railroads which adds a proviso making an allowance "for a reasonable sum because of any excess of value of the terminal facilities or other similar advantages situated in other states over similar facilities or advantages situated in this state."

Another definition of "gross earnings within the state" which obviates this whole question of double tracks, allowances, etc., has been adopted by Minnesota and more recently by California. Thus to quote the California law "gross receipts within the state shall be deemed to be all receipts on business beginning and ending within this state, and the proportion based upon the proportion of the mileage within this state to the entire mileage over which such business is done, of receipts on all business passing through, into or out of the state." Mileage in this case means simply the distance a given shipment is hauled. If we compare the so-called Maine system with the so-called Minnesota system it may be said that while the former is really the simpler, the latter is on the whole more equitable in that it does not attempt to get any taxes or traffic beyond its own limits.[4] As

[1] 18 Wall. 208, 231. Cf. 92 U. S. 608; 125 U. S. 530; 45 Md. 38-4; Ul U. S. 18; 55 Fed. Rep. 206.

[2] 64 Wis. 130.

[3] 74 Md. 405.

[4] Cf. for a discussion of the two methods Report of the California Commission on Revenue and Taxation, 1906, pp. 171-174.

to other than transportation corporations the gross earnings tax can be easily arranged so as to obviate double taxation.

If in lieu of the gross earnings tax a tax on net receipts or income be imposed, how does the matter stand then? Strictly speaking, only so much of the income as is earned within the state should be assessed; but since it is exceedingly difficult to apportion the expenses of a large corporation among all its branches in different commonwealths, it would seem preferable to adopt some approximate standard by which the net receipts could be measured. As the most practicable and easily ascertained measure is gross receipts, the most approved method of taxing corporate income would be to assess that proportion of the total net income which the gross receipts within the state bear to the entire gross receipts. Such a system would present no difficulties, and would preclude all chance of double taxation of this kind.

We have thus far considered only the question of complications arising from international or interstate taxation. Of minor consequence, but still of sufficient importance to deserve mention, are the problems of inter-municipal double taxation. These are of minor consequence because, in the United States at least, there are, with the exception of street-car lines, few instances of local taxes on the receipts of corporations which do any business without the limits of the local divisions. On the other hand, we find local taxes on the total property and on the capital stock of corporations which have more than a purely local significance. The rules should be the same as those applied above to cases of interstate taxation. But so long as very few of the commonwealths accept these principles, it will scarcely surprise us to find that the local divisions almost completely ignore them. Thus in New York City, the home of many huge corporations of national importance, it is the common practice to assess for local purposes the entire capital stock of a domestic corporation, irrespective of the question whether a portion of its stock may not be employed or owned, outside of the confines of the city. This is manifestly a crude practice, the injustice of which can be removed by pursuing the plan here laid down—i.e. by taxing corporations for local purposes only on their real estate. Ultimately, perhaps, if the local needs become more pressing, a proportionate share of the proceeds of the commonwealth corporation taxes may be distributed

among the local divisions. In this way no possible complications could arise from inter-municipal double taxation.

What can we learn from Europe on this whole subject of interstate or inter-municipal double taxation? The only countries in which such interstate complications can arise are the federal states of Germany, Austria-Hungary and Switzerland. In two of these an attempt has been made to regulate the matter.

In Switzerland the constitution of 1874 imposes on the federal legislature the obligation of preventing double taxation, without attempting, however, to analyze or to point out the various forms of double taxation.[1] While several decisions of the Swiss courts have definitely settled some of the simpler problems of duplicate taxation, the more subtle questions that interest us under this fourth heading have not yet been adjudicated to any extent. Beyond the principle that corporations, like natural persons, are taxable on their income and on their property by the canton where their chief office or establishment is situated, or where their business is conducted, no successful attempt has as yet been made by the federal legislature or courts to solve the problems here discussed.[2] A few of the cantons, however, have recently embodied in statutes the principle that only so much of the capital or income as is employed or received within the commonwealth should be taxable. Such, for instance, is now the law in Vaud, Ticino and Baselstadt.[3] In Bern the same principle is ap-

[1] Art. 46: "Die Bundesgesetzgebung wird . . . gegen Doppelbesteuerung die erforderlichen Bestimmungen treffen." A translation of the Swiss constitution has been published as no. IS of the Old South Leaflets, Boston, 1890.

[2] Zürcher, Kritische Darstellung der bundesrechtlichen Praxis betreffend das Verbot der Doppelbestetuerung (Basel, 1882), pp. 88-93; Schreiber [same title], p. 259. Cf. also, in general, Speiser, *Das Verbot der Doppelbesteuerung* (Basel, 1886); and the chapters on double taxation in W. Gerloff, *Die Kantonale Besteuerung der Aktiengesellschaften in der Schweiz,* Bern, 1906.

[3] In Vaud, all individuals as well as private corporations or societies, "sont soumis a l'impôt pour tout le capital mobilier affecte au service de leur activité dans le canton." Loi d'impôt sur la fortune mobilière et sur la fortune immobilière, du 21 aout, 1886, chap, iii., art. 12. Printed in Schanz, *Die Steuern der Schweiz,* v., p. 387; cf. also, iv., p. 128.—In Ticino, "le persone, le ditte commerciali, le societa o gli enti morali in genere, che, non avendo il loro domicilio o la loro sede nel Cantone, vi tcgono stabilimento, succursale, agenzia, rappresentanza, o vi esercitano un' industria, oppure vi poseggono beni o rendite . . . sono tenuti al pagamento dell' imposta,

plied to intermunicipal taxation.[1] In Uri the taxable property and profits are calculated in proportion to relative mileage.[2] In Neuchatel foreign corporations are taxable only for the profits earned within the commonwealth.[3] In Appenzell it is provided that corporations should pay the income tax in the place where the business is carried on, but in such a manner as to avoid double taxation.[4] The law of Ticino is especially interesting for the further reason that it also imposes a tax on all corporate loans, but allows the corporation to deduct the tax only from the interest on the bonds owned within the canton.[5] Foreign-held bonds thus escape taxation in the hands of the individual holder except by the state of the owner's residence.

