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TAXATION OF NATIONAL BANK SHARES

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Inequalities in taxation have been increasingly apparent. The last General Assembly, by joint resolution, provided for the appointment of a tax survey committee, with the obvious purpose of bringing about more equitable distribution of tax burden.[1] Undoubtedly important tax legislation will be passed by the coming legislature. The function of the committee and the legislators will be to bring about just legislation which will satisfy all requirements as to constitutionality. It might be well at this time to consider certain statutory requirements with reference to taxation of shares of stock in national banks.

SECTION 5219 AND AMENDMENTS

In the famous case of *McCulloch v. State of Maryland*,[2] after holding that the national Act incorporating the Bank of the United States was constitutional and that the power of establishing a branch in the State of Maryland might be properly exercised by the bank itself, the court, speaking through Chief Justice Marshall, held that the law passed by the legislature of Maryland imposing a tax on the bank of the United States was unconstitutional and void, since it was "a tax on the operation of an instrument employed by the government of the United States to carry its powers into execution." The opinion recited, however, "it does not extend to the tax paid by the real property of the bank, in common with the other real property within the State, nor to a tax imposed on the interest which the citizens of Maryland may hold in this institution, in common with other property of the same description throughout the state."

The crux of the decision is embodied in the classical statement of Daniel Webster as set out at page 327 as follows: property of the same description throughout the State."

"An unlimited power to tax involves, necessarily, a power to destroy; because there is a limit beyond which no institution and no property can bear taxation. A question of constitutional power can hardly be made to depend on a question of more or

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* See biographical note, p. 380.

1 6 Ind. L. J. 99.

2 (1819) 4 Wheat. 316.

less. If the States may tax, they have no limit but their discretion; and the bank, therefore, must depend on the discretion of the State governments for its existence. This consequence is inevitable."

In spite of the dictum laid down by the Chief Justice in the passage hereinabove quoted in reference to taxation of real property and the interest of citizens in the institution as represented by shares, the idea has now become prevalent that shares in national banks could only be subject to state taxation as expressly permitted by Congress. It was affirmatively stated in numerous decisions of the Supreme Court that the states could levy no tax otherwise than in conformity with the consent given by Congress.[3]

The Act establishing the present national banking system in 1863 made no provision for the taxation of national banks or their shares by the states. State taxation of national bank shares was permitted by the forty-first section of the Act of Congress of June 3, 1864, subject to the restriction that it should not be at a greater rate than that imposed upon other moneyed capital in the hands of individual citizens of the same state.[4]

That section also provided

"that the tax imposed, under the laws of any state, upon shares of any of the associations authorized by this act, shall not exceed the rate imposed upon the shares in any of the banks organized under the authority of the state where such association is located."

The Act of 1864 was amended by that of February 10, 1868,[5] by eliminating the reference to shares in state banks. Thereafter the validity of such state taxation was to be determined by the inquiry, whether it was a greater rate than was assessed upon other moneyed capital in the hands of individual citizens, and not necessarily by a comparison with the particular rate imposed upon shares in state banks. The effect was to preclude the possibility of states discriminating against national bank shares in favor of moneyed capital not invested in state bank stock by

[3] *Boyer v. Boyer*, (1885) 113 U. S. 689, 5 S. Ct. 706; *Des Moines National Bank v. Fairweather*, (1923) 263 U. S. 103, 44 S. Ct. 23, 68 L. Ed. 191; *First National Bank v. Anderson*, (1926) 269 U. S. 341, 46 S. Ct. 135, 70 L. Ed. 295.

[4] 13 St. c. 106, Sec. 41.

[5] 15 St. c. 7.

[6] *Boyer v. Boyer, supra.*

imposing the same taxation upon national bank shares as upon shares in state banks.[6]

As stated in *Des Moines National Bank v. Fairweather*,[7]

"Its main purpose is to render it impossible for the state, in levying such a tax, to create and foster an unequal and unfriendly competition, by favoring institutions or individuals carrying on a business similar to that of national banks or engaging in operations and investments of like character."

