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**Report to**  
**Governor Charles Edison**  
*on*  
**Railroad Taxation in New Jersey**  
**(1932-1940)**

**TRENTON, NEW JERSEY**  
February 22, 1941

**New Jersey State Library**

Until there is a settlement of the railroad tax controversy in New Jersey the accounts of the State and of numerous municipalities cannot be placed on a realistic basis. Railroads pressing litigation against the State owe something over \$34,000,000 in taxes from 1932 to 1940, exclusive of interest.

Some of the railroads owing this money are in bankruptcy. Others are reported to be in such condition that they will seek bankruptcy if unable to adjust their tax problem.

I have been studying possible ways of working out this situation. The State and the affected municipalities require cash tax payments in place of obligations to pay. At the same time, all Jersey men want the railroads to be given such aid as will enable them to keep up their payments to employees, maintain service with safety, and continue to be a source of tax income in the future.

The railroad tax question involves more than a rule of law. New Jersey railroads are large employers of labor. Their service is an important factor in the lives of many thousands of Jersey men who commute to work. Many industries are located in the State because it is one of the chief railheads of the nation.

The railroads have suffered a heavy loss in income since the start of the depression. Part of their loss has resulted from the development of automobile, bus and truck competition, which they are not likely to overcome in the future. A complaint of the railroads which has considerable justice is that taxation in New Jersey is by a method that takes no account of changes in their income.

Important functions of the State and municipalities have been paid for in the past out of the railroad taxes. Failure of railroads to pay in recent years has left the Teachers' Pension and Annuity Fund with accounts receivable for almost \$10,000,000 rather than cash. It has left county school funds with accounts receivable for more than \$7,000,000 rather than cash.

At my request, the subject of railroad taxation has been studied by a group who strove to balance the large public and private interests involved. The members of the group were Dr. John F. Sly, Director of the Princeton Surveys; Brigadier General Lewis B. Ballantyne of Newark, who is associated with the Firemen's Insurance Company; Carl Holdeman, of Labor's Non-Partisan League and Albert R. Jube of South Orange, a member of the New York firm of Chamberlain, Kafer, Wilds and Jube, Attorneys.

They have made a report of their studies, which is issued in conjunction with this statement. As the problem of railroad taxation in the State will remain under any possible outcome of the pending application by some of the railroads before the United States Supreme Court, we cannot begin too soon to study reasonable proposals for a settlement.

The groups who studied this question have made a conscientious and capable effort to assemble relevant data. I consider they have given thoughtful consideration to the central factors. They have offered a set of recommendations which are on Page 21 of the accompanying report.

The recommendations are:

"(a) The payment of all railroad tax delinquencies in full over a designated period of years without penalty.

"(b) A new tax structure for the railroads based upon a 100% ad valorem valuation as at present but levied at a flat rate tentatively suggested at 3%.

"(c) The second class railroad tax be apportioned to the various municipalities. ~~Each municipality will receive that portion of the second class railroad tax determined by the ratio of its total local assessed value of second class railroad property to the total assessed value of second class railroad property in the state.~~

"(d) The first class railroad tax be paid into the general fund of the state as at present and apportioned by the legislature in such manner as may be determined. We urge that allocations for educational purposes be maintained as closely as possible to the present amount either from this fund or from other funds.

"(e) In order to assure that the railroads' capacity to pay taxes is given proper consideration, it is proposed that in determining franchise values that earnings shall be a substantial element in the measure of such value. It is the purpose of this proposal that those railroads that now have substantial earning capacity shall pay taxes in excess of those that have little or no capacity. The difference of the assessed valuations of the various New Jersey railroads may well be reflected in franchise values determined in this manner."

I pass on these recommendations for careful study by the Legislature, county and municipal officials, by others whose interests are directly involved, and by the public.

Railroad taxes levied in New Jersey last year totaled \$13,296,690. By computations detailed on the last page of the accompanying report, proposed changes in the law would have reduced this amount \$5,033,690 if a basic tax rate of 3 per cent were used or \$612,691 if the rate were 4 per cent.

The new tax structure proposed for the railroads would incorporate such a basic tax rate in place of the present system of having taxes on railroad property vary with local rates. Coupled with the application of a uniform rate for all parts of the State would be a system of varying the franchise valuations of railroads in line with their earnings, so that a railroad with large earnings would pay considerably more in taxes than one which had little or no earning capacity.

State, county and municipal governments would ultimately receive the full amount of past taxes, as they had the right to assume would happen when they were incurring obligations. The railroads would get a chance to pay off these debts over a reasonable period and would be helped by lower taxes in the future to get their businesses going soundly.

I understand, as do those who prepared the report, that more complete data can alter some of the computations that are appended. Further study might be given to the rate at which the proposed new tax system would be equitable.

There would have to be some trimming of sails as a result of the reduced revenues levied under proposed changes in the tax law. It should be kept in mind, however, that while levies now are higher than these proposals, a sizeable part of the levies are not being collected.

I wish to urge education groups and teachers in the pension fund to note that no proposal is made to ask them to bear such loss of revenue as might result. The only equitable course would be to make adequate provision for these activities from general funds of the State.

In conclusion, I wish to reiterate that there are large public interests involved in the railroad tax question which overbalance the interests of any of the parties directly or indirectly involved in the existing controversy. I trust that discussion and judgment of these proposals and others that have been or may be made will be with cognizance of that fact. Any settlement of the railroad tax question must be in the interest of the people of New Jersey as a whole.

REPORT TO GOVERNOR CHARLES EDISON  
on  
RAILROAD TAXATION IN NEW JERSEY  
(1932 - 1940)

SUBMITTED AT THE GOVERNOR'S REQUEST

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TRENTON, NEW JERSEY  
February 22, 1941

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February 22, 1941

HONORABLE CHARLES EDISON

GOVERNOR OF THE STATE OF NEW JERSEY

Dear Governor:

Pursuant to your request, we have given consideration to the railroad tax problem presently existing in New Jersey and report to you herewith our conclusions.

Among other sources of information consideration has been given to the

(a) briefs in the litigation instituted by the railroads in the United States District Court for New Jersey which involved taxes for the years 1934, 1935 and 1936;

(b) the opinion of Judge Forman rendered in that case;

(c) the opinion of the Circuit Court of Appeals for the Third Circuit rendered on November 27, 1940, which reversed the decision of the District Court;

(d) the testimony of Mr. Focht, head of the Railroad Tax Division of the State Tax Department, given in the proceeding before the State Board of Tax Appeals in the 1940 tax cases, which is explanatory of the method of assessing and taxing railroad property in New Jersey;

(e) Senate Bill 304 introduced by Senator Foran on March 27, 1939, which was not adopted but which sets forth a proposed method of compromise of the unpaid portion of railroad taxes in litigation for the years 1932 to 1938, inclusive, and certain statements and data presented at the public hearing on this Bill which was held on May 4, 1939;

(f) Governor Moore's messages to the legislature on November 27, 1933, and May 2, 1934, and Governor Hoffman's on January 14, 1936;

(g) a report dated February 26, 1934, of the legislative committee appointed to consider the taxation of railroad and canal property in New Jersey and of the compromise of the taxes then in dispute;

(h) various data submitted by the Lehigh Valley Railroad Company concerning that railroad and other railroads involved in the problem and by the Central Railroad Company of New Jersey.

We have also had compiled by the Princeton Surveys under the direction of Professor John F. Sly a factual and statistical analysis of Railroad Tax Delinquencies in New Jersey which is annexed hereto as appendices. It shows substantially the essential facts necessary for an intelligent consideration of questions, and to the extent that we believe additional data is necessary, we will refer to it in the body of this report.

In the litigation presently existing before the courts and the State Board of Tax Appeals which involves taxes for the years 1932 to 1940, the railroads claim that the taxes levied against them are illegal because in violation of the constitutions of the state of New Jersey and of the United States. The courts have consistently decided against the railroads and this question is no longer open unless the Supreme Court of the United States should permit the case to be carried to that court, which we believe doubtful. The decisions of the courts, however, (see the decision of the C.C.A. 3d Cir. rendered on 11/27/40 in C.R.R. v. St. Tax Com.) have been based on legal rather than economic grounds and have quite properly left open the question of whether or not the railroads have been and are being excessively taxed in New Jersey as a matter to be determined by the legislature and not by the courts.

We have given our principal consideration to the two main problems involved in the railroad tax situation:

(a) whether the state should accept the proposal of the litigating railroads to pay over a period of time about \$10,876,000, in full settlement of their delinquent taxes for the years 1932 to 1940, inclusive, which amount (exclusive of very substantial interest) to about \$34,268,000, and

(b) whether the present railroad tax law should be changed, and if so, in what respect.

We will discuss these questions in the order in which they have been stated and will give our conclusions separately with respect to each.

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Should the Compromise Proposed by the Railroads be Accepted?

After consideration of this question, we have decided that the compromise in the form proposed by the railroads should not be accepted by the state. Our reasons for this conclusion are as follows:

Page 12 and the following pages of Appendix I, which is attached, reveal that roughly one-half of the delinquent taxes owed by the litigating railroads, about \$16,889,000, belongs by virtue of the provisions of the railroad tax law to the various municipalities of the state. This tax was assessed on second class railroad property located in these municipalities and is part of the general property tax of each taxing district comprised therein.

The total, \$17,030,633, of delinquent second class railroad property taxes throughout the state, substantially all of which is owed by the railroads involved in this problem, is for the account of 281 municipalities, and 83 per cent of this amount is owed to the ten municipalities of Hudson County. Sixty-one per cent is owed to Jersey City alone. The table on page 13 of Appendix I shows these delinquencies expressed as percentages of total 1940 property taxes levied in five Hudson County municipalities. In Jersey City this percentage is 32.5; in West New York, 37.9; and in Weehawken, 81.8. As compared with 33 per cent in Hudson County, the percentage is only 4 in Essex County, 3 in Bergen County, and 10 throughout the rest of the state.

On pages 16 and 17 of Appendix I we show that if the proposed settlement offered by the railroads is accepted, the municipalities of the state would receive about \$5,000,000 and would be compelled to write off about \$11,814,000. Hudson County municipalities would receive \$4,212,600 and would write off \$9,805,000. Essex County municipalities would receive \$203,000 and write off \$472,500. Bergen County municipalities would receive \$152,265 and write off \$354,420, and the rest of the counties of the state would receive \$507,549 and write off \$1,181,399.

The foregoing figures have led us to conclude that the settlement proposed by the railroads should not, as a matter of fairness, be consummated without the approval of Hudson County because by far the largest part

of the delinquent second class tax is receivable by municipalities of that county. Acceptance of the compromise without their consent would in effect be depriving them of valuable assets which the law gives to them. As a matter of practical fact, we doubt if the compromise could be consummated without their cooperation as evidenced by the failure of the legislature to adopt the Foran bill (Senate 304), which contained substantially the compromise now offered and failed of passage in 1939.

The first class railroad tax delinquency of approximately \$17,800,000 is owing in the first instance to the state and through it to the state fund, the teachers' pension fund and to the counties of the state for schools in the proportions shown on page 7 of Appendix I. This tax lends itself more conveniently to the proposed settlement than the second class tax in that the write-offs could perhaps be made up in part at least by the state from other sources of revenue. It would be difficult, however, to compromise the first class tax without also compromising the second class tax.

It is also impractical to consummate the railroads' offer of compromise because four of the seven railroads are in bankruptcy and three of these -- Central R.R. of N.J., New Jersey and New York, and New York, Susquehanna and Western -- have withheld announcement of their willingness to settle on the proposed basis. What they will or can do respecting the proposed compromise is not presently known because their course depends upon

the decision of the courts under whose jurisdiction they are now operating. This means that there is really no actual offer of settlement except from the Lehigh Valley, the Lackawanna, Erie and New York Central.

We are fully aware of the fact that the railroads not now in bankruptcy may place themselves under the courts' protection if the state seeks to enforce the collection of the delinquent taxes, and that in consequence, the state, and hence municipalities, may never be able to collect more of the second class tax than the amount now offered. Still we feel that, in fairness, this question must be determined by the entities so preponderantly involved, especially those municipalities which have in good faith anticipated revenues virtually promised them in the past by the legislature of New Jersey. Since they oppose the settlement, we do not feel that we can advise that the state accept it against their wishes.