In Germany, the conditions are much the same. In 1870, an imperial law was enacted which forbade in express terms double taxation arising from interstate complications. This law provided that individuals should be taxed by the state of their domicile, and that real estate should be taxable by the state of its location. The only clause affecting corporations prescribed that the occupation as well as the income from the business could be taxed only by the state where the

---

in ragione della sostanza e della rendita che hanno nel Cantone." Legge suU' imposta cantonale (April 28, 1890), art. 14. In Schanz, v., p. 462.—In Ba.selstadt, "bei Gesellschaften welche neben der Niederlassung im Kanton auch eine solche ausserhalb des Kantons besitzen, tritt eine dem Umfange der auswärtigen Niederlassung entsprechende Minderung des Steuerbetrags ein." Gesetz betreffend die Besteuerung der anonymen Erwerbsgesellschaften, vom 14 Oktober, 1889, § 4. In Schanz, v., p. 50.

[1] "Bei Unternehmungen, die in verschiedenen Gemeinden ihr Gewerbe ausüben, ist die Steuer nach Verhältnis der Ausdehnung des Geschäfts an diese Gemeinden zu entrichten." Gesetz über das Steuerwesen in den Gemeinden, vom 2 Sept., 1867, ñ 7. In Schanz, v., p. 88.

[2] Uri, Steuergesetz vom 10 Mai, 1886, art. 13. In Schanz, v., p. 376.

[3] "Les sociétés anonymes . . . sont soumises au mémé impôt pour les ressources que leur procurent les affaires faites dans le pays." Loi sur l'impôt direct du 18 octobre, 1878, art. G, § 3. In Schanz, v., p. 219.

[4] "Immerhin unter Vermeidung von Doppelbesteuerung." Vollziehungsverordnung über die Ausführung von Art. 16 der Verfassung betreffend das Steuerwesen (April 5, 18S0), art. 6. In Schanz, v., p. 26.

[5] The corporations "sono tenuti al pagamento dell' imposta . . . sull' importo complessivo delle obbligazioni al portatore da loro emesse." But the law contains this further provision: "Non saranno colpiti dall' imposta i capital! [including the boufl.s] di cui . . . ove il contribuente dimostri che cio costituirebbe una dojipia imposta." . . . Arts. 15 and 3, § 3 of the law of 1890. In Schanz, v., pp. 460, 462; cf. iv., p. 282.

business was carried on.[1] The commission which drafted the law, however, evaded the main question by asserting that the exact proportion of the corporate business or income taxed by any one state must depend on "the particular form of the actual conditions."[2] This has settled nothing, and the matter remains, as before, a subject for the separate states to regulate.

Several of the German commonwealths have now adjusted the difficulties in very much the same way that has been adopted or proposed in various American states. Thus the Baden law provided that only so much of the corporate income shall be assessed as is proportional to the amount of capital employed within the state.[3] So the earlier Prussian law provided that the taxable net income of railroads which lie partly in other states should be estimated by the proportion of gross receipts within the state, and that this again should be calculated according to mileage.[4] The Prussian local law tax of 1885 measures the proportion of corporate income or net profits due to each tax district by the share of gross receipts in the case of banks and insurance companies, and by the share of expenses for salaries and wages in the case of transportation companies.[5] The income-tax law of 1891 states that only that part of the net receipts actually earned in Prussia shall be taxable."[6]

The tendency therefore seems to be the same in all countries. Whether the tax be imposed on property or on income, the law should be applicable to both domestic and foreign corporations; and while no deduction should be made for non-resident holders of stock

---

[1] Reichsgesetz wegen Beseitigung der Doppelbesteuerung; vom 13 Mai, 1870, § 3. Reprinted in Meitzen, Die Vorschriften über die Klassen und klassifizierte Einkommensteuer in Preussen, no. 6.

[2] "Dass die Entscheidung immer von der besonderen Gestaltung der tatsachlichen Verhältnisse abhangen werde." Cf. Clauss, "Das Reichsgesetz wegen Beseitigung der Doppelbesteuerung," in Schanz's Finans-Archiv, v., pp. 138-197, especially p. 179.

[3] Badisches Einkommensteuergesetz von 20 Juni, 1884, art. 5, lit. B. In Finanz-Archiv, iii., p. 368.

[4] Law of March 16, 1867, ñ 9. For the judicial decisions and rescripts on this point, see Clauss, op. cit., p. 181.

[5] Communalsteuernothgesetz von 27 Juli, 1885, ñ 7. Printed in Finanz-Archiv, iii., pp. 174-193, together with an explanatory article hy Secretary Herrfurth.

[6] Einkommensteuergesetz von 24 Juni, 1891, § 16.

or bonds, only so much of the property or income should be assessed as is employed or received within the state. Since an exact standard is unattainable, it is advisable to use the approximate test of relative mileage in the case of transportation companies and of relative gross receipts in the case of other corporations.

V. Taxation of the Corporation and of the Security Holder

We come finally to the fifth and most important division in the subject of duplicate taxation—the taxation of the corporation and of the shareholder or bondholder. The question is: If we tax the corporation, shall we also tax the individual who owns the stock or bonds of the corporation? Is this double taxation? Is it unjust?

Let us first discuss the actual practice both here and abroad. In the United States the legal conditions are absolutely lacking in uniformity. In some states the tax on the corporation is declared to be a tax on the shares, which are accordingly exempted from assessment. Thus in California, the statute declares that "shares of stock possess no intrinsic value over and above the actual value of the property of the corporation for which they stand," and that to tax both corporation and shareholder is double taxation.[1] In Arizona, we find exactly similar language used.[2] In most of the other commonwealths, also, shares of stock in the hands of individuals are exempt when the corporation itself is taxed, although the reason of the rule is not always expressly stated as in the cases just cited.

On the other hand, the statutes in North Carolina, Wyoming and Iowa (except for manufacturing corporations) and the judicial decisions in Illinois, Iowa, Louisiana, Maine and Maryland are to the contrary effect.[3] This was formerly true also in Indiana, Pennsylvania and Tennessee.[4] In some of these cases it has been held that "the

---

[1] Cal. Code, § 3608, new sec. March 7, 1881; cf. Burke vs. Badlam, 57 Cal. 594; 21 Fed. Rep. 539; 22 Fed. Rep. G02.

[2] Ariz. Code, § 2633.

[3] Porter vs. Railroad Co., 76 111. 5G1; Danville Banking Co. vs. Parks, 88 111. 170; Cook vs. Burlington, 59 la. 251; New Orleans vs. Canal Co., 32 La. Ann. 51; Cumberland Marine Railroad vs. Portland, 37 Me. 444. Wilkens vs. Baltimore, 103 Md. 293, and Baltimore vs. Alleghany Co., 99 Md. 1.