Moreover, the state's power to tax must be exercised in the manner and form expressed in the warrant of authority to the state.[8]

In the amended form the provision above set out was carried into the revised statutes of 1878, which was a perfected edition of the first official codification of the general and permanent laws of the United States made in 1874, as section 5219, which prescribed that state taxation of shares in national banks "shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such state."[9]

The section was amended by the Act of March 4, 1923,[10] permitting alternative methods of taxing national banks. These alternative methods permitted the states to tax the shares or to include dividends derived therefrom in the taxable income of an owner or holder thereof, or tax the income of such association provided that the imposition of any one of the above three forms should be in lieu of the others. The further alternative was

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[7] (1923) 253 U. S. 103, 44 S. Ct. 23, 68 L. Ed. 191.

[8] *Central National Bank v. McFarland*, (1927) 20 F. (2nd) 416, 26 Fed. (2nd) 890, 278 U. S. 606, 49 S. Ct. 12.

[9] The act thus read:

"Nothing herein shall prevent all the shares in any association from being included in the valuation of the personal property of the owner or holder of such shares, in assessing taxes imposed by authority of the State within which the association is located; but the legislature of each state may determine and direct the manner and place of taxing all the shares of national banking associations located within the State, subject only to the two restrictions, that the taxation shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State, and that the shares of any national banking association owned by non-residents of any State, shall be taxed in the city or town where the bank is located, and not elsewhere. Nothing herein shall be construed to exempt the real property of associations, from either State, county, or municipal taxes, to the same extent, according to its value as other real property is taxed."

[10] 42 St. 1499, c. 267; U. S. C. A. title 12, Section 548.

added that in case of a tax on shares, the tax imposed should not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such state coming into competition with the business of national banks, provided that bonds, notes or other evidences of indebtedness in the hands of individual citizens, not employed or engaged in the banking or investment business, and representing merely personal investments not made in competition with such business, shall not be deemed moneyed capital within the meaning of the section. In the case of a tax on income, it was provided that the rate shall not be higher than the rate assessed upon other financial corporations, nor higher than the highest rates upon the net income of mercantile, manufacturing and business corporations. In case of a tax on dividends, the tax should not be at a greater rate than is assessed upon the net income from other moneyed capital.[11]

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[11] The amended Act reads as follows:

"Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 5219 of the Revised Statutes of the United States be, and the same is hereby amended so as to read as follows:

'Sec. 5219. The legislature of each State may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares of national banking associations located within its limits. The several States may tax said shares, or include dividends derived therefrom in the taxable income of an owner or holder thereof, or tax the income of such associations, provided the following conditions are complied with:

'1. (a) The imposition by said State of any one of the above three forms of taxation shall be in lieu of the others.

' (b) In the case of a tax on said shares the tax imposed shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks; Provided that bonds, notes or other evidences of indebtedness in the hands of individual citizens not employed or engaged in the banking or investment business and representing merely personal investments not made in competition with such business, shall not be deemed moneyed capital within the meaning of this section.

' (c) In case of a tax on the net income of an association, the rate shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing State upon the net income of mercantile, manufacturing, and business corporations doing business within its limits.

' (d) In case the dividends derived from the said shares are taxed, the tax shall not be at a greater rate than is assessed upon the net income from other moneyed capital.

'2. The shares or the net income as above provided of any national

The section was again amended by the Act of March 25, 1926,[12] adding to the authorized methods a tax "according to or measured by their net income." This provided that the imposition by any state of any one of the above enumerated forms of taxation shall be in lieu of the others with certain exceptions.[13]

No further amendments have been made to section 5219. In the past few years there has been some friction between forces contending for its repeal or modification, and those interests which insist that the section gives sufficient latitude to state taxing authorities and at the same time safeguards national banks from unfriendly and discriminatory state legislation. It is highly unlikely that the present national Congress will make any changes of consequence. Therefore, it is most important that any proposed tax law be scrutinized to see if it will come within the protective provisions of section 5219.