We believe, however, that the interest which the entire state has in the efficient operation of its railroads makes advisable the settlement of the tax delinquency of the seven litigating railroads upon the basis of payment by them in full of the entire amount unpaid over a designated period of years without the presently accrued interest but with interest at the rate of 3 per cent per annum from the effective date of the compromise.

Coupled with such an understanding the railroad tax law should be amended as hereinafter provided. The proposed amendments will, we believe, have the effect of reducing taxes for those railroads whose earnings have

been reduced. Such a settlement would be advantageous to Hudson County in that it would provide for ultimate receipt of the full tax levied; it would not be unduly burdensome on the railroads not in bankruptcy because they would receive sufficient time to pay, would be relieved of a very substantial sum of interest penalties, and very likely would be relieved of the necessity of placing themselves under the control of the courts.

The railroads in bankruptcy would have to obtain the approval of the court before they could accept any compromise and payment by them of delinquent as well as current taxes would be dependent upon court order; but their existing delinquent tax bill would be substantially reduced by the elimination of the penalties and they would receive time to pay. Their reorganization and discharge from judicial custody should be expedited particularly if their current tax accruals are reduced by the change in the tax law suggested below.

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Should The Present Railroad Tax Law Be Changed  
And If So In What Respect?

The law under which railroad taxes are assessed is contained in Chapters 19 to 29 inclusive of Title 54 of the Revised Statutes of 1937. Since 1884 to the present time, the law has directed the separate valuation and taxation of four (4) classes of railroad property. These classes are set forth in Revised Statutes of 1937, 54:22-1, as follows:

"I. The length and value of the main stem of each railroad, and of the waterway of each canal and the length of such main stem and waterway in each taxing district;

"II. The value of the other real estate used for railroad or canal purposes in each taxing district in this state, including the roadbed (other than main stem), waterways, reservoirs, tracks, buildings, water tanks, waterworks, riparian rights, docks, wharves and piers, and all other real estate, except lands not used for railroad or canal purposes;

"III. The value of all the tangible personal property of each railroad and of each canal company;

"IV. The value of the remaining property, including the franchise."

The law prescribes no method of valuation of railroad property for tax purposes. It leaves to the assessor the choice of the method of valuation, how he should determine values, what exceptions should be made, what standards of value he should adopt, and what information he should require in the tax returns submitted by the railroads. The assessor is empowered by the statute to use his own knowledge and judgment as to the value of the property to be assessed (Focht 2671).

It appears from the testimony of Mr. Focht, who is in charge of this work for the state, that two general rules have been followed by the state in valuing railroad property for taxes, namely (a) the constitutional requirement that all property shall be assessed under uniform rules according to its true value, and (b) "true value" is value at which, in the judgment of the assessor, it would sell on the assessing date at a bona fide sale between a willing buyer and a willing seller, neither of whom was under any necessity or compulsion to deal with the other.

The railroads contend that the New Jersey assessments of railroad property are excessive and result in such heavy taxes that the railroads are unable to pay them and still maintain their property in efficient operating condition. This results, the railroads claim, from the failure of the state to include in its indicia of value current railroad earnings. We believe it is a fact that the state of New Jersey does not accord any substantial consideration to railroad earnings in fixing value. The following table of gross system revenues, net operating income before taxes and fixed charges, and New Jersey taxes for the years 1926 to 1938, covering all the litigating railroads and supplied by the Lehigh Valley Railroad, seems to bear out this contention:<sup>1</sup>

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<sup>1</sup>Barrett, p. 3. Table of Gross Earnings and Taxes -- all roads.

	Gross Revenues (System)	Net Operating In- come before Taxes and Fixed Charges		New Jersey Taxes (a)
1926	\$942,147,944	\$233,732,944	(1928)	\$11,643,785
1927	902,932,124	204,431,058	(1929)	11,904,341
1928	896,022,719	219,984,035	(1930)	12,779,311
1929	919,987,850	223,543,212	(1931)	13,154,119
Average -	\$915,272,660=100%	\$220,422,812=100%		\$12,370,390
1932	\$477,758,670	\$ 87,426,169	(1934)	\$12,270,836
1933	458,764,283	97,102,784	(1935)	12,347,490
1934	478,273,380	94,352,609	(1936)	12,291,809
1935	494,660,285	94,493,825	(1937)	12,164,446
1936	569,032,721	124,720,764	(1938)	12,764,381
1937	573,760,031	111,235,396	(1939)	11,325,741
1938	476,905,957	77,873,574	(1940)	11,478,613
Average -	\$504,165,049-55.08%	98,172,160 - 44.54%		\$12,020,474

The average gross earnings of the latest period (1932-1940) are therefore 55.08% of the earlier period (1926-1929), while the net earnings available for taxes and fixed charges for the latest period are 44.54% of the average for the pre-depression period.

(a) Assessment and taxes two years later than fiscal year.

The railroads are, of course, public utilities in whose welfare the public has an important and profound interest. For this reason the railroads are not free as other corporations are to fix the terms and conditions upon which they do business. They cannot regulate their income because they cannot fix their own freight or passenger rates; they cannot relinquish unprofitable lines or property at will but only with the approval of public authority which is usually difficult to obtain; their rates of wages are matters of public concern and regulation; they are

completely subservient to public regulatory bodies because they are public corporations. Their income is therefore largely beyond their individual control.

Railroad income is expended first for labor and taxes. If anything is left, payment is made to the owners. The railroads must defray the costs of transportation and of the maintenance of their equipment before any disbursements can be made to the owners. Of the seven railroads involved in this discussion, four are already in bankruptcy, namely: Central R. R. of N. J. which owes roughly \$13,450,000 of the total of about \$34,268,000 owed by all of the litigating roads; Erie R. R. which owes \$4,700,000; Susquehanna which owes \$1,217,000; and the N. J. and N. Y. R. R. which owes about \$287,000. The roads not in bankruptcy are: the Lehigh Valley which owes about \$4,550,000; the Lackawanna which owes about \$7,345,000, and the N. Y. Central which owes about \$2,700,000.

The Lehigh Valley has had a deficit every year since 1932 except in 1936 when it earned some money. It has paid no dividends on its preferred stock since 1932 or on its common stock since 1931. Within the last year or two the Lehigh Valley, through court proceeding under the Chandler Act, has received some relief on its bonded indebtedness which we believe has been in the nature of the postponement of maturities.

The Lackawanna has had a deficit in every year since 1932; it has paid no dividends since 1931.

The New York Central had deficits from 1932 to 1934 inclusive; income in 1935 to 1937 inclusive; a large deficit in 1938, and income in 1939 and

1940. It has paid no dividends since 1931.

Inasmuch as the owners (that is, the stockholders and bondholders) of the four railroads in bankruptcy are not receiving any part of the fund, we believe that the real problem involved in this branch of our discussion is how each dollar of railroad income shall be distributed among two of the three major claimants named above: the workers and the government. While the bondholders of the other roads are probably receiving their interest in part at least, the stockholders are receiving nothing, and the security of the bondholders seems to have been impaired. The owners of the New York Central, while better off probably than the security holders of any of the other railroad companies involved, are not in a very secure position.

To the extent that the railroad income dollar is distributed to the workers, the maintenance of the railroad in good repair and its efficient operation is enhanced. Other things being equal, some preference, we believe, should be given to this avenue of distribution, especially if, as we believe is the fact, New Jersey has been more severe in the taxation of her railroads than other states.

The limited area of New Jersey and her intensive industrial development make her peculiarly dependent upon efficient transportation at reasonable cost because only in that way can she secure adequate raw materials at low cost and the necessary opportunity to send her finished products

throughout the country at competitive prices. Only railroads which are efficiently and economically managed can supply this service which is unusually necessary to New Jersey. If our railroads should deteriorate, the state would suffer economically.

If the tax load of New Jersey railroads is too great, it is to be expected that the maintenance of equipment and consequently efficient and economic operation of railroad property will decline. Not only will this cause economic loss to workers and merchants in the state but the usefulness of our railroads in aid of national defense will suffer. In these days when our federal government and all the citizens of our country are embarked on a superlative effort for national defense, we should be particularly careful that our railroads are permitted to earn sufficient money to keep their properties in repair and capable of rendering maximum service.

A statement submitted by J. K. Hiltner, Traffic Manager, United States Pipe and Foundry Co., at the hearing on Senate Bill 304 in May, 1939, contained the following:

"The other serious condition that would confront the industries of New Jersey if the volume of our business should be suddenly increased, either as the result of a return of prosperity or of a war demand for transportation, is strikingly suggested by a report which the Interstate Commerce Commission released last month showing the extent to which the railroads, under the pressure of the depression, have reduced their facilities and particularly their equipment.

This report, for example, shows that in 1929 the Central Railroad owned 22,780 freight cars, whereas in 1937 it owned only 12,850 freight cars; the D. L. and W. in 1929 owned 25,900 freight cars, and in 1937 they owned 19,070 freight

cars; the Erie in 1929 owned 44,590 freight cars, while in 1937 it owned 25,665 freight cars; the Lehigh Valley in 1929 owned 26,154 freight cars, while in 1937 it owned only 15,485 freight cars; the New York Central in 1929 owned 217,000 freight cars, while in 1937 its ownership had been reduced to 146,000 freight cars.

To people familiar, or who have had experience with this transportation problem, such figures are startling. They mean that if and when business in New Jersey becomes normal again, we are likely to be confronted with the most serious car shortage in the history of the State. I say to you with all the emphasis I can command that if the policy of the State of New Jersey in over-taxing its railroads is largely responsible for an enormous retirement of freight car equipment which has occurred in this State during the past six years, then such policy will prove to have been totally lacking in vision because it will mean that when everything is set for transportation to come back, we will have a broken down machine that will make it impossible for our factories and industries to meet the demands which will be placed upon them.

Moreover, this report by the Interstate Commerce Commission contains a lot more statistics showing not only a startling reduction in the available freight cars owned by these New Jersey railroads, but the figures also demonstrate that the rights of way and rails and other facilities are not being maintained and repaired according to normal standards. These figures show, for example, in the case of all of these New Jersey railroads, that the number of tons of rail replaced annually during the past five years is less than 50% of the rate of replacement that prevailed in 1929.

Furthermore, they show that the number of man hours employed by these railroads in the maintenance of ways and structures during the past five years has been less than 50% of the normal employment in maintenance work."

The President of the New Jersey Taxpayers Association at a public hearing held May 4, 1939, on Senate Bill 304 stated:

"I am an employer of labor. For years my company found in common with hundreds of other companies around the State, that prosperous railroads were large buyers. The railroads have not been large buyers for years. And as a result my

company has not employed men who need work and whose lack of steady income hurts us all, but when men can't find work the home owner is the one who suffers most.

When the railroads are practically bankrupt and cannot buy, then unemployment is made worse because industry after industry which depend upon a healthy condition of the railroads, finds its market gone and hence can offer no jobs to the workingmen who need them, and these workingmen in turn fall back upon the State for support, thus adding to the taxes of those who still have jobs. Again the home owner suffers.

Still looking at this problem from the standpoint of the small home owner, what will the effect on his investment be if the railroads are driven into bankruptcy so that their train service must be curtailed; I live on a railroad that is always in financial trouble and I do not note that anybody either employees or home owners, are benefitted. All over the State there are communities depending on regular and efficient train service. Isn't it clear that the value of their home will be reduced if the railroads on which they depend are forced to curtail their service and facilities?"

The President of the New Jersey State Chamber of Commerce at the same public hearing said:

(1) The railroads constitute one of the chief industries of the State, employing a great army of citizens which in normal times exceeded 50,000 and at the present time exceeds 27,000 individuals and purchasing approximately \$25,000,000 annually of materials and supplies from New Jersey industries.

(2) These railroads are performing a vital public service, transporting not merely the raw materials and fuel inbound and manufactured products outbound on which the prosperity of our factories and the employment of our working people depend, but they also transport daily over 325,000 commuters.

(3) Any disruption or curtailment of this service upon which industry depends for prompt and efficient handling of goods and passenger travel, would be disastrous to the business interests of the State. It would be as serious to small business as it would to large business; every one would be affected."