[4] 15 Ind. 150; 49 Pa. State, 526; 66 Pa. State, 77; 47 Pa. State, 106. But it has been recently held in Pennsylvania that double taxation will not be supported except

tangible property of a corporation and the shares of stock are separate and distinct kinds of property under different ownership; the first being the property of the corporation and the last the property of the individual stockholder." Taxation of both corporation and shares of stock is hence pronounced neither duplicate nor unjust taxation, even though the shares of stock have no value save that which they derive from the corporate property and franchise.[1] In other cases again, it has been held that even though the taxes amount to double taxation, they are not unconstitutional. This, however, is true only in those states which admit double taxation, as Pennsylvania formerly did, even though it be confessedly unequal.

Other commonwealths, again, take a less logical middle ground. In the case of certain corporations they do not permit taxation of both shares and corporation; in the case of other corporations they do not object to this simultaneous taxation. In the case of national banks, as we know, the taxation of the corporation itself is made impossible by federal law. Most of the states, therefore, tax only the individual shares, although they collect the tax through the corporation.[2] In many cases this system has been extended to other banks besides national banks. A few commonwealths (Delaware, Georgia, Kansas and North Carolina) pursue this method with regard to all corporate shares in general, and collect the tax from the corporation.[3] In a few others, including Iowa, Kentucky and Vermont, the prohibition of simultaneous taxation of both shareholder and corporation applies only to definite classes of corporations.[4] In Ohio it is true only of domestic corporations. In Massachusetts domestic corporations are

---

by express enactment. 156 Pa. State, 488; 151 Pa. State, 265 and 276; 139 Pa. State, 612.

[1] So also in Switzerland this simultaneous taxation has been upheld on the strictly juristic ground that the corporation and the shareholder are distinct persons. See Speiser, *Das Verbot der Doppelbesteuerung*, and Roguin, *La Régie de Droit* (Lausanne, 1889), 141 and passim.

[2] See supra, p. 155.

[3] Del. Laws, 13, chap. 393; Ga. Code, sec. 815; Kan. Comp. Laws, chap. 107, sec. 6; N. C. Machinery Act of March 11, 1889, sec. A 6.

[4] In Iowa the prohibition applies only to manufacturing companies, Acts 18th Gen. Assembly, chap. 57, §§ 1, 2; in Kentucky to turnpike, gas, telegraph, telephone, express, street-railway and toll-bridge companies, Revenue Law of 1886, chap. 1223, art. iv., ñ 8; in Vermont to railroads, Rev. Laws, sec. 270.

taxed and the individual shareholders are exempt as regards all dues except those for school-district and parish purposes.[1]

The decisions of the United States Supreme Court are somewhat conflicting. The earlier cases seem to uphold simultaneous taxation of corporation and of shareholder. In a late case, however, the court asserts that double taxation is never to be presumed; and that, although the commonwealths have an undoubted right to levy such taxes, in the absence of a special statutory provision the presumption is against such an imposition.[2] On this point, accordingly, we find contradiction of theory.

In a cognate matter there is a still greater diversity of practice.

Some commonwealths, as we have just seen, tax the stockholders on the full value of their shares, irrespective of the question whether the corporation has been taxed or not. In other states, however, only a portion of the value of the shares is taxable. Thus in Louisiana, Minnesota and Nebraska, in the assessment of shares of stock to the holders, a proportionate part of the value of the real and personal corporate property taxed within the state is deducted from each share.[3] In New Hampshire and Tennessee,[4] as formerly in New York in the case of banks,[5] a proportionate part of the real estate actually taxed is deducted from each share. In Rhode Island, a proportionate part of the real estate and machinery is deducted."[6] In Maine, a proportionate part of the machinery, goods manufactured or unmanufactured, and real estate locally taxable is deducted.[7] Finally, in New York, the statute (which applies, however, only to state and national banks) provides for the deduction of the assessed value of the real

---

[1] Mass. Pub. Stat., chap, xi., sec. 4.

[2] Tennessee vs. Whitworth, 117 U. S. 13G, 137; also. New Orleans vs. Houston, 119 U. S. 265. For the earlier cases, see Van Allen vs. Assessors, 3 Wall. 573; The Delaware Railroad Tax Case. 1S Wall. 230; Farrington vs. Tennessee, 95 U. S. 686; Sturges vs. Carter, 114 U. S. 511.

[3] La. Acts of 1888, no. 85, sec. 27; Minn. Gen. Stat., chap, xi.; Neb. Act of March 1, 1879, sec. 32.

[4] N. H. Gen. Stat., chaps. 53-5.5; Tenn. Laws, 1868-69, chap. 9, sec. 9.

[5] N. Y. Laws of 1SG6, chap. 761; Laws of 1882, chap. 409, § 312. Cf. People vs. Commissioners of Taxes, 69 N. Y. 91. These New York laws were repealed when the special 1% bank tax was imposed in 1901. Cf. supra, p. 157.

[6] R. L Pub. Stat., chap. 43, sec. 12.

[7] Me. Rev. Stat., tit. i.. sec. 14, § 3.

estate. In all these cases only the property actually taxable within the state is deducted. In Vermont, on the other hand, in the case of manufacturing companies the value of the corporate realty and personalty, and in the case of all other corporations the value of the realty, is deducted whether the property be located or taxable within or without the commonwealth.[1] And in the revised franchise tax on business corporations in Massachusetts the value of the taxable property both within and without the state is deducted.[2]

A somewhat analogous question is that of the taxation of the shares of foreign corporations in the hands of individual residents. All those states which, as we have seen, declare it to be justifiable to tax both corporation and shareholder, of course do not hesitate to tax the shares held by residents, even though the foreign corporation itself be taxed. There is here, therefore, no discrimination between domestic and foreign corporations. The other states which declare the simultaneous taxation of corporation and shareholder to be duplicate taxation, may be divided into two classes. Some of them exempt the shares held by residents in foreign corporations, but only when the foreign corporations themselves are actually taxed by the state of their residence. This is the rule in almost all of New England and in a few other states, like California, Louisiana and New Jersey.[3] New York goes still further, and always presumes that the foreign corporation has been taxed by the state of its residence.[4] In actual practice the custom is very much the same in the other states mentioned.