Before discussing the various forms of discrimination against

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banking association owned by nonresidents of any State, or the dividends on such shares owned by such nonresidents, shall be taxed in the taxing districts where the association is located and not elsewhere; and such associations shall make return of such income and pay the tax thereon as agent of such nonresident shareholders.

'3. Nothing herein shall be construed to exempt the real property of associations from taxation in any State or in any subdivision thereof, to the extent, according to its value, as other real property is taxed.

'4. The provisions of section 5219 of the Revised Statutes of the United States as heretofore in force shall not prevent the legalizing, ratifying, or confirming by the States of any tax heretofore paid, levied, or assessed upon the shares of national banks, or the collecting thereof, to the extent that such tax would be valid under said section."

[12] 44 St. 223, c. 88.

[13] Subd. (c) as amended reads as follows:

"(c) In case of a tax on or according to or measured by the net income of an association, the taxing State may, except in case of a tax on net income, include the entire net income received from all sources, but the rate shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing State upon mercantile, manufacturing and business corporations doing business within its limits: Provided, however, That a State which imposes a tax on or according to or measured by the net income of, or a franchise or excise tax on financial, mercantile, manufacturing, and business corporations organized under its own laws or laws of other States, and also imposes a tax upon the income of individuals, may include in such individual income dividends from national banking associations located without the State on condition that it also includes dividends from foreign corporations, but at no higher rate than is imposed on dividends from such other corporations."

shareholders in national banks, a short discussion of the economic background which led up to the adoption of various tax laws is necessary to an intelligent consideration of the decisions.

At the time of the passage of the statute in 1864, practically every state had in force a general property tax under which all property, whether real or personal, tangible or intangible, was included in the assessment roll and taxed at the same rate, with certain exceptions in case of charitable or benevolent institutions, and later stock in domestic corporations. This ideal was evidenced by the passage in various states of a requirement that taxes be equal or uniform or proportional. As intangible property increased in popularity and demand, it was placed in the same category for tax purposes as tangible property. Authorities later came to recognize the difficulties in the way of taxation of tangibles and intangibles at the same rate, and it was considered economically unsound and unjust.[14]

Shares of national banks naturally took their place in the mass of intangible property. During this period, while there was considerable tax evasion, there was little discrimination against national bank shares in favor of other moneyed capital in the hands of individual citizens since the taxing authorities were endeavoring to tax money and credits at the same rate as shares in national banks. During this period, the litigation arose with reference to deductions or systematic undervaluation.

Recently an entirely different form of discrimination arose, leaving in its wake a mass of cases decided and pending, covering the right of states to classify property for tax purposes and taxing money and credits at one rate or at a small percentage of their value, or exempting them either entirely or taxing them upon income at a low rate, whereas shares in national banks were taxed at a higher rate. Moreover, moneyed capital in the hands of individuals coming into competition with the business of national banks greatly increased.

METHODS OF TAXATION UNDER SECTION 5219

At the outset it should be remembered that the tax is not to be levied against the capital stock of national banks as the property of the bank, but should be against the shares of stock as the property of the shareholder. In the case of *Owensboro National*

[14] 18 Calif. L. Rev. 497; Seligman on Taxation, pp. 62, 73, and 74.

Bank v. Owensboro,[15] the Supreme Court pointed out that a tax levied upon a corporation, measured by the value of its shares, is not equivalent to one upon the shareholders in respect of their shares. The recent case of *First National Bank of Gulfport, Miss. v. Adams,*[16] held that a tax levied on a banking corporation, measured by the value of its shares, is not one on the shareholders in respect of their shares, and cannot be sustained where its validity is properly challenged.[17] The state may require the tax on the shares to be paid by the bank, and this does not amount to the imposition of a tax on the bank as distinguished from the shareholders, the theory being that the tax so payable is not imposed against the bank on its capital stock, but merely as a collecting agency acting in behalf of its shareholders.