Judge Forman in his opinion in Central Railroad v. The State Tax Commission pointed out that the decrease in earnings of the railroad properties is not temporary but has been due to a permanent loss of traffic as a result of changes in business and transportation methods. It must be remembered, he said, that these railroads were built to provide transportation before the perfection of the motor truck and the construction of the highway system. A large proportion of the traffic formerly carried solely by the railroads is now being transported by trucks, buses, etc. The rapid development of concrete state highways has resulted in the diversion to truck haulage of a vast tonnage of freight including anthracite coal. Coal shipments have also declined because of the growing use of petroleum for fuel which does not move by rail to any extent. Judge Forman said that he was moved to take notice of the loss of export traffic. Foreign nations have increased their custom duties on American products in reprisal for the increase in the tariff on imported goods with the result that their trade has gone elsewhere. He concluded that in order to reflect this deflation and diversion of business, it is imperative that the earnings should permeate every item of railroad property tangible and intangible.

Harley L. Lutz, Professor of Public Finance, Princeton University, published a pamphlet entitled "A Statement on the Proposed Compromise Settlement of the New Jersey Railroad Tax Levies" in May of 1939, in which he showed that the ratio of taxes to Gross Revenues of Class I Railroads in the United States for the years 1932 to 1938 was 9.56% (page 5)

whereas for each of the five more important New Jersey roads involved in this problem the ratio (on a system basis) was 11.19<sup>o</sup>/<sub>o</sub> in the case of the Delaware, Lackawanna and Western; 7.19<sup>o</sup>/<sub>o</sub> for the Lehigh Valley; 6.87<sup>o</sup>/<sub>o</sub> for Erie; 20.08<sup>o</sup>/<sub>o</sub> for Central Railroad of New Jersey, and 8.95<sup>o</sup>/<sub>o</sub> for New York Central.

Professor Lutz also shows (page 7) that if the railroad taxes levied in New Jersey are compared with that part of system earnings allocated to New Jersey on the basis of all track miles which gives at least some recognition to the fact that New Jersey is a terminal state, the nationwide ratio of taxes to gross earnings which, as stated, is 9.56<sup>o</sup>/<sub>o</sub> becomes in New Jersey 25.3<sup>o</sup>/<sub>o</sub> for the Lackawanna; 25.4<sup>o</sup>/<sub>o</sub> for Lehigh Valley; 23.7<sup>o</sup>/<sub>o</sub> for Erie; 20.09<sup>o</sup>/<sub>o</sub> for New Jersey Central and 46.2<sup>o</sup>/<sub>o</sub> for New York Central.

Comparisons are also given in the pamphlet which show, for instance, in the case of the Lehigh Valley Railroad that New Jersey taxes for 1932-1938 were 60.44<sup>o</sup>/<sub>o</sub> of its entire system taxes, while it had only 9.41<sup>o</sup>/<sub>o</sub> of its road in the state and only 16.53<sup>o</sup>/<sub>o</sub> of its trackage. In the case of the Lackawanna Railroad the New Jersey taxes were 63.30<sup>o</sup>/<sub>o</sub> of the system taxes while only 23.7<sup>o</sup>/<sub>o</sub> of its road was in the state and only 28<sup>o</sup>/<sub>o</sub> of its trackage.

Another comparison given in Professor Lutz's pamphlet based on annual averages, 1932-1938, is that in the case of the Lackawanna, the average tax per mile of road within New Jersey was \$13,961 whereas it was \$1649 per mile outside of New Jersey; and the average tax per mile of

track within New Jersey was \$4,315 and \$641 without the state. Similar comparisons with respect to others of the litigating roads are given, each showing a much higher tax in New Jersey per mile of road and per mile of track than outside of the state.

The same pamphlet contains a comparison of the operating income of five of the litigating railroads (viz: Lackawanna, Lehigh Valley, Erie, Central R. R. of N. J. and N. Y. Central) averaged for the years 1932 to 1938 allocated to New Jersey and the taxes levied by New Jersey. In the case of the Lackawanna, the income was \$2,492,927 and the tax \$3,270,553; in the case of the New Jersey Central it was \$2,794,364 income as compared with a tax of \$3,843,091 and the remaining roads showed in every case that the average annual tax was greater than the average annual net operating income.

In commenting on this comparison, Professor Lutz says that it is fortunate for New Jersey that the other states in which these railroads operate did not attempt to keep pace with her in the amount of railroad taxes levied because the capacity of these roads to serve New Jersey population and industries would have been impaired much more severely and at a much earlier date.

The pamphlet referred to shows on page 14 that on an annual average, 1932 to 1938, the ratio of taxes to operating income of five of the railroads involved was for the New York Central 246.36% in New Jersey and 41.79% outside; for the Lackawanna 131.9% in New Jersey and 19.49%

outside; for the Erie 108.53<sup>o</sup>/<sub>o</sub> in New Jersey, and 18.40<sup>o</sup>/<sub>o</sub> outside; and for the Lehigh Valley 137.26<sup>o</sup>/<sub>o</sub> in New Jersey and 15.04<sup>o</sup>/<sub>o</sub> outside.

A publication of the Interstate Commerce Commission, "Statistics of Railways in the United States 1937," shows in statement No. 39 the tax accruals in each state per mile of road. In this statement, New Jersey is highest, viz: \$9,902 per mile as compared with the average throughout the United States of \$1,475.

New Jersey seeks to justify the large taxes assessed against its railroads on the ground that it is a bridge-head state with short mileage and large terminals which are of great value. While we agree that a short line railroad leading to a valuable terminal has more value per mile than a road of great length leading through a sparsely settled district, we do not think the comparisons made in Professor Lutz's pamphlet can be adequately justified on this basis particularly where his allocations are made on an all-track basis which allows, in part at least, for the value of the terminals.

An opinion of Judge Clark of the District Court of New Jersey, rendered in December of 1940 in the Matter of the New York, Susquehanna and Western Railroad, shows a comparison of taxes levied per mile of the railroads of New Jersey and certain other states in 1931 to 1936. This has been extended through 1938 as follows:

State	1931	1933	1935	1937	1938
New Jersey	\$10,256.	\$9,136.	\$8,998.	\$9,902.	\$10,545.
Dist. of Co.	4,481.	4,378.	3,937.	7,946.	10,156.
Rhode Island	4,016.	3,741.	3,570.	3,845.	4,164.
New York	3,550.	3,522.	3,039.	3,720.	4,351.

Data obtained from Interstate Commerce Commission, Statistics on Railroads in the United States, Annual Reports, 1931-1938.

Professor Lutz refers on page 11 of his pamphlet to what he calls the sinister significance of the deficits of the railroads in question as revealed by a circular of the Interstate Commerce Commission dated January 1, 1939 which reported that as of that date the under-maintenance of the Central Railroad of New Jersey was \$4,874,814; the Lackawanna, \$ 2,091,800; the Erie, \$5,102,801; the Lehigh Valley, \$1,634,255; and the Reading, \$6,336,373.

We believe it is common knowledge that real estate and other property is not assessed in New Jersey at full value. The percentage of full value represented by assessments probably varies in the different taxing districts according to the judgment of the local assessors. Several state commissions or other investigating bodies have attempted to find out what the state average is in this regard but without complete success. The properties of the railroads, however, are undoubtedly assessed for at least full value against which the average state tax rate is applied in the case of first class property and the local rate in the case of second class property. The average rate in 1933 was 3.75% and 4.63% in 1939. This is probably one explanation of the high taxes assessed against New Jersey railroads.

Considering this problem from the standpoint of the welfare of the state, we are led by the foregoing data to the conclusion that the economic interests of New Jersey require amendment of the railroad tax law so that taxes on the railroads will be reduced at least with respect to those railroads which are having difficulty in meeting operating expenses. If taxes are not reduced we believe that the ability of these roads to transport passengers and freight efficiently and at reasonable cost will be jeopardized. Such a result would manifestly be most unfortunate in an industrial state like New Jersey.

We therefore recommend:

(a) The payment of all railroad tax delinquencies in full over a designated period of years without penalty.

(b) A new tax structure for the railroads based upon a 100<sup>o</sup>/o ad valorem valuation as at present, but levied against at a flat rate tentatively suggested as 3<sup>o</sup>/o.

(c) The second class railroad tax be apportioned to the various municipalities. Each municipality will receive that portion of the second class railroad tax determined by the ratio of its total local assessed value of second class railroad property to the total assessed value of second class railroad property in the state.

(d) The first class railroad tax be paid into the general fund of the state as at present and apportioned by the legislature in such manner as may be determined. We urge that allocations for educational purposes be maintained as closely as possible to the present amount either from this fund or from other funds.

(e) In order to assure that the railroads' capacity to pay taxes is given proper consideration, it is proposed that in determining franchise values that earnings shall be a

substantial element in the measure of such value. It is the purpose of this proposal that those railroads that now have substantial earning capacity shall pay taxes in excess of those that have little or no capacity. The difference of the assessed valuations of the various New Jersey railroads may well be reflected in franchise values determined in this manner.

We believe that legislation giving effect to the foregoing recommendations would be beneficial to the State of New Jersey as a whole because it would materially reduce railroad taxes which appear to us to be presently too high, especially as compared with the ability of the New Jersey railroads to earn money. If railroad taxes are not reduced, we believe that our railroads will deteriorate and become increasingly unable to render efficient service.

Our suggestions are not as drastic as they may at first appear to be since up to about 1905 railroad property was taxed in New Jersey at a limited rate of one and one-half per cent (1 1/2%).

The foregoing report is respectfully submitted.

Carl Holdeman

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APPENDIX I

Railroad Tax Delinquencies in New Jersey

(1932-1940)

February 6, 1941

## APPENDIX I

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## SUMMARY

This memorandum contains an analysis of all delinquent railroad taxes in New Jersey which have resulted from nonpayment of levies for the years 1932 to 1940, inclusive. Delinquencies are shown by roads and are divided as between First (state) and Second (local) Class taxes. Further divisions show the distribution of taxes due as between litigating and non-litigating railroads (p. 4).

Total payments required to settle delinquencies of litigating roads upon the basis of 75 per cent of taxes levied for the entire period have been computed. "Hidden refunds" resulting from the inclusion of levies fully paid in the base for such a settlement have also been computed (p. 2).

Similar computations based upon a 75 per cent settlement of levies for each year not already paid to that extent have been made. No "refunds" would result from such a compromise (p. 3).

Claims against First Class Railroad Tax delinquencies are shown by funds in the order of their statutory priority (p. 8). Following a historical summary of First Class Taxes covering the period 1932-1940 (p. 5-7) the effect of a compromise settlement of unpaid taxes at 75 per cent of levies is shown by roads and by funds (p. 7-11).

In a similar manner, claims against Second Class delinquencies are shown by municipalities holding the major portion of them as receivable (p. 14). The effect of a compromise settlement of such delinquencies is shown by roads and by municipalities (p. 14-17).

## A. Introduction

During the years 1932 to 1940, inclusive, a total of \$174,112,886 in taxes was levied against all railroads in New Jersey. Of this amount, \$34,821,779, or 20 per cent were outstanding and delinquent as of December 31, 1940.

Seven railroad systems accounting for \$110,170,063, or 63 per cent of the total levy have been in almost constant litigation of their tax bill to the state. These systems were delinquent at the close of the calendar year 1940 to the extent of \$34,268,405. They accounted for slightly more than 98 per cent of all delinquent railroad taxes. Delinquencies for these roads averaged 31 per cent of total levies imposed upon them during the period 1932-1940.

A compromise with the litigating roads based upon 75 per cent of levies during the period 1932-1940 would result in a settlement of \$34,268,405 in claims for \$6,725,887. However, some of the litigating roads have already paid all of their levies for the years 1932 and 1933. In total they are only delinquent 9.4 per cent and 16.2 per cent respectively of their levies for these years. Such a group settlement based upon any percentage less than 90.6 would result in "hidden refunds" of taxes already paid for these years. A 75 per cent settlement would imply \$4,260,449 of such refunds to the litigating roads. As a group they would, in effect, be settling their tax bill for the years 1934-1940 for only 71.3 per cent of original levies. For roads which have paid their 1932 and 1933 taxes in full this percentage is much lower.