Some states, however, like Massachusetts, make a distinction between foreign and domestic corporations, exempting the shareholders of domestic corporations (or taxing them only through a simple tax on the corporation itself), but assessing the shareholders of foreign corporations on their shares. This practice has given to considerable

---

[1] Vt. Rev. Laws, tit. 9, chap. 22, sec. 288. Cf. on this point, Moore, "Corporate Taxation," in *American Law Review* for 1884, p. 771. Moore's statements are not entirely accurate.

[2] Cf. supra, p. 205.

[3] N. H. Gen. Laws 1878, chap. 53, sec. 6; Vt. Rev. Stat., tit. ix., chap. 12, sec. 270; R. I. Pub. Stat., chap. 42, sec. 10; N. J. Revis. 1877, p. 115; sec. 64. Cf. Smith vs. Ramsey, 25 Vroom, 546 (1893); Lockwood vs. Weston, 61 Ct. 211 (1891); City of San Francisco v. Mackey, 22 Fed. Rep. 602.

[4] Cf. Hoyt vs. Commissioners, 23 N. Y. 224 (1861).

controversy;[1] but from the standpoint of justice in taxation it can be defended only to a very limited extent. According to the principle of relative economic interests, the shareholder of a foreign corporation is indeed under a certain obligation to support the state of his residence. The proper way to satisfy the conflicting claims is, however, to have the foreign state, which taxes the corporation, divide the tax according to some agreement with the state where the stockholder resides. To tax the shareholder when the foreign state already taxes the corporation seems inadmissible; while entirely to exempt the shareholder is unfair to the state of his residence. Some *modus vivendi* ought to be arranged; but so long as it does not exist, the New York rule should be followed.

Such is the situation in regard to shares of stock. The same question can, of course, arise in reference to mortgage bonds. As regards the simultaneous taxation of corporate property and the individual bondholder, the disagreement is less profound only because corporate loans are, as we know, rarely taxed. In the one commonwealth, Connecticut, where certain corporations pay what has been pronounced a property tax on the value of their stocks and bonds, it has been held not to be double taxation to assess the individual bondholder as well as the corporation.[2] Yet Pennsylvania comes to the opposite conclusion, so far as the bonds in this commonwealth are taxable only to the corporation and not to the individual bondholder;[3] for in these states neither stockholder nor bondholder is liable. The federal Supreme Court virtually accepts the same principle in deciding that a tax on the bonds is a tax on the bondholder,[4] the corporation being used merely as a convenient means of collecting the tax. It may be confidently asserted, therefore, that so soon as the taxation of

[1] This has been the law since 1836. But up to 1866 taxes paid on Massachusetts real estate and machinery by the foreign corporation were deducted from the tax on the shareholder. Mass. Rev. of 1836, chap. 7, sees. 2, 4; Dwight vs. Boston, 12 Allen, 316. Cf. Crocker, *The Injustice and Inexpediency of Double Taxation*, 1892; R. H. Dana, *Double Taxation Unjust and Inexpedient*, 1892. The rule is the same in Md. See Code of Public General Laws (1904), art. 81, sec. 156.

[2] Bridgeport vs. Bishop, 33 Conn. 187.

[3] Pa. law of June 30, 1885, § 4. Before the corporation-tax law of 1880, the same principle applied to all corporations in New York. Before the law of 1896 this principle applied also in Maryland.

[4] State Tax on Foreign-held Bonds, 15 Wall. 300.

corporate loans becomes as general as is now the taxation of corporate stock, we shall be confronted by precisely the same difficulties.

If we turn to Europe, we shall find a still greater diversity of practice. Of the European countries, Switzerland is the only one in which some of the cantons still tax corporate property or capital stock; and in Switzerland the condition is just as chaotic as with us.[1] Thus one set of cantons (Glarus, Grisons, Baselstadt, Aargau and Ticino) formerly taxed only the shareholder.[2] The intercantonal complications, however, soon assumed important proportions; for it frequently occurred that the great majority of the shareholders resided in a different canton from the home of the corporation, to the manifest detriment of the public revenue in the latter. Owing to this fact, the above system has now been abandoned by all the cantons except Glarus.

A second set of cantons, which tax the corporate property and income, deduct the shares, dividends or interest in the hands of the security holders of domestic corporations from this taxable property or income. Such is the law in Schaffhausen, Bern, Vaud, Aargau and Uri,[3] and is the practice in Baselstadt, Schwyz and Zug.[4] The security holders of foreign corporations are, however, not exempted from taxation. Grisons, moreover, has the curious provision that while corporations are taxed directly, only the shareholders of domestic corporations are exempt, the bondholders of both domestic and foreign corporations being taxable equally with the corporation.[5] In

---

[1] Cf. in general, Schanz, *Die Steuern der Schweiz,* i., pp. 90-99; and Zürcher, *Kritische Darstellung betreffend das Verbot der Doppelbesteuerung,* pp. 36-41. Cf. the caution on page 200, supra.

[2] This was true in Grisons from 1871 to 1881; in Baselstadt up to 1879; in Aargau to 1885; in Ticino to 1890. See the respective laws in Schanz, op. cii., iii., p. 247; ii., p. 40; v., p. 4, §20; iv., p. 281. For Glarus, see ibid., v., p. 175.

[3] Schaffhausen, Steuergesetz vom 29 Sept. 1879, arts. 9 and 10, in Schanz, v., p. 259; ii., p. 169; Bern, Vollziehungsordnung, vom 22 März, 1878, § 3, in Schanz, v., p. 83; Vaud, loi d'impôt sur la fortune mobilière du 21 aout, 1862, art. 6, in Zürcher, op. cit., p. 38, cf. Schanz, iv., p. 158 (true only to 1886); Aargau, Grossrätliche Verordnung über den Bezug der direkten Staatsund Gemeindesteuer, vom 26 November, 1885, § 7, in Schanz, v., p. 15; Uri, Steuergesetz vom 10 Mai, 1886, art. 5, in Schanz, v. p., 375.

[4] For these cantons, see the judicial decisions in Zürcher, op. cit., p. 38.

[5] Graubünden, Steuergesetz vom 28 August, 1881, ñ 16; in Schanz, v., p. 192.

some of the above cantons, as in Uri, Bern and Aargau, the security holders are exempt only from commonwealth taxes, but are liable for local burdens.[1] It is the same system, it will be observed, as in Massachusetts.