WHAT CONSTITUTES MONEYED CAPITAL

Before undertaking to classify the various kinds of discrimination under section 5219, a consideration of what constitutes competing moneyed capital is advisable. This was first construed in the case of *Evansville National Bank v. Britton,*[18] and in the case of *Mercantile National Bank v. Mayor.*[19] The court attempted to define moneyed capital as follows:

"The terms of the Act of Congress, therefore, include shares of stock or other interest owned by individuals in all enterprises in which the capital employed in carrying on its business is money, where the object of the business is the making of profit by its use as money."

The above quotation has been approved repeatedly by the Supreme Court of the United States, and was adopted by the Supreme Court of the State of Minnesota in the case of *State of Minnesota v. First National Bank.*[20] In that case, after referring to the Mercantile National Bank case, *supra,* the court said:

"As we understand these decisions, credits in the form of interest-bearing demands and money invested in loans or securities, whether such investments are of a permanent character or for a temporary purpose, and also shares of stock held by

15 (1899) 173 U. S. 664, 676, 677, 19 S. Ct. 537, 43 L. Ed. 850.
16 (1922) 258 U. S. 362, 42 S. Ct. 323, 66 L Ed. 661.
17 *Klauss v. Citizens Nat'l Bk.,* (1909) 46 Ind. App. 683.
18 (1882) 105 U. S. 322, 26 L. Ed. 1053.
19 (1886) 121 U. S. 138, 7 S. Ct. 826, 30 L. Ed. 895.
20 (1925) 164 Minn. 235, 204 N. W. 874, at 877.

individuals in corporations the business of which is the making of profit by using their capital as money, that is, by loaning it at interest or investing it in interest bearing securities, are deemed moneyed capital used in competition with national banks within the meaning of section 5219."

One of the latest decisions adopting the above interpretation is the case of *First National Bank v. City of Hartford.*[21]

VARIOUS KINDS OF DISCRIMINATION.

Discrimination which, if enjoyed by substantial competing moneyed capital, would be sufficient to violate the federal enactment, may arise under various situations, either by the state statute itself or the interpretation given it by the state court. Moreover, the test laid down has been defined as whether moneyed capital was engaged in competition with the business which national banks were authorized to carry on, rather than whether it was being used in operations which brought it into direct competition with actual transactions then and there being carried on.[22]

DISCRIMINATION BY CLASSIFICATION

The ordinary situation under which assertions of discrimination have been made is where property is classified and money and credits taxed at a lower rate than shares of national banks. This was the situation in *Merchants National Bank v. City of Richmond.*[23] Likewise was there a classification and a different rate provided for shares in national banks than for competing moneyed capital in the case of *First National Bank v. Anderson,*[24] in which case bank stock was taxed at 143.5 mills on the dollar, whereas notes, mortgages and other evidences of debt and investment of individuals in securities were only taxed at 5 mills on the dollar, in view of which the collection of the tax was restrained. The same form of discrimination existed in the case of *Voran v. Wright,*[25] and the Supreme Court of Kansas held the statute discriminatory.

The same type of discrimination also exists where a portion

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[21] (1927) 273 U. S. 548, 47 S. Ct. 462, 71 L. Ed. 767.

[22] *People v. Goldfogle,* (1926) 242 N. Y. 277, 300, 151 N. E. 452, 460.

[23] (1921) 256 U. S. 635, 41 S. Ct. 619.

[24] (1926) 269 U. S. 341, 46 S. Ct. 135, 70 L. Ed. 295.

[25] (1930) 129 Kan. 601, 284 Pac. 807.

of the taxable property enjoys an undervaluation, and such tax was held invalid in the case of *First National Bank of Albuquerque v. Albright.*[26]

DISCRIMINATION BY REASON OF COMPETING MONEYED CAPITAL ESCAPING TAXATION.