Four of the litigating systems have announced their willingness to settle their tax bill to the state upon this basis. These roads, however, are now paid up to about 75 per cent of their total levies for the years 1932-1940. They are the systems which stand to gain most from the element of "hidden refunds" because of full payment of taxes levied for the years 1932 and 1933. Little actual revenue (about \$1,000,000) would accrue to the state from these four roads from such a settlement;

<u>SYSTEMS</u>	<u>PER CENT OF 1932-1940 LEVIES PAID</u>	<u>"REFUNDS"</u>	<u>AMOUNTS REQUIRED IN SETTLEMENT</u>
1. Lehigh Valley	72.3	\$ 894,772	\$ 441,822
2. Delaware, Lac., W.	74.6	1,712,980	121,865
3. New York Central	73.9	620,152	113,458
4. Erie	73.1	<u>928,090</u>	<u>330,819</u>
TOTALS		\$4,156,002	\$1,007,964

Three of the seven litigating systems have withheld the announcement of their willingness to settle upon this basis. These are the roads which are most delinquent and which stand to gain least from "hidden refunds";

<u>SYSTEMS</u>	<u>PER CENT OF 1932-1940 LEVIES PAID</u>	<u>"REFUNDS"</u>	<u>AMOUNTS REQUIRED IN SETTLEMENT</u>
1. Central R.R. of N.J.	60.0	None	\$5,051,738
2. N.J. and N.Y.	36.6	\$ 12,289	174,128
3. N.Y. Sus. and W.	58.0	<u>92,158</u>	<u>492,059</u>
TOTALS		\$104,447	\$5,717,925

But there is yet another approach to the proposed settlement of delinquencies upon the basis of 75 per cent of levies. This involves the

the settlement of taxes for each year more than 25 per cent delinquent without regard for years in which payments exceed 75 per cent of levies. By such a procedure, "hidden refunds" as described above would be eliminated. The railroads have computed payments required by this method. Independent computations have been based upon records of the State Comptroller of the Treasury. These are shown in comparison for the roads now willing to settle as follow:

<u>SYSTEMS</u>	<u>REQUIREMENTS COMPUTED BY RAILROADS</u>	<u>REQUIREMENTS COMPUTED INDEPENDENTLY</u>
1. Lehigh Valley	\$1,335,975	\$1,336,594
2. Dela., Lack., Western	1,726,054	1,834,845
3. New York Central	733,606	733,610
4. Erie	<u>1,258,704</u>	<u>1,258,917</u>
TOTALS	\$5,054,339	\$5,163,966

For the three litigating roads which have not announced their willingness to settle upon the basis of 75 per cent of levies, these figures are as follow:

<u>SYSTEMS</u>	<u>REQUIREMENTS COMPUTED BY RAILROADS</u>	<u>REQUIREMENTS COMPUTED INDEPENDENTLY</u>
1. Central R.R. of N.J.	\$5,051,739	\$5,051,738
2. New Jersey and N.Y.	186,417	186,418
3. N.Y., Sus. and W.	<u>584,214</u>	<u>584,217</u>
TOTALS	\$5,822,370	\$5,822,373

In order to measure the effect of any settlement upon the governments

holding delinquent railroad taxes as receivables, it is first necessary to divide proposed payments as between such governments. As of December 31, 1940, total railroad tax delinquencies (\$34,821,779) were held as receivables by the state and by municipalities to the extent of \$17,791,144 and \$17,030,633 respectively. These receivables represent claims against delinquent roads as follows:

	<u>TOTAL DELINQUENCIES</u>	<u>1ST CLASS (STATE)</u>	<u>2ND CLASS (LOCAL)</u>
Litigating Roads:			
1. Central R.R. of N.J.	\$13,459,697	\$ 7,247,747	\$ 6,211,949
2. Lehigh Valley R.R.	4,550,513	2,385,759	2,164,754
3. N.J. and N.Y.	287,403	264,541	22,861
4. N.Y., Susq., and W.	1,216,931	899,230	317,700
5. D. L. and W.	7,344,937	3,637,015	3,707,922
6. New York Central	2,707,419	861,119	1,846,300
7. Erie	<u>4,701,505</u>	<u>2,083,512</u>	<u>2,617,994</u>
SUB-TOTALS	\$34,268,405	\$17,378,923	\$16,889,480
Non Litigating Roads:			
1. Central R.R. of N.J.	\$ 6,502	\$ 5,921	\$ 581
2. New York and L. Br.	378,287	298,908	79,379
3. Reading	127,589	83,401	44,188
4. Pennsylvania	11,875	-	11,875
5. Unclassified	<u>29,121</u>	<u>23,991</u>	<u>5,130</u>
SUB-TOTALS	\$553,374	\$412,221	\$141,153
TOTALS	\$34,821,779	\$17,791,144	\$17,030,633

## B. First Class Railroad Tax

### 1. General Summary

This is the tax on the "main stem", or roadbed not exceeding one hundred feet in width, tracks and all structures (with the exception of passenger and freight buildings), all tangible personal property, such as rolling stock and machinery, the franchise and all remaining property not included in the second class railroad tax which is used for railroad purposes.

Such property is assessed by the State Tax Commissioner. The average tax rate for all municipalities in the state determines the amount to be levied. This rate was 3.75 in 1933 and 4.63 in 1939.

Taxes are paid to the State Treasurer. A sum equal to one half of one per cent of the total assessed valuation of first class railroad property is available for general state purposes. The remainder of the tax is "devoted to the maintenance and support of a thorough and efficient system of free public schools" (Rev. Stats. 18:10-30).

These educational funds, composed of the balance of the tax after the deduction for general state purposes, are used to meet the appropriations for the State Department of Education, the state normal schools, the State Agricultural College, the Teacher's Pension and Annuity Fund and other state educational purposes.

All monies remaining after deductions for (1) general state purposes and (2) state educational purposes outlined above, are apportioned among

the several counties in proportion to the amount of taxable property in each. They are, in turn, apportioned among the school districts within the counties (Rev. Stats. 18:10-31 and 18:10-33).

Actually what has happened during the years 1932 to 1940 inclusively is this:

1. The State Fund has realized \$9,923,077 to be used for general purposes. Except for \$758,380 of the 1934 tax which was "diverted" from this use to the Teacher's Pension and Annuity Fund, all levies originally apportioned to the State Fund for general purposes have been paid.<sup>1</sup>
2. Cash requirements to meet the annual appropriations for state educational purposes (i. e. State Department of Education, Agricultural College, etc.) have been supplied. All railroad levies apportioned for such (\$33,798,304) have been paid.
3. Commitments from the first class railroad tax to the Teacher's Pension and Annuity Fund have amounted to \$40,193,126. Of this, \$30,387,048 have been met and \$9,806,078 remain outstanding.
4. And finally, of \$9,919,004 of levies apportioned to the counties for school districts, only \$2,691,517 have been paid and \$7,227,487 remain payable. No payments on this account have been made from any taxes levies since 1933. These funds have been (to an unknown extent) expended up to 80% of the total

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<sup>1</sup>The Appropriations Act for 1940 (Ch. 158, P.L. 1940) provided that \$604,029 be paid to the Teacher's Pension Fund from the State Fund. Accordingly, this amount has been deducted from the railroad tax payable to the State Fund from the 1940 tax and added to the amount payable to the Teacher's Pension Fund. See Appendix II

by anticipational borrowing.

Failure to receive \$17,791,945 of first class railroad taxes levied and apportioned for the years 1932-1940 has resulted in the following situation. There are due and owing to:

<u>First:</u> The State Fund	\$ 758,380
<u>Second:</u> The Teacher's Pension Fund	9,806,078
<u>Third:</u> The Counties for Schools	<u>7,227,487</u>
Total	\$17,791,945 <sup>1</sup>

<sup>1</sup>\$800 error in 1940 tax computations. Totals do not check with computations by roads by this amount.

## 2. Effect of Partial Settlement

Allocations of the first class railroad tax are made by years in which they are levied. As these taxes are collected, they are paid to the fund first in priority of allocation, which has not been fully satisfied. Unpaid taxes are carried as receivables by funds which have not received the full amount of their allocation by this rule. Exceptions to this procedure can be made only by an act of the Legislature.

An example of such an act by the Legislature can be found in the disposition of taxes levied in 1933 and 1934. Collections of taxes levied for these years were paid first to the Teacher's Pension and Annuity Fund and second to the State Fund. Since that time, collections of the tax have been sufficient to meet the requirements of both of these funds in full for 1933. The State Fund still carries as receivables \$758,380 of delinquent taxes levied in 1934.

Without a further act of the Legislature, any future collections of delinquent taxes for the years 1932 to 1940, must be paid to the following funds, in amounts indicated, and in order of priority reading from left to right:

**CLAIMS AGAINST DELINQUENT FIRST CLASS RAILROAD TAXES  
IN NEW JERSEY (1932-1940)**

(As of December 31, 1940)

Year of Tax	1 State Fund	2 Teacher's Pension Fund	3 Counties for Schools	Totals
1932	-	-	\$ 879,918	\$ 879,918
1933	-	-	1,153,932	1,153,932
1934	\$ 758,380	-	1,375,321	2,133,703
1935	-	\$ 1,502,949	574,213	2,077,162
1936	-	1,112,666	1,144,158	2,256,824
1937	-	1,889,029	744,518	2,633,547
1938	-	2,094,103	601,858	2,695,961
1939	-	2,098,552	66,365	2,164,917
1940	-	1,018,779	687,204	1,795,983
<b>Totals</b>	<b>\$ 758,380</b>	<b>\$ 9,806,078</b>	<b>\$ 7,227,487</b>	<b>\$17,791,945</b>

A settlement of first class railroad tax delinquencies of the four roads which have expressed a willingness to pay 75 per cent of their levies for the years unpaid would result in payments amounting to \$2,483,785 as follows:

REQUIRED PAYMENTS FOR 75 PER CENT SETTLEMENT  
OF FIRST CLASS RAILROAD TAXES  
FOR 4 LITIGATING ROADS

(As of December 31, 1940)

Year of Tax	.. Roads				Total
	Lehigh Valley	Delaware Lack., and W.	New York Central	Erie	
1932	-	-	-	-	-
1933	-	-	-	12,236	12,236
1934	48,412	89,115	17,172	44,753	199,452
1935	48,507	105,815	17,526	44,340	216,188
1936	96,339	120,625	17,750	46,595	281,309
1937	149,118	239,459	54,607	131,968	575,152
1938	203,611	270,471	58,240	139,869	672,191
1939	115,065	69,307	52,894	101,179	338,445
1940	<u>43,990</u>	<u>65,813</u>	<u>17,411</u>	<u>61,598</u>	<u>188,812</u>
TOTALS	705,042	960,605	235,600	582,538	2,483,785

A similar settlement for the three litigating roads which have not expressed their willingness to pay 75 per cent of levies would require payments amounting to \$3,427,066 as follows:

REQUIRED PAYMENTS FOR 75 PER CENT SETTLEMENT  
OF FIRST CLASS RAILROAD TAXES  
FOR 3 LITIGATING ROADS

(As of December 31, 1940)

Year of Tax	Central of New Jersey	Roads		Total
		N.J. and N.Y.	N.Y., Sus. and West- ern	
1932	282,910	-	-	282,910
1933	491,954	11,595	21,862	525,411
1934	320,594	6,514	13,813	340,921
1935	299,196	6,810	13,309	319,315
1936	373,466	22,166	12,142	407,774
1937	282,075	23,879	179,928	485,882
1938	290,726	42,159	108,741	441,626
1939	256,751	36,008	51,790	344,549
1940	<u>227,712</u>	<u>22,361</u>	<u>28,605</u>	<u>278,678</u>
<b>TOTALS</b>	<b>2,825,384</b>	<b>171,492</b>	<b>430,190</b>	<b>3,427,066</b>

Such a settlement of delinquent first class railroad taxes with the litigating roads would result in payments to the state amounting to \$5,910,851 and the cancelation of outstanding taxes amounting to \$11,468,072. Comparisons between the three preceding tables indicate that these payments and write-offs would be distributed according to present statutory requirements as follows:

DISTRIBUTION OF PAYMENTS AND WRITE-OFFS OF DELINQUENT  
FIRST CLASS RAILROAD TAXES (1932-1940) RESULTING  
FROM SETTLEMENT WITH LITIGATING ROADS

(as of December 31, 1940)

Allocations	Total Receivables	Payments from Litigants	Write-offs from Litigants	Receivables from non- Litigants
1. State Fund	\$ 758,380	\$ 540,373	\$ 173,047	\$ 44,960
2. Teacher's Pension and Annuity Fund	9,806,078	4,549,921	4,892,276	363,881
3. Counties for Schools	<u>7,227,487<sup>1</sup></u>	<u>820,557</u>	<u>6,402,749</u>	<u>3,381</u>
<b>TOTALS</b>	<b>\$17,791,945<sup>1</sup></b>	<b>\$5,910,851</b>	<b>\$11,468,072</b>	<b>\$412,221</b>

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<sup>1</sup>\$800 error in 1940 tax computations. Totals do not check across by this amount.