A third set of cantons do not shrink from double taxation, but tax both corporation and shareholder. Such is the law in Baselstadt and Neuchatel.[2] On this point the decisions of the Federal Council are contradictory.[3] Finally, a fourth set—and this seems the growing tendency in Switzerland—seek to divide the tax between corporation and shareholder. Thus Geneva taxes the corporation on its realty and the shareholder on his shares; but does not permit the shareholder to make a proportionate reduction for the corporate realty already taxed, as is the case in New York, New Hampshire and Tennessee.[4] Appenzell taxes the shareholders on the market value of their shares, but the corporations only on their reserve funds.[5] In Zurich, the shareholders are taxed on their shares; the corporations on their reserve fund and their income in excess of five per cent of the capital. The income below five per cent is not taxed because it is supposed to be hit by the tax on the shareholders. For purposes of local taxation, however, the shareholders are assessed on their shares, but the corporations pay only on their realty and on a proportionate part of their reserve funds.[6]

---

[1] See the respective provisions in Schanz, v., p. 375, art. 5; 88, § 7; 15, ñ 7; and 19, § 18.

[2] Bern, Gesetz betreffend die direkten Steuern, vom 31 Mai, 1880, §§ 1,8; and Gesetz betreffend die Besteuerungder anonymen Erwerbsgesellschaften, vom 14 Oct., 1889, § 1; in Schanz, v., pp. 41, 43, 49; Neuchatel, Loi sur l'impôt direct du 18 Oct., 1878, art. 5 and art. 6, ñ 3; in Schanz, v., pp. 218, 219. Schanz, i., p. 95, also includes Zug in this class, but erroneously, as appears from the official decision quoted in Zürcher, op. cit., p. 38.

[3] See the several cases in Schreiber, *Verbot der Doppelbesteuerung*, pp. 199-202. He opposes double taxation. On the other hand, see Meili, "Rechtsgutachten über die Besteuerung der Aktiengesellschaften," in the Zeitschrift für schweizerische Gesetzgebung, v., p. 489. See also Zürcher, op. cit., p. 40.

[4] Genève, Loi générale sur les contributions publiques, du 9 novembre, 1887, arts. 300, 321; in Schanz, v., pp. 151, 155.

[5] Vollziehungsverordnung über die Ausführung von Art. 16 der Verfassung betreffend das Steuerwesen (April 5, 1880), arts. 5, 6. Schanz, v., p. 26.

[6] Gesetz betreffend die Vermögens-, Einkommen- und Aktivbürgersteuer vom 24 April, 1870, §§ 2, 4; Anleitung betr. das bei der Selbsttaxation . . . zu beobachtende

The 1885 "draft of a federal law on double taxation" sought to divide the tax between corporation and shareholder in a new way. The stockholder was to be assessed by the place of his domicile on the market value of his shares up to the amount actually paid or on the dividends up to five per cent; while the corporation was to pay only on the value of the capital or dividends above this figure.[1] Although this particular draft failed of adoption because of the jealousy of the individual cantons at the supposed infringement of their state rights, the principle has nevertheless been accepted by a single commonwealth,—Vaud. In this canton all shares which stand above par and all bonds which pay more than four per cent interest are assessable to the individual owners at their par value. The corporations are assessed only on the surplus above the capital stock, i.e. the reserve and sinking funds and other sums earned during the year.[2] Such a clumsy method is not likely to be adopted in this country. On the other hand, in St. Gallen the stockholder is taxed on his shares, the corporation on its income in excess of four per cent interest on the capital.[3] We see, then, that Switzerland has no settled practice.

In the other important European countries the prevailing system as we have learned is that of the taxation of incomes. The same questions arise as to the taxation of corporate profits and of shareholders' or bondholders' income.

In England, the income tax payable on annual profits, or gains according to schedule D of the income tax is advanced by the corporation, and is deducted by it from the dividends or interest due the security holders, who are then to that extent exempt from the income

---

Verfahren, § 6; Gesetz betreffend das Gemeindewesen, § 137, d, e. Schanz, v., pp. 423, 424, 431, 439; ii., p. 435. Cf. Zürcher, op. tit., p. 39.

[1] Bundesgesetzentwurf vom 6 März, 1885. In Schanz, i., p. 96.

[2] "Les actions et parts de sociétés qui ont leur siégé en Suisse et dont le cours d la bourse est supérieur a leur valeur nominale ou qui rapportent un intérêt supérieur au 4 per cent de cette valeur, sont comptées dans la fortune mobilière du porteur ou des créanciers pour leur valeur nominale seulement. . . . L'avoir net (réserves et amortissements compris) des sociétés ... est compte dans la fortune mobilière de ces sociétés pour tout ce qui excédé le capital social." Loi d'impôt sur la fortune mobilière, etc., du 21 aout, 1886, art. 11. Schanz, v., p. 387; iv., p. 158.

[3] Gesetz über die Einkommensteuer, sowie über die Besteuerung der anonymen Gesellschaften (1863), art. 5; Verordnung über Besteuerung der anonymen Gesellschaften vom 28 Jan., 1867, arts. 4, 11. Schanz, v., pp. 309, 311.

tax.[1] In Austria the facts are similar to those in England.[2] In Italy, the law requires the income tax to be paid by the corporation, but does not interfere with the adjustment of the tax between the company and the shareholders. Nothing would prevent the corporation from deducting the tax from the dividends; but in fact, it is the custom for the corporation to charge the tax to expense account, with the same result for the shareholder. The latter is not assessable on his dividends because the law expressly forbids double taxation of this kind.[3] As regards bondholders the companies are required to pay the tax: on coupons, with a right to recoup from the bondholders.[4] The companies generally do not deduct anything from the coupons, but, as with dividends, charge the tax to expense account. In this case it would seem as if the stockholders were liable for the tax, since, strictly speaking, it would have to come ultimately out of the stockholders' dividends, and not out of the bondholders' interest, which is legally fixed. In actual practice, however, this distinction is not observed. The bondholders, moreover, are not assessable if the corporation has paid the tax. In France, the tax *sur le revenu des valeurs mobilières,* so far as it applies to the dividends or interest of corporate securities, may be primarily collected from the company and then deducted by it from the sums due the security holders, as in England; or the tax may be assumed directly by the companies,[5] as in Italy.

In Germany, every possible plan has been tried, without reaching any definite or uniform conclusions. The matter is, moreover, further complicated by the fact that corporations like individuals must pay a

---

[1] Ellis, A Guide to the Income Tax Acts, pp. 78-112.