Another method of discrimination occurs where a substantial amount of competing moneyed capital escapes taxation. This, of course, is simply carrying to its ultimate limit the discrimination previously discussed of classification and applying either different rates or a different valuation. An example of this type appears in the case of *First National Bank of Hartford v. City of Hartford.*[27] In that case by statute an *ad valorem* tax was assessed upon shares of national banks. By another section, all moneys or debts due or to become due to any person, and all stocks and bonds including bonds issued by any county, town, etc., were exempt from taxation. Acting under these statutes, the taxing authorities made no assessment or tax upon credits or intangible property other than the shares of stock in banking corporations, and the moneyed capital thus favored was held to have been employed in substantial competition with the business of national banks, and the tax was accordingly held invalid. The same type of discrimination appeared in the case of *National Bank of Commerce v. King County,*[28] and in *Roberts v. American National Bank of Pensacola.*[29] A similar situation confronted the courts in the case of *Public National Bank of N. Y. v. Keating,*[30] in which the tax was held invalid. The above cases condemn the failure to tax competing moneyed capital whether it be by the terms of the statute, by a misconstruction or misapplication of a statute, or by a systematic and intentional omission by the taxing officials.

DISCRIMINATION BY REASON OF SUBSTANTIAL COMPETING MONEYED CAPITAL BEING ALLOWED DEDUCTIONS

Frequently statutes permit the deduction of *bona fide* indebtedness of a taxpayer from what are denominated credits.

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[26] (1908) 208 U. S. 548.
[27] Note 21 *supra.*
[28] (1929) 153 Wash. 351, 280 Pac. 16.
[29] (1929) 97 Fla. 911, 121 So. 554.
[30] (1930) 38 F. (2nd) 279.

It logically follows that if competing moneyed capital in a substantial amount is allowed to deduct *bona fide* indebtedness, and this right is denied to shareholders of national banks, discrimination in violation of section 5219 results. The question was first raised in the Supreme Court of the United States in the case of *People v. Weaver,*[31] the court holding that the denial to holders of bank shares of the right to deduct *bona fide* indebtedness when such a privilege was granted to the holders of competing moneyed capital, was a discrimination within the meaning of the above section. The ruling in this case on the question of debt deduction was followed by the Supreme Court of the United States in numerous other cases.[32]

DISCRIMINATION BY REASON OF MONEY AND CREDITS BEING TAXED ON INCOME AND EXEMPTED FROM *AD VALOREM* TAX, AND TAXING NATIONAL BANK SHARES AT A GREATER AMOUNT UNDER THE *AD VALOREM* TAX.

Discrimination within the meaning of section 5219 would exist, if allowed to a substantial amount of competing moneyed capital by taxing money and credits on income and exempting them from the *ad valorem* tax, and taxing national bank shares at a greater amount under the *ad valorem* tax. This situation exists in a few states, but apparently has escaped being the subject of litigation.

Other situations producing discrimination have been corrected by the courts. In Missouri national bank shares were assessed at 90% and other property at 75% of full value. When objection was made, the assessing officers promptly raised the assessment of the bank shares to 100%, thus indicating the necessity of the protective features of section 5219. However, the Supreme Court of Missouri held the assessment unconstitutional and discriminatory in the case of *Boonville National Bank v. Schlotzhauer.*[33]

Th above discussion presents some of the difficulties arising

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[31] (1880) 100 U. S. 539, 25 L. Ed. 705.

[32] *Supervisors of Albany County v. Stanley,* (1882) 105 U. S. 305, 26 L. Ed. 1044; *Hills v. National Albany Exchange Bank,* (1882) 105 U. S. 319, 26 L. Ed. 1052, and *Evansville National Bank v. Britton,* (1882) 105 U. S. 322, 26 L. Ed. 1053.

[33] (1927) 317 Mo. 1298, 298 S. W. 732.

in connection with the drafting of an equitable tax law, and points out some of the features that cannot be ignored if a satisfactory law is to be put on the statute books. The fact that certain classes of property, including stock in national banks, have borne more than their share of the tax burden in the past is all the more reason for using the utmost care in avoiding such discrimination in any proposed tax legislation so that it would be unnecessary to resort to the protection guaranteed by section 5219.