C. Second Class Railroad Tax

1. General Summary

This is the tax on all property used for railroad or canal purposes and not included under the First Class Railroad Tax. Examples of such properties are passenger and freight buildings, roadbed other than main stem, reservoirs, tanks, etc.

Second class railroad property is assessed by the State Tax Commissioner. The tax rate of the local taxing district in which the property is situated determines the amount of annual levy. The tax is collected by the state and distributed by the Comptroller of the Treasury to the county treasurers. After deducting county taxes due from the taxing district, county treasurers remit amounts of the tax due each district.

This Second Class Railroad Tax is part of the General Property Tax of each taxing district. Assessed valuations of second class railroad property is included in the total assessable property on which the local rate is based. Delinquencies in this tax have precisely the same implications and results as delinquencies from any other property.

The \$17,030,633 (exclusive of interest and penalties) of delinquent second class railroad taxes is owed to 281 municipalities. Eighty-three per cent of this amount is owed to the ten municipalities of Hudson County. Sixty-one per cent is owed to Jersey City alone. Delinquent second class railroad taxes amount to more than sixty per cent of total tax delinquencies in several taxing districts. These delinquencies expressed as percentages of total 1940 property taxes levied in five Hudson County municipalities follow:

<u>HUDSON COUNTY MUNICIPALITIES</u>	<u>TOTAL DELINQUENT R.R. TAX</u>	<u>TOTAL PROPERTY TAX LEVY (1940)</u>	<u>o/o R.R. DELINQUENCIES TO TOTAL PROPERTY LEVY (1940)</u>
Jersey City	\$10,391,899	\$31,966,385	32.5
Hoboken	1,013,717	4,287,733	23.6
Weehawken	1,264,539	1,545,269	81.8
West New York	894,214	2,373,660	37.9
Bayonne	309,994	7,990,503	3.9
All others	206,551	10,958,928	1.9
Total Hudson County	\$14,080,914	\$59,122,478	23.8

These considerations would indicate that the settlement of the Second Class Railroad Tax is primarily a Hudson County problem.

## 2. Effect of Partial Settlement

Apportionment of the second class railroad tax is made to taxing districts in which the assessed property is situated. For this reason, payments of the tax are divided among the taxing districts in which the property of the paying road is located.

Any detailed appraisal of the effect of payments of delinquent second class railroad taxes by fewer than all roads must be concerned with an analysis of such payments by roads and by municipalities effected. A payment by one road may have a materially different effect than a similar payment by another road because different taxing districts may be effected in different degree.

Beyond demonstrating the distribution of total delinquencies among municipalities and counties, no such analysis has been made for this study. This distribution appears as follows:

### DISTRIBUTION OF SECOND CLASS RAILROAD TAX DELINQUENCIES IN NEW JERSEY 1932-1940

(as of December 31, 1940)

Counties and Municipalities	Total Delinquencies (1932-1940)	
	Amount	Per cent distribution
1. Hudson County:	\$14,080,914	83
A. Jersey City	10,391,899	61
B. Hoboken	1,013,717	6
C. Weehawken	1,264,539	8
D. Other Municipalities	1,410,759	8
2. Essex County:	725,413	4
A. Newark	555,533	3
B. Other Municipalities	169,880	1
3. Bergen County:	516,488	3
4. Rest of State	1,707,818	10
TOTALS - ALL DELINQUENCIES	17,030,633	100

In the event of a settlement of all delinquencies at any constant percentage of their face, such a distribution is adequate for calculating the effect upon taxing districts. Errors arising from its use in connection with settlements by fewer than all roads and at percentages other than constant are not believed to be as serious as might be expected a priori. Reasons for this belief lie in the geographical situation of Hudson County. About every system operating in New Jersey has extensive property holdings in this area. Any settlement of delinquent taxes would be felt by the taxing districts located there.

A settlement by the litigating roads of their delinquent second class railroad tax upon the basis of 75 per cent of levies would result ; in payments to municipalities (via state) amounting to \$5,075,488.. Write-offs involved in such a settlement would amount to \$11,813,992. These calculations have been made without regard for \$141,153 of delinquencies owed by non-litigating roads:

REQUIRED PAYMENTS AND WRITE-OFFS FOR 75 PER CENT  
SETTLEMENT OF SECOND CLASS RAILROAD TAXES BY  
LITIGATING ROADS

(as of December 31, 1940)

Roads	Total De- linquencies	Payments Required	Write-offs Required
A. Roads Ready to Settle:			
1. Lehigh Valley	\$2,164,754	\$ 631,552	\$1,533,202
2. Del., Lack and W.	3,707,922	874,240	2,833,682
3. N. Y. Central	1,846,300	498,010	1,348,290
4. Erie	<u>2,617,994</u>	<u>676,379</u>	<u>1,941,615</u>
Sub-totals	\$10,336,970	\$2,680,181	\$7,656,789
B. Roads Not Ready to Settle:			
1. Central of N. J.	\$6,211,949	\$2,226,354	\$3,985,595
2. N.J. and N. Y.	22,861	14,926	7,935
3. N.Y., Sus., and W.	<u>317,700</u>	<u>154,027</u>	<u>163,673</u>
Sub-totals	\$6,552,510	\$2,395,307	\$4,157,203
TOTALS	\$16,889,480	\$5,075,488	\$11,813,992

According to the percentage distribution of all second class railroad tax delinquencies shown above, these payments and write-offs from the litigating roads would be distributed as follows:

DISTRIBUTION OF PAYMENTS AND WRITE-OFFS FOR 75 PER CENT  
SETTLEMENT OF SECOND CLASS RAILROAD TAXES  
BY LITIGATING ROADS

(as of December 31, 1940)

<u>Counties and Municipalities</u>	Payments	Write-offs	Total
1. Hudson County:	<u>4,212,655</u>	<u>9,805,613</u>	<u>14,018,268</u>
A. Jersey City	3,096,048	7,206,535	10,302,583
B. Hoboken	304,529	708,840	1,013,369
C. Weehawken	406,039	945,119	1,351,158
D. Other Municipalities	406,039	945,119	1,351,158
2. Essex County:	<u>203,020</u>	<u>472,560</u>	<u>675,580</u>
A. Newark	152,265	354,420	506,685
B. Other Municipalities	50,755	118,140	168,895
3. Bergen County:	<u>152,265</u>	<u>354,420</u>	<u>506,684</u>
4. Rest of State	<u>507,549</u>	<u>1,181,399</u>	<u>1,688,948</u>
TOTALS	<u><u>5,075,488</u></u>	<u><u>11,813,992</u></u>	<u><u>16,889,480</u></u>

APPENDIX II

The Railroad Tax Controversy in New Jersey

—  
A Proposal for Its Settlement

February 13, 1941

## APPENDIX II

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## SUMMARY

Annual requirements for full settlement of delinquent railroad taxes have been computed by several assumptions. Assuming amortization over a five year and a ten year period, annual payments are shown by roads (p.4). Further assumptions that a different number of payments should be allowed different roads, led to the development of a standard for determining the number of such payments. Results from its application are tabulated by roads (p. 5). Total payments accruing to the state over the life of the amortization program are shown (p. 6).

Probable tax levies at a flat rate applied against all railroad property have been calculated. At a 3 per cent and a 4 per cent rate, these are shown (p. 10). Reductions in levies from the 1940 level are shown by roads (p. 11). Comparisons between these reductions and annual requirements for settlement of delinquencies (p. 13) indicated that some roads would not receive any net benefit until the old taxes were fully paid. Additional computations indicated the number of payments required to insure that reductions would exactly offset payments on account of old taxes (p. 14).

The distribution of present assessments and taxes on second class property among counties and municipalities are shown along with the distribution of levies at the new rates (pp 15-17).

Present statutory requirements for the distribution of first class taxes and the effect of their use in distributing levies at the 3<sup>o</sup>/<sub>o</sub> and 4<sup>o</sup>/<sub>o</sub> rates are set forth in Section 4 (pp. 18-19).

Following a hurried exploration of methods for evaluating railroad franchises, one method is illustrated for five roads (pp. 20-23).

## INTRODUCTION

In a previous memorandum<sup>1</sup> it was pointed out that seven railroad systems in New Jersey have been in almost constant litigation of their tax bill to the state since 1932. It was shown that these systems account for 63 per cent of all railroad taxes levied in the state during the period 1932-1940. Of the total railroad taxes levied in this period, \$34,821,799 were delinquent as of December 31, 1940. \$34,268,405, or 98 per cent of these delinquencies were owed by the seven litigating systems.

Litigation has been based upon the contentions that (1) the assessed valuations of railroad property have been in excess of "true value", (2) earnings have not been taken into account in determining valuations or the amount of taxes levied, (3) the railroads are unable to pay their taxes in full and remain solvent, and (4) railroad taxes in New Jersey are too high in comparison with those levied in other states.

There have been attempts to arrive at a compromise with the state based upon a percentage settlement of levies outstanding. The most recent discussion along these lines has been a settlement at 75 per cent of such levies. The probable effect of such a compromise upon the governmental funds holding railroad tax delinquencies as receivables was demonstrated in a former memorandum<sup>2</sup>.

Because non-litigating railroads, accounting for 37 per cent of total

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<sup>1</sup>Railroad Tax Delinquencies in New Jersey, typewritten, February 6, 1941.

<sup>2</sup>Ibid

levies, have paid their taxes almost in full, these efforts toward compromise have met with serious obstacles. It has been argued that percentage settlements by some roads and not by others involves a violation of equity of treatment among tax-payers.

It has been further argued that a compromise settlement of delinquent taxes owed by the litigating roads would not constitute a permanent solution to the problem. If these roads are truly unable to pay, they will simply continue to default their tax levies. In a few years, the current situation would again arise and another compromise would be required. Because precedent would have been established, it is not unlikely that the number of litigants involved in future defaults would be increased.

To meet these and other criticisms, an alternate proposal has been discussed. This approach provides for full payment of all delinquent railroad taxes over a period of years. Simultaneously, it provides for a scaling down of future levies by reducing the rate at which they are computed. The income factor as a determinant of ability to pay can be taken into consideration in determining the assessed valuation for railroad franchises as a part of the tax base. This memorandum presents the basis for discussion of the proposed treatment.

1. SETTLEMENT OF DELINQUENT RAILROAD TAXES  
OVER A PERIOD OF YEARS

The selection of a period over which to spread payments of delinquent taxes must itself involve some compromise. The state is interested in converting its receivables into cash in the shortest possible time. The railroads are interested in spreading their payments over the longest possible time because such procedure lessens their annual cash requirements. If payments are spread too much, resulting receipts will be insufficient to do the state any material good. If they are not spread enough, the roads may be unable to meet them when due.

No accurate measure of ability to pay can be determined. Differences between roads with regard to their financial condition and their obligations hinder the selection of a period equally advantageous to each of them. Assuming like periods of settlement for each road, the following table indicates annual requirements by roads for 5 years and 10 years.