[2] Wagner, "Direkte Steuern," § 103, in Schönberg, Handbuch der politischen Ökonomie, in., p. 307. Wagner's discussion of these points is not adequate or conclusive.

[3] "Ne saranno soltanti eccettuati [in the taxable income] i redditi die per disposizione della presente legge siano gia una volta assoggottati all' imposta in essa stabilita." Legge per 1'imposta sui redditi di ricchezza mobile, art. 8, § 2.

[4] " . . . Le societa anonime dichiareranno non solo i redditi propri, ma eziando . . . gli intercssi dei debiti da loro contratti e delle obbligazioni da lore emesse, e pagho-ranno direttamentc 1' imposta relativa anche a questi ultimi redditi, rivalondosone .sui loro assegnatori e creditori mediante ritenuta." Ibid., art. lo.

[5] Tanquèrey, *Traite . . . de l'impôt sur le revenu des valeurs mobilières,* pp. 143-150; Vignes, Traite des impôts en France, i., pp. 405-409; Kauffmann, *Die Finanzen Frankreichs*, pp. 288, 291.

business tax (Gewerbesteuer), somewhat akin to licenses or occupation taxes in the Southern states of the American Union. In a number of German states (Oldenburg, Brunswick, Gotha, Schaumburg-Lippe, Waldeck and Lübeck) the corporations pay no income tax, but the shareholders and bondholders are taxed.[1] In other states, like Saxe-Weimar, Lippe-Detmold, Bremen and Hesse, the corporations are assessed, but the shareholders and bondholders are exempt.[2] Even in these commonwealths, however, the definitions of corporate net income do not tally. In most of the remaining states, like Prussia, Saxony, Baden, Bavaria, Würtemberg, Mecklenburg, Anhalt and the other minor commonwealths, both corporation and security holder are taxed—the corporation on its income or business, the individual on his income from the corporate security.[3] In one case (Baden) the same income was until recently taxed four times—that is, the corporation paid a business tax (Gewerbesteuer) and an income tax, while the individual shareholder or bondholder paid not only an income tax

[1] Cf. the details in Antoni, "Die Steuersubjecte im Zusammenhalte mit der Durchführung der Allgemeinheit der Besteuerung nach den in Deutschland geltenden Staatssteuergesetzen," in Finanz-Archiv, v., pp. 91G-1033, especially 1010. The statements in this paragraph are true of the situation in 1895. For later changes see the work of Blum, cited supra, p. 262, note 3.

[2] Sachsen-Weimar, Gesetz über die allgemeine Einkommensteuer, von 19 März, 1809 [with amendments of 1874, 1877 and 1880], §§ 48 and 4. Printed in Finanz-Archiv, ii., 932.—Lippe-Detmolt, Gesetz die Klassen und klassifizierte Einkommensteuer betreffend, von 1858 [with amendments of 1882 and 1885), §§ 1, 7.—Bremen, Einkommensteuergesetz von 17 Dez., 1874, § 5.—Hessen, Gesetz von 1884, die Einführung der Einkommensteuer betreffend, arts. 4, 19. In Finanz-Archiv, ii., pp. 383-434. For Hesse in particular, see Schanz, "Die direkten Steuern Hessens und deren neueste Reform," Finanz-Archiv, ii., pp. 235-529. Also Conrad's *Jahrbücher*, xii., p. 40.

[3] Sachsen, Einkommensteuergesetz von 1878, § 4.—Bayern, Einkommensteuergesetz von 1881, art. 1, § 15. In Seisser, *Die Gesetze über die direkten Steuern im Kgr. Bayern*, i., 158.—Würtemberg, Gesetz von 1872, art. 1, § 3. In Sammlung württembergischer Steuergesetze (1883).—Mecklenburg, revidiertes Contributionsedict von 1874, §§ 13, 45.—Baden, Gesetz von 1884, die Einführung einer allgemeinen Einkommensteuer betreffend, art. 5. In Finanz-Archiv, ii., pp. 361-394. Cf. Philippsberg, *Gesetz über die direkten Steuern in Baden* (1888).—Anhalt, Gesetze von 1886, die Einführung einer Einkommensteuer . . . betreffend, §§ 2, 4. Cf. Schanz, "Die Steuern im Herzogthum Anhalt, ihre Entwickelung und neueste Reform," *Finanz-Archiv*, iv., pp. 961-1070, especially 1016. For Prussia, see Einkommensteuergesetz von 1891, §§ 12 b, 14.

but also a tax on the interest of his capital invested in the bonds or stock (Kapitalrentensteuer).[1] In the original draft of the bill to reform the Prussian law, this same quadruple taxation was proposed;[2] but its injustice was so manifest that the project failed. It was also proposed in Hesse, but without success. In 1906 the supplemental property tax took the place of the business tax and of the capital tax in Baden, but as both corporations and individuals are subject to this property tax, the quadruple system virtually continues.[3] Baden, therefore, is the only state in the world which can pride itself upon assessing the same subject four times.

We see, thus, that in Europe there is no settled practice at all, although the tendency seems to be to tax the corporation and to exempt the individual on his income from corporate investments. Is this the correct policy? Is it true that in taxing the corporation, whether on property or on income, we are taxing the individual holder of the shares or bonds?

This brings us to the pith of the question. What is the incidence of the corporation tax? Where does the burden really fall? This question has never yet received adequate attention.[4]

VI. Incidence of the Tax

It is generally assumed that a tax on a corporation is a tax on the shareholder or bondholder. But as has already been pointed out,[5] a distinction must be drawn between the original holder and the recent purchaser of corporate securities. Under certain circumstances the burden of a tax is not borne by the purchaser of new corporate securities, but falls entirely on the original holder of the old securities issued before the tax was imposed. If a corporation is taxed on its income, and if no similar tax is levied on other corporations or on other securities, the stock will fall in value and the new purchaser who buys at the reduced price really buys free of tax. Although he

---

[1] *Finanz-Archiv*, ii., p. 320. Cf. Lewald, "Die direkten Steuern in Baden," in *Finanz-Archiv*, iii., p. 350.

[2] Einkommensteuergesetzentwurf von 1883.

[3] Cf. Blum, op. cit., pp. 52-56.

[4] The nearest approach to a discussion of this question is to be found in Helferich, "Ueber die Einführung einer Kapitalsteuer in Baden," in *Tübinger Zeitschrift für die gesamte Staatswissenschaft,* 1846, pp. 291-324, especially 315 et seq.

[5] Supra, p. 108.

pays the tax, the amount of the tax is thus discounted in the depreciation of the security. With the lapse of time and the fluctuations in the market the original holders all disappear. Hence at any given time an exclusive income tax levied only on the corporation and not on the shareholder does not affect anyone except the original holders who bought before the imposition of the tax. It is only a question of time until this class of original holders disappears entirely.

As to bondholders, the argument is precisely the same if the corporation is empowered to deduct the tax from the interest. The lower rate of interest is discounted in the depreciation of the bond, so that the new purchaser loses nothing. Moreover, in those cases where, as we have seen, the tax is borne by the corporation and not deducted from the interest,[1] the bondholder does not suffer at all, except in so far as it somewhat lessens the security of the mortgage.

Of course this is more or less true of all new taxes under certain conditions. By virtue of what is called the capitalization of taxation a new tax may affect the original owner of the taxable article more than the new purchaser. In the case of direct taxes the original holder may be injured while the future purchaser may discount the tax in the depreciation of the article. In the case of indirect taxes the reverse is true, for the effect of the tax often is to increase the price. The lucky owner who holds the commodity before the imposition of the tax then reaps the benefit of the rise in price. The point which is usually overlooked, however, is the question whether the new tax is general or partial. If the direct tax applies to all subjects in the class and to all classes, then the new purchaser is taxed equally with the original owner. For if the tax is general there will be no depreciation in value. It is only when the tax is partial, assessing some articles in the class more than others, that it may under certain conditions be capitalized, and that a decrease in the value of the overtaxed article may ensue.

[1] During the Civil War, when a federal tax was imposed on the coupons and dividends of certain corporations, many corporations declared these "free of tax," and refused to withhold the amount from the sums due to the bondholders and stockholders. They simply assumed the tax and charged it to expense account, asserting that while the law authorized, it did not direct, them to withhold the tax. See *Internal Revenue Record,* vol. i. (1865), p. 153.—The practice was thus the same as in Italy to-day.

If we apply this principle to the corporation tax, we reach the following results: If the corporation tax simply forms a part of a general scheme of income taxation, as in England or in Italy, the shareholder must indeed be exempted. Since the tax affects the interest on all investments, not simply on corporate securities, the investor, whose interest was cut down, will not find any non-taxable securities of equal desirability from which he can obtain the original rate of interest. In such a case, therefore, the tax on the corporation is a tax on the investor. To tax both corporation and individuals on their income would really be double taxation. On the other hand, if the corporation tax is partial—i.e. if only corporate, and not other, securities are taxed, or if only a few classes of corporations are taxed—then the taxation of the corporation is not sufficient to reach the purchaser. He will practically escape, because the freedom of investing in non-taxable securities will enable him to discount the tax in the price he pays. If a general income tax is imposed, it will not be valid for the new purchaser of corporate securities to claim exemption on the ground that a tax has already been imposed on his particular corporation. To tax both the corporation by a special corporation tax and the shareholder by a general income tax in such a case is not unjust or double taxation. To tax the corporation alone would in reality not burden the shareholder who purchased after the tax was imposed. An additional tax on the new shareholder in common with all other recipients of income would thus really constitute no injustice to him. The practical difficulty of course would consist in distinguishing between the old and the new owners.

Thus far we have been discussing the incidence of the corporation tax in a scheme of income taxation. How does the matter stand in the case of a property tax?

The principle is the same. Let us assume that in addition to the corporation tax a general property tax is actually levied on all individuals. The corporation would then pay the first tax, and the individuals would pay the second tax upon corporate shares and bonds. This would indeed be duplicate taxation, but only on the assumption that the corporation tax is imposed on all corporations in general, and that the property tax is actually assessed on all kinds of property. In such a case it would be unjust to tax both corporation and shareholders. This is the assumption made by most of the American common-

wealths, which, as we have seen, generally exempt the shares when the corporate property or franchise is taxed.

The assumption, however, is not always correct. In the first place, only special classes of corporations are sometimes taxed. Secondly, the general property tax we know to be general only in name, for by far the larger part of personal property or of investments in the hands of individuals escapes taxation. Under these conditions the matter may be entirely different. If the tax be imposed on only a particular class of corporations, and if the conditions are not such as to bring about a shifting of the tax to the consumer of the commodities produced, the corporation tax will, if all other securities escape assessment, be discounted in the lower market value of the shares, because, other things being equal, the value of new investments will vary in proportion to the net profits to be derived therefrom. Although the corporate tax reduces the dividends, the reduced dividends on the reduced value will yield to new investors as large a percentage as did the larger dividends on a property of greater value—greater because untaxed. Thus where there is only a partial tax of this kind on personal property a special corporation tax puts the new purchaser of shares in the same position as if he owned non-taxable property, t. e. it virtually imposes no additional burden on any of the shareholders except the original owners. In the case of bondholders where the corporation tax is deducted from the interest, this is equally true. When the corporation tax is assumed by the corporation and not deducted from the interest—the almost universal rule in the United States—the bondholders are not reached at all, except in the very indirect way that they may be exposed to an ultimate diminution in the security of their lien. The tax as such does not strike them; their property, consisting of corporate bonds, goes scot-free. A property tax or franchise tax on the special corporation, under the given conditions, is really not an additional burden on the individual holder of corporate securities or at all events not on all the individual security holders.

The practical conclusion applicable to the United States to-day is as follows:

If the corporation tax is to be utilized as a means of reaching the faculty of the security holder, rather than of the fictitious person known as the corporation, it is necessary to generalize the tax—to

levy a general tax on corporations, as a few states are now beginning to do. Furthermore, the corporation tax must be regarded simply as a part of a larger system of taxation, the constituent elements of which must endeavor to reach the other sources of the taxpayer's ability. The corporation tax, in other words, must be supplemented by other taxes, both state and local, in order that these taxes combined may stand in some proportion to the revenue of the individual. Then, but only then, will it always be double taxation to assess the corporation as well as the security holder. So far as there is a decided tendency to generalize the corporation tax, the trend of American legislation, in seeking to avoid double taxation, is in the right direction.

VII. Local Taxation

Up to this point we have discussed chiefly the state taxation of corporations. But the lesser governmental divisions also have their claims to urge, especially in modern times when local needs outweigh so heavily those of the states. There are no less than five different methods of taxing corporations for local purposes in the United States. These are as follows:

1. A local general property tax.
2. A local corporate franchise tax in addition to the general property tax.
3. A local tax on real estate.
4. No local tax at all.
5. A distribution of the state tax on corporations to local districts.