ANNUAL REQUIREMENTS FOR SETTLEMENT  
OF DELINQUENT RAILROAD TAXES IN NEW JERSEY

(Data as of December 31, 1940)

System	Annual Requirements for 5 Years			Annual Requirements for 10 Years		
	Total	1st Class (State)	2nd Class (Local)	Total	1st Class (State)	2nd Class (Local)
<b>Litigating Roads:</b>						
1. Central R.R. of N.J.	\$2,691,939	\$1,449,549	\$1,242,390	\$1,345,970	\$ 724,775	\$ 621,195
2. Lehigh Valley R.R.	910,103	477,152	432,951	455,051	238,576	216,475
3. N.J. and N.Y.	57,481	52,908	4,572	28,740	26,454	2,286
4. N.Y., Susq. and W.	243,386	179,846	63,540	121,693	89,923	31,770
5. D.L. and W.	1,468,987	727,403	741,584	734,494	363,702	370,792
6. New York Central	541,484	172,224	369,260	270,742	86,112	184,630
7. Erie	<u>940,301</u>	<u>416,702</u>	<u>523,599</u>	<u>470,151</u>	<u>208,351</u>	<u>261,799</u>
Sub-totals	\$6,853,681	\$3,475,784	\$3,377,896	\$3,426,841	\$1,737,892	\$1,688,948
<b>Non-litigating Roads:</b>						
1. Central R.R. of N.J.	\$ 1,300	\$ 1,184	\$ 116	\$ 650	\$ 592	\$ 58
2. N.Y. and Long Branch	75,657	59,782	15,876	37,829	29,891	7,938
3. Reading	25,518	16,680	8,838	12,759	8,340	4,419
4. Pennsylvania	2,915	-	2,915	1,188	-	1,188
5. Unclassified	<u>5,824</u>	<u>4,798</u>	<u>1,026</u>	<u>2,912</u>	<u>2,399</u>	<u>513</u>
Sub-totals	<u>\$110,675</u>	<u>\$82,444</u>	<u>\$28,231</u>	<u>\$55,337</u>	<u>\$41,222</u>	<u>\$14,115</u>
<b>TOTALS</b>	<b>\$6,964,356</b>	<b>\$3,558,229</b>	<b>\$3,406,127</b>	<b>\$3,482,178</b>	<b>\$1,779,114</b>	<b>\$1,703,063</b>

In finally determining such a period, however, it may become necessary to use a different number of payments for different roads. One basis for such differentiation may be found in the percentages of total levies unpaid by systems for the period 1932-1940. The number of payments could for instance be determined upon the basis of one payment for each nearest multiple of five in these percentages, with a maximum of ten payments. Results obtained from the application of this formula are shown as follows:

NUMBER AND AMOUNT OF PAYMENTS FOR SETTLEMENT  
OF DELINQUENT RAILROAD TAXES IN NEW JERSEY  
(Data as of December 31, 1940)

System	Per Cent Levies Defaulted	Number of Payments	Amount of Payment		
			Total	1st Class (State)	2nd Class (Local)
<b>Litigating Roads:</b>					
1. Central of N.J.	40.0	8	\$1,682,462	\$ 905,968	\$ 776,494
2. Lehigh Valley	27.7	6	758,419	397,627	360,792
3. N.J. and N.Y.	63.4	10	28,740	26,454	2,286
4. N.Y., Susq. and W.	42.0	8	152,117	112,404	39,713
5. D. L. and W.	25.4	5	1,468,987	727,403	741,584
6. N.Y. Central	26.1	5	541,484	172,224	369,260
7. Erie	26.9	5	<u>940,301</u>	<u>416,702</u>	<u>523,599</u>
Sub-totals			\$5,572,510	\$2,758,782	\$2,813,728
<b>Non-litigating Roads:</b>					
1. Central of N.J.	6.1	1	\$ 6,502	\$ 5,921	\$ 581
2. N.Y. and Long Branch	21.6	4	94,572	74,727	19,845
3. Reading	2.1	1	127,589	83,401	44,188
4. Pennsylvania	0.03	1	11,875	-	11,875
5. Unclassified	0.5	1	<u>29,121</u>	<u>23,991</u>	<u>5,130</u>
Sub-totals			\$269,659	\$188,040	\$81,619
<b>TOTALS</b>			<u>\$5,842,169</u>	<u>\$2,946,822</u>	<u>\$2,895,347</u>

If each road met its obligations under this plan of settlement, receipts by the state during the installment period would be as follows:

PAYMENTS	AMOUNTS RECEIVED		
	Total	1st class (State)	2nd class (Local)
Initial Payment	\$5,842,169	\$ 2,946,822	\$ 2,895,347
1st Annual	5,667,082	2,833,509	2,833,573
2nd Annual	5,667,082	2,833,509	2,833,573
3rd Annual	5,667,082	2,833,509	2,833,573
4th Annual	5,572,510	2,758,782	2,813,728
5th Annual	2,621,738	1,442,453	1,179,285
6th Annual	1,863,319	1,044,826	818,493
7th Annual	1,863,319	1,044,826	818,493
8th Annual	28,740	26,454	2,286
9th Annual	<u>28,738</u>	<u>26,454</u>	<u>2,284</u>
<b>TOTALS</b>	<b>\$34,821,779</b>	<b>\$17,791,144</b>	<b>\$17,030,635</b>

## 2. NEW TAX LEVIED AT FLAT RATE

At the present time, railroads are taxed upon the ad valorem assessed valuation of their property holdings. Assessed values of the main stem, tangible personal property and franchise comprise the base for first, third and fourth class taxes. Taxes for state use (commonly referred to as the First Class Tax) are levied against these bases at the average state property tax rate.

In 1940, the total base for state taxes upon all railroad property amounted to \$195,638,452. The average state rate applied against this base was 4.718 per cent. Total taxes levied for state uses amounted to \$9,230,222. These were distributed among the three classes of property as follows:

<u>Class of Property</u>	<u>Assessed Valuations</u>	<u>State Taxes Levied</u>
Main stem (1st class)	\$144,268,892	\$6,806,606
Tangible Personalty (3rd class)	48,488,471	2,287,696
Franchise (4th class)	<u>2,881,089</u>	<u>135,930</u>
	\$195,638,452	\$9,230,222 <sup>1</sup>

In addition to state taxes levied against 1st, 3rd and 4th class railroad property in 1940, \$9,066,467 of taxes for local use were levied against \$176,439,659 of assessed values of second class property. These valuations are determined by the State Tax Department and taxes are levied at local rates prevailing in the taxing districts where such property is located.

<sup>1</sup>Error of \$10 in total not accounted for.

Total assessed valuations in 1940 by systems and by class of property

follow:

ASSESSED VALUATIONS OF RAILROAD PROPERTY  
IN NEW JERSEY (1940)

Systems	Main Stem (1st class)	Personalty (3rd class)	Franchise (4th class)	Total for State	Local (2nd class)	Total Valuations
<b>Litigating Roads:</b>						
1. Cen. of N.J.	\$ 22,727,825	\$ 8,821,666	\$ 627,000	\$ 32,176,491	\$ 34,626,921	\$ 66,803,412
2. Lehigh Valley	14,197,457	4,114,522	292,467	18,604,446	17,876,911	36,481,357
3. N.J. and N.Y.	416,577	214,359	1,000	631,936	74,853	706,789
4. N.Y., S. and W.	3,661,104	375,831	5,000	4,041,935	2,063,811	6,105,745
5. D. L. and W.	21,832,389	5,692,701	372,647	27,897,737	30,585,196	58,482,933
6. N.Y. Central	5,826,238	1,538,333	15,200	7,379,771	15,529,315	22,909,086
7. Erie	<u>13,046,483</u>	<u>4,293,951</u>	<u>259,149</u>	<u>17,599,583</u>	<u>23,183,885</u>	<u>40,783,468</u>
Sub-total	\$ 81,708,073	\$ 25,051,363	\$ 1,572,463	\$ 108,331,899	\$ 123,940,892	\$ 232,272,790
<b>Non-litigating Roads:</b>						
1. Cen. of N.J.	\$ 95,588	\$ 32,714	\$ 2,000	\$ 130,302	\$ 4,578	\$ 134,880
2. N.Y. and L.Br.	2,461,840	7,258	1,000	2,470,098	634,129	3,104,227
3. Reading	4,265,847	1,938,978	96,000	6,300,825	2,424,064	8,724,889
4. Pennsylvania	40,371,839	18,004,213	1,028,526	59,404,578	43,970,525	103,375,103
5. Penn-Reading	7,561,356	1,065,333	22,000	8,648,689	2,781,156	11,429,845
6. Unclassified	<u>7,804,349</u>	<u>2,388,612</u>	<u>159,100</u>	<u>10,352,061</u>	<u>2,684,316</u>	<u>13,036,377</u>
Sub-total	\$ 62,560,819	\$ 23,437,108	\$ 1,308,626	\$ 87,306,553	\$ 52,498,768	\$ 139,805,321
<b>TOTALS</b>	<b>\$144,268,892</b>	<b>\$48,488,471</b>	<b>\$2,881,089</b>	<b>\$195,638,452</b>	<b>\$176,439,659</b>	<b>\$372,078,111</b>

It has already been pointed out that total taxes levied against these valuations in 1940 amounted to \$9,230,222 for state uses and \$9,066,467 for local purposes, or \$18,296,689 in all. These levies were distributed among the systems in the following way:

RAILROAD TAXES LEVIED IN NEW JERSEY  
1940

	Taxes Levied			Percentage Distribution
	State	Local	Total	
<b>Litigating Roads:</b>				
1. Central of N.J.	\$1,518,087	\$1,790,388	\$ 3,308,475	18.1
2. Lehigh Valley	877,758	935,280	1,813,038	9.9
3. N.J. and N.Y.	29,815	3,789	33,604	0.2
4. N.Y., Susq. and W.	190,698	81,595	272,293	1.5
5. D. L. and W.	1,316,215	1,589,965	2,906,180	15.9
6. N. Y. Central	348,178	797,836	1,146,014	6.3
7. Erie	<u>830,348</u>	<u>1,168,647</u>	<u>1,998,995</u>	<u>10.9</u>
Sub-total	\$5,111,099	\$6,367,500	\$11,478,599	
<b>Non-litigating Roads:</b>				
1. Central of N.J.	\$ 6,147	\$ 235	\$ 6,382	-
2. N.Y. and Long Branch	116,539	33,416	149,955	0.8
3. Reading	297,273	158,235	455,508	2.5
4. Pennsylvania	2,802,708	2,219,016	5,021,724	27.4
5. Penn-Reading	408,045	147,854	555,899	3.0
6. Unclassified	<u>488,410</u>	<u>140,213</u>	<u>628,623</u>	<u>3.4</u>
Sub-total	\$4,119,122	\$2,698,969	\$ 6,818,091	
<b>TOTALS</b>	<u>\$9,230,221</u>	<u>\$9,066,469</u>	<u>\$18,296,690</u>	100.0

It is proposed to substitute for the present tax upon railroad property a new one based upon ad valorem valuations as at present but levied at a flat rate. Assuming two such rates at 3 per cent and 4 per cent, respectively, taxes would be levied against 1940 valuations as follows:

RAILROAD TAX LEVIES BASED UPON 1940 VALUATIONS  
AND RATES AT 3 PER CENT AND 4 PER CENT

Systems	Taxes Levied at 3 Per Cent			Taxes Levied at 4 Per Cent		
	State	Local	Total	State	Local	Total
<b>Litigating Roads:</b>						
1. Cen. of N.J.	\$ 965,295	\$1,038,808	\$ 2,004,103	\$1,287,060	\$1,385,077	\$ 2,672,137
2. Lehigh Valley	558,133	536,307	1,094,440	744,178	715,076	1,459,254
3. N.J. and N.Y.	18,958	2,246	21,204	25,277	2,994	28,271
4. N.Y., S. and W.	121,258	61,914	183,172	161,677	82,552	244,229
5. D. L. and W.	836,932	917,556	1,754,488	1,115,909	1,223,408	2,339,317
6. N.Y. Central	221,393	465,879	687,272	295,191	621,173	916,364
7. Erie	<u>527,987</u>	<u>695,517</u>	<u>1,223,504</u>	<u>703,983</u>	<u>927,355</u>	<u>1,631,338</u>
Sub-total	\$3,249,957	\$3,718,227	\$ 6,968,184	\$4,333,276	\$4,957,636	\$ 9,290,912
<b>Non-Litigating Roads:</b>						
1. Cen. of N.J.	\$ 3,909	\$ 137	\$ 4,046	\$ 5,212	\$ 183	\$ 5,395
2. N.Y. and L.Br.	74,103	19,024	93,127	98,804	25,365	124,169
3. Reading	189,025	72,722	261,747	252,033	96,963	348,996
4. Pennsylvania	1,782,137	1,319,116	3,101,253	2,376,183	1,758,821	4,135,004
5. Penn-Reading	259,461	83,435	342,896	345,948	111,246	457,194
6. Unclassified	<u>310,562</u>	<u>80,529</u>	<u>391,091</u>	<u>414,082</u>	<u>107,373</u>	<u>521,455</u>
Sub-total	\$2,619,197	\$1,574,963	\$ 4,194,160	\$3,492,262	\$2,099,951	\$ 5,592,213
<b>TOTALS</b>	<u>\$5,869,154</u>	<u>\$5,293,190</u>	<u>\$11,162,344</u>	<u>\$7,825,538</u>	<u>\$7,057,587</u>	<u>\$14,883,125</u>