The first plan, that of the local property tax, is still usual, even in some of the commonwealths that have abandoned the general property tax on corporations for state purposes. Corporate property is in some cases measured by the capital stock. In New York, for example, while banks, insurance and telegraph companies are taxed according to special laws, in the case of other domestic corporations the tax is levied at the usual rate of the local tax on the actual value of the capital stock, together with the surplus profits or reserve funds exceeding ten per cent of the capital, after deducting the assessed value of the real estate and of the shares of stock in other taxable

corporations.[1] Foreign corporations, however, are taxable only on the sums actually invested in the state.

The second method, that of a corporate franchise tax in addition to the local property tax, is found in Kentucky, where the tax on the franchises of certain corporations may be levied also by the local divisions. Somewhat analogous to this are the local licenses which in many of the Southern states are imposed on corporations as well as on individuals in addition to the state licenses.

The third method, that of a local tax on real estate only, is becoming more and more common, especially in the commonwealths which impose a separate state tax on certain kinds of corporations, like transportation and insurance companies. It is likewise the custom with banks, which pay a local real estate tax, and also advance the tax on shares assessed to the shareholders.

The fourth plan, the exemption from local taxation, is found in a few states which impose a franchise tax on certain classes of corporations. The only state which has a general corporation tax law in lieu of local taxation is Pennsylvania. Even there certain classes, like purely manufacturing companies, which are excepted from the operation of the general corporation tax, are subject to local taxation on their real estate. Furthermore the real estate of railroad and other transportation and transmission companies, not necessary to the exercise of their franchise, may be taxed by the local bodies. Some cities are also permitted by their charters to tax the real estate of certain corporations, and the courts have ruled that the general corporation tax law does not deprive these municipalities of the right to tax their real estate.[2] Finally, the tax on banks and insurance companies, being in some cases practically a tax on incomes, does not exempt their real estate entirely from taxation. Practically, therefore, in Pennsylvania, as by statute in California, the exemption from local taxation applies only to public-service corporations.

The fifth and last method of local taxation, the distribution of the state corporation tax to local bodies, is found in the case of railroads in several states like Maine, Mississippi, West Virginia and in the case of corporations in general in Massachusetts. But in some of

[1] Laws of 1857, chap. 45G, vol. ii., p. i.

[2] Pennsylvania R. R. Co. vs. Pittsburgh, 104 Pa. State, 522 (1883).

these states the local bodies levy additional taxes, as in Massachusetts on real estate and machinery.

Of all these systems the third is clearly the best. All corporations with the possible exception of those enjoying special municipal franchises should be made to pay a local tax on their real estate; first, because it is mainly the realty which comes into direct relations with the purely local functions; and secondly, because the attempt to tax personalty would immediately lead again to the uncertainty and confusion from which it has been the policy of all recent reforms to extricate us. But in the case of public-service corporations, with contiguous pieces of real estate in many localities, experience has shown the advisability of central assessment, with a unit rule, even if the proceeds of the real estate tax accrue in a fixed ratio to the localities.

The New York system, therefore, is triply unwise: first, because it imposes a state tax on corporate real estate; secondly, because it further imposes a local tax on the total corporate property; and thirdly, because the real estate of public-service, like other, corporations is separately assessed at ridiculously varying sums, by the local officials. The former Minnesota or the Connecticut system, as applied to railroads, is unwise because it imposes no local tax at all. The system as formerly practiced in Washington was unwise because it imposed only a single state tax which was in part redistributed to the local divisions. All these methods err because they fail to analyze the deeper principles that underlie corporate taxation.

The plan of levying a general state tax and distributing a part of the proceeds to the counties or municipalities contains a fruitful idea. It is already in vogue in an incomplete way in a few commonwealths, as we have seen. But it is susceptible of great expansion and may be of considerable value in solving the vexed question of local taxation. As applied to corporations, however, such a plan of redistribution is premature. Until the proceeds of the state corporation tax are sufficient to enable the commonwealth to dispense entirely with the state tax on real property, nothing of the kind should be contemplated. Whatever claims the local divisions may justly have on the overfilled treasury of the commonwealth must be set aside until the taxation of real estate is left exclusively to them. The abolition of the state tax on real estate is perhaps the most necessary reform in the American system; to this all other changes must be subordinated. If the com-

monwealth treasury should be supplied through other sources, such as a state inheritance tax or a state income tax or a state tax on other elements, it would be possible not only to abandon the state taxation of real estate, but also to relinquish to the local bodies a portion of the state corporation taxes. But until that time arrives, a distribution of the corporation taxes among the local divisions will be inadvisable. The logical plan for the immediate future is to tax corporations on their receipts, or on a valuation equal to the stock and bonds, for state purposes; and to tax them on their real property for local purposes, with the understanding that in the case of public-service corporations this local real-estate tax should be subject to central assessment in accordance with, the unit rule. This, and this alone, satisfies the demands of scientific method and of practical policy.

VIII. Conclusion

From the preceding survey it appears that the United States are slowly advancing to a more rational and harmonious system. The tendency of legislation and of judicial interpretation in the most progressive states is toward the following plan, which, although not yet completely realized in all its features in any one state, is in accord with sound economic principles:

1. Corporations should be taxed separately and on different principles from individuals.
2. Corporations should be taxed locally on their real estate only.
3. Corporations should be taxed for state purposes on their earnings, or on their capital and loans.
4. Only so much of total earnings or capital should be taxed as is actually received or employed within the state. In the case of transportation companies, a convenient and fairly accurate test is mileage.
5. Where capital and loans are taxed, the residence of the shareholder or bondholder should be immaterial.
6. There should be no distinction between domestic and foreign corporations. Each should be taxed for its business done or capital employed within the state.
7. If corporations are taxed on their property, property beyond the state should be exempt.

8. If corporations are taxed on their capital stock, they should not be taxed again on their property.
9. Where the corporate stock or property is taxed, the shareholder should be exempt. If corporate loans are taxed, the bondholder should be exempt.
10. Where the corporation and the shareholder or bondholder are residents of different states, the tax should be divided between the states by interstate agreements.
11. An additional tax should be levied on corporations which have through natural, legal or economic forces become monopolistic enterprises.