A comparison between the two preceding tables indicates that the application of the proposed tax would result in substantial reductions in total levies from the 1940 levy. At 3 per cent, such reductions would amount to \$7,134,346. The reduction at 4 per cent would be \$3,413,565. These decreases in levy are shown by systems in the following table:

REDUCTION IN RAILROAD TAX LEVIES FROM 1940 LEVELS  
ASSUMING FLAT RATES AT 3 PER CENT AND 4 PER CENT

Systems	Reductions with 3 Per Cent Rate		Reductions with 4 Per Cent Rate	
	Amount	Per Cent of 1940 levy	Amount	Per Cent of 1940 levy
<b>Litigating Roads:</b>				
1. Cen. of N.J.	\$1,304,372	39.4	\$ 636,338	19.2
2. Lehigh Valley	718,598	39.6	353,784	19.5
3. N.J. and N.Y.	12,400	36.9	5,333	15.9
4. N.Y., S. and W.	89,122	32.7	28,064	10.3
5. D. L. and W.	1,151,692	39.6	566,863	19.5
6. N.Y. Central	458,741	40.0	229,650	20.0
7. Erie	<u>775,491</u>	<u>38.8</u>	<u>367,657</u>	<del>30.7</del> 18.4
Sub-total	\$4,510,415		\$2,187,687	
<b>Non-litigating Roads:</b>				
1. Central of N.J.	\$ 2,336	36.6	\$ 987	15.5
2. N.Y. and L. Br.	56,828	37.9	25,786	17.2
3. Reading	193,761	42.5	106,512	23.4
4. Pennsylvania	1,920,471	38.2	886,720	17.7
5. Penn-Reading	213,003	38.3	98,705	17.8
6. Unclassified	<u>237,532</u>	<u>37.8</u>	<u>107,168</u>	<u>17.0</u>
Sub-total	\$2,623,931		\$1,225,878	
<b>TOTALS</b>	<u>\$7,134,346</u>		<u>\$3,413,565</u>	

A further comparison between these reductions and requirements for settlement of delinquent taxes as computed in Section 1 (see p. 5) indicates that these reductions with a 3 per cent rate exceed even the initial payment for all roads as a group by \$1,292,178. Initial requirements as tabulated (ibid) amount to \$5,842,168 while total reductions from the 1940 tax levies total \$7,134,346. At a 4 per cent rate, the proposed initial payment and first 4 annual payments on delinquencies exceed the expected reductions in total levy. The initial payment exceeds the anticipated reduction, \$3,413,565, by \$2,428,603.

For the litigating systems alone, however, reductions in levy resulting from the application of a 3 per cent rate would amount to \$4,510,415 and the initial payment on delinquencies total \$5,572,509, or \$1,062,094 more than the reductions. At a 4 per cent rate, the reductions would amount to about \$2,187,687, or \$3,384,822 less than the initial payment on account of delinquencies. This situation would exist for the period covered by installment payments of delinquent taxes.

The amounts by which installment payments of unpaid taxes exceed reductions in levy from the 1940 level and the number of years this situation would prevail are shown by systems as follows:

RAILROAD TAX IN NEW JERSEY  
EXCESS OF INSTALLMENT REQUIREMENTS OVER ESTIMATED  
REDUCTIONS IN ANNUAL TAX

<u>Systems</u>	<u>Number of Payments</u>	<u>Excess of Payments Over Reductions</u>	
		<u>At 3 Per cent Rate</u>	<u>At 4 Per cent Rate</u>
<b>Litigating Roads:</b>			
1. Central of N.J.	8	\$ 378,090	\$1,046,124
2. Lehigh Valley	6	39,821	404,635
3. N.J. and N.Y.	10	16,340	23,407
4. N.Y., Susq, and W.	8	62,994	124,052
5. D. L. W.	5	317,295	902,124
6. N.Y. Central	5	82,743	311,834
7. Erie	<u>5</u>	<u>164,810</u>	<u>572,644</u>
Sub-total		\$1,062,094	\$3,384,822
<b>Non-litigating Roads:</b>			
1. Central of N.J.	1	\$ 4,166	\$ 5,515
2. N.Y. and L. Branch	4	37,744	68,786
3. Reading	1	-66,172	21,077
4. Pennsylvania	1	-1,908,596	-874,845
5. Penn-Reading	0	-213,003	-98,705
6. Unclassified	<u>1</u>	<u>-208,411</u>	<u>-78,047</u>
Sub-total		-\$2,354,272	\$ -956,219
<b>TOTALS</b>		<b>-\$1,292,178</b>	<b>\$2,428,603</b>

If it is desired to insure that installment payments on account of delinquent taxes do not exceed reductions in annual tax levies, it becomes necessary to recompute the number of payments allowed for settlement of these old accounts. By providing that annual payments shall exactly equal such reductions, the following results are obtained:

<u>Systems</u>	Number of Payments Required	
	<u>With 3 Per cent Rate</u>	<u>With 4 Per cent Rate</u>
Litigating Roads:		
1. Central of N.J.	10.3	21.2
2. Lehigh Valley	6.3	12.9
3. N.J. and N.Y.	23.2	53.9
4. N.Y., Susq. and W.	13.7	43.3
5. D. L. and W.	6.4	13.0
6. N.Y. Central	5.9	11.8
7. Erie	<u>6.1</u>	<u>12.7</u>
Average	7.6	15.7
Non-litigating Roads:		
1. Central of N.J.	2.8	6.6
2. N.Y. and L. Br.	6.7	14.7
3. Reading	0.7	1.2
4. Pennsylvania	-	-
5. Penn-Reading	0	0
6. Unclassified	<u>0.1</u>	<u>0.3</u>
Average	0.2	0.5
Average all roads	4.9	10.2

### 3. DISTRIBUTION OF SECOND CLASS RAILROAD TAX

Note: Total assessed valuations of second class railroad property in New Jersey (1940) as reported by the Tax Department in its Annual Report, 1940 (Abstract of Ratables) amount to \$177,594,315. Summary sheets of assessments and collections by roads, also obtained from the Tax Department, report these valuations at \$176,439,659. Computations of second class taxes shown in this section are based upon data from the "Abstract of Ratables." They differ slightly from those shown in section 2 because the latter were based upon the "Summary Sheets". No explanation for this discrepancy has been obtained.

At the present time, local rates are applied against assessed valuations of second class railroad properties located within each taxing district. Because local rates vary as among taxing districts, second class railroad tax levies are not distributed in direct proportion to assessed valuations. A taxing district with a high tax rate receives greater share of total taxes levied than does another district containing an equal amount of taxable property but having a lower rate.

Examples of discrepancies due to different local tax rates can be seen in comparing Bayonne (Hudson County), Woodbridge (Middlesex County) and Trenton (Mercer County). Assessed valuations, tax rates and taxes levied in these three taxing districts appear as follows:

TAXING DISTRICT	ASSESSED VALUE		TAXES LEVIED
	2nd Class R. R. Property	Local Rate	2nd Class R. R. Property
1. Bayonne	\$ 1,457,000	.06035	\$ 88,000
2. Woodbridge	1,551,000	.0731	113,000
3. Trenton	1,875,000	.0474	89,000

In 1940, total assessed valuations of second class railroad properties amounted to \$177,594,000. Of this total, \$139,996,000, or 79 per cent represented properties located in Hudson County. \$105,121,000 or 60 per cent of these valuations were in Jersey City alone.

In that year there were only nine counties which contained second class railroad property assessed in excess of \$1,000,000. These nine counties accounted for 97 per cent of all such valuations in the state. Within their boundaries there were only 12 municipalities having valuations in excess of \$1,000,000. These 12 municipalities accounted for \$157,592,000 or 89 per cent of the state total.

Taxes amounting to \$9,066,467<sup>1</sup> were levies against second class railroad property in 1940. Of this total, \$5,569,000, or 61 per cent was levied against property located in Jersey City. The 12 municipalities having assessed valuations in excess of \$1,000,000 accounted for levies of about \$8,183,000 or 90 per cent of the total for the state.

It is proposed to substitute for the present tax on second class railroad property one based upon the application of a flat rate against assessed valuations. Assuming such rates at 3 and 4 per cent, this procedure would result in total levies amounting to \$5,328,000 and \$7,104,000 respectively. Reductions in levies from the 1940 level would thus be \$3,738,000 or 41 per cent, at the lower rate and \$1,962,000, or 21 per cent at the higher rate. The distribution of assessed valuations and the proposed tax among counties and municipalities would appear as follows:

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<sup>1</sup>Levies obtained from "Summary Sheets" by roads. See note at head of Section 3.

DISTRIBUTION OF SECOND CLASS RAILROAD TAX AMONG  
COUNTIES AND MUNICIPALITIES IN NEW JERSEY

	ASSESSED VALUATIONS (1940)	TAX IN 1940		PROPOSED TAX AT	
		Rate %	Tax	.03 %	.04 %
1. Hudson County	<u>\$139,996</u>	-	-	<u>\$4,200</u>	<u>\$5,600</u>
A. Jersey City	105,121	.05298	\$5,569	3,154	4,205
B. Weehawken	12,596	.04495	566	378	504
C. Hoboken	9,033	.05326	481	271	361
D. West New York	6,548	.05754	377	196	262
E. Kearney	2,624	.03843	101	79	105
F. Bayonne	1,457	.06035	88	44	58
G. Rest of County	2,617	-	-	79	105
2. Essex County	<u>10,675</u>	-	-	<u>320</u>	<u>427</u>
A. Newark	8,763	.0485	425	263	351
B. Rest of County	1,912	-	-	57	76
3. Middlesex County	<u>5,962</u>	-	-	<u>179</u>	<u>238</u>
A. Perth Amboy	2,154	.0554	119	65	86
B. Woodbridge	1,551	.0731	113	47	62
C. Rest of County	2,257	-	-	68	90
4. Union County	<u>4,844</u>	-	-	<u>145</u>	<u>194</u>
A. Elizabeth	2,984	.0424	127	90	119
B. Rest of County	1,860	-	-	56	74
5. Bergen County	<u>3,119</u>	-	-	<u>94</u>	<u>125</u>
6. Camden County	<u>3,088</u>	-	-	<u>93</u>	<u>125</u>
A. Camden	2,886	.0444	128	87	115
B. Rest of County	202	-	-	6	8
7. Mercer County	<u>2,608</u>	-	-	<u>78</u>	<u>104</u>
A. Trenton	1,875	.0474	89	56	75
B. Rest of County	733	-	-	22	29
8. Passaic County	<u>1,449</u>	-	-	<u>43</u>	<u>58</u>
9. Atlantic County	<u>1,014</u>	-	-	<u>30</u>	<u>41</u>
10. Rest of State	<u>4,839</u>	-	-	<u>145</u>	<u>194</u>
TOTALS	<u>\$177,594</u>	-	<u>\$9,066</u>	<u>\$5,328</u>	<u>\$7,104</u>

NOTE: Assessed valuations and taxes in thousands of dollars.

#### 4. DISTRIBUTION OF FIRST CLASS RAILROAD TAX

Statutory requirements for the distribution of first class railroad taxes were set forth in a former memorandum (February 6, 1940). Following these requirements, allocations of taxes levied in 1940 appear in the order of their priority about as follows:

<u>FUND AND PURPOSE</u>	<u>AMOUNTS ALLOCATED</u>
1. State Fund (general purpose)	\$ 978,092
2. State Fund (educational)	4,784,221
3. Teacher's Pension Fund	2,780,705
4. Counties (for schools)	<u>687,204</u>
TOTAL LEVIES	\$9,230,222

Note: Official allocation has not yet been released. These were prepared from State Appropriations for Fiscal Year, July 1, 1940 (Ch. 158, P.L. 1940).

It was pointed out in Section 2 of this memorandum that the application of 3 and 4 per cent rates to 1940 assessments would result in total first class railroad tax levies of \$5,869,154 and \$7,825,538 respectively (see p.10 ). The use of one of these rates would thus cause state levies to be reduced by \$3,361,068 or \$1,404,684 from the 1940 level (see p. 11 ).

In the absence of statutory changes in the method for apportioning first class levies among the beneficiary funds, any reductions in levy must be subtracted from the funds last in priority. The use of either of the above rates would thus result in completely eliminating the amounts allocated to counties for educational purposes. In addition, the 3 per cent

rate would provide only \$106,841 for the Teacher's Pension and Annuity Fund, thus necessitating a reduction in allocation of railroad taxes to that fund of \$2,673,864. A 4 per cent rate would provide \$2,063,225 for this fund and require a reduction of \$717,480.

By present statutory requirements, these proposed levies would be apportioned about as follows:

FUNDS AND PURPOSE	AMOUNTS ALLOCATED	
	3 <sup>o</sup> /o Rate	4 <sup>o</sup> /o Rate
1. State Fund (general purpose)	\$ 978,092	\$ 978,092
2. State Fund (educational)	4,784,221	4,784,221
3. Teacher's Pension Fund	106,841	2,063,225
4. Counties (for schools)	-	-
<b>TOTAL LEVIES</b>	<b>\$5,869,154</b>	<b>\$7,825,538</b>

## 5. ASSESSMENT OF FRANCHISE

A complete investigation of alternative methods for assessing railroad franchises is beyond the scope of this memorandum. Such an investigation would involve detailed analyses of operating and financial data for each road operating within New Jersey. Although the lack of time and data prohibits such analyses here, some pertinent observations can be made.

In 1940, the assessed value of franchises in New Jersey amounted to \$2,881,089, or less than 1 per cent of total assessed valuations of all railroad property.<sup>1</sup> Of this amount, \$1,028,526, or about 36 per cent, was assessed against the Pennsylvania system alone. Franchises of the seven litigating systems were assessed in total at \$1,572,463, or about 58 per cent of all such valuations in the state.

Because of its relative unimportance in the present tax base, any effort to affect a graduation of railroad tax levies through the franchise must be concerned with a substantial increase in its assessment. Such increases, unaccompanied by changes in assessed valuations of other classes of property, may serve to offset in full or in part reductions in tax levies anticipated as a result of the proposed new levies at lower rates.

It is proposed that the earnings of railroads be taken into account in evaluating the franchises. Many definitions of earnings can be found. The three following definitions, which may be used as guides in considering the problem, are prescribed for railroad accounts by the United States

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<sup>1</sup>See Section 2, p. 8 .

Interstate Commerce Commission:

1. Net Railway Operating Revenue
  - railway operating revenues less railway operating costs
2. Net Railway Operating Income
  - Net Railway Operating Revenue (1) less
    - (a) railway tax accruals
    - (b) uncollectable railway revenues
    - (c) joint facility rents (dr. and cr.)
3. Net Income
  - Net Railway Operating Income (2) plus
    - (a) dividend income
    - (b) other non-operating income, less
    - (c) miscellaneous rents, tax accruals and charges
    - (d) rents for leased roads
    - (e) miscellaneous rents
    - (f) miscellaneous tax accruals
    - (g) interest on funded debt
    - (h) interest on unfunded debt
    - (i) miscellaneous charges

With the possible exception of (d), "rents for leased roads", the items by which Net Income differs from Net Railway Operating Income arise almost wholly from non-railroading activities. Almost all of the difference is in the costs of financing. Two equally successful roads may show quite different "net incomes" because of different financial structures. One may be financed largely through borrowing and hence have heavy "fixed charges". The other, in turn, may be financed by stock issues and have small "fixed charges".

From the point of view of railway operations, one basis for evaluating franchises for taxation purposes in New Jersey is Net Railway Operating Income allocated to the state in proportion to miles of all track. By

capitalizing such allocated income at 3 per cent and deducting assessed valuations of all railroad property except franchises, this procedure yields approximately the following results:

<u>System</u>	<u>Net R.R. Operating Income (1939)</u>	<u>Per Cent Track in N. J.</u>	<u>Operating Income Allocated to N.J.</u>	<u>N.J. Income Capitalized at 3 Per Cent</u>	<u>Cap. Income Less Ass'd Valuations</u>
<b>Litigating Roads:</b>					
1. Central of N.J.	\$ 1,943,304	67.9	\$1,319,503	\$43,983,433	-
2. Lehigh Valley	7,149,326	16.8	1,201,326	40,044,200	\$ 3,855,310
3. N.J. and N.Y.	-273,985	65.6	-156,118	-	-
4. N.Y., Sus., W.	264,337	97.7	258,257	8,608,257	2,502,822
5. D. L. and W.	6,028,688	27.8	1,675,975	55,865,833	-
6. N. Y. Central	37,303,427	0.7	261,124	8,704,133	-
7. Erie	9,137,670	10.8	986,868	32,895,600	-
<b>Non-Litigating Roads:</b>					
1. Central of N. J.	99,135	100.0	99,135	3,304,500	3,169,620
2. N. Y. and L. B. <sup>1</sup>					
3. Reading <sup>2</sup>	11,931,004	4.3	513,033	17,101,100	8,376,211
4. Pennsylvania	77,304,328	6.1	4,715,564	157,185,467	54,838,890
5. Penn-Reading	-1,812,029	100.0	-1,812,029	-	-
6. Unclassified <sup>3</sup>					
<b>Total Assessed Value of Franchises</b>					<b>\$72,742,853</b>
1940 Assessment - All Roads					<u>2,881,089</u>
<b>Increase in Assessment Indicated<sup>4</sup></b>					<b>\$69,861,764</b>

<sup>1</sup>New York and Long Branch operated jointly by Central R. R. of New Jersey and Pennsylvania. No data were available for these computations.

<sup>2</sup>Distribution of all track miles was not obtained for Reading. Allocations based upon miles of line operated.

<sup>3</sup>Unclassified group made up of a number of small roads. Computations were not made.

<sup>4</sup>No account was taken of nominal values of franchises where 1940 assessed valuations of R. R. property exceed capitalized income allocated to New Jersey.

Two pertinent observations are apparent in the above data. First, this procedure would result in material increases in franchise assessments for five of the systems shown, and in no valuations at all for the others. Second, only two systems show a net loss by this definition and one of these is the one road in the state which is not delinquent in any of its tax bill to the state.

One less apparent observation concerning the data themselves should be pointed out. Earnings were obtained from Moody's Manual of Railroads (1940) for systems. Precaution was taken to insure their accuracy of coverage for the roads involved in the New Jersey railroad tax. However, franchise values are at present determined independently for each road comprising the various systems. Because each road may have a different pattern of earnings, any change in their grouping would result in a changed basis for valuing franchises.

An example of this factor can be seen in the case of computations shown above for the Central Railroad of New Jersey. The Mount Hope Mineral and Wharton and Northern railroads are commonly considered to be a part of the Central system. Because these roads are not involved in the tax litigation, they are carried as "Central R. R. of New Jersey" in the non-litigating group. Considered separately, earnings of these roads are sufficient to warrant a substantial assessment of their franchise. If they were included with the rest of the "central system" as shown, these earnings would not be sufficient to bring the total system earnings up

to a point sufficiently high to supply the base for any assessment of system franchise. Because these roads are operated separately, it is felt the above computations are logically sound.

But other systems as shown may well contain similar discrepancies due to grouping of roads into systems. To the extent that such groupings represent actual operating conditions, they are felt to be justified. To the extent that they contain roads which are separately operated, they fall short of their purpose. In the absence of a more detailed analysis, the above computations can serve only as approximations to the recommended franchise valuations.

In Section 2 of this memorandum (see p. 11), probable reductions in taxes levied against each road from the 1940 level were computed at assumed flat rates of 3 per cent and 4 per cent. These were estimated at \$7,134,346 (for 3 per cent) and \$3,413,565 (for 4 per cent). Assuming no franchise assessment for the roads having property assessments in excess of their income allocated to New Jersey and capitalized at 3 per cent, new levies against \$69,861,764 of franchise valuations would amount to \$2,100,656 at 3 per cent and \$2,800,874 at 4 per cent. Accordingly, reductions in total railroad taxes from 1940 as shown in Section 2 would become \$5,033,690, or 27.5 per cent, at a 3 per cent rate and only \$612,691, or 3.3 per cent, at a 4 per cent rate. These changes appear by roads as follows:

CHANGES IN RAILROAD TAX LEVIES FROM 1940 LEVELS  
AFTER ADJUSTMENT FOR NEW FRANCHISE ASSESSMENT  
ASSUMING FLAT RATES AT 3 PER CENT AND 4 PER CENT

At 3 Per Cent Rate

At 4 Per Cent Rate

Systems	Computed Reductions (Sec. 2, p.12)	Increased Levy on Franchise	Net Reduction After Change	Per Cent Reduction from 1940 Levy	Computed Reductions (Sec. 2, p.12)	Increased Levy on Franchise	Net Reduction After Change	Per Cent Reduction from 1940 Levy
<b>Litigating Roads:</b>								
1. Central of N. J.	\$1,304,372	\$-18,810	\$1,323,182	40.0	\$ 636,338	\$ -25,080	\$ 661,418	20.0
2. Lehigh Valley	718,598	106,885	611,713	33.7	353,784	142,513	211,271	11.7
3. N.J. and N.Y.	12,400	-30	12,430	37.0	5,333	-40	5,373	16.0
4. N.Y., Sus., W	89,122	74,935	14,187	5.2	28,064	99,913	-71,849	-26.3 <sup>2</sup>
5. D.L. and W.	1,151,692	-11,179	1,162,871	40.0	566,863	-14,906	581,769	20.0
6. N. Y. Central	458,741	-456	459,197	40.0	229,650	-608	230,258	20.1
7. Erie	775,491	-7,774	783,265	39.2	367,657	-10,366	378,023	18.9
Sub-Totals	\$4,510,415	\$143,570	\$4,366,845	38.0	\$2,187,687	\$191,426	\$1,996,261	17.4
<b>Non-Litigating Roads:</b>								
1. Central of N. J.	\$ 2,336	\$ 95,029	\$ -92,693	-1452.4 <sup>2</sup>	\$ 987	\$126,705	\$-125,718	-1969.9 <sup>2</sup>
2. N.Y. and L.B.	56,828	- <sup>1</sup>	56,828	37.9	25,786	- <sup>1</sup>	25,786	17.2
3. Reading	193,761	248,406	-54,645	-12.0 <sup>2</sup>	106,512	331,208	-224,696	-49.3 <sup>2</sup>
4. Pennsylvania	1,920,471	1,614,311	306,160	6.1	886,720	2,152,415	-1,265,695	-25.2 <sup>2</sup>
5. Penn-Reading	213,003	-660	213,663	38.4	98,705	-880	99,585	17.9
6. Unclassified	237,532	- <sup>1</sup>	237,532	37.8	107,168	- <sup>1</sup>	107,168	17.0
Sub-Totals	\$2,623,931	\$1,957,086	\$666,845	9.8	\$1,225,878	\$2,609,448	\$-1,383,570	-20.3 <sup>2</sup>
<b>TOTALS</b>	<u>\$7,134,346</u>	<u>\$2,100,656</u>	<u>\$5,033,690</u>	<u>27.5</u>	<u>\$3,413,565</u>	<u>\$2,800,874</u>	<u>\$ 612,691</u>	<u>3.3</u>

<sup>1</sup>Franchise computations not made; see notes to last Table.

<sup>2</sup>Represents increases over 1940 level in taxes levied



